

CASH ASLEEP IN THE BUILDING · CHAPTER THREE

# The Invoice Nobody Could Pay

*The late payment is usually the customer's quality check, catching a fault made several desks upstream.*

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## THE LICENCE

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## A NOTE BEFORE YOU READ

This work is offered for education and leadership development. It is not legal, financial, accounting, investment, medical or psychological advice; take the advice of a qualified professional who knows your circumstances. Companies and events are described from the public record as the author understands it; characterisations are the author's analysis. Examples are illustrative, and no particular outcome is promised to any reader.

## ABSTRACT

The late payment is usually the customer's quality check, catching a fault made several desks upstream. It is ten past nine on a Tuesday, and the credit controller is on her third call of the morning. The invoice on her screen is seventy-four days old, for a set of stainless-steel prep tables delivered to the central kitchen of a group of care homes. Its terms were thirty days. She has emailed twice and left one message. This time a person answers, in the customer's accounts-payable office, and is perfectly pleasant. That one's on hold, he says. It's been on hold since it came in. The purchase-order number doesn't match, and the delivery note says eleven tables, and the invoice says twelve. There is a pause while he scrolls. We sent a query. Did nobody get it?

CHAPTER THREE

# The Invoice Nobody Could Pay

*The late payment is usually the customer's quality check, catching a fault made several desks upstream.*



*The Invoice Nobody Could Pay*

HAUTE LUMIÈRE · CASH ASLEEP IN THE BUILDING · CHAPTER THREE

## Ten past nine, the third call

It is ten past nine on a Tuesday, and the credit controller is on her third call of the morning. The invoice on her screen is seventy-four days old, for a set of stainless-steel prep tables delivered to the central kitchen of a group of care homes. Its terms were thirty days. She has emailed twice and left one message. This time a person answers, in the customer's accounts-payable office, and is perfectly pleasant. *That one's on hold,* he says. *It's been on hold since it came in. The purchase-order number doesn't match, and the delivery note says eleven tables, and the invoice says twelve.* There is a pause while he scrolls. *We sent a query. Did nobody get it?*

Somebody did. It went to a shared inbox in the sales office in the second week, and the person who read it assumed the warehouse would answer, and the warehouse assumed it was a sales matter. The credit controller writes *on hold since day 9* on the pad beside her keyboard and underlines it. The tightness that has sat under her ribs since the first call of the day does not go anywhere. It turns into something nearer anger, and she is not sure at whom.

She is a composite, drawn from the way these calls are described by people who make them and in the house's own practice, and no firm is meant. Her customer was not withholding the money. For sixty-five of the seventy-four days, it had been waiting for her firm to tell it what it owed.

Ammanuel Santa Anna's writing on where flow stops lists the forms stagnation takes in commerce, and the list could be pinned above her desk: it "appears in the marketplace as debts that accumulate, as invoices that go unsent, as money that is hoarded out of fear rather than invested in life." The invoice for the prep tables was sent. In every way that mattered to the care homes, it might as well not have been.[16]

This chapter makes one claim. Much of the cash a firm waits for from its customers is not held up by the customers. It is held up by a fault the firm itself made earlier, at the order desk, in the warehouse or in the sales meeting, which the customer's accounts office then finds and stops on. The credit controller sits at the end of that chain, and is usually the last person in the building to learn where it broke.

## Why customers get thirty days

It helps to ask first why one business lets another pay later at all, because the answer changes how a late payment should be read.

Economists have offered several reasons. In 1997 Mitchell Petersen and Raghuram Rajan, studying American small firms, found evidence that firms lean on credit from their suppliers when credit from banks is not available, and that suppliers lend partly because they know their customers better than a bank does: in their abstract's words, suppliers "have a comparative advantage in getting information about buyers".[17] That is the financing reason, and it is the one most people assume.

There is another, and it is more useful to a credit controller. In 1993 Michael Long, Ileen Malitz and Abraham Ravid argued that trade credit "is not primarily financial in nature, but instead reflects production and marketing decisions".[18] They proposed reading it as a way for a seller to guarantee the quality of what it sells. A customer who pays in thirty days has thirty days to discover whether the tables are the right size, whether there are twelve of them, whether they were delivered to the right kitchen. If they are not, the customer still has the money, and the seller has a reason to put it right. The theory explained, they suggested, why terms tend to be short or absent for food and consumer goods, which a buyer can judge on sight, and longer for heavy industrial equipment, which takes time to test.

Six years later Chee Ng, Janet Kiholm Smith and Richard Smith documented, across many industries, "the rich variation in interfirm credit terms", and found that the evidence supported "primarily" the theories that explain credit terms "as contractual solutions to information problems concerning product quality and buyer creditworthiness."[19] And in 2012 Leora Klapper, Luc Laeven and Raghuram Rajan, studying almost thirty thousand supplier contracts, found support for four reasons at once, including financing, price discrimination and the screening of risky buyers, and also trade credit "as a bond assuring buyers of product quality".[20]

None of these studies is about disputed invoices directly, and it would be overreaching to say they prove anything about the care homes. What they establish is the frame. Between businesses, the payment period is in part a period of inspection, and a customer that stops an invoice because something does not match is using that period for what it is for. The care homes' accounts office was doing its job. The question is why it had something to find.

## The chain behind the invoice

Follow the invoice for the prep tables backwards, the way the credit controller eventually did, and the faults turn out to be ordinary.

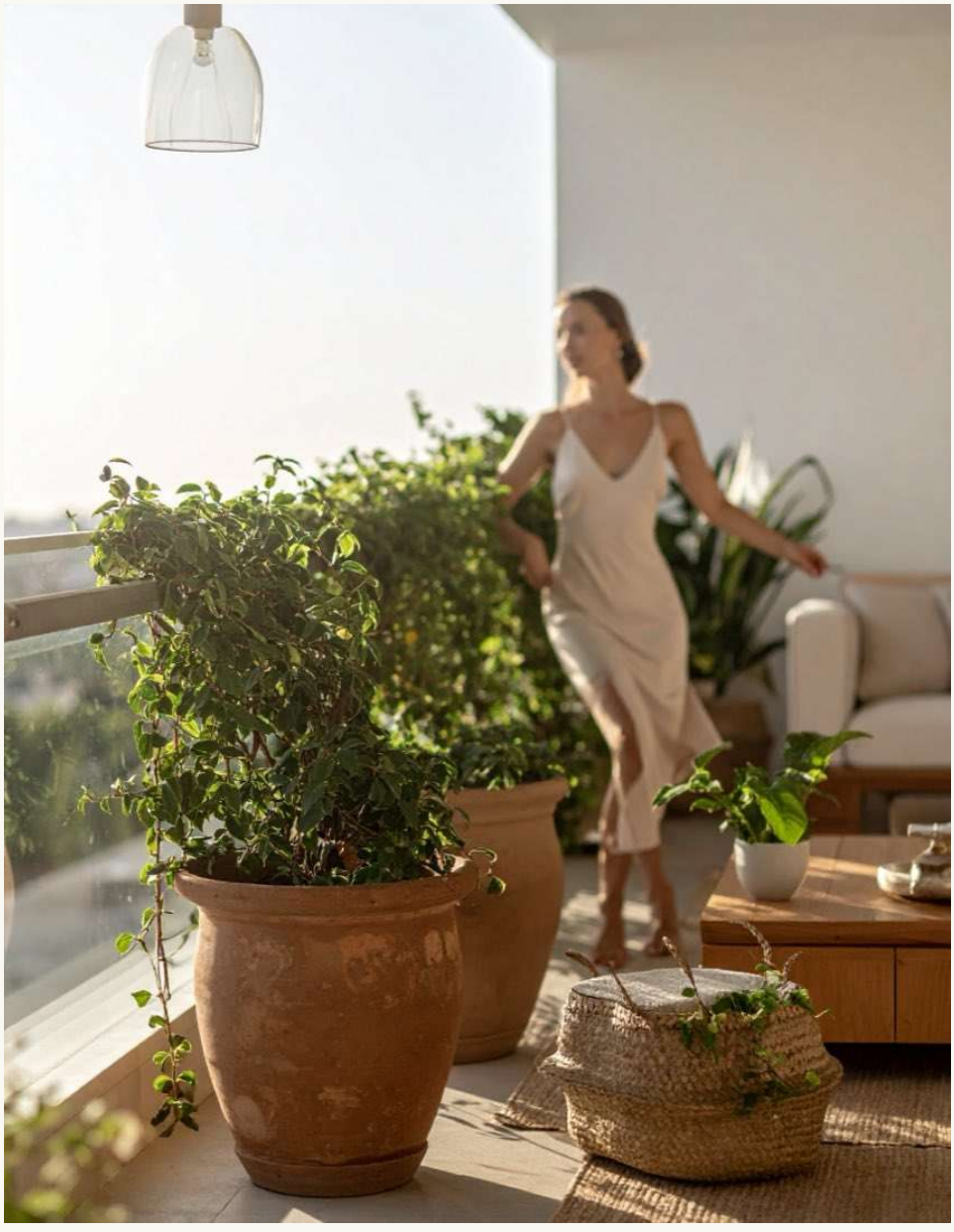
The purchase-order number did not match because the order was taken by phone, from the kitchen manager, who did not have a number yet. The order desk entered it with a note to add the number later, and later did not come, because nothing in the system asked for it. The delivery note said eleven tables because one was damaged in the warehouse, set aside and sent the following week on a second delivery, which was never invoiced separately; the first invoice, raised from the order rather than the delivery, said twelve. And the customer's query went to a shared inbox that three people read and nobody owned.

Each fault was made by a careful person doing something reasonable. Each was invisible from the desk where it was made, because it caused no trouble there. And each became trouble only at the end of the chain, in the customer's accounts office, where invoices are matched against orders and deliveries before they are paid. Accounts-payable departments in larger organisations commonly match each invoice against the purchase order and the goods received before paying it, and an invoice that fails the match is set aside. Such a customer is not being difficult. It is being exact, in exactly the way its own auditors expect.

This is why the measure most firms use for their receivables can mislead them. Days sales outstanding, the average number of days between an invoice and its payment, treats every day as the customer's. On the prep-table invoice, nine days were the customer's normal processing, and sixty-five were the firm's own silence. The measure put all seventy-four in the column marked *customers*.

Santa Anna's canon on the flow of value through an organisation has a sentence for what each of those handoffs was. "Every handoff between departments is simultaneously a material exchange and a relational

event." The invoice crossed the order desk, the warehouse, the billing team and the sales inbox. At each crossing it carried a fact or failed to, and at each crossing somebody assumed that somebody else held the part they did not. The house's first business book walked an order that waited six days for fifty minutes of work, much of it spent on a question that travelled by email. The invoice is the same order's money, waiting on the same kind of question, sent the other way.



*A quarter that ends on a Thursday*

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## A quarter that ends on a Thursday

There is a second source of long receivables, and it sits in the sales office rather than the warehouse.

In 1998 Paul Oyer published a study of what happens to American manufacturers' sales around the end of their fiscal years.[21] Salespeople and executives, he noted, are usually paid in ways that rise sharply when a revenue threshold is crossed, which gives them reason "to manipulate prices, influence the timing of customer purchases, and vary effort over their firms' fiscal years." He found exactly the pattern that reasoning predicts: sales were higher at the end of the fiscal year, and lower at the beginning, than in the middle. In 2014 Ian Larkin looked inside one large enterprise-software vendor and found salespeople "adept at gaming the timing of deal closure", agreeing significantly lower prices in quarters when closing a deal paid them more, at a cost he put at six to eight per cent of the vendor's revenue.[22]

Neither study measured payment terms, and the honest thing is to say so. But both describe the same room, the sales office in the last week of a period, in which something the firm values over the long run is traded for a signature this week. Price is one such thing. Terms are another, and anyone who has worked in that room has seen sixty days offered where thirty would have done, or an installation invoice deferred until the customer is satisfied, so that an order lands before the quarter closes. The receivable that results is long by design, and the credit controller who chases it eight weeks later is chasing a promise she did not make.

The canon's book on governance has a distinction that fits this exactly. "Default erodes trust," it says. "Renegotiation, done honestly and in good faith, can actually build it." An invoice that goes out with terms the customer was never told about, or that the salesperson agreed and nobody wrote down, is a small default waiting to happen. The customer pays when it believes it agreed to pay, the firm records it as late, and both sides leave the exchange trusting each other a little less. The same promise runs the other way too, from a firm to the people it buys from, and a payment date moved from thirty days to ninety, the subject of Chapter 4, is the same small default at the scale of a supplier's payroll.

## What the calls cost

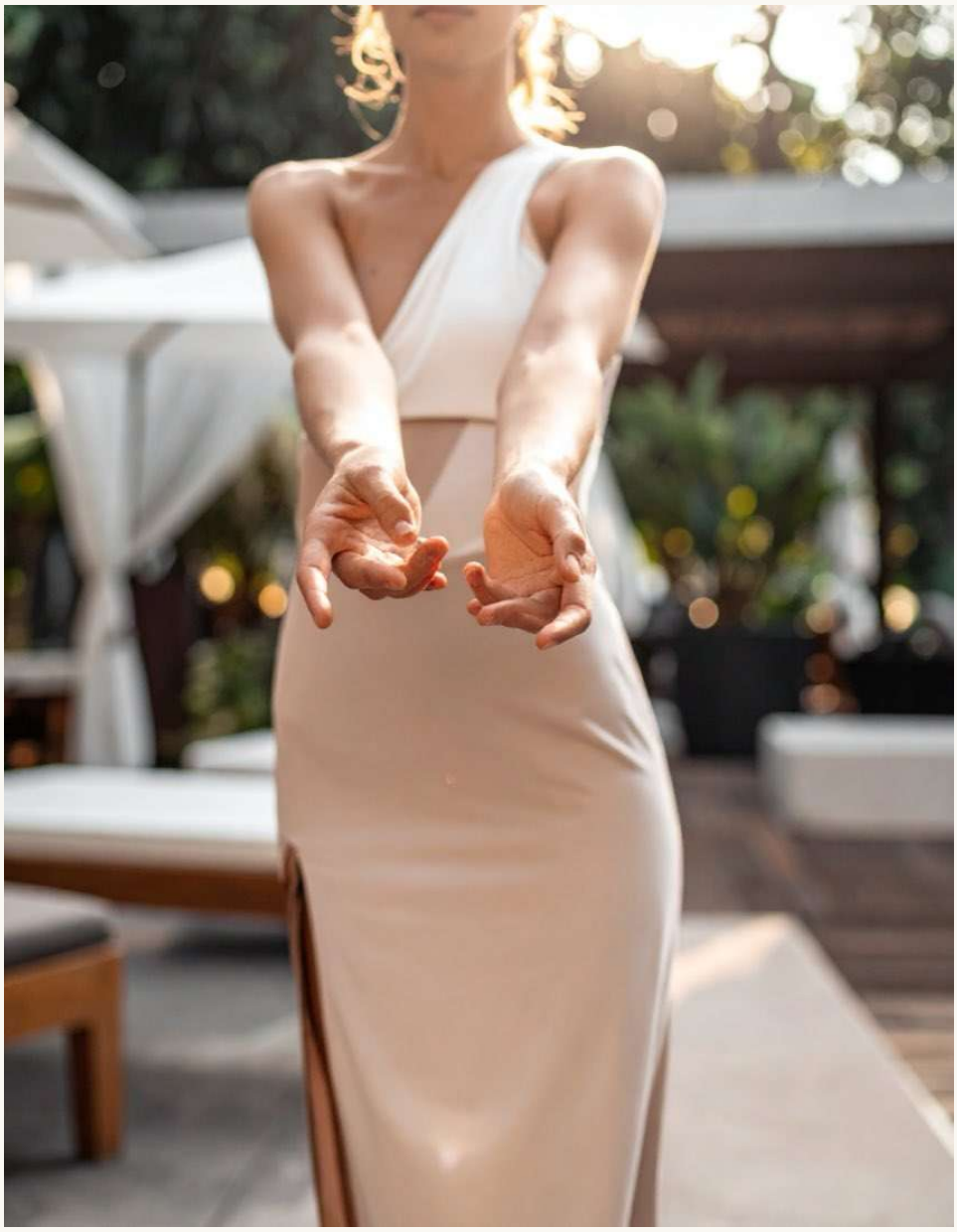
The cost of all this is easy to underrate, because none of it appears on one line.

The first cost is the cash itself: every day a disputed invoice sits unpaid is a day the firm finances its customer's purchase, as Chapter 1 worked out on a napkin. The second is the work. The credit controller's morning, three calls and a page of notes, is spent finding out what happened inside her own firm. The billing team will reissue the invoice. Someone in sales will apologise. The warehouse will find the damaged table's paperwork. That is perhaps two hours of four people's time to collect money that would have arrived on day thirty if one number had been entered on day one.

The third cost is the relationship, and it is the one leaders feel last. Santa Anna's book on living ventures describes customers as "co-creators" of a business, and lists how they shape it: "through their responses, their adaptations, their creative misuses, their complaints, their loyalty, and their departure." An accounts office that has queried three invoices from the same supplier in a quarter has formed a view of that supplier, and it is not the view the sales director would like. The care homes' kitchen manager loves the tables. Her finance department thinks the firm cannot count.

And the fourth cost is to the people at the end of the chain. The canon's book on organisational soul work describes what organisations spend on not naming what is wrong. "Not naming what is real requires continuous effort." Of the energy that effort consumes, it says: "It is the hidden tax of organizational silence". A credit controller who chases faults she did not make, in a firm that measures her on overdue debt, pays that tax every morning. Her anger on the third call was not unreasonable. It was information, arriving in the only part of the firm that could see the whole chain and had no authority over any of it.

*The Margin*, another of the house's books, reads the hours a team spends that nobody budgets. The chasing of disputed invoices is a clean example: work that exists only because an earlier piece of work was incomplete, done by someone measured on the result and not on the cause.



*Walking a dispute backwards*

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## Walking a dispute backwards

What changes this is not a firmer tone on the phone. It is a walk, taken by the credit controller with the people upstream of her, and it turns her list of overdue invoices into a list of faults with owners.

Picture her at the end of that month. She has kept, for four weeks, a simple record of every invoice that was paid late or queried, and for each one she has written the customer's stated reason, in the customer's words. There are thirty-one. She takes them to the finance director and asks for one hour with the order desk supervisor, the warehouse manager and the sales director, and she brings the list on paper.

They go through the thirty-one together and do one thing with each: they find the first desk at which the invoice could have been put right, and write that desk's name beside it. Not the desk where it was noticed, which is always hers, but the first desk where a fact was missing or wrong. Purchase-order numbers missing: the order desk, eleven times. Quantities that did not match the delivery: the warehouse, six. Prices that did not match the quotation: sales, five, all from orders taken in the last week of the quarter. Invoices sent to the wrong address at the customer: the master data, four. Genuine disputes about the work: three. Customers who simply paid late: two.

The table is short and it is startling, and the finance director reads it twice. Of thirty-one late payments, two were customers choosing to keep their money. Twenty-six began inside the firm, at desks where nobody had ever been told what the customer's accounts office needs to see.

It is worth being fair to the two, because they are real and every firm has them. Some customers do pay late on purpose, because they can, or because they are short of cash themselves, and a credit controller who treated every late payment as the firm's own fault would be naive in a different direction. The walk does not excuse them. It separates them. Once the twenty-six are seen for what they are, the two stand out clearly, and they can be handled as what they are: a conversation about terms, held by someone with the authority to have it, instead of a monthly chase that the credit controller can never win because she has nothing to offer and nothing to withhold. And the three genuine disputes about the work are worth their own conversation too, with the people who did the work, because a customer who will not pay for an installation it thinks was badly done is telling the firm something its own inspection missed.

The record itself is the part most firms do not have. Most credit-control systems hold the date an invoice was raised and the date it was paid, and somewhere a free-text field with notes from the calls. Very few hold the customer's reason in a form that can be counted, and fewer still hold the first desk where the fault began. Four weeks of a pad beside a keyboard was enough, here, to produce a table nobody in the building had seen before.

Then the changes, in the order the walk suggests. First, the order desk will not accept an order without the customer's purchase-order number, and when a customer has none yet the order waits in a visible queue rather than going through with a note. Second, invoices will be raised from the delivery, not the order, so that what is billed is what arrived. Third, a query from a customer's accounts office will go to a named person within the day, and the shared inbox will be closed. And fourth, the sales director agrees that terms other than the standard ones will be written on the order, so that the customer, the billing team and the credit controller all read the same promise.

The canon's book on governance puts the principle under the fourth change in a line about commitments: "Commitments are specific and measurable." A payment term is a commitment by both sides. It is kept more often when it is written down where both sides can see it.

There are predictable ways for this to go wrong. A walk that turns into a hunt for the person who made each mistake will empty the list of honest answers by the second month. A rule about purchase-order numbers that nobody explains will be met with invented numbers. And a firm that measures the credit controller only on overdue debt will find that she has every reason to chase harder and no reason to keep the record that made the walk possible. Chapter 7 carries the dispute walk as a run sheet, with the record she kept, the sorting rule and the four changes, and Chapter 6 places it in the order of a first ninety days.

Santa Anna's *Ecstatic Economics* has a line about the relationship between ideas and their practice that might stand over the whole exercise. A good theory, it says, needs "the poem and the muscle, the vision and the invoice." The vision of a firm with a short cash cycle is easy to state. The invoice, correct on day one, is where it is kept.

The gain is again plain once the faults are seen. Days taken out of receivables return cash once and stop costing money to finance for as long as they stay out; the hours spent chasing are given back to the people who spent them; the customer's accounts office starts paying on day thirty because there is nothing to stop on. All of it can be counted from the firm's own ledger, and all of it should be counted honestly, with the measure agreed before the first change, as Chapter 5 describes, because receivables are among the easiest numbers in a business to improve on paper and not in fact.

## Keeping the dispute record

The dispute walk depends on a record most firms do not keep, and the finer points are mostly about keeping it well.

Record every late or queried invoice for four weeks. Not only the overdue ones: every invoice a customer queries, puts on hold or pays later than its terms. For each, write the date, the customer, the amount, the age, and the reason the customer gave, in the customer's own words. *PO number doesn't match* is more useful than *admin issue*. Four weeks is usually enough to see the pattern; in a firm with few invoices, take two months.

Find the first desk, not the last. For each invoice, ask where the fault could first have been put right. The credit controller is always the last desk, because she is the one who finds out. The useful answer is the earliest point at which a fact was missing or wrong: the order taken without a number, the delivery that did not match the order, the price agreed in a meeting and not written down, the customer's address held wrong in the system. Use a short list of first desks, the same every month, so that the record can be counted.

Separate the customers who choose to pay late. Some do, and every firm has a few. Counting them separately does two things: it stops the walk from being naive, and it shows how few they usually are. Those few need a conversation about terms, held by someone with authority to have it, not a monthly chase.

Split days sales outstanding in two. The usual measure treats every day between invoice and payment as the customer's. Once the record exists, divide it: days the invoice spent with the customer in ordinary processing, and days it spent waiting on the firm to correct something. The second number is the one the firm controls, and it is often the larger.

Take the record to the people upstream, together. The order desk supervisor, the warehouse manager, the sales director and whoever owns the customer records, in one room, with the list on paper. Read it as a description of the system. The faults were made by careful people at desks where they caused no trouble; the point of the meeting is to show each desk what the customer's accounts office needs to see, which most of them have never been told.

Make the changes in order of cost. Usually the cheapest is a rule at the first contact: no order accepted without the customer's purchase-order number, and orders without one held in a visible queue rather than pushed through with a note. Then invoice from the delivery, not from the order, so that what is billed is what arrived. Then give customer queries a named owner, answered within a working day, and close any shared inbox that three people read and nobody owns. Then write non-standard terms on the order, where the billing team and the credit controller can read the same promise the customer heard.

Measure the share of invoices that are right the first time. It is the companion to days outstanding and the better measure of the work upstream: of the invoices raised this month, how many were paid without a query? It rises before days outstanding falls, and it tells the order desk and the warehouse that their changes are working, which the credit controller's overdue list never will.

Do not measure the credit controller on overdue debt alone. If her only measure is the debt that is late, she has every reason to chase harder and no reason to keep the record that made the walk possible. Add the share of disputes traced to a first desk, and the share answered within the day. She is the only person in the building who can see the whole chain; measure her on helping it see itself.

Keep the record going, lightly. After the first walk, the record can shrink to a column in the credit-control system: first desk, chosen from the short list. Read it monthly with the same people. When a first desk stops appearing, say so to the people at that desk, by name, in the meeting. When a new one appears, walk it.

Chapter 6 places the dispute record in the first ninety days, beside the shelf walk, and Chapter 7 carries the record sheet, the list of first desks and the sorting rule.

## Ten past nine, a season later

It is ten past nine on a Tuesday in spring, and the credit controller has made one call this morning. It was to the care homes' accounts-payable office, and the same pleasant man answered it. She had rung to say that a credit note for a returned table was on its way, before he had to ask.

The list on the wall by her desk has two columns now: late payments, and the first desk where each could have been put right. This month the second column is mostly empty.

He thanked her for the call. She wrote nothing on the pad.

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