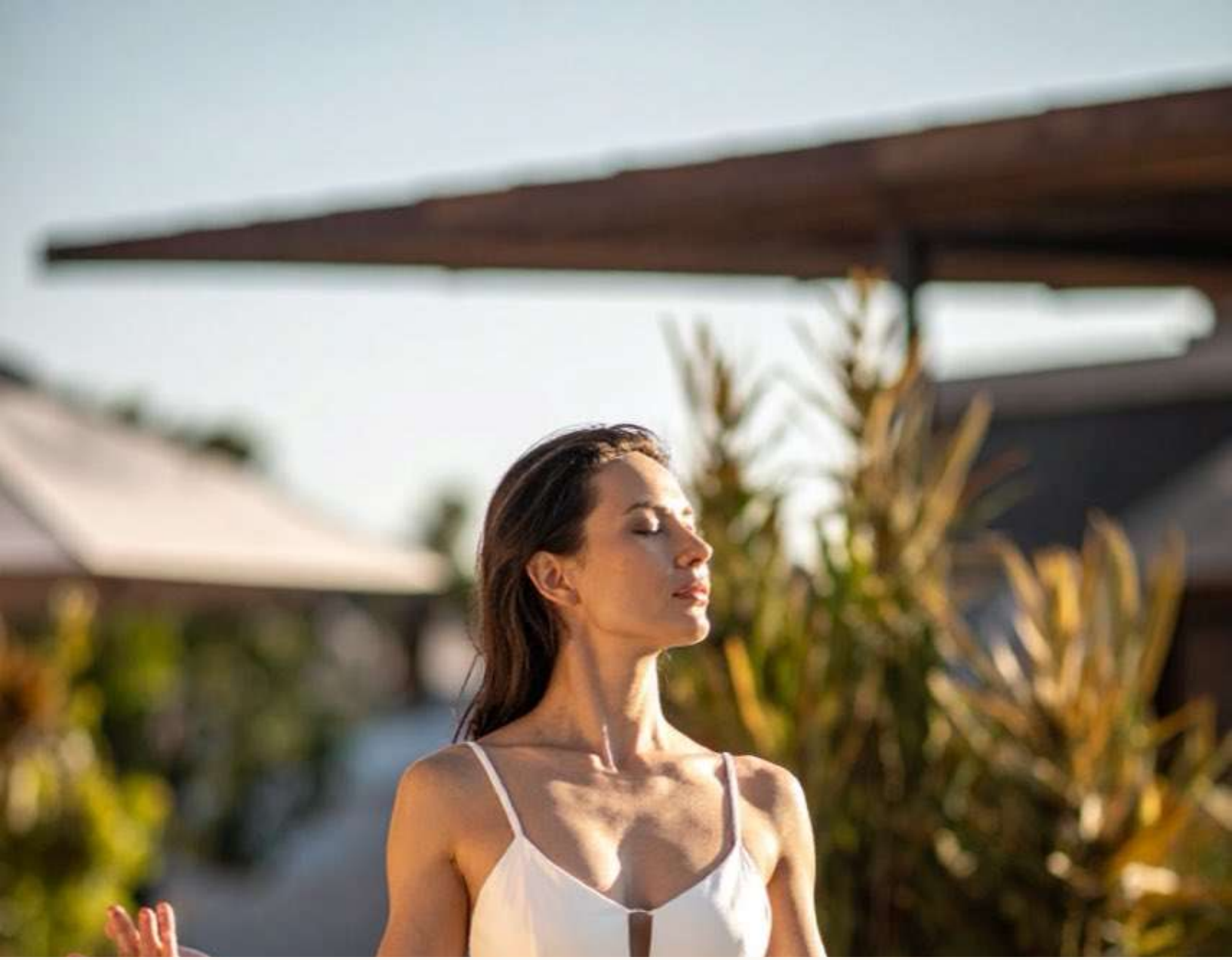


CASH ASLEEP IN THE BUILDING · CHAPTER FOUR

Ninety Days Is Somebody's Payroll

A day added to payables is a day someone else finances, usually the firm least able to.

Ammanuel Santa Anna

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THE LICENCE

Ninety Days Is Somebody's Payroll
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Chapter Four of Cash Asleep in the Building. The whole book, with every chapter, is at business.hautelumiere.life/library/cash-asleep-in-the-building (DOI https://doi.org/10.5281/zenodo.23989319).

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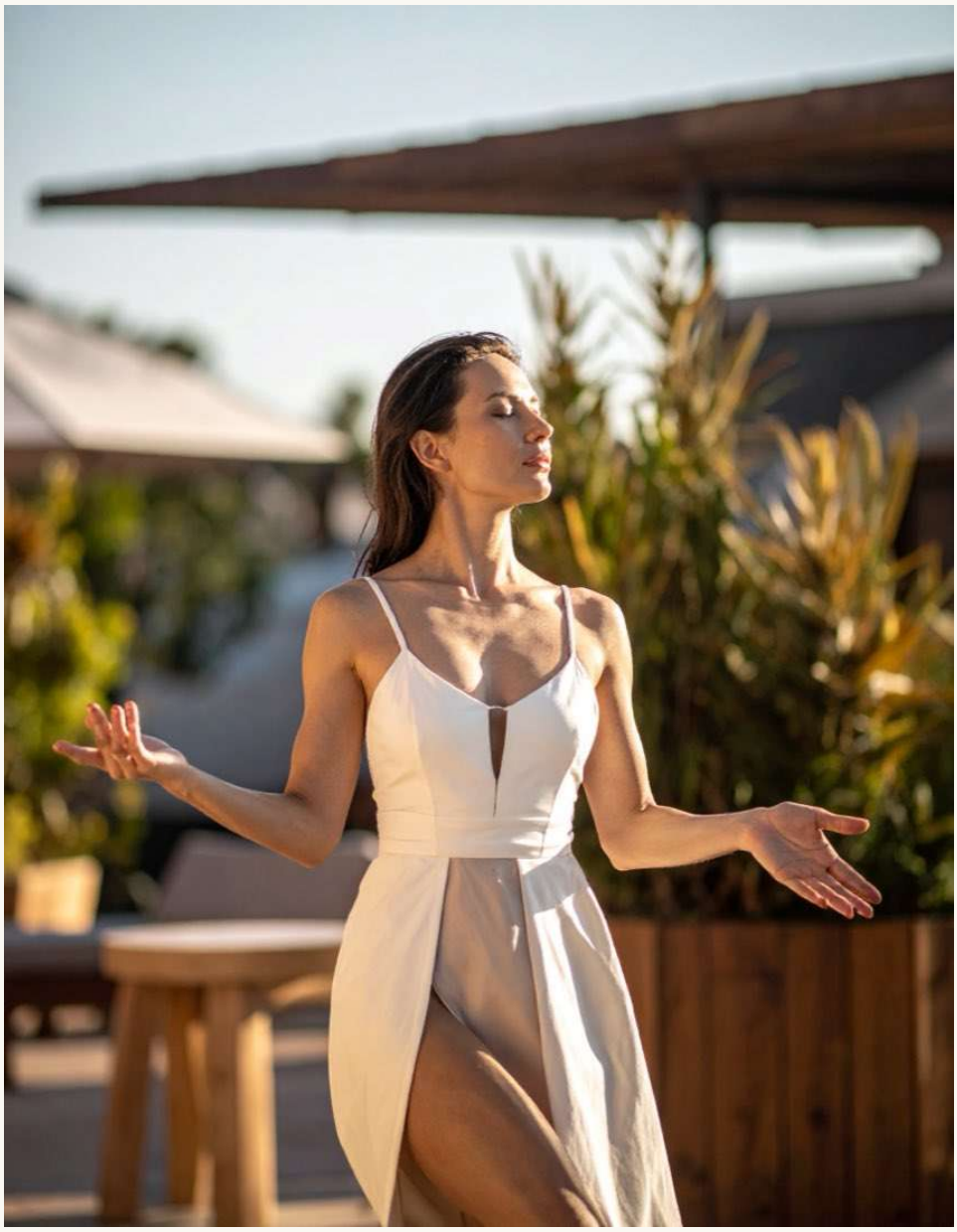
ABSTRACT

A day added to payables is a day someone else finances, usually the firm least able to. It is six in the morning on a Monday in February, and the owner of a firm that makes printed cartons is at her kitchen table with a mug of tea and a letter she has now read four times. It arrived on Friday. Her largest customer, a food company that takes about a third of everything her factory makes, is writing to all its suppliers. From the first of April its standard payment terms will move from thirty days to ninety. Suppliers who would prefer to be paid sooner may join an early-payment programme run with a bank, at a discount that will be set by the bank. The letter thanks her for her partnership. It is signed by someone whose name she does not know.

CHAPTER FOUR

Ninety Days Is Somebody's Payroll

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Ninety Days Is Somebody's Payroll

HAUTE LUMIÈRE · CASH ASLEEP IN THE BUILDING · CHAPTER FOUR

Six in the morning, the kitchen table

It is six in the morning on a Monday in February, and the owner of a firm that makes printed cartons is at her kitchen table with a mug of tea and a letter she has now read four times. It arrived on Friday. Her largest customer, a food company that takes about a third of everything her factory makes, is writing to all its suppliers. From the first of April its standard payment terms will move from thirty days to ninety. Suppliers who would prefer to be paid sooner may join an early-payment programme run with a bank, at a dis-

count that will be set by the bank. The letter thanks her for her partnership. It is signed by someone whose name she does not know.

She has twenty-three people on her payroll, and it falls due every four weeks whether or not anybody has paid her. She does the arithmetic on the back of the envelope. Sixty more days of a third of her sales is a sum her bank would lend her, probably, at a price, against her house. The discount on the programme would be cheaper this year and might not be next. Her shoulders have been up since Friday, and she has not yet told her husband the figure.

She is a composite, drawn from the way these letters are described in the research below and in the house's own practice, and no firm is meant. In the food company's head office, the same morning, a treasury manager will report that the group's payables have lengthened and its cash conversion cycle has improved, and both statements will be true.

Ammanuel Santa Anna's book on doing business as a living system tells the story of a florist whose most reliable customer had squeezed her in the same way, and its list of what the customer did ends with one plain clause: "They paid on 90-day terms, creating cash flow strain." The book's verdict on such arrangements is direct. "In business, parasitic relationships are more common than most founders want to admit."[23]

This chapter makes one claim. When a firm improves its cash cycle by paying its suppliers later, it has not released any cash from the supply chain it depends on. It has moved the cash to the firm least able to hold it, and the cost comes back, later and less visibly, in price, reliability and the health of the suppliers it needs. The cash worth releasing is in a firm's own building. The way to treat a supplier's money is as a promise to be kept on the day it falls due.

Who gets the long terms

There is good evidence about who lends to whom in trade, and it runs in a direction that surprises people meeting it for the first time.

In 2012 Leora Klapper, Luc Laeven and Raghuram Rajan studied a dataset of almost thirty thousand supplier contracts for fifty-six large buyers and more than twenty-four thousand suppliers in Europe and North America.[24] Their abstract states the central finding without decoration: "the largest and most creditworthy buyers receive contracts with the longest maturities, as measured by net days, from smaller, investment grade suppliers." The firms with the easiest access to cheap money are, in this record, the ones borrowing most from the firms around them, and the lenders are often smaller than the borrowers.

What that borrowing costs the lender was measured three years later. Justin Murfin and Ken Njoroge used changes in large retailers' cash-management policies as a natural experiment, tracing what happened to the vendors when the retailers began to pay more slowly.[25] Slower payment by important buyers, they found,

was linked to cutbacks in the suppliers' own spending on their businesses. Their abstract gives one example in a single sentence: "a one month delay in payment by Wal-Mart is associated with 1.2% reduction in capital expenditures for the representative Wal-Mart supplier." The effects were sharpest when bank credit was tight and for suppliers that looked credit-constrained. The suppliers did not, for the most part, borrow their way round the delay. They invested less.

A third study shows what happens when the terms are shortened instead. In 2016 Jean-Noël Barrot examined a French reform that restricted how long the customers of trucking firms could take to pay them.[26] Comparing trucking firms with similar firms the reform did not touch, he found that the trucking firms' probability of default fell by a quarter after the restriction, that the effect lasted, that it was concentrated among firms short of cash, and that it was not offset by lower profits. The restriction was also followed by more small trucking firms entering the market. His abstract opens with the conclusion: "Long payment terms are a strong impediment to the entry and survival of liquidity-constrained firms."

These are careful studies, each with the limits of its setting: one dataset of large buyers' contracts, one set of American retailers and their suppliers, one industry in one country under one law. Read together, they make a point that no single one could make alone. Long terms imposed by large buyers on small suppliers are not a neutral accounting choice. They are a loan, made by the weaker party to the stronger, and the weaker party pays for it in investment it does not make and, sometimes, in failure.

The cycle of the whole chain

The finance literature has a name for the view this makes necessary, and it is worth knowing because it turns a moral point into an arithmetic one.

In 2010 Erik Hofmann and Herbert Kotzab argued that a firm's cash conversion cycle should be read as one link in a chain.[27] Research had shown, their abstract notes, "how individual industries and powerful companies were able to enhance their cash-to-cash cycles at both their supplier's and customer's expense." From the point of view of the chain as a whole, they argued, this "lowers the overall financial wealth of the supply chain", because the cash does not disappear when a buyer pays later; it is simply financed by somebody else, usually at a higher cost. The supplier with a bank overdraft pays more to hold sixty days of the buyer's purchases than the buyer would have paid to hold them itself, and each of those days is worth, to her, a day's cost of sales, the sum Chapter 1 worked on a napkin. Their proposal was the reverse of the letter on the kitchen table: lengthen the cycles of the firms with the cheapest money, and shorten the cycles of the firms with the dearest. A year earlier Wesley Randall and Theodore Farris had made a similar case, with worked scenarios, for managing the cash-to-cash cycle collaboratively across trading partners.[28]

Hofmann and Kotzab are candid about why this rarely happens. "An unequal distribution of power, however, between supply chain members can be the main hindrance for developing a collaborative working

capital management solution." The buyer can lengthen its terms because it can. The supplier signs because a third of her sales is a third of her sales.

The house's Luminous 100, its reading of the frameworks every consultancy sells, describes the purpose of Porter's analysis of supplier and buyer power in exactly the terms Hofmann and Kotzab would recognise. Its upgrade does not merely map where power lies; it looks for "where collaboration, shared consciousness, and mutual flourishing can convert zero-sum rivalry into positive-sum value creation across the entire industry web." A letter moving thirty days to ninety is zero-sum by construction. It improves one number by the amount it worsens another.

Santa Anna's book on living ventures names the habit of mind that writes such letters, and it is not cruelty. "And yet, most entrepreneurship education treats partnerships as transactions. Negotiate the best terms. Protect your interests. Minimize dependency. Extract maximum value." The treasury manager in the food company was doing what she was trained and measured to do. Her cash conversion cycle will improve in the second quarter, and nobody in her building will see what it costs.



What the programme lends

HAUTE LUMIÈRE · CASH ASLEEP IN THE BUILDING · CHAPTER FOUR

What the programme lends

The early-payment programme in the letter has a name in the trade, supply chain finance, and sometimes reverse factoring. Its mechanics, at their simplest, are these. The buyer approves the supplier's invoice, a step at which, as Chapter 3 found from the seller's side, days are easily lost. A bank or other finance provider offers to pay the supplier early, less a discount set by the provider, usually priced on the buyer's credit rather than the supplier's. The buyer then pays the provider on the long date. The supplier gets her cash sooner and pays for it; the buyer keeps its long terms; the provider earns the discount.

Arranged honestly, this can genuinely lower the cost of the chain, because the buyer's credit is cheaper than the supplier's, which is Hofmann and Kotzab's point made into a product. Arranged as an accompaniment to a terms extension, it turns the buyer's improved cycle into a fee paid by the supplier. And there is a further difficulty, which the public record of the last few years has made impossible to ignore. For a long time a buyer using such a programme was not specifically required to disclose it, so that what was in substance a form of borrowing by the buyer could sit in its accounts among its ordinary trade payables.

The collapse of Greensill Capital made that difficulty visible. Greensill described its business as supply chain finance; administrators from Grant Thornton were appointed to Greensill Capital (UK) Limited on 8 March 2021, according to the notice in the *London Gazette*.[29] In the same month Credit Suisse closed four funds at short notice that had invested in assets connected with Greensill; the Swiss financial regulator FINMA, concluding its proceedings in February 2023, reported that "clients had invested a total of around ten billion US dollars" in them at the time of closure, and found that the bank had "seriously breached its supervisory duty to adequately identify, limit and monitor risks".[30] The House of Commons Treasury Committee, reporting on lessons from the collapse in July 2021, described supply chain finance as "a form of short-term finance where future payment obligations are transferred to a finance provider", and did not conclude that it needed to be brought within financial regulation.[31]

Greensill's failure was a failure of one financier and the institutions around it, and it should not be read as a judgment on every early-payment programme, most of which run without incident. Its relevance here is narrower. The standard-setters moved afterwards. In September 2022 the American Financial Accounting Standards Board issued an update requiring buyers that use supplier finance programmes to disclose their key terms and the amounts outstanding.[32] In May 2023 the International Accounting Standards Board amended its standards so that companies disclose the effects of supplier finance arrangements on their liabilities, cash flows and exposure to liquidity risk.[33] A shorter cash cycle that had been achieved by financing, rather than by anything changing in the business, is now meant to be visible as such.

That is the whole lesson for a leader looking at her own cycle. A day removed from stock is a day the firm no longer needs to finance. A day added to payables is a day someone else finances for it, and a day financed through a programme is a day the firm is still borrowing, in a different column. Telling those days apart, month by month, is the work of the ledger in Chapter 5.

The keystone at the edge

Santa Anna's canon has a book about keystones, the people and parts of a system that carry far more than their share and on which the rest depends. Its account of what goes wrong with them is written about people inside an organisation, and it fits the carton maker exactly. The destructive dynamic, it says, is "the tendency of systems to consume their keystones, treating disproportionate contribution as a natural resource rather than a gift that requires return."

A small supplier on whom a large firm depends is a keystone at the edge of the building. She carries the large firm's packaging, its seasonal peaks, its last-minute changes of artwork, and now sixty more days of its working capital. The large firm treats all of this as a natural resource, available at the price on the contract. The first sign that it is not comes later, and it rarely arrives as a letter. Her firm stops investing in the new printing line that would have cut the food company's lead time, which is Murfin and Njoroge's finding at the scale of one factory. Her best production manager leaves for a firm that pays on time. Her quotations for next year rise, by a little more than the cost of the discount, because she has priced the risk. And in a bad year she becomes the supplier who fails, and the food company's procurement team spends a quarter finding another, at a higher price, with a learning curve the food company pays for.

Santa Anna's book on living ventures offers a test for any such relationship that the treasury manager could apply before sending the letter: "The litmus test: Would both partners miss the other deeply if the relationship ended? Is the benefit truly reciprocal?" The carton maker would miss the food company, desperately. Whether the food company would miss her depends on whether anyone in it knows what she does beyond the price on the invoice.



The conversation before the letter

HAUTE LUMIÈRE · CASH ASLEEP IN THE BUILDING · CHAPTER FOUR

The conversation before the letter

What changes this begins on the buyer's side, and it is a conversation rather than a policy.

Picture the treasury manager a year later, at the same food company, asked again to improve the group's cash cycle. This time she does three things before anyone writes to a supplier. She takes the cycle apart into its three numbers and asks her colleagues in operations and sales for the walks the earlier chapters of this book describe: the oldest shelves in the group's own warehouses, and the disputed invoices on its own receivables, because the stock nobody has asked about (Chapter 2) and the invoices (Chapter 3) that wait on

the group's own errors are cash released from its own building. She separates, in her report, the days that come from changes in the business from the days that come from changes in terms or financing, and labels each. And she asks procurement for a list of the suppliers who depend on the group most, by the share of their sales the group represents, and sits down with the first ten.

The conversations are not negotiations, and she says so at the start. She asks each supplier three things. What would longer terms cost you, and how would you pay for them? What do we do that makes you hold more stock or more cash than you need? And what could we do, short of paying you sooner, that would let both of us hold less? The answers to the second question are the ones she did not expect. The carton maker holds six weeks of printed stock for the food company because its forecasts change late and its artwork changes later. Another supplier waits an average of nineteen days for invoices to be approved, which is, in practice, nineteen days of terms the contract never agreed. A third has never been told the date on which the group pays, and so plans for the worst.

The changes that follow are small, and most of them cost the food company nothing. Forecasts are shared with the ten suppliers monthly, with the date of the next artwork change. Invoices are approved within a fixed number of days of receipt, and the payment date, once set, is kept. The terms stay where they were, and the early-payment programme is offered as an option for suppliers who choose it, priced and explained in writing, rather than as the price of keeping the old terms. The treasury manager's cycle improves by less than the letter would have improved it. It improves from the group's own stock and receivables, which means it stays improved, and it shows in her report as what it is.

The canon's book on governance says of commitments something that holds exactly for a payment date: "Commitments are calibrated to capacity." A buyer that sets terms its own approval process cannot meet, and then pays late, has made a promise it could not keep. A buyer that sets terms it can keep, and keeps them, has given its suppliers the one thing that lets them hold less cash on its behalf: a date they can trust.

There are predictable ways for this to go wrong. A conversation held after the letter is sent is a renegotiation under duress, and every supplier knows it. A programme offered as a favour, with its pricing left vague, will be read as the letter in another form. And a treasury team measured only on its days payable will, under pressure, return to the lever it controls. Chapter 7 carries the supplier conversation as a run sheet, with the three questions, the record to keep and the order of the changes, and Chapter 6 places it in the order of a first ninety days.

None of this is charity, and it is worth being exact about why. The firm that keeps its payment dates and helps its suppliers hold less gets better prices over time, earlier warning of trouble and first call on a constrained supplier's capacity in a bad season. Those gains are real, and they are harder to measure than a day of payables, which is why a measure built only on days will always favour the letter. Santa Anna's writing on abundance puts the difference in six words, about rivers and swamps: "A river flows. A swamp stag-

nates." Cash pushed into a supplier's overdraft has not started to flow. It has stopped somewhere the buyer cannot see it.

Holding the supplier conversation

The supplier conversation is the practice in this book most easily done badly, because the firm holding it has the power, and the finer points are mostly about not using it.

Hold it before any change to terms, never after. A conversation held after the letter is a negotiation under duress, and every supplier will treat it as one. If terms have already been changed, say so plainly at the start, and say what the firm is prepared to reconsider.

Choose the suppliers by dependence, not by spend. A firm's largest suppliers by value are often large firms that can look after themselves. The suppliers most affected by its terms are the ones for whom it is a large customer. Ask procurement for each supplier's share of sales that the firm represents, where it is known or can be estimated, and begin with the ten most dependent.

Say what the conversation is for. It is not a renegotiation. It is to find out what the firm does that makes the supplier hold more stock or more cash than it needs, and what could be done about it. Say so at the start, and hold to it; a buyer who opens with partnership and closes with a discount request has taught the supplier how to answer next time.

Ask the three questions, and write down the answers. What would longer terms cost you, and how would you pay for them? What do we do that makes you hold more than you need? What could we do, short of paying you sooner, that would let both of us hold less? The second question is the one that finds the gain: late forecasts, late changes, invoices approved slowly, a payment date nobody has published.

Measure your own approval lag. Before any conversation, find out how many days the firm takes, on average, between receiving a supplier's invoice and approving it for payment. That number is terms the contract never agreed. If it is long, the first change belongs to the firm's own accounts office, not to the supplier.

Publish the payment date, and keep it. Suppliers plan for the worst when they do not know when they will be paid. A fixed, published payment day, kept, is worth more to a small supplier than a few days off the terms, because it can be planned around. A payment run held for a reporting date breaks that promise, and Chapter 5 explains why it should not count.

If a finance programme is offered, offer it as an option, in writing. An early-payment programme can genuinely lower the cost of the chain, because the buyer's credit is usually cheaper than the supplier's. It should be voluntary, its pricing should be explained in writing and in full, and it should not be the price of keeping existing terms. Inside the firm, the days it produces belong in the financing column of the ledger in

Chapter 5, and the amounts outstanding under it should be visible in the accounts, as the newer disclosure standards intend.

Apply the test of the third party. Before any change to supplier terms reaches a decision, write one line naming what the supplier gains from it. If the honest line is *nothing*, the change moves cost rather than removing it, and the gain it shows in the firm's cycle is a loan from the supplier. That line is the same test the house applies to its own work: a gain that exists only because a cost was exported to someone else is not counted as a gain.

Keep a short record of each conversation. The supplier, the date, the three answers, what the firm agreed to change and by when. Read it again in three months, with the supplier. A conversation that produced changes the buyer did not make is worse than no conversation, because the supplier now knows the firm will listen and not act.

Expect the benefits to arrive slowly, and somewhere else. A supplier that holds less on the firm's behalf, and trusts its payment date, quotes more steadily, warns earlier and gives the firm first call on capacity in a bad season. None of this shows in days payable. Note each instance when it happens, so that the case for the conversation does not rest on memory when the next request for a shorter cycle arrives.

Chapter 6 places the supplier conversation after the firm has worked on its own stock and receivables, so that it is not tempted to start with the lever it controls, and Chapter 7 carries the conversation sheet, the dependence list and the third-party line.

Six in the morning, a year later

It is six in the morning on a Monday in February, and the carton maker is at her kitchen table with a mug of tea. There is no letter. There is a forecast, which arrived by email on Friday from the food company's planning team, with the date of the next artwork change in the subject line.

She reads it once. She will print two weeks of cartons, not six.

The payroll falls due on Thursday. She has not thought about it since Christmas.

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