Days Sales Outstanding: What Is It and How To Calculate It

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Ask any business owner, and they'll tell you that of all the things needed for a business to survive, the most important one is cash.

Even if your financial statements show a healthy bottom line, if cash flow isn't consistent, the odds of your business surviving drop.

But how do you know how much cash to expect?

While smaller businesses may be able to predict incoming cash, it’s an impossible task for larger businesses with hundreds or even thousands of customers.

That’s why many CFOs and accounting managers use Days Sales Outstanding to determine how quickly their customers pay their invoices.

What Is Days Sales Outstanding?

Days Sales Outstanding or DSO is an accounting ratio used to determine how quickly your credit customers pay you by measuring the average number of days that it takes to receive payment.

Similar to the accounts receivable turnover ratio, businesses can measure their DSO monthly, quarterly, or yearly, though a yearly calculation may not be frequent enough for businesses with a high number of credit sales.

This metric can be particularly helpful for newer businesses or businesses that have limited cash flow since it can alert business owners to potential cash flow issues.

Before we calculate DSO, let’s review some accounting terms that are directly related to DSO.

- ## Accounts Receivable

  Accounts receivable are what is owed to you by customers that have purchased goods or services from your company on credit.

  While a healthy accounts receivable balance is good for your net income or bottom line, if you’re not regularly collecting on those customer balances, your cash flow will suffer.

- ## Cash Conversion Cycle

  The cash conversion cycle, or CCC, measures the time it takes to convert inventory and supplies into cash.

- ## Cash Flow

  Cash flow is the amount of money that flows into and out of a business. Monitoring cash flow is particularly important for businesses that have a traditionally low cash flow balance.

- ## Credit Sales

  Credit sales are sales made to customers with specific terms attached. Once customers qualify for credit, they are provided with specific payment terms that they must adhere to including a due date.

All of these terms play an essential role when determining your company's DSO.

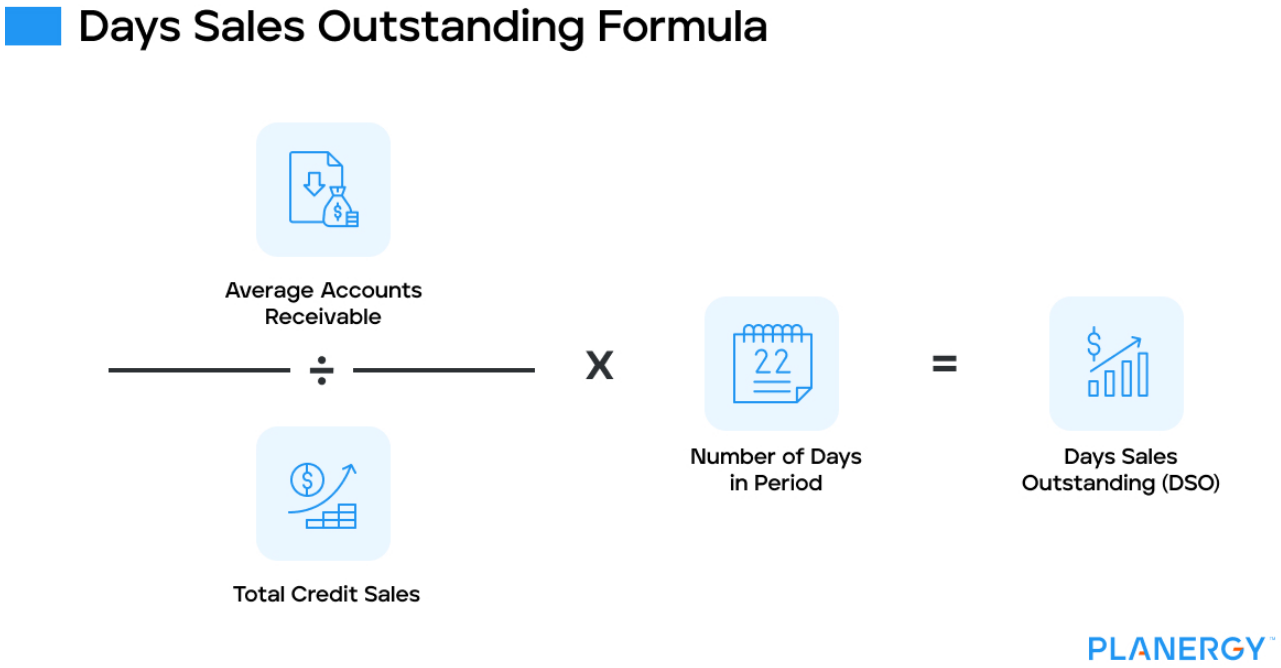
What Is the Formula for Days Sales Outstanding?

Days sales outstanding are calculated by dividing the total accounts receivable for the time period by the total credit sales for the period, divided by the number of days in the period.

This total is then divided by the number of days in the period in which you calculate DSO.

For instance, if you're calculating DSO for the month of July, the total number of days would be 31.

(Average Accounts Receivable / Total Credit Sales) x Number of Days in Period



Below are step-by-step instructions for calculating DSO.

How Do You Calculate DSO?

The DSO formula is simple, though there are some preliminary steps that will need to be completed before calculating.

1. ## Determine the Given Period of Time You Wish To Include

   Some businesses may find it sufficient to calculate DSO quarterly, but for businesses with a high volume of sales, a monthly calculation may be more helpful.

2. ## Calculate the Average Accounts Receivable for the Chosen Period

   The easiest way to calculate your average accounts receivable balance is to refer to your beginning and ending AR balance for the period you're calculating.

For example, if you're calculating DSO for the first quarter of 2023, you would obtain your January 1 AR balance and your March 31 AR balance from your balance sheet.

Once you have those balances, you'll just add them together and divide them by two.

Let's say your January 1 balance was $750,000 and your March 31 balance was $850,000. You'll add those two together and then divide it by two to find your average AR balance for the period.

($750,000 + $850,000) / 2 = $800,00 Average Accounts Receivable

Knowing your average AR balance allows you to move on to the next step.

3. Calculate Net Credit Sales for the Period

You can obtain your net credit sales from your income statement.

Though you may offer various payment methods for your customers, you're only using credit sales in the calculation since cash sales have a DOS of zero.

Let's say that your gross credit sales for the quarter were $195,00, with returns of $15,000, and discounts of $10,000.

To calculate net credit sales, you'll use the following formula:

Gross Credit Sales – Returns – Discounts – Allowances = Net Credit Sales

$195,000 – $15,000 – $10,000 = $170,000 Net Credit Sales

4. Calculate the Number of Days in the Period

To complete the DSO calculation, you'll need to know the number of days for the period. If you're calculating the first quarter of 2023, your days would be:

- January – 31
- February – 28

- March – 31

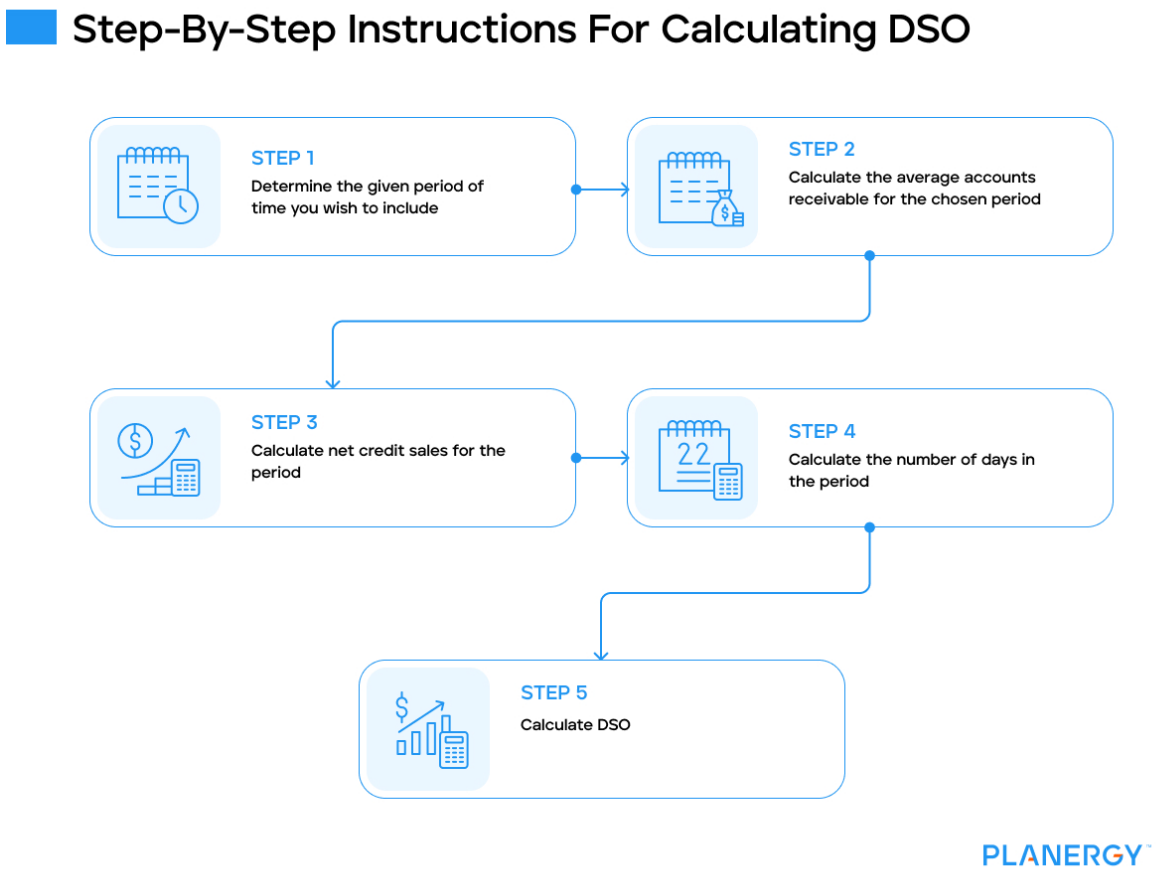
That gives you a total of 90 days for the quarter

5. Calculate DSO

Using all of the numbers from steps 2 through 4, you can now calculate DSO for your business using the days sales outstanding formula.

($80,000 / $170,000) x 90 = 42 days

The result means that it's taking your business an average of 42 days to collect payment on outstanding credit sales.



But what does that result mean?

Is a Higher or Lower Days Sales Outstanding Ratio Better?

Knowing how to calculate your DSO is an important first step in managing your business finances, but it's vital that you understand the results of your calculation.

Is a higher or lower result better? Let's explore both.

- ## Low DSO

  On the surface, a low DSO means that you're collecting payment on your credit sales quickly.

  But digging a little deeper, a lower number also points to a more efficient vetting of your customer's creditworthiness, as well as a good collections process.

  However, a low number does not always equate with efficiency. An abnormally low number can also point to a too stringent credit policy, where the company is only selling on credit to a very limited number of customers.

- ## High DSO

  A high DSO indicates that it's taking longer to collect money from credit customers. That can be due to a number of reasons including offering credit to poorly qualified customers.

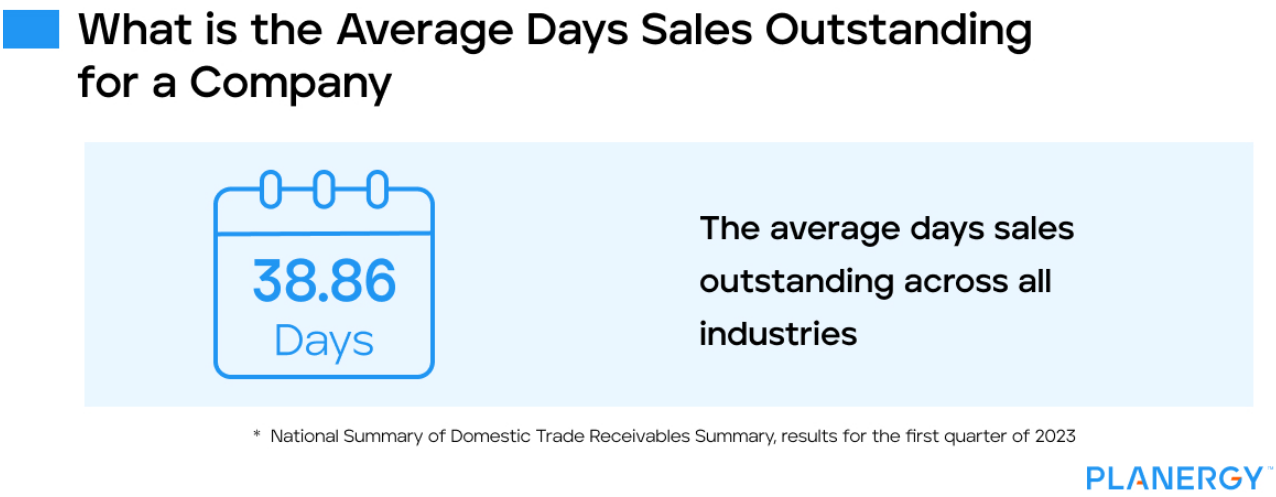
  A higher DSO can also indicate that the proper collections procedures are not in place. However, a higher DSO can also mean that you're offering your customers more generous credit terms, making them unlikely to pay early.

  No matter the result, it's essential to consider all of these factors when calculating your DSO before you determine whether it needs to be improved.

What is the Average Days Sales Outstanding for a Company?

According to the National Summary of Domestic Trade Receivables Summary results for the first quarter of 2023, the average days sales outstanding across all industries is 38.86.

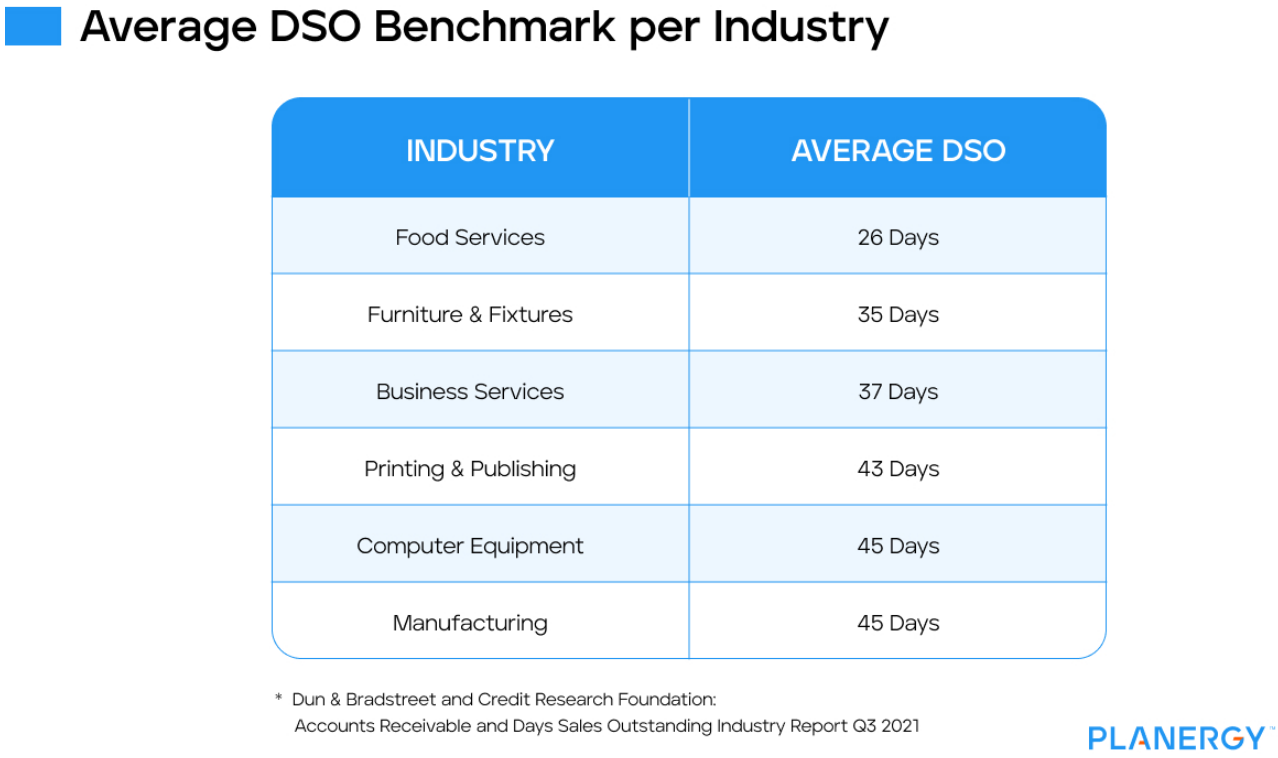
This means it's taking almost 39 days on average for a company to collect on its accounts receivable.



However, different industries do not have the same average DSO, which is why it's important to only compare your DSO results to those of similar companies.

The following is a sample of the average DSO benchmark per industry.

Industry	Average Days to Collect on Credit Sales
Food Services	26 Days
Furniture & Fixtures	35 Days
Business Services	37 Days
Printing & Publishing	43 Days
Computer Equipment	45 Days
Manufacturing	45 Days



This is just a brief sample of how DSO can vary between industries.

What Are the Benefits of Calculating Days Sales Outstanding?

If you offer credit terms to your customers, it's vital that you know how quickly they're paying their debt, which DSO can do.

Regularly tracking DSO results can also provide insight into other important areas of your business such as cash flow and customer satisfaction.

DSO can also signal a potential issue in your accounts receivable processes such as the lack of prompt follow-up on past due invoices and flagging of customers that always make late payments.

What Is the Relationship Between DSO

and Profitability?

Your DSO can directly impact both cash flow and profitability.

Cash flow is directly impacted by a high DSO, since the longer a debt remains on the books as an accounts receivable balance, the less cash you'll have flowing into your business, which can result in cash flow problems.

With a lower DSO, your customers are paying you quickly, increasing the amount of your company's cash flow.

DSO also impacts profitability as well. In many cases, the longer an accounts receivable balance remains on your books, the more difficult it becomes to collect on it.

Once a debt become uncollectable, it's usually written off as bad debt, which can negatively impact your profit margin.

How Can You Lower Your DSO?

If your days sales outstanding is too high, there are some steps you can take to lower it.

- ### Measure It Against Similar Companies

  Before you begin reviewing accounts receivable processes, it's important that you measure your results against those of similar companies.

  For example, if you're in an industry that has an average DSO of 50 and yours is 47, then even though it's higher than the average DSO of 38, it's still in the normal range for your business.

- ### Focus on Customers

  In most cases, a high DSO starts with your customers. Is your credit department adequately screening customers before offering them credit? Are the credit terms a good fit for them?

While there can be a problem with lax credit standards, you can also go too far and stop offering credit to all but the most stellar customers, with either stance likely to hurt your business.

Review Payment Processes

Are you giving your customers enough ways to pay? If the only way to pay an invoice to your company is by sending in a check, you're more likely to wait for that payment.

Providing your customers with incentives to pay early and easily can quickly lower your DSO.

Review Invoicing Processing for Delays

Timely invoicing plays an important role in getting paid on time. If your sales department is slow in invoicing customers, or sending invoices with errors, there will be delays in receiving payment.

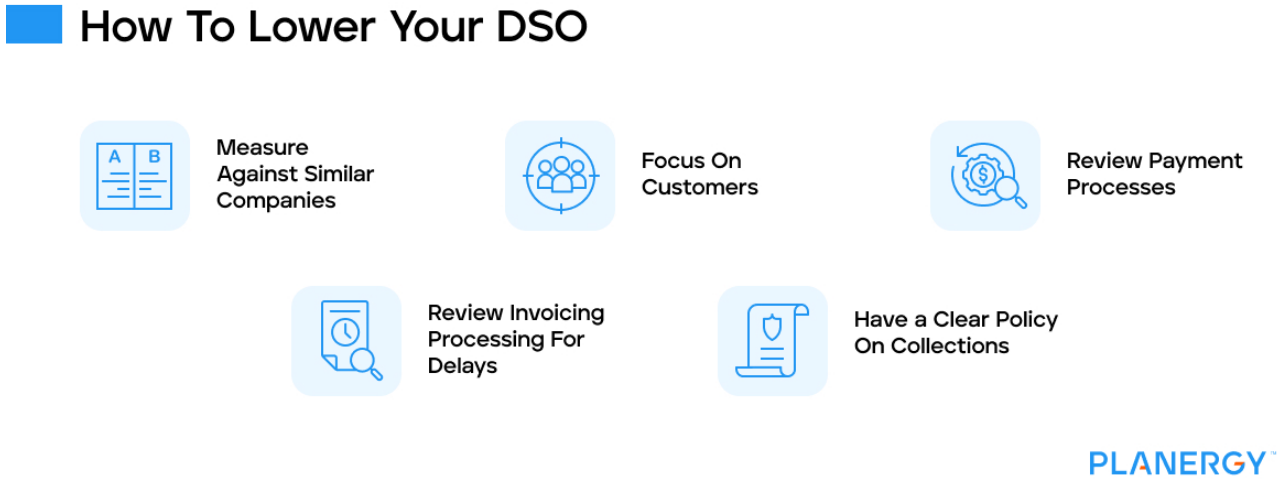
Do a thorough assessment of your billing department and make sure that invoices are sent to customers promptly.

Have a Clear Policy on Collections

There should be set guidelines in place for the proper handling of unpaid invoices, including establishing a collection period.

Guidelines should include when a customer should be contacted regarding payment, when to set up a payment plan, and when the balance should be turned over to collections.

These guidelines should also include details on handling an uncollectible balance.



How Do You Use Days Sales Outstanding To Calculate Cash Flow Conversion?

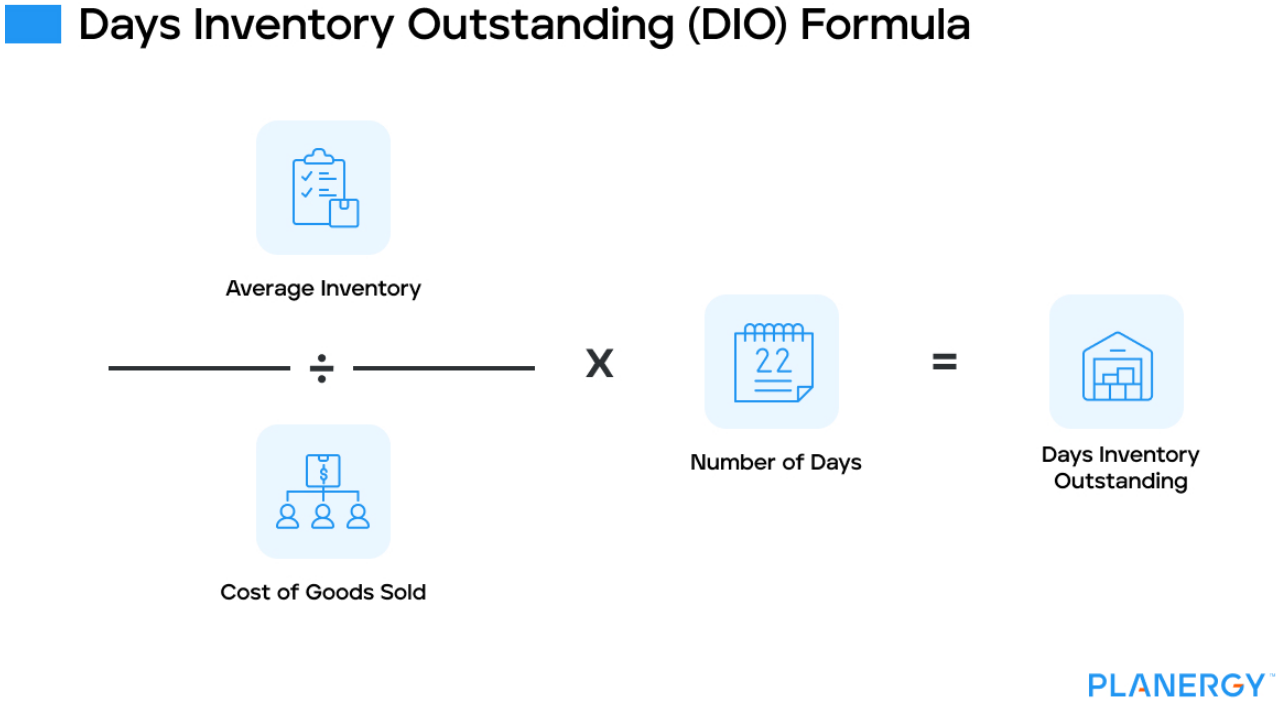
Aside from calculating days sales outstanding as a way to measure debt collection, the metric is also used when calculating the cash conversion cycle or CCC.

A more in-depth metric, the CCC measures the time it takes to purchase goods or materials, turn them into a saleable product, sell the product, and collect the payment from the sales.

The cash conversion cycle first measures Days Inventory Outstanding, which is measured similarly to DSO, only using inventory totals instead.

The formula for calculating DIO for the first quarter of 2023 is:

(Average Inventory / Cost of Goods Sold) x 90 days = Days Inventory Outstanding



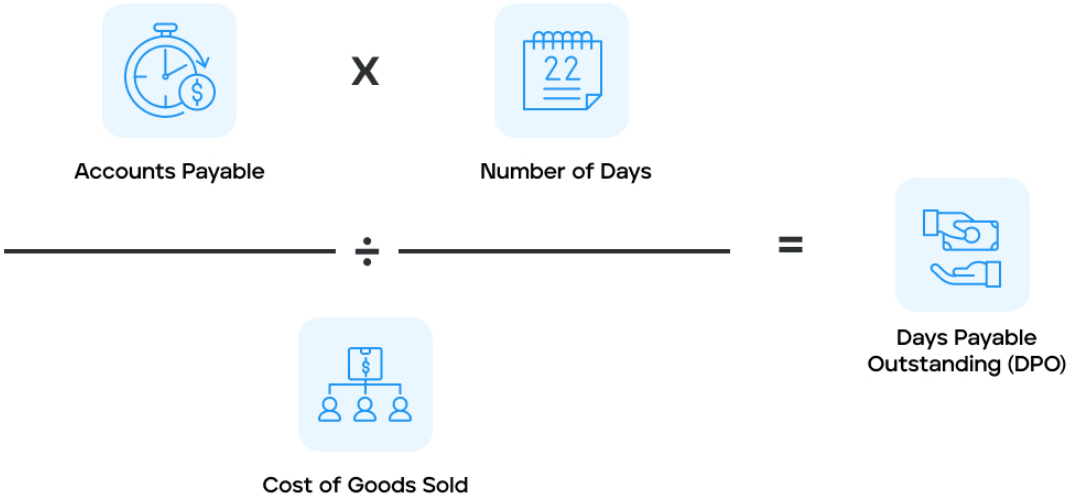
You'll also have to calculate Days Payable Outstanding or DPO, which measures the amount of time it takes to pay your suppliers and vendors.

You'll use the beginning and ending accounts payable balances to calculate your average accounts payable, which is needed to complete the calculation.

The formula for calculating DPO for the first quarter of 2023 is:

(Average Accounts Payable / Cost of Goods Sold) x 90 = Days Payable Outstanding

Days Payable Outstanding (DPO) Formula



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Now that you have DIO, DSO, and DPO totals, you're ready to calculate the cash conversion cycle.

Days Inventory Outstanding (DIO) + Days Sales Outstanding (DSO) – Days Payable Outstanding (DPO) = CCC

Cash Conversion Cycle (CCC) Formula

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While measuring DSO provides needed insight into accounts receivable process efficiency, CCC measures efficiency across business operations.

Should You Calculate the DSO Value for Your Business?

The DSO ratio is one of the simplest accounting ratios to calculate. Various profitability ratios, liquidity ratios, activity ratios, and solvency ratios have their own benefits to calculate regularly.

Knowing and understanding your days sales outstanding metric can give you better insight into company performance and financial health.

It can also help you evaluate the current efficiency of your accounts receivable and credit department.

Using automation is the best way to calculate your DSO, though you can also use Microsoft Excel to calculate it manually. Whichever way you use, there's no good reason not to calculate your DSO.

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