

Zero-Sum Receivables Management

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Someone wins, someone loses. The zero-sum working capital tension between you and your customers requires a driven effort to enforce your invoice terms; that is, focus on getting your receivables paid on time. There are many companies that could improve their Days Sales Outstanding (DSO) by 10, 20, even 30% if they 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.

Recognize that a certain percentage of late payments are basically "baked in" to the system; that is, many customers have no plans to pay to you on the date due. "Give them an inch, they'll take a mile." To illustrate how being passive leads to even worse results, some A/P departments use software that tracks how quickly (or slowly) you follow up for payment, and adjusts the payment rules accordingly. The less aggressively you follow up, the more slowly you get paid and vice versa.

In addition, all businesses have hundreds of thousands or even millions of dollars of cash "frozen" due to process errors, deductions, or disputes that are holding up invoice payment, yet few companies have invested in systems. Once practices and habits become ingrained, negative practices are hard to break.

How can you break this cycle and unlock this cash flow? Mining internal and 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 the technology and data to point you in the right direction, you're pretty much running in place instead of changing the course of events.

With fewer employees, data and systems have taken on critical importance for targeting collection, cash flow, and deduction strategies versus the old days of thumbing through accounts A through Z and "dialing for dollars". What we in the business know is that it is not merely how many you call (although that's important), but selecting who you call with what frequency.

Developing Your Scorecard and Identifying the Cash Flow Gaps

Understanding where you are, relative to the best in your industry, is the first step. Use current industry benchmarks to determine the improvement possibilities — what we call the cash flow "gap."

At Credit2B, we compare your scores against the best performers in the industry, calculating the Cash Flow Gap in days and dollars on a customer-by-customer basis to give you a measurable target for your collectors.

Set your DSO targets based on top industry performers, not the averages. Your best-in-class competitor's DSO could be 20 percent or more better than yours, indicating the improvement potential. Both on a general and customer-specific basis, you may find great opportunity.

Here are three hypothetical, representative \$100 million companies, all in the same industry. We calculate the Cash Gap by comparing peer receivables data with your company's data to determine the overall cash potential, and for each major customer.

Overall DSO Comparison and Cash Gap (\$100 Million Company)			
Competitor	DSO	Cash Tied Up In A/R	The Gap
A (best)	37	10,138,000	0
B	45	12,330,000	2,192,000
C (you?)	62	16,988,000	6,850,000

This analysis can be done across the business, and for each major customer. You may be able get peer data from industry credit groups, or we will help you at Credit2B, as we monitor vendor and factor payments for a million retailers including all of the big-box stores.

Best Collection Practices

1. Target the results achieved by the best in your industry.
2. Use an automated collection system that will prioritize action based on the size of opportunity and age.
3. Track results to make sure you are making the progress you anticipated.
4. Separate deductions from collections and have them handled by specialists who understand the complex business issues that are involved.
5. Don't be afraid to escalate big problems. Have your president, for example, call his customer counterpart. ■

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