

# Customer Segmentation for AR

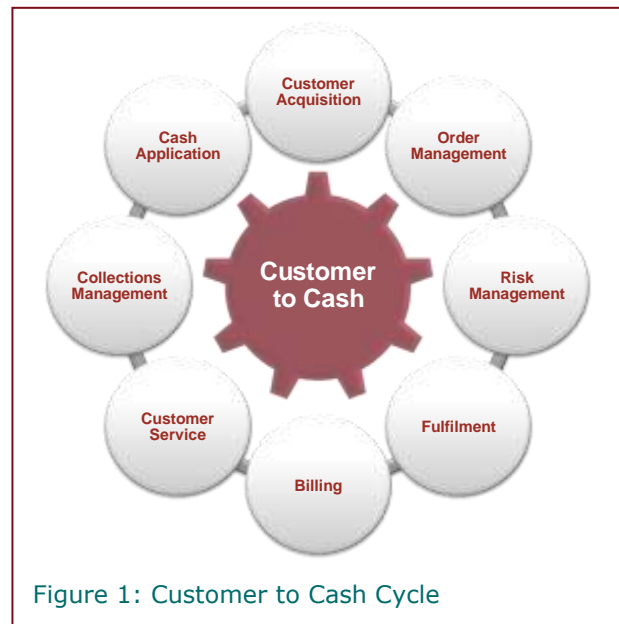
## Working Capital Series

By Perry Tong

Collections represents the 'end' of a sales cycle. It also represents the firm's ability to convert cash expended from when a customer order arrives through fulfilment and payment. For many firms the operating motto in this area of working capital management is to simply try to collect faster. Few go beyond to address this 'end of sales cycle' activity that is the key provider of cash for the firm.

Collections management represents an opportunity to fully utilize a firm's systems and resources. Leveraging simple technology is possible and enhanced through *customer segmentation*.

An ability to segment one's customers, for the larger firms particularly, allows for differing policies and treatments when it comes to receivables management. Intuition plays a large part in determining the amount of investment required in a given relationship in most cases but this should be applied only to one segment of customers. Policies dictating the handling of other relationships may be drafted according to the resourcing and strategic requirements of the firm. Resources, electronic and otherwise, can then be planned for accurately given business cycles.



## How to Segment

Often the first step is to naturally want to segment customers by the revenue streams provided. Pareto breakdowns are feasible and may be determined internally to fit a firm's risk and resource capabilities. In the example provided the large or 'A' customers form some 55% of revenue over the last 12 months. 'B' customers form 31% of sales and the rest falls into the 'C' segment.

Note that there are indications of percentage past dues for each segment. This is an arbitrary number based on the risk the firm is willing to accept. As segments 'A,' 'B' and 'C' are parsed we develop a risk profile of the existing customer base and this is divided generically into 'high' and 'low' risks as may be seen in Figure 2.

Following segmentation we develop policies for each particular segment reflecting on the resource capabilities and intended commitment levels.

Simplified example of a Collections Strategy following customer segmentation for receivables management:

- ❑ A & B High Risk - Proactive calling, incoming orders > dynamic credit limit held, referred to collections
- ❑ A & B Low Risk - Reactive calling, incoming orders > dynamic credit limit approved if no past dues
- ❑ C High Risk - Reactive calling / dunning letters, incoming orders > dynamic credit limit held, referred to collections
- ❑ C Low Risk - Reminder letters, incoming orders > dynamic credit limit approved if no past dues

	High Risk	Low Risk	Total
A	36% AR 51% Past Due 3% Customers	19% AR 3% Past Due 2% Customers	55% AR 54% Past Due 5% Customers
B	19% AR 30% Past Due 11% Customers	12% AR 1% Past Due 7% Customers	31% AR 31% Past Due 18% Customers
C	8% AR 15% Past Due 50% Customers	6% AR 0% Past Due 27% Customers	14% AR 15% Past Due 77% Customers
Total	63% AR 96% Past Due 64% Customers	37% AR 4% Past Due 36% Customers	

Figure 2: Segmentation of Customers

Collection activities are now much more focused and management has a line of sight into the behaviour of customers allowing for the strategic reallocation of resources. Not only is working capital more visible – which allows for action plans – the opportunity for operational expenditure to decrease presents itself.

Segmentations based on corporate and debt risk profiling can also give rise to actions beyond collection activities and include mandates for customer service levels and even fulfilment obligations. Segmentation is also a pre-requisite activity leading to others, covered in future articles touching on the C2C area of total working capital, resulting in a potential reduction of DSO or receivables. Combined with these other activities we have seen reductions in overall receivables ranging from 20% to 60% in some instances.

## About the Author

**Perry Tong** is the Singapore-based Managing Consultant for Centre for Organisational Effectiveness Pte Ltd. He helps companies in Asia, Europe and North America understand the importance of process improvement with impacts on working capital as a primary objective and increased customer service levels as a secondary objective. He has extensive experience in implementing process and organisational improvements for various industries. Perry can be reached at [Perry.Tong@COE-Partners.com](mailto:Perry.Tong@COE-Partners.com)