NUS National University of Singapore

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What is days sales outstanding?

Ted Teo

WHAT DOES IT MEAN?

Days sales outstanding (also called DSO or days sales in receivables) refers to the average number of days that the customers of a company take to pay their invoices.

It can be estimated by dividing the average account receivables of the company, say, over a year, by its average daily revenue. It can also be computed over a monthly or quarterly period.

WHY IS IT IMPORTANT?

DSO is a reflection of how fast the company is able to generate cash with its sales. A decrease in DSO over time indicates that the company has been able to convert its sales (in account receivables) into cash over a shorter period. The faster the cash is freed up, the quicker the company is able to use it to generate more economic returns.

DSO is also a reflection of the company's market position vis-a-vis its customers and its industry. A decrease in DSO over time may be an indication of an improvement in the company's sales collection capabilities or its bargaining power over customers. It may also be an indication of an improvement in the credit condition of the company's customers or the industry the company is part of.

An increase of DSO over time, however, may indicate that the company is losing its bargaining power with customers, a deterioration in customer credit quality, or a decline in health for the industry the company is in.

By examining how DSO changes over time, one can detect subtle changes in a company's market position and environment.

IF YOU WANT TO USE THE TERM, JUST SAY:

"The company has improved its operating cash flow over time by managing its credit sales more diligently and shortening its days sales outstanding."

• Ted Teo is an adjunct senior lecturer, Department of Finance, National University of Singapore (NUS) Business School. The opinions expressed are those of the writer and do not represent the views and opinions of NUS.