CHAPTER 1

Introduction

WHY IS RECEIVABLES MANAGEMENT IMPORTANT?

It can be argued that revenue generation is the most critical function of a company. Dot-com companies that created exciting new products but failed to generate significant revenue burned through their cash and ceased operating. Every company expends substantial resources to generate increasing levels of revenue.

However, that revenue must be converted into cash. Cash is the lifeblood of any company. Every dollar of a company's revenue becomes a receivable that must be managed and collected.

Therefore, the staff and processes that manage your receivables asset:

- Manage 100% of your company's revenue.
- Serve as a service touch point for virtually all your customers. (Only Sales and Customer Service speak more with your customers.)
- Can incur or save millions of dollars of bad debt and interest expense.
- Can injure or enhance customer service and satisfaction, leading to increases or decreases in revenue.

If increasing revenue, enhancing customer satisfaction, and reducing expenses are important to you, read on.

The benefits of effectively managing the receivables asset are:

- Increased cash flow
- Higher credit sales and margins
- Reduced bad debt loss
- Lower administrative cost in the entire revenue cycle
- Decreased deductions and concessions losses
- Enhanced customer service
- Decreased administrative burden on sales force

These benefits can easily total millions in profit and tens of millions of cash flow in a year.

IF IT WAS EASY, EVERYONE WOULD DO IT (WELL)

Management of the receivables asset is a demanding task. The vast majority of companies expect that over 99.9% of all billings will be collected. *Collecting ninety five percent of revenue is not good enough.* Companies will tolerate bad debt expense of several tenths of a percent of revenue, but not much more. Which other departments are expected to perform at 99 plus percent effectiveness?

It is generally expected that a high percentage of invoices will be paid on time and over 90% within 30 days of the due date. Management expects that the asset will be managed to promote sales and that all customers will be served promptly, courteously, and professionally. Astoundingly, most firms also expect this all to be accomplished for a cost equal to about *two to three tenths of a percent of revenue. Quite a bargain!*

Management of the receivables asset is a complex task. It addresses the ramifications of practices and processes usually outside the span of control of the responsible manager. It requires balancing of opposing

CASE HISTORY

How Improved Receivables Management Can Revitalize an Organization

A high-technology firm whose products were well regarded by the marketplace was experiencing an especially serious receivables management problem. Bad debt exposure and the investment in receivables were high (days sales outstanding [DSO] was just over 100 days). Millions of dollars in disputed amounts were being conceded annually, not in response to valid customer disputes, but simply as a function of age. In addition, the company's stock price was depressed because of the high DSO. Wall Street analysts interpreted the elevated DSO as an indication that:

- Their new products did not work properly, or
- Products were delivered on a trial basis, were not valid sales, and therefore were not true receivables.

Clearly, this firm was feeling tremendous pain from failure to manage its receivables.

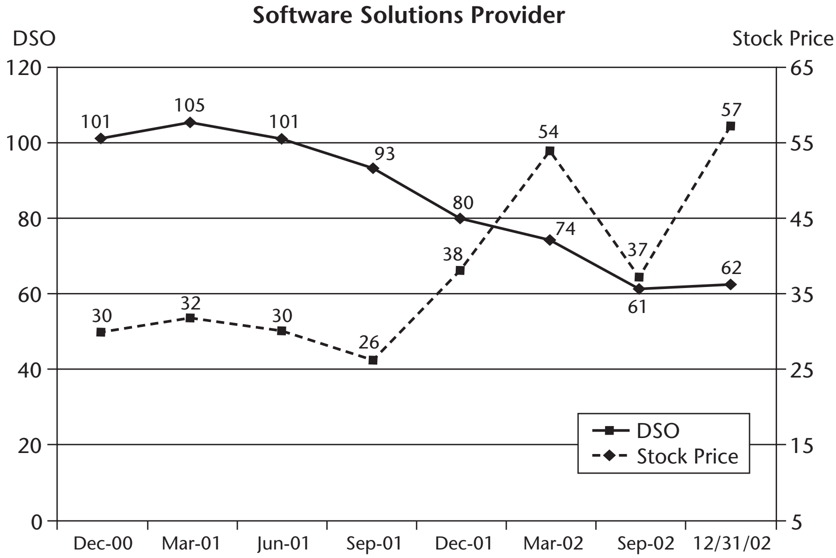
Over an 18-month period, this firm completely redesigned its receivables management process, tools, staff skills, and management culture, implementing most of the principles and techniques described later in this book. The benefits from the company's improvement in its receivables, illustrated in Exhibit 1.1, include:

- A huge increase in the stock price, and
- An increase in cash on hand equivalent to four months of sales.

In addition to the increase in stock price and cash on hand, bad debt and concession expenses decreased by several million dollars annually.

priorities. It is affected by the state of the domestic and global economy, interest rates, foreign exchange rates, banking regulations and practices, business law, and other factors. Excellence in receivables management is a combination of art as well as science; it involves business process, technology tools, staff skills, motivation, company culture, changing behavior of both customers and coworkers, the right organization structure and metrics, incentives, and flexibility to deal with changing external influences.

Exhibit 1.1 Benefits of Improved Receivables Management



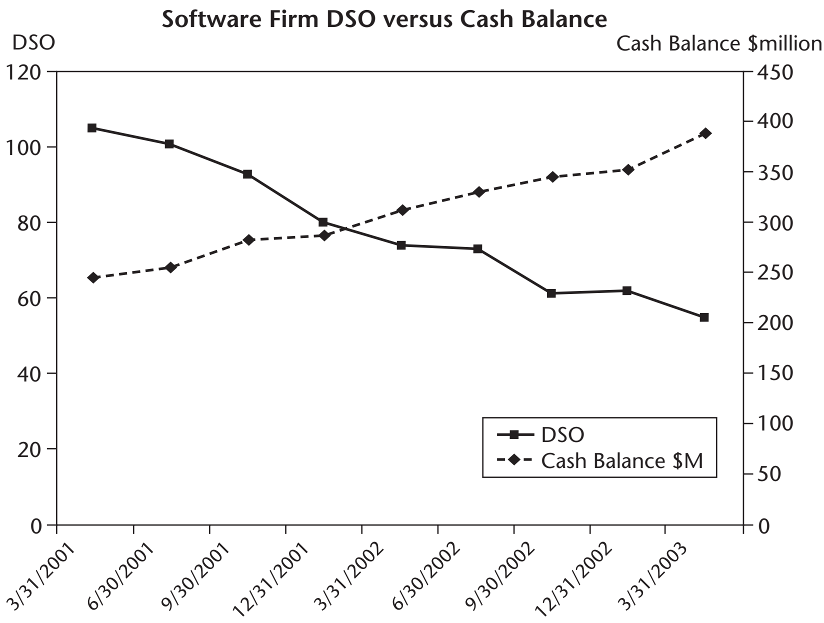
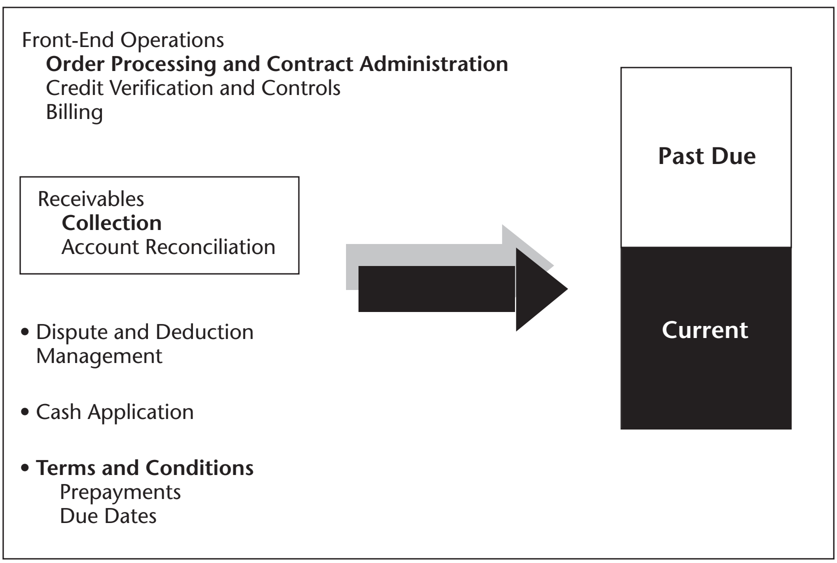


Exhibit 1.2 illustrates the determinants or drivers of receivables management. Most of them are outside the direct control of the manager with responsibility for receivables.

INFLUENCES OUTSIDE THE CONTROL OF THE RESPONSIBLE MANAGER

The receivables asset is sometimes called the garbage can of the company. This is because the receivables asset reflects the quality of the entire revenue cycle operation. If an error is made in taking an order, fulfilling it, invoicing it, applying the customer payment, or if the customer is dissatisfied with the product or service, it will manifest itself as a past due or short payment in the receivables ledger. The quality of the receivables asset is an excellent barometer of customer service. It is feedback the customer willingly and quickly gives. It is tempting to call it a free quality control measurement system, except it is not free. The firm does not have to pay customers for the feedback, but it does incur costs in remediating the problems.

Exhibit 1.2 Drivers of Improved Receivables Management



In most companies the sales strategy and/or the front-end operations (i.e., order processing and fulfillment, etc.) are outside the direct management control of the person responsible for receivables management results. In such cases, the manager is measured on the results of a process that he or she does not fully control. In response to this, enlightened companies will place the entire revenue cycle (order to cash cycle) under the control of a single executive, as a "process owner." This arrangement has numerous advantages, the primary one being the matching of authority with responsibility. Even then the executive does not have total control over all the determinants, specifically the sales strategy and the "need to make the numbers" at the end of a month or quarter.

CONFLICTING PRIORITIES

Excellence in receivables management requires trade-offs between conflicting goals. The trade-offs are best balanced in accordance with the company's overriding strategic objectives. To optimize the trade-off, the relative ranking of these strategic objectives must be understood:

- Sales growth
- Profitability
- Cash generation
- Market share
- Risk tolerance

The conflicting objectives are to:

- Loosen credit acceptance criteria and controls to boost sales versus tightening credit controls to minimize the investment in receivables and the exposure to bad debt loss
- Achieve strong receivables management results and provide excellent financial service to your customers versus minimizing the cost of the function

The Best Practices described in this book, when tailored to a company's strategic objectives, culture, and industry, will enable excellence in receivables management in all of its dimensions. This excellence will deliver the profit and cash benefits available to your company.[1]

Note

1. *Fortune*, Special Issue, vol. 149, no. 7 (April 5, 2004), pp. F1–F20.