Let the Cash Flow

A practical guide to getting paid on time by your customers

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Revenue is vanity
Profit is sanity
Cash is reality

– Anonymous

Contents

Why we wrote this book 9

Part 1: This book, and how to use it 11
1.1 What's in this book
1.2 Definition and measurement of Accounts Receivable
1.3 Why receivables matter
1.4 Why receivables matter now
1.5 How this book will help
1.6 In disruption be bold

Part 2: The Virtuous Revenue Cycle 32
2.1 Meet the VRC
2.2 Challenge receivables myths
2.3 Forecast your cash needs
2.4 Take risk seriously
2.5 Insolvent customers and bad debt

Part 3: Case studies 62
3.1 Background
3.2 The MNC: Cash is reality
3.3 The SME: See it as love
3.4 The start-up: Trust gets paid
3.5 Key lessons

Part 4: Into action 83
4.1 Top-down ownership
4.2 Clear credit policy
4.3 Prompt and accurate invoicing
4.4 Proactive customer service model
4.5 Prompt discrepancy resolution
4.6 Systematic root cause elimination
4.7 Engaged, motivated sales team
4.8 Balanced scorecard

Part 5: Other opportunities 126
5.1 Reduce credit terms using BPDSO
5.2 Trade credit insurance
5.3 Leverage digital engagement

Part 6: Your start-up advantage 139
6.1 Why do start-ups fail?
6.2 The right foot
6.3 SME checklist

Part 7: How to make it happen 142
7.1 Value discovery – Why do it at all?
7.2 The elements of value discovery
7.3 Building support – Why does change fail?
7.4 Sequencing the changes
7.5 Outcome-based training

Part 8: Postscript 155
8.1 It's a journey
8.2 Make it positive
8.3 Tell us how you got on

Part 9: Appendices 157
Appendix 1: Acronyms you will need
Appendix 2: Credit policy template
Appendix 3: Proactive collections, guidelines, script
Appendix 4: Issue resolution templates
Appendix 5: Audit and measurement

Why we wrote this book

When I first sat down with Simon over coffee to talk to him about accounts receivable, collections and cash flow, my training business was going strong.

It was 2016. Our sales were growing. Our customer base was growing. But our overdraft was growing, too. Some months we were struggling to pay salaries and rent. We were spending a growing amount of time chasing overdue invoices. The sales wheels were spinning, but cash flow was bogged down.

How could this be, I often wondered, when we had a delightful list of blue-chip clients.

How could this be, when we had a wonderfully warm working relationship with the decision makers who booked our services?

How could this be, when bookings were rolling in and I was virtually working 24/7?

Some months before my fateful coffee with Simon, I had made yet another collections call during which the customer told me she couldn't find the invoice … oh wait, there it was, at the bottom of her in-tray.

I was fed up. I rolled up my sleeves and conceived of an online platform to send automated email reminders to our clients, telling them in the nicest possible way to pay up!

"A customer who doesn't pay isn't a customer, it's a charity," I ranted to Simon, and underscored it with a final swig of my cup. "Or worse, a parasite!"

He chuckled and shook his head, and uttered those words that at first I hated to hear. "Mark, when you don't get paid on time, it's because of something you did or did not do *before* your invoice became due."

How could this be? A customer doesn't pay, and it's *my* fault?

But I contemplated this for a while. Simon was very experienced in this area, had a 30-year track record in consulting to large companies, was a working capital specialist. Could he be right?

One of the most uncomfortable realisations about not getting paid on time was that most of the time it *was* my own fault: Invoices not sent in hard copy. Invoices not sent. Invoices not even written. Not checking the invoice for errors. Not checking whether the invoice had arrived. Not confirming the invoice was going to be settled by the due date. Not aware of the customer's lengthy and elaborate onboarding process before delivering the product or service. I couldn't even submit the invoice, whether it was correct or not.

Not only have I come around to Simon's way of thinking, there is a pressing need to spread the word. You would think something as essential as cash flow would get a great deal of attention. But we have found the issue doesn't even get enough recognition from the companies that need it most: Small and Medium Enterprises.

Just look at the shambolic invoices you receive from time to time from some of your suppliers. Misspelling your company name. Misstated prices. Missing Purchase Order. Missing account details to remit payment to. Missing due date. On occasion, I have even seen an expiry date on invoices! So, I just need to wait it out and then I won't need to pay it, is that right?

Many SMEs string along their own suppliers as long as possible before they promise to send a cheque and then take weeks more before they actually do, yet expect customers to pay instantly. And then they assume that after providing the product or service they are somehow magically going to get paid. And if not, shrug, there's nothing they can do about it.

The working capital gap starts with this knowledge gap. Worse, a whole industry has sprung up to take advantage of it. Invoice factoring services, microlending services, invoice gateways, payment gateways, procurement portals, accounting software and yes, automated reminder email platforms such as the one I had myself conceived, all promise to help you improve cash flow.

But what they are all missing is that getting paid on time is not a *technology* problem. It's a *communications* problem. It follows that it requires a communications solution.

That's what this book is about: how to talk to your customers so you are not only getting paid on time but building your relationship with them in the process.

Some of it will make you uncomfortable, as it challenges the entrenched notion that a delayed payment is always the customer's fault.

But as you settle back and read it with your own cup of coffee in hand, you will feel empowered because there *is* something you can do. You will feel reassured because you can regain control of your balance sheet. You will feel your business move forward because cash flow will gain traction when you rev up sales. You will look forward to calling customers as a contribution to customer service, rather than a drain of your valuable time.

And you will never have to make those dreaded collections calls again.

Part 1
This book, and how to use it

1.1 What's in this book
1.2 Definition and measurement of Accounts Receivable
1.3 Why receivables matter
1.4 Why receivables matter now
1.5 How this book will help
1.6 In disruption be bold

1.1 What's in this book

This book is designed to help you get paid on time by your customers. It is intended for companies of all sizes who allow their customers credit terms and are struggling with late payments.

Whether you are a start-up or a substantial enterprise, you will find here a solution to the problem of managing accounts receivable.

We simply argue that, since solvent companies always pay some suppliers every month, you should make it your objective to be one of the suppliers who gets paid.

This requires removing any real or imagined obstacle to timely customer payment through a single-minded approach to communication and service.

If you currently get paid in cash and are not owed money by any customers, you might want to spend your time – and your money – elsewhere. Unless you are just curious – in which case, read on!

Nor is this a manual for those in crisis, though we certainly offer good advice for companies for whom late payment has become critical, as well as a "quick wins" guide in Part 8.

Every company which offers credit terms will benefit from what is in this book, because the solution offered builds better customer relationships, unites your team, and creates resilience in times of disruption.

In the book we lay out practical steps to becoming "first in line to get paid" based on the adoption of what we call the Virtuous Revenue Cycle, which emphasises customer intimacy and service.

Early on, we describe and debunk nine commonly held misconceptions

about why companies (you!) get paid late, to help you build alignment within your own team by anticipating objections.

Overview

We recommend you read this book as a whole, but to help you get started there follows a summary of what is in each of the 9 parts.

Part 1: Definitions

In Part 1 we define "accounts receivable" (AR), or simply, "receivables". We describe how the money your customers owe you can be broken down into a "terms-driven" and a "process-driven" component, each of which must be treated differently.

We also suggest you measure AR using the term Days Sales Outstanding (DSO) so you can track how effectively you are managing this important asset. We provide examples of DSO measures.

Part 2: The Virtuous Revenue Cycle (VRC)

In Part 2 we introduce the Virtuous Revenue Cycle (VRC) and briefly summarise each of its elements.

The VRC is a cycle of continuous improvement which changes service culture, delights customers by anticipating and responding to their every need and ensures that you get paid on time.

The magic of the VRC is that the delivery of prompt payment is an implicit outcome rather than an explicit one – your customer interactions begin and end with service and intimacy, and ugly conversations about tardy payments are consigned to the past.

The VRC begins with top-down ownership and a clear definition of mutual expectations through written credit policy and uses proactive customer service and responsiveness and total team engagement to identify and resolve unmet customer expectations and assure timely payment.

Your VRC will also, over time, provide your team with new and important skills, and enable greater competitiveness and growth.

Part 3: Case studies

This book distils years of hands-on experience, including some successes and many failures. To encourage you to follow the VRC path, we include three examples of companies which followed these principles under our guidance.

One was already a substantial recently listed technology MNC destined to grow into a $5bn company; the second, a $20m B2B SME now transitioning out of SME status (>$100m); and the third, a small start-up now doubling in size each year.

Each one has seen enormous success – including rapid growth, strong

cash flow, and remarkable resilience during disruption.

Each one acknowledges in the clearest terms how adopting the principles in this book early on has played a key role in their success, with some compelling examples.

In one case, the co-founder of a specialty chemicals SME describes how rapidly improving receivables management became a life-or-death issue – and how solving that issue using the VRC built a very healthy and cash-rich company over time.

Part 4: Into action

In this part each component of the Virtuous Revenue Cycle is introduced in detail, with clear steps, illustrations, and Do's and Don'ts.

The content of this part should be treated as a whole – without every element of the VRC, your programme will either not succeed or after brief success will fail to endure.

Part 5: Other opportunities

Once you have the VRC in place and working, other things become possible because of the enhanced quality of your processes, the reduction of customer risk, and the improved transparency of receivables data.

Your data on discrepancies and the financial and service benefits to your customer of root-cause elimination will permit you, in selected cases, to negotiate terms-reduction with customers.

We lay out a simple but effective methodology for you to use to identify and agree terms reduction with selected customers.

We also explore the opportunity to leverage credit insurance to offset bad-debt risk, summarising interviews with leaders in this field.

In addition, we address the significant opportunity which now exists to leverage digital communication in the service of customer engagement at selected stages of the VRC.

Part 6: Your start-up advantage

Most start-ups fail. Most often they fail by running out of cash. A start-up that takes this book seriously and follows its suggestions from the very outset will enjoy a distinct advantage and will have mitigated the principal failure risk.

Established companies which have operated in a certain way for years and have a defined culture face greater obstacles when they try to install the VRC and assure timely payment.

They already have complex operations, staff used to behaving in a particular way (and in many cases being rewarded for it), as well as customers who have become used to paying late. Their journey will be a much tougher one and they will need to make greater efforts to correct things.

If you can, ensure you build the Virtuous Revenue Cycle into your start-up culture from day one and do not simply assume that you can easily deal with it later.

To help start-ups, we provide a simplified checklist with links to the various parts of this book that provide greater detail.

Part 7: How to make it happen

Data shows that 70% of major change programmes fall short of their objectives. Many companies grapple ineffectively with their receivables challenges, and some make multiple vain attempts to change payment outcomes.

Part 7 therefore equips you for success by providing guidelines for building the case for change, tracking the pace of change and areas of internal resistance, and creating internal consensus. We also suggest the best sequence to use when installing the VRC in your company.

We also suggest using "outcome-based training", a type of training that incorporates real business situations from day one and builds hands-on skills.

Part 8: Postscript

We emphasise again that fixing receivables should not be treated as a one-off. You cannot make a few changes and then move on. If you do, the problem will quickly resurface!

This is a programme of continual action to bring about a cultural change that delivers happy and loyal customers, healthy cash flow, and the ability of your team to learn and improve.

Part 9: Appendices

We include a glossary of terms, useful templates we have assembled that may be helpful to you as you build your VRC, and other relevant resources.

1.2 Definition and measurement of Accounts Receivable

Accounts receivable, or receivables for short, or AR (both definitions appear in this book) consist of invoices which have been produced for goods or services that you have already provided to your customer but which have not yet been paid.

Receivables can be measured purely in value – as in "We have US$10.3m of receivables."

This is not enough. We advocate measures that relate receivables (what we are owed) to what we have sold (sales), either measuring receivables as a percentage of sales, or in "Days of Sales Outstanding" or DSO.

DSO is our recommended measure.

If you allow your customer credit terms, then when you total your receivables, some will be "current" – not yet due for payment based on the agreed credit terms for that customer – and some will be "overdue" – i.e. should already have been paid given the terms that were agreed at the beginning of the transaction.

Definition and significance of DSO

If you are selling on credit terms, then the more sales you have, the greater will be the total value of your receivables.

In one sense, therefore, growing receivables are a measure of your success and a healthy outcome of growth. Receivables may grow even if your customers always pay you on time, simply because you are invoicing more.

For this reason, tracking receivables value alone is not helpful as a way of measuring how good you are at getting paid on time. Since that is the subject of this book, we are going to suggest you use DSO as it is a better measure of the effectiveness of your receivables management effort.

Days Sales Outstanding (DSO) tracks total receivables in days of sales equivalent.

If my sales in a 30-day month are $10m, and I have $10m in receivables, then my DSO is 30 – that is, equivalent in value to 30 days of sales.

Fig. 1.1 - DAYS SALES OUTSTANDING (DSO) FORMULA

$$\left(\frac{\text{current AR } \textbf{balance}}{\text{credit sales } \textbf{revenue} \text{ during measured period}}\right) \times \text{number of } \textbf{days} \text{ in measured period} = \text{DSO}$$

Several ways of measuring DSO

There are different ways of measuring DSO, and each has its advantages and disadvantages.

At this point we simply want to encourage the idea that the best sales-related measure of how well you manage your receivables is DSO and we strongly suggest you adopt it as a key measure of how well you are doing with this programme.

Your DSO *is* within your control

Often when companies struggle to get paid on time, they attribute that failure to external forces beyond their direct control, such as the market or the customer (see 2.2: Challenge receivables myths).

We believe strongly that the key to getting paid on time lies in your own hands, whatever you may have been told or may be hearing from your colleagues, customers or lenders.

To get paid on time, you need to think about receivables as a measure of the effectiveness of your own processes, starting from how you act when you first onboard a new customer to the time their payment arrives in your bank account.

We advocate using DSO because, by relating receivables to sales, DSO provides a normalised measure of how well you are managing getting paid on time.

DSO tells you how effective your processes are. DSO also provides a firm basis for internal comparison, so that you can see how your receivables performance is improving or worsening month by month, irrespective of whether your sales go up or down.

DSO also allows a common basis for external comparisons – you can benchmark yourself against competitors or other similar businesses.

If your business is growing in a healthy way, the value of your receivables may increase. But your DSO (time it takes to get paid) can go up or down, depending on what *you* do to influence it.

When DSO goes up, that generally tells you that you are taking longer to get paid because of something you should have done differently, and that you may therefore need to change something.

It is a key message of this book that *you* determine your DSO and can take firm control, if you choose to.

DSO consists of two distinct parts

If you grant credit to customers, then you will always have outstanding receivables.

If you allow your customers 30 days credit, then you will have a DSO of at least 30 even if all your customers pay you on time.

In the real world, not all customers pay on time, some pay late. Your DSO at any one time will consist of a part driven by the terms you grant – in this case 30 days – and another part caused by delayed customer payments, the overdue part.

If you have credit terms of 30 days but your DSO is 40, then we would say that 30 days of your DSO is "terms-driven" and 10 days is "process-driven" because the latter is in your control and your customer should have paid you so that you have a DSO of 30.

Since you probably have multiple customers with different terms, calculating the "terms-driven" part of your DSO requires adopting a weighted average measure which tracks the blend of terms you are using every month (see BPDSO).

DSO will always grow, untended

In a busy business, growing healthily with new customers, DSO *never stays the same.* Unless you actively manage all aspects of your receivables, and have an effective VRC, your DSO is more likely to increase than to decrease.

There are many reasons why DSO tends to grow, but here are four common ones:

1. Customers like their cash, and will delay if you let them

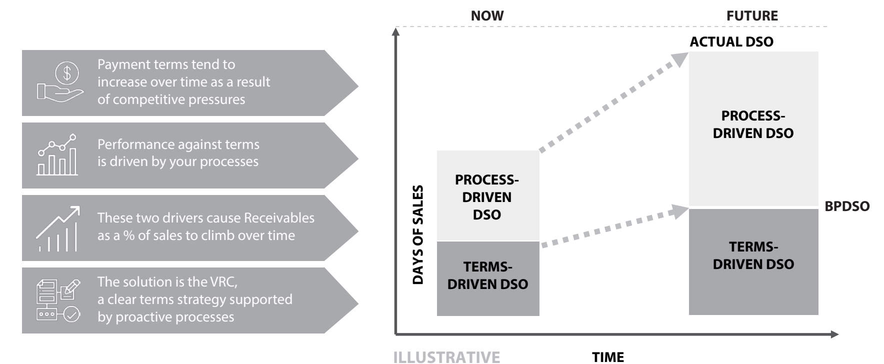
Customers (even good customers) look for ways to pay later – and if you do not ask promptly for payment, you are giving them a way to pay later.

They say to themselves, in effect: "We have not been specifically asked for a payment by this supplier, so apparently it is not very important to them when they get paid." (The second case study alludes to such a case.)

Remember that even well-meaning customers tend to draw out their payments over time unless they are actively managed. This is not reprehensible in their eyes. They regard it as acceptable business practice.

They may take advantage of lapses on your part, including the rationalisation that if you do not ask maybe you do not especially care, but in their own minds they are simply playing the game in a logical way.

Fig. 1.2 -
POOR TERMS DISCIPLINE & PROCESS VARIABILITY LEAD TO RECEIVABLES INCREASE



2. Salesmen (and women) are primarily motivated to sell

One thing that may cause DSO to grow is the tendency of a sales team to allow longer payment terms when asked by a prospective customer.

They may see this flexibility as a way of pleasing the customer and improving the odds of closing a sale. A keen salesman wants the sale and if he does not appreciate the financial impact of slower payment he may feel it is perfectly fine to grant more days to pay.

And a customer will nearly always ask! If you say yes, he will ask again!

Later, we will equip your sales team with an understanding of why the payment terms they agree to matter very much. We will help them find new ways to get the sale whilst staying firm on terms.

For now, let us note that this is a natural occurrence in a growing concern without active receivables management, and one you will need to address.

3. Shift to export? Beware

When companies grow outside their home turf, into other countries, they encounter new challenges. Other countries have different customs and often different business terminologies.

These days, in our connected world, most export customers demand credit terms – in the past, letters of credit were almost universally used. Insisting on LOC is now often a competitive disadvantage.

The fact is that export business tends to result in more complexity for you to manage, and the potential for slower payment.

Getting more export sales is a good thing, but again, unmanaged, will tend to grow your DSO.

4. The perils of complexity

The fourth reason DSO grows is business complexity. Unless you have a really good VRC, increasing complexity – which generally comes with growth – will in itself result in a lengthening of DSO.

Complexity can include the number of customers, new points of sale, the number of products, the number of different terms, currencies, banks, fiscal rules, etc.

We all seek growth. Complexity, unmanaged, tends to favour the customer who wants to hang on to his money because it is harder for you to manage.

DSO does not go down, unmanaged

DSO will nearly always go up unless you actively manage it.

Managed, it will go down, and our promise is that if you follow this book, your DSO will decrease significantly in a few months.

But it never stays still, so if you do want to have more cash and a lower DSO in the future, you have no choice but to act now and to introduce changes that are designed to last.

BPDSO: Best Possible DSO

In practice, few companies have a single credit term. They tend to have a range of different customer payment terms, and often these proliferate as the business grows and becomes more complex.

Large customers with many operations are often adept at progressively obtaining longer terms over time. Once you have granted one of their subsidiaries or affiliates longer terms – perhaps to win new revenue – you are likely to be asked to extend the longer term to all of their operations.

To track the impact of granting longer terms, you will need to measure the terms-driven part of your DSO – which gets more complicated as you grow. We encourage you to use something called BPDSO: best-possible DSO.

This involves calculating a weighted average theoretical BPDSO by noting what percentage of your sales are made on each credit term and calculating a weighted average.

The benefit of calculating BPDSO is that you can track whether, due to a change in business mix (i.e. more sales to customers with longer terms) or to sales choices, your weighted average terms are going up.

This would mean that your DSO would have increased even if all your customers had paid you to terms, which of course they never do.

Here is an example:

Fig.1.3 - HOW TO CALCULATE BPDSO

	Credit Term	Number of Days	Sales Per Term ($m)	Sales Per Term as % of Total Sales	Term BPDSO
Term 1					
Term 2					
Term 3					
Term 4					
Term 5					
Term 6					
Term 7					
Term 8					
		TOTAL SALES		BPDSO	

Number of Days * % of Total Sales /100

Sum of Term BPDSO

Because we believe – and will show – that late payments occur for the most part because of something you could have done differently, we refer to the overdue portion of your DSO as being process-driven.

Don't worry if this seems strange to you – we will explain in this book how you can get control of late payments by making changes to the way you

work with your customers, from the very beginning of the relationship.

Our focus is on helping you to ensure that the overdue portion of your receivables is kept to an absolute minimum.

As we have seen, your actual DSO can go up even if you are paid on time, if you allow customers, on average, longer terms.

So later on (Part 5.1), we explain how it is important to track the terms you grant, using BPDSO snapshots, and how once your VRC is working well you will be able to find ways to reduce BPDSO or average terms. But do not worry about this for now.

In the next section, we dwell briefly on why how well you manage this part of your business is so important.

1.3 Why receivables matter

A lack of sufficient working capital to run your business day to day is by far the biggest cause of business failure. Rarely is it caused by a lack of growth opportunity.

Entrepreneurs are good at creating products and good at selling them. They tend to neglect getting paid on time, often until it is too late. This is the main reason many start-ups fail (see Part 6 for help with your start-up).

By the way, the fact that running out of cash is the biggest cause of company failure holds true, worldwide, for companies both large and small.

This book is concerned with the management of accounts receivable, a term we defined earlier.

Receivables is an area where many companies struggle but where improvement can be achieved relatively quickly if the right changes are made in the right way.

There may also be opportunities for companies to generate cash by reducing stocks of raw materials, work in progress, or finished goods. (You may want to look at these areas but they are not the subject of this book).

Lack of focus

Entrepreneurs, full of zeal and armed with new and differentiated business ideas, are often ill-equipped to handle the impact of their own success on their working capital.

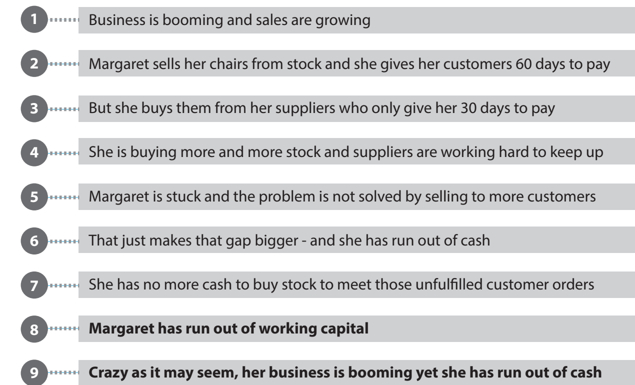
Unless it is consciously and diligently managed, working capital will always go up.

They wrongly believe that with more sales must come more cash. Yet most of the time, for most businesses, growth will require *more* working

capital, not less. (See the case studies in Part 3 for examples.)

This predicament is summed up in Figure 1.4 “Margaret makes chairs” which sets out in very simple terms why a vibrant and growing business may need more working capital as it grows and unless it plans for this may find itself unable to meet its commitments.

Fig. 1.4 - MARGARET MAKES CHAIRS



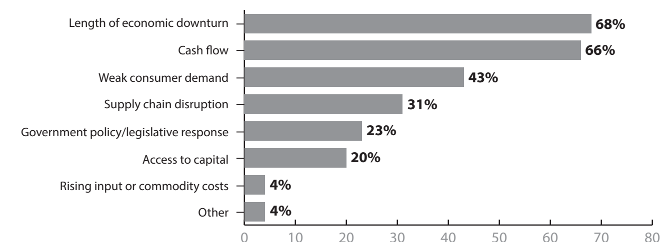
Yet despite its importance, receivables management often suffers a low status within companies, measured by the time invested by management, the relative seniority of those charged with assuring good receivables performance, and their relative remuneration and perceived status.

Business impact of overdue receivables

In a recent survey 66% of business leaders cited cash flow as their primary concern (after the length of the COVID downturn).

Fig. 1.5 - TOP OF MIND

What are the top three most pressing concerns for your company’s executive management team?



Multiple responses allowed | Source: Mar 26 - Apr 2 CFP survey of 333 finance executives, “The Economy in Limbo”

When you have a high level of overdue receivables, you are being deprived of much-needed cash and you may also be funding borrowing costs to plug the gap.

But the commercial impacts of overdue receivables go well beyond simply creating a cash and funding gap.

Increased costs for you (and for your customer)

You get paid late because your processes allow it. Going to and fro with the customer whilst you resolve discrepancies costs him, and you, money.

You can actually measure the impact of incurring increased operating costs from receivables management and show how, the later the receivable, the greater the investment of time and effort. These costs can include:

- Service time reaching out to the customer
- Travel costs visiting the customer
- Time of other functions invested in resolving discrepancies
- IT costs of producing a correction
- Recurring costs of repeating the same mistake
- Loss of sales time for selling

Remember that, crucially, every time you reach out to the customer to deal with late payment and end up investigating and correcting a discrepancy, it affects your Total Cost to Serve and it is costing the customer money as well.

Later on, when you start to get better at correcting errors before they occur, we will help you demonstrate to your customer how you have saved them money by taking out rework and improving the overall process.

This is important because it will make you an easier and less costly supplier to do business with, thereby increasing the likelihood that you will be able to retain and grow your customers. Because you will have the data to show them how you are cheaper to do business with.

Increasing customer satisfaction

When a well-organised company – say one of your big customers – evaluates a supplier, they will certainly always look at price, product quality and delivery responsiveness.

The best ones, though, also make a point of calculating Total Cost to Serve, which includes looking at a particular supplier (i.e. you) to see how many errors occur on average per transaction, how long it takes you to correct them and how much this adds to their total supplier cost.

It is quite likely that if you are getting paid late, your total supplier cost for your customer is unnecessarily high, because late payments invariably indicate additional rework. A savvy customer will take this additional cost into consideration when deciding which supplier to work with.

When you adopt the VRC and start to systematically identify and eliminate discrepancies, you will have an opportunity to demonstrate to your valued customer how you are saving them money because you care and are improving service quality. You can measure this in terms of time invested and transaction costs.

When your customer evaluates and compares suppliers in order to select the best, you do not want to be considered "high cost". This book will show you how to ensure you are not.

High-cost suppliers (are you one?) have poorer customer retention than low-cost suppliers. That is, if you are getting paid late, you are costing your customer more time and money than your competitor who gets paid on time, and when he works that out, your customer may decide to go elsewhere. Your objective is to be a low-cost supplier and to make your customer aware of that!

Sales productivity

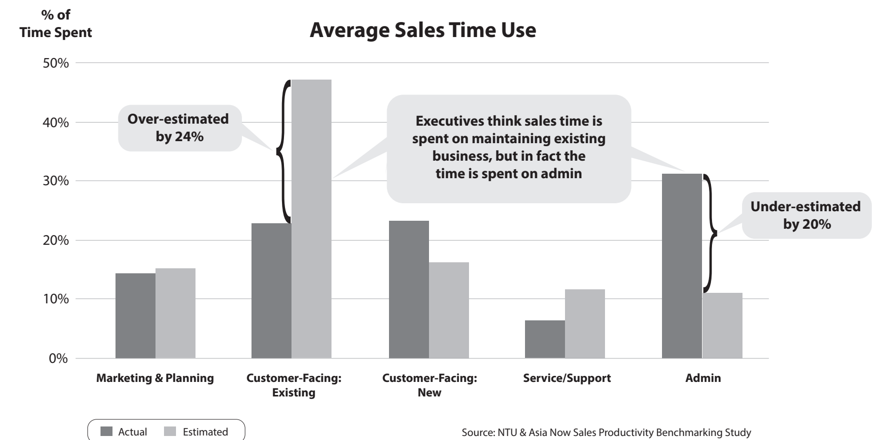
There is another significant implication of having higher than average overdues compared to your competitors.

Because later payment implies more discrepancies and ensuing corrections, companies with higher DSOs than their competitors tend to be generating more discrepancies and investing more time in correcting them.

Those same companies, when they measure sales and service time using activity-based analysis (ABA), find that significant sales and other time is invested in resolving customer discrepancies.

Interestingly, when we tested this by carrying out a survey, we also found that leadership commonly underestimated the time their sales team spent on dealing with receivables issues with customers.

Fig. 1.6 - HOW WELL DO YOU KNOW THE PERFORMANCE OF YOUR SALES TEAM?



We show you how to do this measurement in Part 7, as it is a useful way both to highlight the problem and to show sales how the VRC will make their jobs easier by reducing rework.

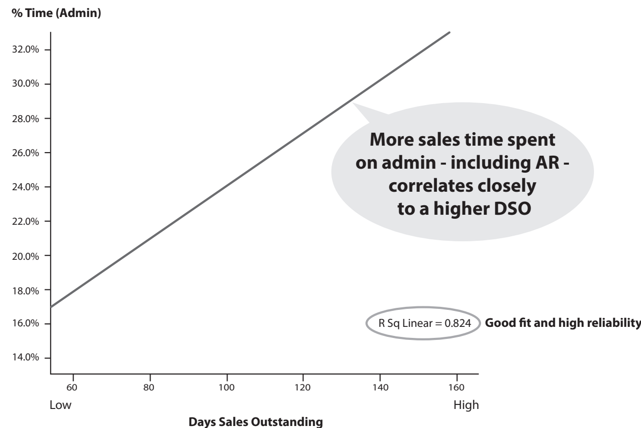
Sales time spent dealing with invoicing and payment issues is sales time that cannot be spent on selling. Discrepancies therefore also have a negative effect on growth, by depriving your commercial team of much-needed selling time.

When you improve your receivables processes using the VRC, errors will disappear, excuses for late payment will vanish, and your sales and service teams will have more time to spend with the customer growing the business. As opposed to batting away service problems.

When you measure lost sales time, you can also calculate the lost revenue that can result by reversing new sales into existing customer-facing sales time.

Remember: the higher your overdues, the less efficient your receivables management, the less sales time your salesmen have for selling, the greater the lost revenue. Less sales time also means poorer customer service.

Fig. 1.7 - HIGHER DSO CORRELATES CLOSELY TO LOST SALES TIME



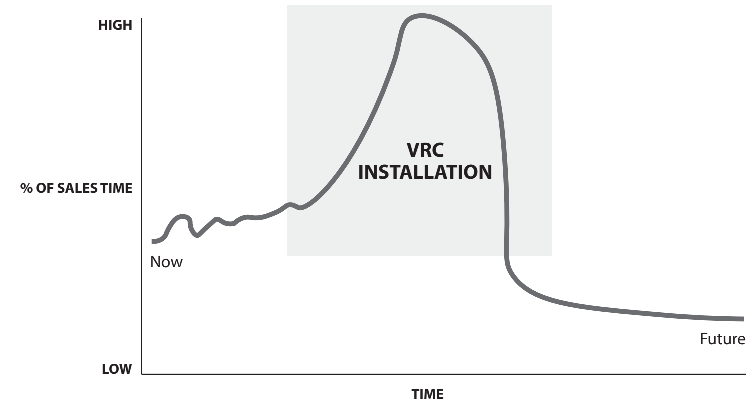
Investing in the future

Once you have got the VRC in place and have reduced discrepancy occurrence, your sales team will be largely freed up from receivables and process discussions.

But when you are actually installing the VRC for the first time and clearing up past errors, your sales team will for a short period spend *more* of their time on resolving discrepancies and other issues than they have been used to.

You will need to be clear about this and about the need to make this investment in a better future.

Fig. 1.8 - SALES TIME USED FOR ADDRESSING CUSTOMER RECEIVABLES ISSUES - HOW IT VARIES OVER TIME



Summary

Receivables matter because when poorly managed they increase operating costs, impact borrowing, limit cash available for investment, damage customer retention, and constrain the effectiveness of your sales team.

In general, companies that have higher DSOs than their peers can be shown to have:

- Less cash to operate and grow
- Higher borrowing
- Less happy customers
- Less happy service and sales staff
- Less productive sales staff
- Higher transaction costs

Later on, we will show how you can measure and track all of these critical performance areas as they improve. We will also provide you with related templates and guides in Part 9.

When building a case for change with your team – see Part 7 – showing how much late payments really cost you by demonstrating all of these impacts may prove critical in gaining their attention and support.

This is why we urge you to investigate these areas and build a detailed case for change before asking your own team to make changes to the ways they think and operate.

1.4 Why receivables matter now

The debt overhang

Many companies, especially SMEs, have taken advantage of cheap and plentiful borrowing to neglect AR discipline over many years, and have allowed overdues to grow to historically high levels.

The availability of cheap borrowing has come about as a result of government policy, principally in the USA and Europe, which has led to the Federal Reserve and the European Central Bank pursuing a policy of quantitative easing (QE).

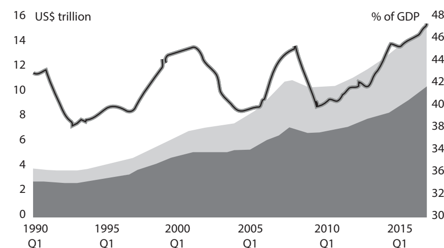
QE simply means making more and more money available to banks and businesses at historically low interest rates. That money, originally intended to prop up banks, has in fact led to an over-supply of credit. The abundant cash has flowed around the world into equities and real estate, but especially into commercial borrowing.

Companies that in the past would not qualify for corporate debt have been able to raise money very cheaply, and non-traditional intermediaries have been promoting loans to companies of all sizes, including SMEs. In addition (see Fig 1.9), the quality of those loans has progressively eroded.

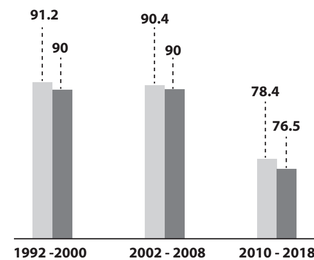
Fig. 1.9 - HOW HAS CORPORATE DEBT FARED RELATIVE TO GDP GROWTH?

Nonfinancial corporations are carrying slightly more debt today than just before the Great Recession (as a percentage of GDP)

- Nonfinancial, noncorporate businesses debt outstanding (US$ trillion, left axis)
- Nonfinancial corporate debt outstanding (US$ trillion, left axis)
- Nonfinancial corporate debt outstanding as percentage of GDP (%, right axis)



Share of investment grade in total corporate bond sales (average for the period, %)



"Why go through the pain of dealing with tricky customer issues when we can simply borrow more cheap money to plug the gap?" is the thinking of many companies under cash flow pressure.

This response to a growing DSO and increasing late payments may seem to offer a quick way of sidestepping internal and customer conflict and

focusing instead on growth, but it is unsustainable and toxic.

Not only does it lead you into greater debt, it allows you to ignore the service and relationship gaps that invariably lie behind overdue payments.

Reduced resilience

If you maximise borrowing during normal times to offset weaknesses in your balance sheet which could have been avoided by better management of cash flow, you may find that when real disruptions occur your options have become much more limited.

Companies with this mindset are often poorly positioned to cope with external disruptions to business activity.

In the recent past, disruptions have included:

- Geological and meteorological events
- Geopolitical rivalries
- Trade disputes, which reduce activity and shift supply chains
- Diseases such as SARS or COVID-19, which hinder or prevent commercial activity
- Political instability

When the competitive environment worsens due to these and other factors, many companies naturally try to strengthen customer payment discipline, especially if they are already bumping against borrowing limits.

But in times when everyone is under cash flow pressure, this is a difficult undertaking.

One reason it is difficult is that they will be doing it at the same time as their competitors who are experiencing the same challenges.

They need a differentiated approach, which we call *being first in line to get paid*. This book is that approach.

1.5 How this book will help

This book contains workable solutions to getting paid on time, based on building what we call the Virtuous Revenue Cycle (VRC).

Three very different companies that took our advice and adopted the VRC are included as case studies in Part 3.

In these pages we suggest you make changes to your processes from the very beginning of each customer relationship and will lay each change out in detail in Parts 2, 4 and 5, whilst helpful templates and examples can be found in Part 9.

We are not here to tell you how to close the stable door after the horse has bolted by, for example, employing lawyers or debt collectors. By then it is already too late.

We are not here to tell you how to borrow money from banks or other intermediaries to plug your cash gap. There are plenty of sources for such advice, because there is lots of cash around.

The idea is that by getting paid on time, every time, your need for lawyers, reactive solutions or more borrowing will be reduced.

We have dedicated a chapter to helping you deal with customers who are insolvent and cannot pay (bad debt) because this happens to every company sooner or later.

But we want to help ensure that you *never* get to that situation. Most of the changes we advocate to prevent late payment or bad debt actually occur very early in your customer interactions, not later on when it is already too late to affect outcomes.

The prescription given here is tried and tested. Properly executed, it has helped companies of all sizes to be first in line to get paid.

Because the execution is key – it is easy to make mistakes – we have devoted Part 7 to:

- How to build consensus around the need for change
- How to sequence the changes correctly
- How to check for misalignment or anxiety in your team

This way, you can address misunderstandings and fear promptly and effectively.

Getting paid on time does not depend on automation, on your relative market share, or on your willingness to be aggressive with customers. We address these and other myths in Part 2.2.

Our solution

The key to sustained AR improvement lies in your ability to deliver competitive service and to build – and maintain – customer intimacy.

This intimacy starts early in each relationship. It is based on early and repeated customer contact. It is driven by an internal culture of balance sheet awareness and ownership which starts from the very top, and by clear, consistent communication, as well as rapid responses to errors or omissions, however trivial, wherever found and however identified.

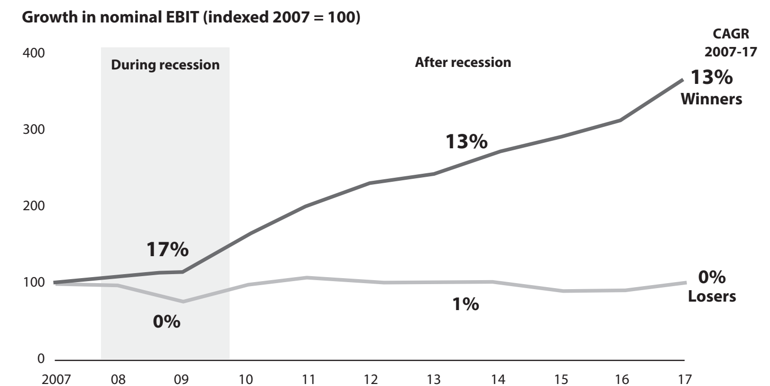
These chapters are based on more than 30 years of working with companies of all sizes across many geographies and industries.

We offer you a high-impact yet easy-to-read how-to guide to de-risking your accounts receivable, accelerating inward cash, and taking your customer service to the next level.

1.6 In disruption be bold

By using a new service-based approach to understand your customers better, you can reduce risk and find new ways to grow and prosper.

Fig. 1.10 - WHAT CAN WE LEARN FROM THE PAST?



As a reminder that swift action pays dividends, Fig 1.10 show how 13% of listed companies fared well after the 2007 crisis by acting quickly on costs and working capital.

We urge you to be one of them.

This book is mainly about how building genuine intimacy with customers enables longer-term relationships and puts you at the front of the queue when it comes to getting paid.

When you take noise, cost and conflict out of your customer relationship and replace them with the Virtuous Revenue Cycle, you become, over time, easier and cheaper to do business with, compared with your competitors.

We challenge the received opinion that automation, outsourcing, and above all using digital means to transact business is the way forward.

None of these innovations, whilst undoubtedly beneficial if done right, directly addresses the problem of getting paid on time. If you have limited bandwidth, pursuing them may also divert you from the VRC, which is your solution.

One of the things about the customer intimacy that lies behind effective receivables management is that by embracing this new model you will not only be first in line to get paid but will also:

- Improve customer retention by becoming an attentive and low-maintenance supplier
- Free up your sales department from transactions and discrepancies and create bandwidth for
  - Intelligence-gathering to help anticipate risk
  - Building new relationships and investing in existing ones

If you can follow these few principles and build them into your relationship DNA, you have a bulwark against disruption.

You can anticipate disruption early, address it openly, and you can rely on VRC-driven trust and intimacy to put you ahead of your competitors when payment is at issue.

Far from making relationships problematic, a readiness to listen and negotiate during general market stress allows "moments of truth" and great steps forward in retention and trust.

To weather disruption, we encourage you to:

- Pause and ensure you understand your customer's situation properly
- Conduct a customer triage based upon their relative risk and importance
- Identify shaky customers who may be at risk of insolvency, reach out to them, limit the downside
- For the top 20% of customers (consider future growth potential), move quickly to adopt the proactive service model laid out in these chapters, seek to offer support early and often
- Enhance your customer early-warning system – traditional credit reports are generally too reactive to be effective in a real crisis (see Part 2.5: Take risk seriously).
- Coach your sales team on intelligence-gathering – what should they look for when visiting a customer, how can they enhance sharing with competitors
- Talk to competitors – you might be surprised how open they are to sharing when the chips are down
- Hoard your cash as much as you can

This book does not set out specifically to provide a model for accelerating growth, although we will help you measure the impact of enhanced service on the retention of existing customers and freeing up sales time for growth.

Ways to find growth

One common result of disruption is that supply chains change, sometimes dramatically. In other words, customers become more open to moving to new suppliers.

In Asia in late 2019, a trade war between the US and China, followed within months by a China lockdown to arrest the spread of the COVID-19 pandemic, shifted production and supply from China to other countries. Companies struggled to adjust, some doing better than others.

By building greater intimacy with key customers through the VRC, you will find ways to anticipate their challenges, protect your cash flow, and in some cases support them in ways that will redefine your relationship and assure greater growth in the future.

Other (potential) customers who are currently buying from your competitors may come under pressure and be more open to switching some (or all) of their supply – your sales team can be mobilised to listen for these opportunities and taught how to probe for details.

In conclusion, we strongly believe that adopting the service-based solutions in this book so that you build a self-sustaining VRC will make your business more resilient in times of disruption as well as providing you with a more reliable cash flow and a reduced need for borrowing.

Do

- Prepare for disruption by hoarding your cash, both from receivables and elsewhere.
- Have a back-up supply plan especially for the top 20% of inputs and customers.
- Use disruption to cement existing relationships by being the supplier who always listens and responds.
- Upskill your sales team so that existing relationships are strengthened.
- Engage your sales team in active risk assessment and intelligence-gathering so you can detect early when a customer is in trouble, and act to help, or mitigate bad-debt risk (move to cash terms, develop a payment plan, etc.).
- Use your enhanced service model to embrace key accounts, remove obstacles to timely payment and listen for opportunities to grow through adjacencies.

Do not

- Make hasty decisions on accepting higher risk or longer credit simply to get a sale.
- Be seduced into unnecessary borrowing when you can generate the cash you need from getting your invoices paid quicker.
- Extend longer payment terms unless you are certain that customers are solvent.
- Be persuaded that automation will accelerate cash in – automation may well help you reduce transaction costs and even headcount, but the key to getting paid always lies in relationships.

Part 2
The Virtuous Revenue Cycle

2.1 Meet the VRC
2.2 Challenge receivables myths
2.3 Forecast your cash needs
2.4 Take risk seriously
2.5 Insolvent customers and bad debt

2.1 Meet the VRC

Getting paid on time is mainly about relationships and service, and requires that you refine and adopt what we call the Virtuous Revenue Cycle (VRC). It is most especially *not* about vigorously chasing already late payments by any means possible including lawyers, courts and bailiffs.

Fig. 2.1 - MEET THE VIRTUOUS REVENUE CYCLE

The VRC recognises that building customer intimacy is a constant endeavour, requiring a transparent and self-correcting culture of continuous service and improvement, with

- Active ownership from the very top
- Clear payment and service expectations communicated from the beginning of every customer relationship
- Accurate and timely transactions, including crystal-clear revenue recognition
- Carefully maintained processes of customer intimacy with early identification of issues and their prompt resolution
- Cross-functional engagement linked to service and receivables metrics and variable remuneration

Customer intimacy is not a mysterious bond forged by gifted leaders and salesmen with unique talents. It involves your whole team. It is cultural in nature. It starts at the top and is created by process, hard work and discipline. It takes time to develop, and it is built upon a bedrock of professionalism, openness and service.

The key elements are neatly captured in the Virtuous Revenue Cycle:

The graphic shows the individual activities required to earn customer trust and loyalty and ensure the timely, error-free completion of every transaction.

This book takes each step in the VRC and describes why you need it, what it requires, and how to go about building it.

It can be hard to do

Many companies recognise the need for a change in service culture but struggle to make it happen. Many companies have called on us after one or several internal efforts to change service and payment culture have failed.

Part 7 offers some advice – born of trial and error over many years – on how best to go about making these essential changes so they last and become part of your culture.

These include clearly defining the financial consequences of "doing nothing" and ensuring that the payment impacts of reactive service and discrepancies are measured so as to make clear that the solution lies within, not outside, your own operations.

We urge you to read Part 7. If you rush ahead with implementing your VRC without reading the "how to do it" and "how to avoid common pitfalls" you may find you quickly run into internal opposition, cause customer alarm, and come to a halt.

It is much harder to make this programme work if you go about it in haste, run into trouble, and have to start again! Each time you try to do it, you further erode credibility.

The elements of the VRC

Here is a brief description of each step in the VRC. These steps are explained in more detail in Part 4.

Top-down ownership

A close friend recently reminded me – based on his own experience – how frustrating it is to try and implement any change in company process and culture that is not fully embraced, and led, from the top.

See the case studies in Part 3 for compelling examples of how three leaders, from very different industries and cultures, led a move to the VRC in their companies and thereby laid the foundations for profitable growth with a healthy cash flow.

Each of them stresses the importance of their very direct and visible (senior) ownership of the VRC and how their personal examples changed team culture and gave a new importance to getting paid.

Clear credit policy

In order have a clear understanding of expectations with a customer – without which service and payment performance cannot be tracked or evaluated – every customer should sign a short credit policy that summarises:

- Service expectations on both sides
- Payment terms
- Dealing with discrepancies when they arise
- Key people and contact details
- Timing for future review of the credit policy or of selected elements

Prompt and accurate invoicing

A high percentage of late payments arise from invoice errors. These may include details like price, PO, etc., but they may also be caused by disagreements over when revenue can actually be recognised and an invoice raised. This is a critical issue with companies that deliver a mix of hardware and service (see our first case study in 3.2) where sending an invoice may require that specific acceptance criteria be met, and where those criteria are unclear or not accepted.

Proactive customer service model

Most companies only ask for invoices to be paid when they are already late. Even if you have clear direction from the top, and a signed credit policy with each customer, you can be certain that you will sometimes be paid late if you omit to reach out to your customers until due date has passed.

“You didn’t ask so we assumed it was not important” is commonly heard from customers at the outset of a VRC programme.

We therefore advocate introducing a process of early customer contact,

immediately after invoicing, to reinforce your commitment to service and demonstrate a willingness to address gaps and issues and resolve them promptly. We call this proactive service.

Unless an issue preventing payment is identified well before invoice due date, it cannot be resolved in time to unblock payment.

In effect, by waiting to ask, you reinforce a customer culture of “I have an issue but since they have not asked for payment I am comfortable waiting to be contacted”.

Prompt discrepancy resolution

Often when you contact a customer, he will report a discrepancy. This may be an omission, an error, or simply a dubious attempt to find a reason to delay (like “We cannot find your invoice”).

By calling early – soon after invoicing – you identify these “unaddressed expectations” and give yourself the time to resolve them.

But since different issues will have different functional owners, you also need to be clear about who in your organisation must resolve each type of issue and have a service level agreement (SLA) to which you can hold your team.

Systematic root cause elimination

Once you start recording all the discrepancies reported by your customers, you are in a strong position to resolve them and unblock invoice payment.

But you can actually do a lot more to effect lasting change in the ability of your customer to pay you late. We say “ability” because customers feel able to withhold payment if there is a mistake or an omission on your part. Sometimes these “delay enablers” can seem quite trivial!

The more information about discrepancies you are able to collect, the more data you will have on why invoices get held up. When you list the value of invoices held up for payment by each type of discrepancy (the LRF – lost revenue factor), you will discover that 20% of issue types hold up 80% of invoices by value.

When you go back and understand why these top 20% of discrepancies occur, you can work cross-functionally to resolve them at source – so they stop happening.

This may involve clearer communication, paperwork or messaging, or actual changes in process and data, with training.

Engaged, motivated sales team

Just as the company leadership, from the very top, must embrace the VRC and support a two-way service promise, so must all functional leads, and most especially, sales and commercial managers and staff.

If salesmen and women, who probably spend more time with the