Buried Treasure

Unlocking cash from your accounts receivable

When faced with an economic downturn, companies often do what individuals do in hard times – they spend less and look harder for cash. This long, troubled time has been no exception. With credit harder to come by, most executives know that in the end, companies with cash stay in business, while companies that don’t hoard their cash may well find themselves on their way to bankruptcy court.

Conceptually, the response to save cash seems simple. But as with so many things in business, the reality is more complex. In fact, acting on that instinct in a panic can actually make problems worse rather than better. By suddenly insisting on quick payment, a supplier can make customers suspicious of its financial stability and cause them to diversify their orders. Goodwill can be hurt, too, if the company has no easy mechanism to resolve disputes with customers. And a large company can easily waste time and money chasing down invoices that turn out to have already been paid.

A better response is to turn the company’s focus inward rather than outward. Although it’s easy to think of cash collection as an external problem – the company versus a world of deadbeats – a backlog of receivables is really the result of an internal process that needs to be optimised. Asking how to prevent bad debts, reduce billing errors, and minimise payment disputes is much more promising than asking what it will take to get a particular customer to send a cheque. A thorough examination of the entire customer-to-cash cycle can lead not just to a one-time recovery of a delinquent account but to lasting gains for the company in cost and customer satisfaction: a treasure within.

Activities before delivery

In attempting to improve their cash position, most companies focus on activities that take place after product and service delivery. In fact, they have the order exactly backward, because the structure of the sale shapes everything that follows. To no small degree, whether an account ends up being easy to collect or difficult depends on what goes on before the contract is signed.

Customer acquisition, in particular, offers a huge opportunity for improving working capital performance. Negotiating short payment terms with new customers and renegotiating payment terms with existing customers can help companies slash the need for working capital dramatically. Renegotiating a contract with an old customer takes time, since the best moment to renegotiate payment terms is usually during annual contract reviews. With a new customer, however, the process is much simpler.

Avoiding bad accounts is also easier before the product is sold. Clear, upfront processes and policies go a long way toward avoiding problems later.
Companies reduce their exposure to late payers by adopting and enforcing credit limits and warning customers in advance that delivery will be stopped as soon as they exceed a credit limit. Over time, such clear policies reduce the weight of bad payers on a receivables portfolio and, particularly, the dangerous potential to concentrate a receivable in one account.

Better order processing also improves a company’s cash flow situation. Minimising the time between receipt of the order and serving the customer minimises the time before the company can send out an invoice. Tighter, more automated policies also help prevent the sales situations in which the processing cost exceeds the margin the order generates – which easily arises when there is a long, loose period between sale and delivery.

**Activities after delivery**

Most companies looking for cash, however, focus first on collecting for products or services already delivered. But once again, panic often substitutes for process. Companies expend energy chasing down unpaid invoices rather than improving their payment system, which would ultimately reduce the need for such time-consuming collection.

Like customer acquisition problems, many of the problems that arise after delivery stem from poor communication. Lack of internal communication slows down every aspect of cash collection, from invoicing to dispute resolution, while better processing saves companies money right away. The need for good communication begins as soon as the service or product is delivered. Right then, delivery should be communicated to the finance department as soon as possible, to enable finance to speed an invoice to the customer. Because many companies now will pay only after a certain number of days have elapsed since receiving the invoice, sluggish invoicing costs the company money.

The next potential bottleneck is another communication issue: an error on the invoice. Particularly in these times, when procurement departments are scrutinising their bills more closely, mistakes can lead to costly delays in payment. A tighter, cleaner process, which can be created in part by using automated billing software, not only reduces the time to produce an invoice but minimises invoicing errors, thus improving customer service by avoiding mutually aggravating disputes over paperwork.

But better communication is only a part of the solution. The other element is strategic. A world-class collection management process segments customers, separating good payers from bad payers and the important accounts from the marginal. Then the company can make decisions early to focus collection attention where it matters most, thus improving cash collection efforts.

Focussing on the most important accounts has other benefits as well. Paying close attention to key customers rather than anyone who happens to pick up the phone helps the company detect potential problems with the customer more quickly, whether it’s a potential invoice dispute or a looming risk to the customer’s business health.

But knowledge about such risks and disputes should not just be kept within finance. The collection process should
be designed so that when potential problems arise, the trouble is made known to anyone who might be able to contribute to the resolution. This is particularly true when it comes to payment disputes. Finance departments sometimes serve as the dumping ground for problems created in other parts of the company. A system with clear decision rules, such as a seven-day window to settle a problem before elevating it to a manager in another department, can dramatically improve collection rates and eliminate future sources of trouble.

Once the cash is collected, finance should immediately allocate it to the proper invoice. Otherwise, the company’s collections agents could still be dunning for money already received – a waste of time for the company and an annoyance to the customer.

The larger view

In the end, reducing the level of accounts receivable isn’t about adding a few desks in the accounts receivable office. Nor is it about software. Although dedicated personnel and improved billing software can enhance the process, there is no substitute for knowledge. Only after the company has developed a thorough understanding of how and when cash flows from the client to the company can it begin to design a system that will best optimise those flows. Creating such a system is not as easy as stepping up the pressure on overdue accounts or snapping some software in place. However, it’s the only way to make the long-lasting improvements in receivables that a company needs – not just to survive this downturn, but to thrive when the good times roll once more.

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