



The love/hate relationship between DSO and the collections professional



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Introduction

Days Sales Outstanding (DSO) has an impact that can be felt well beyond the finance department, as it reflects the size of a company's outstanding accounts receivable (AR) – one of the largest assets on a balance sheet.

What we've learned from speaking to our customers is that credit and collections managers sometimes have a love/hate relationship with DSO. Why is that? In business, an increase in something is generally seen as a positive thing, such as revenue or efficiency. But in terms of DSO, an increase is often

negative because it potentially indicates less efficiency and a reduction in free cash flow.

DSO is more nuanced than that, though. Finance professionals know that an increase in DSO doesn't always reflect the true efficiency of the collections team. So while DSO is an incredibly valuable metric, it also catches a bad rap for this reason.

With that in mind, let's take a deeper dive into what DSO is, what DSO is not and how to calculate it.



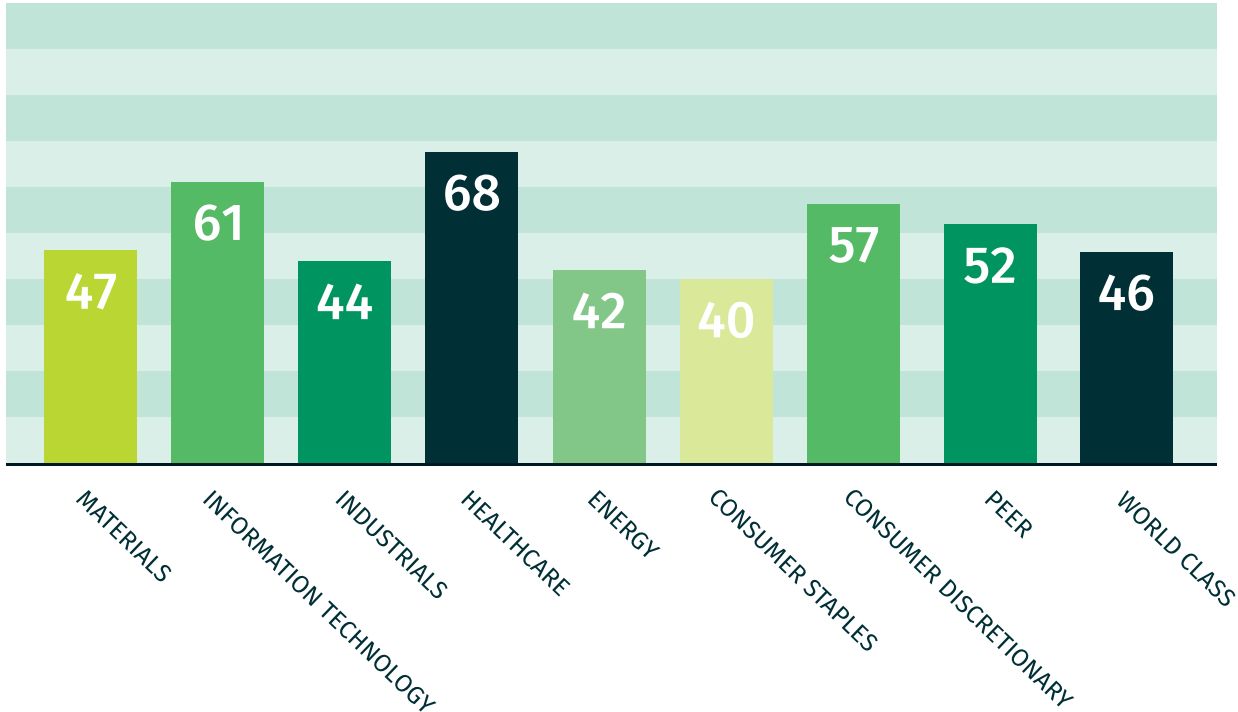
Defining DSO

DSO is often confused for “the time it takes to fully collect unpaid invoices.” Mathematically, this has no direct relationship to the number of days it takes to get paid; it’s simply an indicator of how many days of sales are tied up in receivables.

There are many elements that can affect this metric.

For example, DSO can vary from month to month over the course of a business cycle, especially if an organization is seasonal. DSO even varies wildly by industry, as demonstrated by recent research from The Hackett Group:

Average DSO by industry



Introducing the love/hate relationship: What DSO is not

Now that we have a formal definition of DSO, let's take a look at its direct business impact. DSO extends past the finance department and into the sales force as it is a direct component of sales.

A company's sales impact how DSO increases or decreases.

This fact begins to explain why DSO may not always be the best measure of a credit and collections team's true effectiveness and efficiency.

What if your DSO improved by 20 days?

Sounds amazing at first, but this scenario actually indicates that either less of your product was sold, or that customers actually paid everything on time. The latter being completely unrealistic!

Thoughts on DSO from Billtrust's VP of Product Strategy, Art Hernandez:

"If you were to speak with a credit and collections manager about their opinions on DSO, their thoughts most likely would be that it provides only one perspective of the overall picture. More importantly we should look at complementing metrics to provide a true reflection of how we are performing. While DSO is fine — and by its nature uses sales as a criteria which we have minimal influence on — we should also measure trends such as collector effectiveness, overdue percent, dispute aging and closure rates. We've built all of these indicators into the Billtrust Collections solution to provide a clearer picture of collections success."

How to calculate DSO

As previously mentioned above, a company's AR balance is one of the largest assets managed on a balance sheet. With that said, DSO is a vital metric for indicating how much cash is outstanding.

Here is an easy way to calculate DSO. First, you want to make sure you have the following numbers handy:

- Current AR balance
- Annual credit sales revenue

Let's say you run a B2B company that generates about \$365 million in credit sales. We can say on average, one day's sales is about \$1 million. If your average AR balance for a given month is \$48 million, that means you have 48 days worth of sales sitting on your book. The number of DSO is equal to 48.

Your DSO formula will then look like this:

$$\frac{\text{Accounts receivable}}{\text{Total credit sales}} \times \text{Number of days} = \text{DSO}$$

As you can see, DSO doesn't tell the whole story for credit and collections teams, but instead provides a quick, informal look into cash flow. For a more precise view of your collections department, take into consideration multiple indicators like those provided by the Billtrust Collections solution: collector effectiveness, overdue percent, dispute aging and closure.

