Bill's Building Blocks

Managing Accounts Receivable

When the self-cleaning feature of our stove failed, the oven door locked and could not be opened by the technician without a complete disassembly of the unit. Sooo…it was time for a new stove. Its installation required two trips by the installer. The check for the first part of the installation cleared the bank in two weeks. After four weeks, when the check for the second part of the installation had not cleared the bank, I called to ask if this was normal? The person answering the phone said, "This is not normal! You're the second person to call today. It turns out I put nineteen checks in the glovebox of my car. My car went in for repairs which lasted three weeks, and I completely forgot about the checks."

As mundane as it may seem, managing your accounts receivable is key to your company's survival. It's quite simple: No cash, no company. When a business is flush with cash, this seems irrelevant. But, when a business is living on the edge, it becomes focused on the electronic notification of a funds transfer and on the daily mail delivery. Sometimes companies will even send an employee to the customer to pick up their check.

Receivables and payables drive the size of your cash-to-cash cycle. How many days lie between when you must pay for inventory being bought from an upstream seller and when you are paid by a downstream buyer for inventory sold to them? A negative cash-to-cash cycle is a beautiful thing because the buyer has paid before the seller must be paid. A positive cash-to-cash cycle, while quite common, is bad because the seller must be paid before the buyer pays. This effectively makes you a bank for the seller.

Each supply chain echelon has their own cash-to-cash cycle. These cycles can be described using two performance measures: velocity and variability. Velocity is the number of days, positive or negative, in the cash-to-cash cycle. Ideally velocity is a large negative number. The following factors will slow cash velocity and cause an increasingly positive cycle: 1) Having to prepay a seller for inventory, 2) Holding inventory longer than necessary, and 3) Allowing buyers to buy on credit.

The variation in days of velocity measured across many cycles is the variability. Ideally variability should be small. But when logistics transit times stretch, variability increases.

Manage accounts receivable carefully. Periodically measure your cash-to-cash velocity and variability, and do not wait to take corrective action.

©2022 William T. Walker, CFPIM, CSCP-F, CLTD-F, CIRM has 42 years practitioner experience, authored *Supply Chain Construction* and *Supply Chain Architecture*, and teaches Supply Chain Engineering at NYU Tandon and Demand Planning at Rutgers Business School. He is a 40+year ASCM member and APICS E&R Foundation past president. email: wt_walker@verizon.net