

Cash is King

Strategies to Maximize Your Cash Flow

IDEA E-BIZ FORUM 2008

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- ▶ C.P.A., formerly Ernst & Young and *PriceWaterhouseCoopers*
- ▶ Graduate of University of Pennsylvania, Wharton School of Business
- ▶ 10-year 2Medical Device Industry Executive
- ▶ Publications:
 - *Level-3 Processing: An Opportunity for increasing sales and reducing costs*, Authors: Wayne Berson, CPA and Wade Tetsuka, CPA, *Government Express*, Washington, D.C., September 2006
 - *Lower Costs & Greater Marketability through Purchase Card Acceptance and Level III Processing*, Author: Wade Tetsuka, CPA, *Off The Shelf Newsletter*, Washington, D.C., October 2006
 - *The Future of the Federal Government's SmartPay® II*, *Amtower Off Center Talk Show*, 1050 AM Federal News Radio, Washington, DC, June 2007
- ▶ Memberships and Affiliations:
 - Vistage CEO Membership Organization, Member
 - Board of Trustees, Loudoun Education Foundation
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The Accounts Receivable Cash Trap

*One of the most common cash traps is uncollected sales,
a.k.a. accounts receivable*

Credit-to-Cash Advisor, ABC-Amega, Inc. 2008



Presentation Overview

- ▶ MEASUREMENT
 - How to Measure sales credit-to-cash performance

- ▶ COST OF QUALITY IN A/R COLLECTIONS
 - What is the cost of poor performance in A/R

- ▶ BEST PRACTICES
 - Practical recommendations for improvement based on actual Case Studies



Measurement of credit-to-cash efficiency

DSO = Days sales outstanding - measures the time it takes a company to collect account receivables from credit sales.

(Total Receivables/Total Credit Sales) x Number of Days in the measurement period = Day Sales Outstanding

Example of DSO:

Total Receivables = \$5,000,000

Total Credit Sales = \$10,000,000

Number of days in period = 90

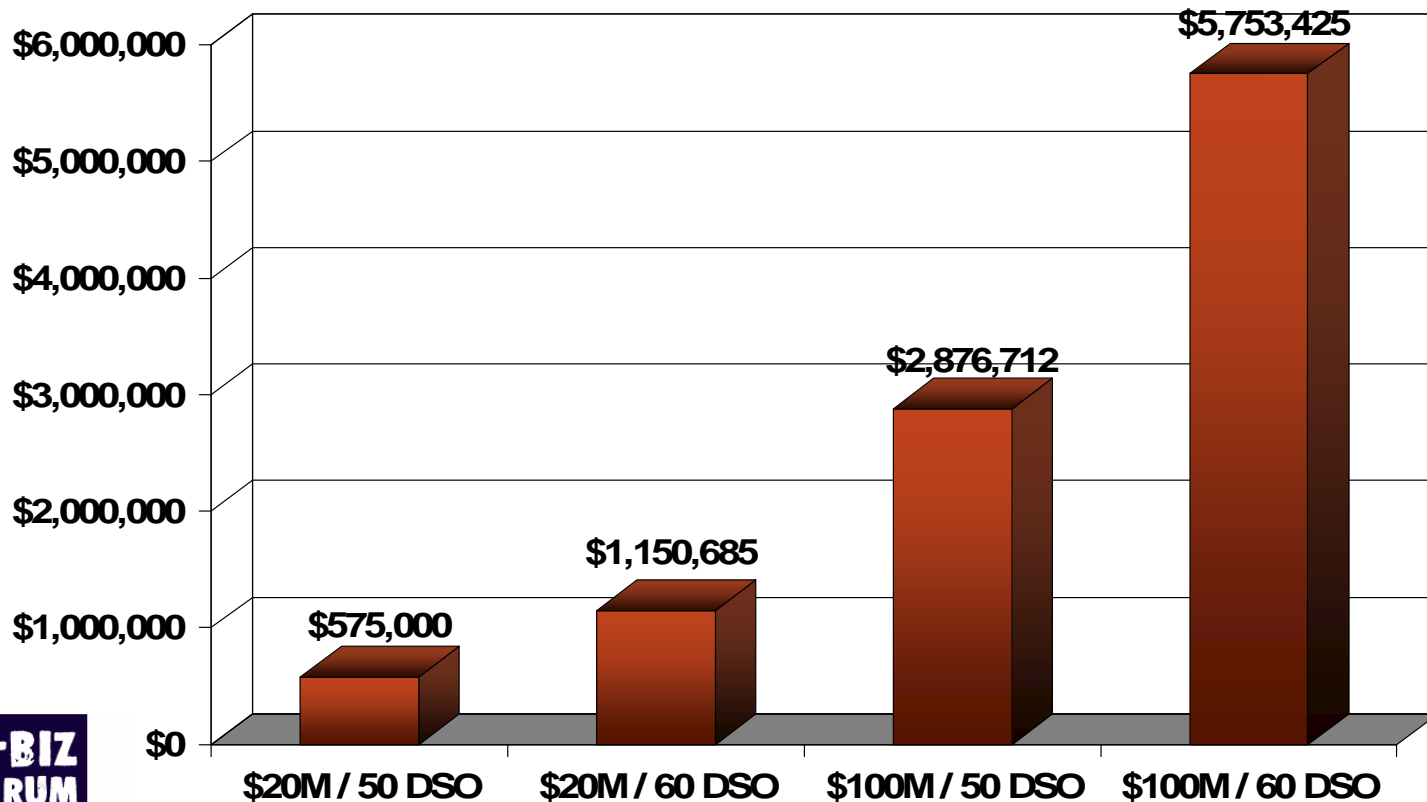
$(5,000,000 / 10,000,000) \times 90 = 45$ days (DSO)

In this example it takes 45 days (on the average) for the company to collect its account receivables.



How much Excess-Cash is tied up in your A/R ?

Assumptions: \$20 million or \$100 million in annual revenue,
50 days or 60 days DSO



Other assumptions: 5.00% interest rate and 40 days DSO industry average

For calculation, see Appendix

Current Environment

- ▶ Degradation of A/R Terms
 - Customers asking for Net/45 or Net/60 days

- ▶ DSO is increasing
 - Especially with builder customers

- ▶ Customers are “shopping” Vendors for better terms



Source: Electrical Trends by Channel Marketing Group and Allen Ray Assoc.; company CFOs interviewed for this presentation

Excuses Excuses !!

▶ Excuse #1

- I did not receive the invoice (customer's Accounting Department)

▶ Excuse #2

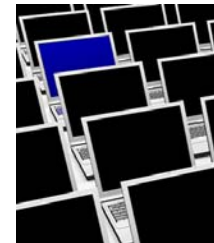
- I did not get confirmation of receipt from the Receiving Department

Recommendations based on recent Case Studies

- A. a \$1.5 billion manufacturer of electronic and electrical connectors for automotive, telecom, industrial, data, consumer and energy markets.**



- B. a \$500 million value added reseller of computer hardware and software solutions to commercial and public sector clients.**



- C. a \$200 million manufacturer, designer and distributor of tableware products for the hospitality, restaurant, retail store, and food services industries**

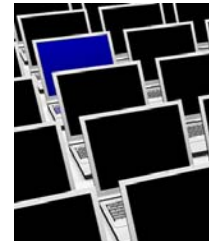


Results based on recent Case Studies

- A. Lowered DSO by 5 days.
Reduced past due A/R from 20% to only 8%**



- B. DSO is now at an all time low.**



- C. A/R write-offs in past year have been at an all time low, at less than \$100,000**



Best Practices: Practical recommendations for improvement

- ▶ 1) Define targeted policies and procedures and follow them diligently
- ▶ 2) Apply pre-emptive “strikes”, a.k.a. “Customer Service Calls”
- ▶ 3) Use of Credit Card acceptance as a tool for collection and transfer of credit risk
- ▶ 4) Introduce Automation

1) Define targeted policies and procedures and follow them diligently

▶ Credit Review Process

- Set credit limits based on diligent Financial Statement review
- Put customer on credit hold when they become 60 days past due (to be defined based on own experience)
- Ensure proper segregation of duties: credit as an accounting/finance function, not a sales department function.
- Have customer sign credit terms and conditions and renew this agreement annually.
- Use of credit cards for deposit or advance payments in cases of new customers or delinquent customers

1) Define targeted policies and procedures and follow them diligently

▶ Billing

- Timely and Correctly (especially if selling to Fortune 1000 or to public sector entities)
- Employee training and re-training with regard to invoice preparation
- Review and validation of invoices before sending to customer
- Electronic invoicing where possible

1) Define targeted policies and procedures and follow them diligently

▶ Collections

- Customer calls at due date as well as 30,60, and 90 days past due.
- 45 or 60 day past due ship/credit hold
- Credit card acceptance:
 - ▶ At invoice due date, take customer's credit card
 - ▶ Take credit card at shipment
- Other Strategies:
 - ▶ Assign customers to collection staff according to the talent of the collection person (not by alphabetical assignment or other haphazard approach)
 - ▶ Collection staff have incentive plans (prizes, pizza, lunches, \$50 gift certificate, etc.)
 - ▶ “Clawback” conditions on commission payout (or best is to pay commission only when cash is collected).

2) Apply pre-emptive “strikes”, a.k.a. “Customer Service Calls”

▶ Collections

- Within 10 days of invoice issuance date, call customer to determine:
 - ▶ Is everything okay
 - ▶ Did you receive invoice
 - ▶ Are there any questions about it
 - ▶ Did accounting department obtain confirmation from Receiving Department.

3) Credit Card acceptance as a tool for collection and transfer of credit risk

▶ Collections

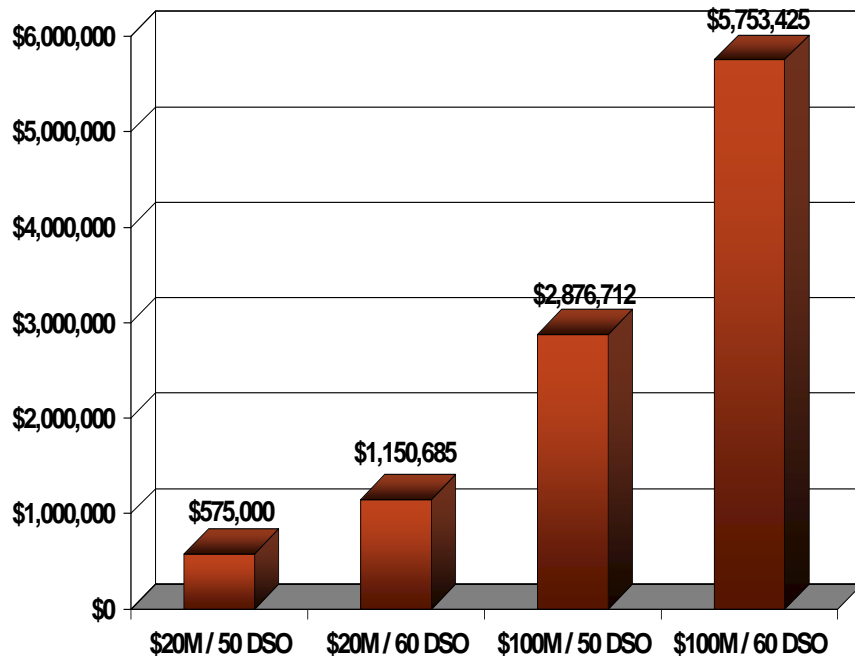
- New customer; no credit established
- Payment at time of shipment
- A Strategy for Credit card acceptance:
 - ▶ At invoice due date, give them option to pay with credit card
 - ▶ Emphasize customer's advantage of having additional 30 days to still pay balance when using credit card.
 - ▶ Psychological impact for customer of paying later when "things will be better"
 - ▶ Card holders have economic advantages for using credit cards due to points/rewards or cash rebates from bank.

4) Automation

▶ Billing and Collections

- Electronic Invoicing (may reduce errors and prevents excuses of customer not having received invoices)
- Streamline the entire order to cash process.
- Collection reminders:
 - ▶ Use of templates for collection reminder letters.
 - ▶ Addresses ALL customers including small and mid size ones.
 - ▶ Ensures that actions are taken uniformly across all customers and on-time.

Summary: How much excess cash is in your A/R ?



- ▶ 1) **Follow your policies and procedures !** Don't get lazy you're A/R will suffer.
- ▶ 2) **Creative use of "customer service" calls** within 10 days of invoicing
- ▶ 3) **Use of Credit Card acceptance** as a tool (this gives your customers options and allows you to transfer credit risk to the bank)
- ▶ 4) **Automation**

Appendix – Calculation table for Cost of Excess Cash in A/R

Cost of Excess Cash in A/R

Assumed Annual Sales		\$20,000,000	\$20,000,000	\$100,000,000	\$100,000,000
XYZ's DSO (in days)	days	50	60	50	60
Industry DSO (in days)	days	<u>-40</u>	<u>-40</u>	<u>-40</u>	<u>-40</u>
Excess investment in A/R	days	10	20	10	20
1 day's sales (Annual Sales/365)	x	\$54,795	\$54,795	\$273,973	\$273,973
Cash Invested in Excess A/R		\$547,945	\$1,095,890	\$2,739,726	\$5,479,452
Cost of Borrowing		5.00%	5.00%	5.00%	5.00%
Annual Interest		\$27,397	\$54,795	\$136,986	\$273,973
Total Excess Cash "Trapped" in A/R		\$575,342	\$1,150,685	\$2,876,712	\$5,753,425

