Best Practice Network

Frank Anderson on how to influence and understand Days Sales Outstanding drivers.

ONE of the challenges a credit manager has when he or she walks into new employment on day one is the expectation of 'picking up the ball and running with it'. This can be even more challenging if the new position is in an industry with which you are not accustomed to. Over the years as part of my own continuous personal development (CPD) I set myself the challenge of exactly that when moving employers to ensure that I gathered broader experience of industry and had exposure to and resolved many different types of issues impacting credit management. This in later years proved to be most beneficial when I crossed to the dark side and moved into a management consultancy role as it had equipped me with a more rounded trade craft, coupled with an understanding that whether you are there as a consultant or a new credit manager, finance directors have the same expectations of excellence of speed, value for money and driving performance.

Typically the expectation of most employers (or clients) is that after the niceties of a few hours induction that you will then spend a couple of weeks understanding the lay of the land (whilst keeping any fires under control) and then come back with a plan to deliver change over the coming eight to 10 weeks.

Daunting as it may sound, it is probably one of the most exciting and fast moving parts of credit management that can be experienced and the methodology detailed in this article is the approach that I have personally used in delivering cash generation and performance management both as an operational credit manager, and as a management consultant to achieve results in both multi-national and SME industries.

The DSO look

In a typical organisation when the subject of DSO is discussed with an existing credit team, I have found that there are a variety of responses to the question: DSO is constant and within tolerance; DSO is too high – my finance director told me so; DSO is going north – help; we have seasonal variations in level of debt/sales, difficult to say; and do not measure DSO.

General reactions to how you think your DSO looks in many cases can send credit teams down the wrong path such as: complacency – credit team becomes reactive not proactive; increase in cost to reduce DSO, ie) throw staff/temporary workers at process; credit manager under pressure from finance director; and commercial, operations or customer service functions continue to influence DSO but not accountable.

This methodology enables a credit professional to peel back their Days Sales Outstanding calculation to understand the key drivers and then enable focus and prioritisation of the key elements that can be influenced.

Underlying drivers

Analysis of the monthly aged debt and sales reporting enables the credit manager to easily quantify how the headline DSO number is actually broken down as shown in Fig 1. At a glance it makes the task of deciding focus and prioritisation easier, for example the overdue debt only accounts for two DSO days, therefore recruiting an army

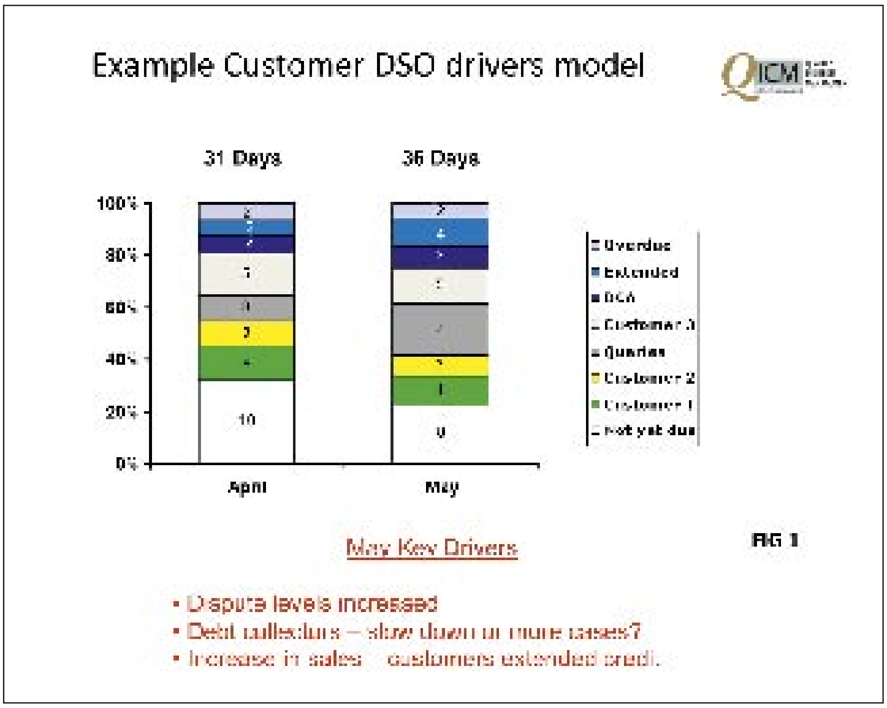

FIG 1

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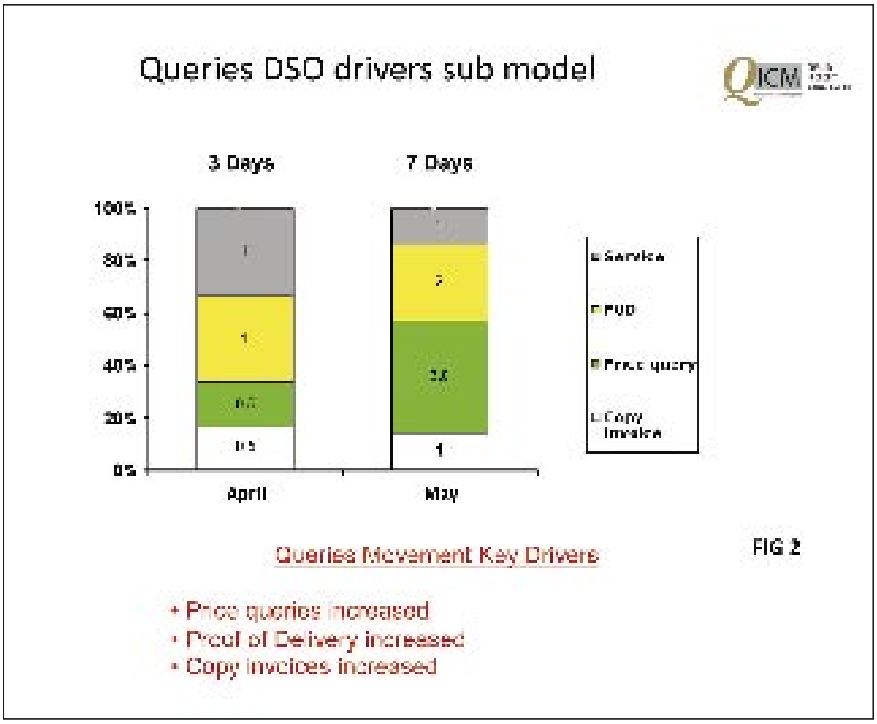

FIG 2

of temporary staff to chase overdue debt will merely add cost and will not deliver a significant improvement overall in its own right.

There is a significant increase in the impact of customer queries between April and May in 'Fig 2'. When we start to drill down further there is an increase in mainly price queries, proof of deliveries and copy invoices. This may be customer specific or a system issue, but at least it gives the credit manager the information to approach the operations/sales/customer service team responsible for pricing and clearing any backlog which will have a positive impact in the overall DSO.

Additional example models that can be utilised are: geographic – country or domestic sales territory; sales rep code; product; payment terms; dunning cycle.

With the analysis now complete, the credit manager should now start to formulate a plan: where do I need to get to?; how do I get there?; and who is responsible for delivering?

Next you need to come up with an approach to the plan: identify the current bottlenecks and potential solutions in each area from the DSO analysis; agree with functional managers work stream treatment and required step change; formulate an action plan in each case providing a phased reduction to year end or agreed completion date; and coach the functional heads to manage the work streams and resources to timetable.

Once you have created the overall plan, it is important that you share the plan with all stakeholders and this is the opportune time to obtain your finance director's sponsorship of the plan before anyone else. It is important that progress around the plan is communicated on a regular basis to all stakeholders.

So in summary – increase focus on DSO and create momentum: analyse – identify key drivers – think process, think customers; plan – where do I need to get to? A realistic phased timescale, who is doing what and when; people – daily, weekly, monthly cash targets for business units and credit controllers; and communication – daily, weekly and monthly dashboards.

If in doubt, ask yourself one simple question – "How much is a one day sales outstanding reduction worth to my company?" CM

Frank is an active member of the QICM Best Practice Network where organisations share knowledge and information about credit management best practice and presented to the QICM Best Practice Conference in 2012. If you want to know more about QICM, contact: qicm@icm.org.uk.