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# Down Economy, Found Money: How to Uncover Hidden Working Capital In Your Receivables

## 5 Proven Methods For Optimizing Cash Flow

by Michael Baldwin

It's no great insight to note that the business world has been turned on its collective ear in the past several months. The drumbeat of negative economic news seems unrelenting, as media pundits seem to almost revel in grim superlatives. "Indicators all point downward." "No end in sight." "Worst since the Great Depression."

Sales and revenues are down. Past-due receivables and DSO are up. It's a dispiriting formula that has left corporate financial professionals scrambling for ways to ensure that the lifeblood of their organizations — cash — is kept flowing.

Down business cycles have historically prompted a dual reflex action on the part of corporations:

1. Cost-cutting (starting with the biggest line-item expense: payroll), and
2. Increasing focus on sales efforts, via new business development and/or enhanced client relationship-building and loosening of credit policies.

But if the news coming out of both Washington and corporate America is any indication, this recession is shaping up to be particularly vexing. It will almost certainly exceed (if it has not already) the 11-month timeline that is historically the average duration of recessionary cycles. According to experts, the tsunami of bad credit that caused this mess will take its time washing over the system, and businesses will need to tread water longer than usual in anticipation of some semblance of economic equilibrium being restored.



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In the meantime, corporate financial professionals are discovering that cutting costs and boosting sales efforts are, while somewhat effective, not nearly sufficient to ensure a continued, adequate flow of working capital. They are assessing nearly every aspect of their financial operations, up and down both the supply chain and demand chain. And in doing so, many have identified an area that is showing considerable promise in terms of delivering needed cash. That area is Accounts Receivable.

### **Uncovering hidden cash**

Not surprisingly, in a down economic cycle, the receivables line item on a corporate balance sheet tends to expand — and DSO (days sales outstanding) as well, in lock step. Of course, if one could dramatically reduce both of these items, one could discover an otherwise hidden trove of locked-up cash.

Accelerate receivables recovery plus shrink DSO equal enhanced cash flow. In theory, it sounds simple and logical. In practice, however, it's usually a good deal more challenging. The reasons, typically, involve both tactical and cultural factors.

So, where does one begin? How does one uncover hidden working capital within one's Accounts Receivable operation?

### **Five building blocks**

In my experience analyzing end-to-end receivables solutions for some of the world's most revered companies, I have found that the most successful cash flow optimization initiatives tend to hinge upon achieving five key objectives. The first three are tactical in nature, the last two are cultural. (And, notably, the more successful you are at achieving the three tactical attributes, the easier it will be to achieve the two cultural ones.)

# 1. Science!

Invoice-based collector workflow systems. Automated treatment technology based on scoring and predictive variables. IVR systems. Integrated letter series. Predictive auto-dialers. Cash application workflow tools. Credit card chargeback research systems. Web-based escalation and communication platforms. Automated dispute resolution workflow tools.

If those don't look familiar, well, they should. They're among the advanced productivity tools being used by today's most successful A/R Departments. When prudently deployed, they facilitate dramatic results in accelerating workflow...and cash flow. When they're not, it's usually a sign of an ill-equipped and under-performing receivables function.

Superior technology can pay for itself. Here's one example: A customer may be holding up a million dollars in payments to you because of a small error on a single, modest invoice. By combining an effective dispute management process with a superior workflow tracking tool, one could flag this error and avoid the DSO issue...not to mention the associated customer dissatisfaction.

Alas, however, many A/R Departments receive little or no such investment in technology. While other, more visible corporate functions typically benefit from the occasional tech upgrade, A/R often goes without the tools to analyze and segment portfolios and drive collection matrix strategies.

**Building Block #1: Technology is a key element in driving best-in-class A/R performance. Invest in the tools that allow A/R to work smarter and accelerate cash flow.**



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## 2. Analyze this

### Pop quiz:

*Which of your accounts will become delinquent four weeks from now?*

*What are your customers' average days to pay? How about average DDO (days disputes outstanding)?*

*What are your most common customer disputes, and how are you tracking and resolving them?*

*What are your customers' historical pay patterns?*

*What are your portfolios' key customer segments? What are your delinquency rates within each segment?*

*How do you integrate risk and scoring indicators into your treatment flow?*

If you cannot easily glean the answers to those, you likely have a portfolio analytics issue that, in turn, hinders visibility into and diagnosis of order-to-cash processes.

A first-rate A/R Department knows the answers to the above questions, because they have an effective analysis and reporting function. So they can readily identify product performance, quality and delivery issues. They can flag chronic and frequent billing errors. They can pinpoint pricing disputes. They can avoid offending good customers who have long-established in-terms payment histories.

In short, quality analysis tools can identify and address the most common sources of customer disputes before they turn into delinquency-causing, relationship-jeopardizing problems. And quality reporting can proactively alert you to A/R degradation before it becomes a big problem.

When disputes and degradation are nipped in the bud, your A/R is performing not merely as a collections function, but as a key contributor to maintaining positive customer relationships.

**Building Block #2: Be sure that your A/R reporting capabilities are up to snuff.**

**Quality analytical tools can provide a roadmap for driving your entire A/R strategy.**



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### 3. Fishing upstream

A common perceptual mistake in C-suites — and one that contributes mightily to underperforming receivables operations — is equating A/R solely with collections. As a result, collections is often the first (or only) activity to be addressed when attempting to remedy A/R woes. In fact, though, the root of slowing cash flow may have much less to do with collections than with other, “upstream” order-to-cash processes.

Order entry. Order approval. Sales terms. Invoicing. Lockbox performance. Dispute resolution. Each of these activities is a key part of the order-to-cash continuum. Each of them provides valuable insight into customers’ hot buttons, pain points and satisfaction with your service. And each of them, if mishandled, can affect downstream activities, creating a bottleneck that slows customer payments.

Consider this: Especially in tough economic times, Accounts Payable Departments tend to slow or withhold payment for products delivered or services rendered not because they’re unable to pay, but because they’re dissatisfied with some aspect of your service. By neglecting key upstream order-to-cash processes, you may be giving them reason for dissatisfaction. (The majority of DSO problems are driven by activities undertaken in the first 10 days of a transaction.)

A quick example of the above: With sales reps under increasing pressure to meet ever-more challenging quotas, out-of-policy terms may be used to book business. Ironically, though, the more flexible sales terms often result in lengthier payment delays — not to mention a dissatisfied new customer.

**Building Block #3: Look beyond collections, and focus on upstream activities in the order-to-cash cycle.**



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As mentioned earlier, finding hidden working capital in your A/R function encompasses more than just an adjustment of processes and procedures. It also takes an attitude adjustment to company culture, particularly in the perception of and regard for the A/R Department. To wit:

## 4. R.E.S.P.E.C.T. (Just a little bit)

One of the first steps in building a stronger, harder-working A/R function is to engender greater company-wide respect for it.

It's hardly a secret that A/R — like other traditionally back-office departments — is often not regarded as a core company function, and thus fails to garner the respect that revenue-producing departments do.

Often, the issue is a matter of understanding...or lack thereof. In many companies, senior management is simply unaware of the link between A/R and customer satisfaction (and attrition).

This “end-of-the-line” regard for A/R has multiple unfortunate consequences, ranging from sub-optimal staffing (in both number and experience level), to inadequate employee training, to insufficient systems documentation, to the aforementioned lack of advanced technology and tools.

What's required is for A/R to be internally perceived and treated not as a back-office backwater, but rather a key front-office function. The litmus test here is customer contact. Like other front-office functions such as Sales and Marketing, A/R is highly customer-facing. Thus, the caliber of A/R staff and processes has a significant effect on customer relationships.

Overturing the back-office perception of A/R, however, is no easy task. (Ask anyone who's tried.) For that reason, any successful initiative to raise company-wide regard for the A/R Department — and its ability to reduce DSO and accelerate cash flow — must have strong, visible and unwavering support by the highest levels of the organization.

**Building Block #4: : If you're looking for an A/R function that works harder, elevate its stature and perception within the organization, starting with strong and ongoing support from top management.**

**The A/R Department — and its ability to reduce DSO and accelerate cash flow — must have strong, visible and unwavering support by the highest levels of the organization.**



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## 5. ‘Sales Director, tear down this wall.’

There may be no greater impediment to a strong A/R Department than a strong Sales Department — or rather, a domineering Sales Department. It’s not difficult to understand why. The two functions are often seen at cross-purposes: Sales giveth, and A/R taketh away.

The A/R Department is often seen as playing the bad guy, red-flagging (and contacting) accounts who are deleterious to the company’s bottom line. This can tend to make A/R personnel rather unpopular with Sales personnel, who regard the former as revenue-killers.

In my experience, the most successful customer service-focused organizations — and those with best-in-class A/R performance — are the ones in which the Sales and A/R personnel are well aligned. When a company’s compensation structure is such that the Sales force has a vested interest in timely customer payments, DSO reduction and rapid customer dispute resolution, the A/R function is viewed not as a buzz-kill, but rather as a key contributor to customer satisfaction...and company profitability.

Fair warning: In companies that are sales-driven, aligning Sales with A/R is typically a task much easier begun than completed. Pushback is not uncommon from a Sales force that is compensated by business booked rather than revenue received. Bear that fact in mind before you begin, and you may prevent a lot of headaches down the line.

**Building Block #5: : If you’re looking for an A/R function that works harder, align its mission and goals with the Sales function.**



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### **The outsourcing question**

Clearly, extracting hidden working capital from your Accounts Receivable operation is not as easy as flipping a switch. It takes a total, long-term dedication to the A/R function as a whole.

From a resources standpoint, that may mean a greater commitment to high-caliber, experienced personnel, a focus on best practices, and a significant investment in the advanced technologies that enhance the A/R function.

From a cultural standpoint, it may mean an ongoing campaign to change the perception of A/R (from a back-office to a front-office activity) and move it up the corporate food chain, with all the bumps and bruises that are inherent in such an effort.

Because those challenges can be daunting, many companies find it preferable to buy a better solution rather than try to build one. They investigate outside receivables management specialists, recognizing that a firm that is wholly dedicated to cash flow optimization would already have in place all the factors and capabilities to which they aspire.

At the very least, the presence of receivables management companies prompts many corporate financial professionals to pick up the phone and pick the brains of professionals whose sole business is about cost-effectively accelerating the order-to-cash cycle.

### **A/R and the customer's pulse**

In these times of slowing cash flow, injecting needed working capital into operations has become a critical corporate priority. In growing numbers, today's companies are focusing on improving the A/R Department as a key method of uncovering that capital.

When they do so, they actually realize another benefit — one that has perhaps greater long-term significance for the company. They discover that A/R is a direct link to the voice of the customer. Whereas Sales' interaction with customers generally ends when the order is signed or contract finalized, A/R touches the customer at multiple points in the CRM process.

As a result, an effective A/R operation can detect the first rumblings of customer issues, from minor complaints to major disputes. A/R can be proactive in addressing these issues and preventing potential attrition. In short, A/R can be a key means of customer care and satisfaction.

These days, that is not an insignificant consideration.

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#### **About the author**

Michael Baldwin is President and CEO of Receivable Management Services Inc., a leading A/R optimization outsourcer. RMS's proven success and expertise in DSO reduction and cash flow management serve to dramatically and cost-effectively accelerate the order-to-cash cycle. Its global operations include three U.S. locations, as well as facilities in Mexico, Canada, India and China. A 25-year veteran of the credit and receivables industry, Mr. Baldwin also served in multiple roles at Dun & Bradstreet Corporation, including Vice-President of Sales for D&B's largest sales region, President of Market Data Retrieval, and Senior Vice-President of Sales.