Managing Your Biggest Current Asset

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Accounts receivable is often a business's largest current asset, yet more often than not it receives little top management attention. Companies of all sizes can benefit from a focused effort to improve this most important element of working capital.

The working capital tension between you and your customers requires a driven effort to enforce your invoice terms. There are many companies that could improve their Days Sales Outstanding (DSO) by 10%, 20%, even 30%. In order to accomplish this, they can use what we call the Cash Gap Strategy to direct their efforts to the right customers at the right time, and employ technology to drive the collection workflow.

It's a zero-sum game. The creditor-supplier always loses, as the system has already been fixed; late payments are "baked-in," and most customers have no plans to pay to you on the date due. To illustrate how being passive leads to even worse results — a vicious virtual cycle — many A/P departments use software that tracks how quickly (or how slowly) you follow up for payment, and then adjusts the payment rules accordingly.

Working Capital In Ice

In addition to the systemic late payments, a good size business will have millions of dollars of cash "frozen" due to process errors, deductions, or disputes that hold up invoice payment. Once negative practices and payment habits become ingrained, they are hard to undo.

We have found that mining both internal, as well as industry data, to find ways to speed cash flow and reduce disputes is no less important than optimizing inventory management. Both assets depreciate, and both have the same impact on working capital. With bank lending constrained these days, why not find growth financing internally? Unfortunately, unless you have modern technology and the data to point you in the right direction you are pretty much running in place instead of changing the course of events.

With fewer employees on staff, better use of data and systems has taken on critical importance for targeting collection, cash flow and deduction strategies. What we in the business know is that it is not merely how many you call, but selecting who you call with what frequency.

Developing Your Scorecard And Identifying The Cash Flow Gaps

The first step is to understand your position, relative to the best in your industry. You can use current industry benchmarks, to determine the improvement possibilities, what we call the "Cash Gap." Set your DSO targets based on top industry performers, not the averages. Your best-in-class competitor's DSO could be 20% or more better than yours, indicating the improvement potential. Both on a general, and on a customer-specific basis, you may find great opportunity. Here are four hypothetical, yet representative 100 million dollar companies, all in the same industry on standard thirty-day terms.

Overall DSO Comparison And Cash Gap ($100 Million Company)

Competitor	DSO	Cash Tied Up In A/R	The Gap
Perfect	30	8,219,178	0
Company A	37	10,136,986	1,917,808
Company B	45	12,328,767	4,109,589
Company C (you?)	62	16,986,301	8,767,123

You can perform this analysis across the business, as well as customer-by-customer. Peer data might be available from industry credit groups, or you give us a call as we monitor vendor and factor payments of two million retailers including all the big box stores. The first step is to do the above analysis and find out how well you are doing. If you find that there is a material difference between what your receivables and cash position is versus what it should be will be a wake-up call to take action.

1. Appoint a "C" level executive to oversee the effort.
2. Collect the peer performance data you need from your associations, credit groups, or contact us.
3. Target the results achieved by the best performers in your industry.
4. Do the Cash Gap analysis for the company as a whole, as well as for each individual major account.
5. Acquire an automated collection and deduction management system that will prioritize action based on the size of opportunity and age.
6. Have separate teams handle invoice collections and deduction resolution for better focus.
7. Do not be afraid to escalate big problems. Have your president, for example, call his customer counterpart.
8. Track results to make sure you are making the progress you anticipated and adjust where required.

By implementing this plan, you can transform your company's working capital and reduce the amount you need in bank financing, possibly adding millions of cash to your books.

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