How to Realize Capital Improvements by Automating Your Collections Process

Here's What You'll Learn

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The Big Black Hole

Virtually every challenge facing corporate finance stems from a lack of visibility. Whether you're dealing with regulatory compliance, consolidating information from various business units or patching together data from multiple computer systems, greater visibility makes it easier to overcome these challenges.

Nowhere is the need for financial visibility more important than in accounts receivable (A/R) management. In today's corporate environment where every risk must be identified and quantified, A/R is more likely to resemble an insatiable black hole that's swallowing your limited resources than a stellar source of power that's driving your working capital needs.

The increased visibility of your accounts receivable is sure to reveal both the good and the bad: opportunities for maximizing customer profitability and increasing cash flow as well as sources of profit dilution and risk.

There is a single most common reason that companies struggle with the performance of their A/R: Inadequate information systems. In particular, most Enterprise Resource Planning (ERP) and financial software systems force collectors to rely excessively on manual, clerical tasks such as retrieving documents from and recording information in a multitude of data caches. The result? Collectors spend way too much time trying to bridge islands of information — instead of contacting delinquent accounts.

Further productivity gains result from better task management and an ability to share information amongst colleagues and customers that are geographically dispersed. These gains translate to a lower cost to collect, better collection coverage and increased cash flow.

The returns from investing in credit and collection software that facilitate workflow and transactional transparency can be enormous. Within just three to six months, most companies can expect at least a 25 percent reduction in past-due balances and a 10 percent decrease in days sales outstanding (DSO). The resulting future expansions of credit capacity and reductions in bad debt write-offs are ongoing bonuses when it comes to real profit improvements.

Critical Success Factors:
Visibility
Compliance
Productivity
Liquidity

The Costs of Decentralized Receivable Data

Several factors can limit your A/R visibility, but one of the most common is decentralized information systems. Whether you are dealing with independent business units, distributed operations, international operations or multiple ERP or legacy A/R computing systems, it can be very difficult to achieve the required visibility across your entire receivable portfolio.

Inconsistent Standards Among Distributed Operations
In the case of distributed operations, most organizations have neither the visibility nor the processes in place to enforce their service operations to fully comply with company policies. Lacking the leverage needed to ensure that service operations meet consistent standards, countless disputes are generated that eventually flow to the collection process, where they consume an inordinate amount of time and overhead.

Multiple Systems Produce Islands of Information
Another common obstacle stems from having multiple ERP or legacy A/R systems. It's extremely difficult to get a good view of your receivables when you have to look up information that resides on different computer systems. This is a particular problem when there's been a merger or acquisition since the two entities are often running different software systems.

Companies with independent business units face a similar situation. With each organization running its own computer systems, even when they are all using the same software, corporate staff is unlikely to be able to view accounts receivable detail in a consolidated format. And, firms with dozens of independent business units selling different products to the same customers rarely have more than scant information about their combined credit exposure to even their largest customers. When A/R data is spread across multiple islands of information, concentration risks often go unnoticed.

Multiple Currencies Exacerbate the Problem

International operations and companies dealing with multi-currency situations often face circumstances similar to those caused by multiple systems. Lacking a currency-translated view into their receivable portfolio, they cannot see the big picture and will thus be unsure about where they stand and any progress they may be making.

Many Systems Set Limitations

To make matters worse, most ERP and legacy A/R systems don't provide the tools needed to track payment promises and trends. So, on top of the difficulty of reviewing a customer's status across multiple business units, most individual systems provide only static and limited insight into the status of individual accounts.

Dynamic information is, of course, much more valuable. It is extremely difficult to prioritize, much less optimize, your collection efforts when you cannot see your receivables from various perspectives. What have you collected so far? What has been promised? What is likely to be paid on time without further intervention? And what could be collected if extra efforts were made? Cash flow projections are no better than ballpark estimates under these circumstances. And taking steps to change the outcome is often a hit-or-miss proposition.

Regulatory Compliance Challenges

Corporate governance and regulatory compliance issues continue to make business news headlines. So it should come as no surprise that revenue and corresponding accounts receivable processes are receiving greater scrutiny than ever before. As public corporations and their finance departments continue to digest the developing implications of the Sarbanes-Oxley (SOX) legislation, they are learning more about how it affects their receivables — especially their invoice accuracy, process documentation, deduction handling, portfolio risk management and bad-debt reserve calculations. And private companies aren't off the hook either, just because they are not currently covered by SOX. Many pundits are predicting that state legislatures will soon be imposing SOX-like regulations on the private sector too.

Here are some components a collection software solution must have to help improve accounts receivable performance.
Consolidated information
Integrated A/R, tickler and notes
A configurable collection strategy engine
Automated work queues
Built-in communication tools
Online access to documentation
Online reporting and analysis
User configurable alerts

Make Your Invoices Accurate

Invoice discrepancies are a much bigger problem than most corporations realize. Not only are inaccurate invoices paid much more slowly than clean invoices, but they also create huge amounts of work that produce little, if any, benefit. Moreover, companies that engage in activities that result in invoices being cancelled and re-billed at a later date (a regular month-end practice at some firms) will find themselves not only in trouble with their customers, but also under the scrutiny of regulators.

By making sure that your order fulfillment process is in alignment with your customer contracts and by paying attention to order details (everything from the address, to the bill of materials, to the terms), you can significantly increase your invoice accuracy. To do that, however, you will need to have visibility into all the information that flows from the point your orders are received through to your invoicing process.

Document Your Collection Process

You also need to make sure your collection process is well documented. This is easier to do when you have a clear view of your transaction process. Without this visibility, there is no assurance that your collection efforts are either effectively or comprehensively addressing the risks inherent to your receivables portfolio. Using an automated system driven by collection strategies — ones that have been applied to specific types of accounts — you'll have a high degree of confidence that your staff is appropriately contacting all past-due accounts.

The same holds true for dispute handling and deduction processing. Deductions and other payment discrepancies can significantly dilute your profits. The approval of credits and other adjustments, the identification and processing of debits and the time it takes to clear disputed items are the issues here.

An automated system can ensure that you are properly addressing each type of discrepancy in a timely manner. With no visibility into the items in process, you can't tell what kind of impact they're having on your receivables. And, unless your deduction handling process is well documented, what kind of assurance could you have that these issues are being handled properly? And how can you be sure you're in compliance?

Identify Your Risks

Your billing and collections processes may actually be the cause of risk to your accounts receivable. However, only when you can identify these risks can you treat your A/R as a portfolio.

Ultimately it's a matter of managing exposure. To help avoid credit risk, you must be able to identify those accounts likely to pay slowly and those likely to fall into bankruptcy or otherwise default. You also need to be able to identify customers with multiple accounts that might pose greater risks. And, when customers in the same industry reach critical mass within your receivable portfolio, you're facing a concentration risk.

If your systems can't give you visibility into every single one of these issues, you won't be able to clearly see the entire picture. And, when you can't see the entire picture, you can't accurately forecast your bad debt reserve requirements. A system that provides full visibility into your receivables will greatly facilitate your auditors' ability to test the system and verify your reserve calculations. Furthermore, lacking solid intelligence about your receivable portfolio risks, you will need to take a larger bad-debt reserve to cover the greater margin of error caused by the uncertainty.

Here are the most critical problem/ deduction tracking functions a software solution must be able to perform.
Isolation of problems and disputes
Identification of recurring issues and reasons for occurrence
Quantification of problem types
Formulation and implementation of proven workflow solutions
Tracking contacts with internal and external customers
Escalation of items to a supervisor if not resolved within parameters
Shorten resolution and cycle times

A strong collection process can provide controls to identify revenue recognition issues. Lacking such control could be the root cause for having to do a revenue restatement in order to attain regulatory compliance. This can be a disaster, resulting in a reduced company valuation, a weakened corporate image, lost customers and low employee morale. Its role in erroneous revenue forecasts can bring about shareholder lawsuits, lower profits and reduced cash flow due to lower sales and inflated expenses. An effective and comprehensive accounts receivable collections process can make a huge contribution to achieving regulatory compliance.

Information Powers Change

Most credit departments are sitting on a wealth of customer and operational data. Unfortunately, it's difficult to obtain actionable intelligence from this data because it is accessible in neither a unified nor organized manner. In fact, the lack of credit and collection utilities offered by your ERP or legacy A/R system means that most of your credit and collection activities have a strong manual component and are highly individualized. Your credit and collection staff is gathering lots of information but, to a large extent, everybody is doing their own thing. This makes information sharing, much less data consolidation, extremely difficult.

Improving Your Processes

A fully automated collection and dispute resolution process collects a wealth of data you can use to not only enhance your customer intelligence, but also to identify and address the weaknesses of your process. You can use the data collected by an automated system for many process improvements, including exception monitoring, cycle time enhancement and workflow reorganization.

In a very real sense, how your customers are paying is indicative of your operational effectiveness. Payment problems are much more likely to be administrative in nature than a consequence of credit risk. Since most companies' systems are not capable of deriving actionable intelligence about their operations from their collection processes, they are destined to repeating the same mistakes and compounding the problems created by their systems' weaknesses.

Easy Access to Documentation

You can't have transactional visibility (process awareness) without material information and the supporting technology to deliver it. Different industries and markets will have unique needs. For instance, many service operations won't require proofs of delivery, but they will all need access to service contracts, service logs and work orders. In contrast, companies in any type of supply business will benefit from online access to proofs of delivery since questions about this issue are at the root of many customer objections.

The objective is to remove all the non-payment excuses customers may bring up. With automated systems, invoice, shipping and cash receipt details are all available through a single interface. Related document images such as invoice copies, remittance advices and proofs of delivery are also just a mouse-click away. Effective automated systems also support notes that users enter regarding each transaction to promote resolution and collaboration. In these circumstances, there are very few issues a customer might raise that a collector cannot readily address.

The Benefits of Transactional Transparency
Improved decision making - faster and better
More productive internal and external communications
Much shorter cycle times
Lower transaction costs
Improved customer support and satisfaction

Visibility Gives Rise to Improvements

Transactional transparency is critical to process improvement from two standpoints. Visibility makes transaction processing easier and, in most cases, makes cycle times shorter and work more accurate. And, it makes it easier to see where your process isn't functioning as well as it should be. Some situations actually produce errors and other undesirable outputs. Some cause bottlenecks that slow the entire system down. In either case, being able to more readily identify system weaknesses gives you an opportunity to implement system solutions that generate substantial process improvements, transaction after transaction.

Keys to Greater Effectiveness

At the core of any receivables solution is the issue of knowledge management, and centralizing your A/R data is a key factor here. Once this is accomplished, your data needs to be enhanced. You can do this by collecting supplementary data elements that add value to your knowledge base and then integrating the database with tools that can help you analyze it.

Use Customer Intelligence to Improve Your Collection Process

There are three primary types of customer information that will add value to your collection process. The first is customer contact information. While ERP and legacy A/R software systems do contain contact databases, the number of contacts you can maintain per account is typically limited, a problem that's exacerbated when the contact database must be shared with others.

Collecting and resolving disputes can involve interacting with a large number of your customer's principals and intermediaries. So to be effective, your automated collection process users need access to the full details (name, location, title, department, phone, fax, email and so forth) for many contacts per account. When this information isn't readily available, considerable time can be wasted trying to re-identify a person who can resolve the situation.

Second, customer information needs to be collected during every customer interaction. Activity logs and call notes provide valuable insight into your customers' behavior. Customer comments, your collectors' observations and the activity logs also provide information you can use to identify tendencies and trends. Then it can all be translated into actionable intelligence you can use to improve your collection process.

And third, add external information sources to your centralized A/R database. In particular, credit bureau data is an excellent adjunct to any A/R database. Then you can use information in your enhanced database to create credit scores — and gain analytical capabilities and a variety of operational enhancements. Public records ranging from SEC filings to news articles will also give you a more rounded view of your customers.

Leverage Reporting Tools to Measure Cycle Times

Measurement and reporting tools are also vital. To draw real intelligence from your enhanced A/R database, you need good reporting tools. And, when they are integrated with communication tools such as your fax, email, customer self-service portals and auto-dialers, it's much easier to share information. Reporting tools let you monitor your collection and dispute resolution processes and manage exceptions. The ability to monitor cycle times, in particular, adds tremendous value.

Before you can measure cycle times, however, you need to define your critical metrics. Things such as the number of days past due, the amount past due, the time passed since the last contact, a dispute code, the credit risk and any orders pending can all serve as triggers that are tied into cycle time. Either the account status or an event could trigger the system to schedule an action (who to contact and when) and retrieve the associated information.

One of the great strengths of automated systems is their ability to identify issues. By making reason analysis easier (what needs to be fixed?), they also make it possible to identify process weaknesses, customer shortcomings and staff deficiencies. And by highlighting areas of weakness much earlier than is typically possible with traditional systems, you can also avoid much bigger problems later.

Use Collaboration to Get the Big Picture

Once any issues are identified, they need to be resolved. The advantages an automated system provides here are collaborative tools. By removing credit, sales, order fulfillment and customer data from functional silos and sharing it with all interested parties, everybody gets to see the big picture and contribute their expertise along with any additional documentation they might have in their possession to bring the collection matter to a speedy resolution.

In this kind of automated credit and collection environment, information is delivered to each user's desktop. Instead of relying on printed collection reports, user-defined dashboards and account management computer screens play the most important role. No longer limited by static paper-based reports, information and its analysis will be more dynamic.

Greater Focus Makes You More Effective
One way you can achieve real dynamism is by assigning your staff specialized roles. Automation provides the empowerment and, in turn, specialization adds even greater efficiency. Specialization can be based on the type of accounts (things such as size, deduction volume, distribution channel, market type) as well as account status (things such as days past due, scheduled action, risk). The advantage here is that more focused, expert work will be performed, which ultimately translates into productivity gains.

Specialization helps you match collection efforts with accounts. Workflow is improved when you focus people with specialized skill sets on the appropriate roles. Having deduction analysts resolve disputes is more productive than having collectors focusing on this lower-value activity to the detriment of their primary collection responsibilities. Similarly, it makes better sense to have your experienced collectors calling on your larger and longer past-due customers, while your junior-level collectors concentrate on making soft calls to your smaller, recently past-due accounts.

Dynamic accounts receivable management solutions help you realize benefits in seven ways by:
Increasing your collection velocity
Lowering your transaction costs
Managing your receivable portfolio
Leveraging your sales process
Maximizing your financing eligibility
Complying with regulations
Improving your customer service

Realizing Capital Improvements

What are the bottom line benefits of automating your collections and dispute resolution processes? Increased cash flow — with less profit dilution, because implementing the kind of receivables management solution discussed in this paper is essentially an investment in your ability to raise capital. But how do you get there?

Technology is the ultimate enabler when it comes to dynamic accounts receivable management solutions. When you leverage technology to improve your information relevancy and timeliness, you can turn data into information and information into actionable intelligence, thereby creating value. By leveraging technology to facilitate workflow and transactional transparency — providing clear visibility of both individual customers and your entire receivable portfolio — you can create a collaborative framework, supported by workflow tools that can radically improve your credit and collection performance.

Collection Velocity
First, by organizing whom, how and when to contact customers, your collection team will not waste time on unnecessary or low-reward efforts. This means a more structured collection process. Automated collection strategies, follow-up actions and promises to pay add discipline and structure. Second, by providing your collection team with all the information they need, in one place, to mitigate a customer excuse or resolve a dispute, your collectors and their support team will spend less time looking for answers.

This reduces your collection cycle time, thus you will pull in cash faster and more efficiently. You'll have more available cash to run your business just by increasing your velocity.

Moreover, speeding up your collections will give you a commensurate decrease in your DSO, which translates to lower carrying costs. In fact, most companies that implement an automated collection solution achieve roughly a 25 percent decrease in past-due receivables — within the first few months. The cost to carry accounts receivable on your balance sheet is either the weighted average cost of capital (WACC) or the opportunity cost of investing in the business, whichever is greater. Do the math and get a quick estimate of just the short-term benefit of automating your company's collections.

Transaction Costs

A fully automated receivables solution will generate improved results with a smaller staff. And when the system is configured to take advantage of the specialized skill sets your staff brings to the equation, productivity is raised all the more.

Ready access to information also provides both direct and indirect savings. It will translate into better decisions that impact both performance and costs. And higher information visibility ultimately lowers your transaction costs by promoting greater efficiency and shorter cycle times.

What's more, greater collection efficiency will increase your available cash. Inefficient collection processes raise operating costs and trap your cash in receivables. Improving your collection efficiency reduces your order-to-cash cycle times and improves your cash flow. It also provides more cash to operate and grow your business, reducing your reliance on borrowing and equity transactions.

Portfolio Risk

Just by reducing your past-due exposure, you will also reduce the risks you are carrying in your receivables portfolio. Automating your receivable processes enables you to take a more sophisticated approach to credit line management. Making it easier to identify your account level risk and being able to monitor your risk at the portfolio level ensures that your approach to risk classification is more consistent. And, you'll be able to identify changing risk patterns much earlier than you could with your ERP or legacy A/R system.

Sales Activity

Having a better handle on risks — identifying them sooner and remediating them more effectively — provides lift to your sales process in several areas. With greater visibility into customer credit, your sales staff can focus on customers that are worthy of more credit, while spending less time on higher risk accounts. When they can see a customer's A/R status, they are much more likely to spend time on customers with available credit. The likely result is an increase in repeat sales to lower risk customers. By the same token, your sales staff is less likely to waste time and effort on high-cost accounts when customer credit information is readily accessible.

Financing Eligibility

Fully automating your receivables process also makes your A/R a financing security asset. Perhaps the biggest hindrance to securitization is the inability of the loan applicant to provide a complete risk profile of the A/R in question, from both micro and macro perspectives. Automated systems provide access to the necessary information and analysis that can overcome this obstacle.

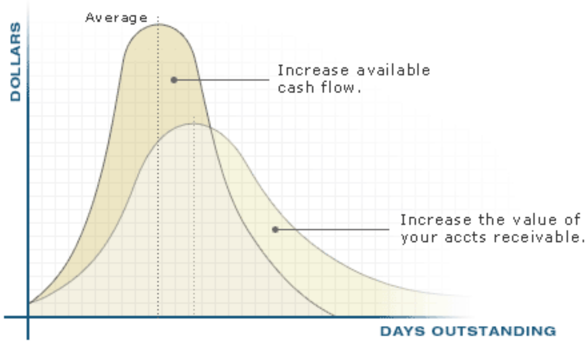
Even within a straightforward lending environment, credit and collection software can provide much more detail than is typically required by lending institutions. Typically there are three bank reporting requirements for an asset-backed loan:

1. A month-end, aged-receivable trial balance

2. A corresponding exception list tallying the total due from accounts with balances extending beyond 60 days past due

3. A top 50 (or 100 or more depending on the portfolio) list of the largest customers

When you accelerate your cash flow, more closely and comprehensively monitor risk and better leverage your sales efforts, you can also reduce your A/R rollover. The better the quality of your receivables, the fewer receivables will roll over from current to past due and from aging bucket to aging bucket. Because the valuation of receivables drops precipitously with age (studies show that a 90-day past due is worth 30 percent or less than its original value), reducing your rollover has significant advantages.



Reducing rollover helps companies improve the financing eligibility provided by their accounts receivable. Lenders typically exclude all receivables on all accounts with even portions of their receivables more than 60 days past due. By reducing rollover in general and using tools that let you focus your efforts on accounts at risk of being classified ineligible, collection software can help you increase your available credit line on receivables-based, asset-backed loans.

An automated receivables system can provide your lenders a much more detailed analysis of your receivable portfolio status. And that can translate into a higher percentage being lent against eligible accounts at lower rates.

Regulatory Compliance

Whether it's administering credit policy, issuing accurate invoices or handling past due accounts, automated receivable solutions can help you ensure process consistency. These solutions provide the visibility and collaboration necessary to monitor the accounts receivable process and maintain control over the process. It's a combination of process consistency and the consistent use of controls that result in regulatory compliance.

Customer Service

Last but not least is the considerable savings derived from a significant increase in customer satisfaction. If your collections staff can build rapport with their customers, and maintain healthy working relationships, they will be much more effective when they try to work with customers that are past due. If you are proactive and contact your customers early in the collection process, with a sense of customer service, you will be more likely to build positive working relationships.

When you can align people, processes and technology, you not only spark productivity, but you also make it easier for everybody to work together. Being easier to do business with than your peers can deliver a substantial competitive advantage. And the value of that asset is priceless.

A Measurable Return on Investment

There are many benefits to a fully automated receivable process and the unique attributes of each business will determine the magnitude. But it is clear that in order to realize capital improvements, a business must invest in technology to create visibility, increase productivity and generate liquidity.

Such investment typically pays for itself in as little as 2 to 3 months — definitely a return on investment that can be easily measured.

About the Authors

George Sprenkle
Chief Executive Officer
ezBackOffice, Inc.
www.ezbackoffice.com

George Sprenkle is the Chief Executive Officer at ezBackOffice, an application software firm he co-founded in 2000. ezBackOffice specializes in innovative web-based receivable management systems and solutions. George has more than 20 years of experience in the realm of finance and a strong international background that includes asset management and systems implementations.

Most recently, George has helped several start-up companies with their financial planning and infrastructure deployment. Previously he was CFO of Gentia Software, PLC, a multinational firm providing analytical applications to Fortune 1000 clients. He also worked at Unisys Corporation (and its predecessor, Burroughs), a $7.5 billion integrator of hardware and software systems, where he held key positions in their financial organizations.

George graduated from Temple University with an undergraduate degree in Business with a field of concentration in Accounting and Finance. He is a CPA and currently chairs the audit committee for Moro Corporation.

David Schmidt
Principal
A2 Resources
www.a2resources.com

David Schmidt is an active principal at A2 Resources, a commercial credit consulting firm that specializes in process improvement and cash flow optimization with a focus on software evaluation and consultation. Before founding the firm in 1994, David had spent 17 years in the field of corporate credit management in a variety of roles. He began his commercial credit career in 1976 as a business analyst with Dun & Bradstreet after graduating from the University of Michigan.

As a thought leader in the credit and collection industry, more than 100 articles written by David have been published in a variety of business and trade publications. He is also a contributing editor for the Business Finance Magazine and the monthly newsletter, Credit Today, and writes a bi-monthly column for Collection Advisor Magazine. David is also a co-author of the seminal text on automating collections, "Power Collecting: Automation for Effective Asset Management." (1998, John Wiley & Sons, New York, NY).

A member of the Credit Research Foundation (CRF), the New York Credit & Financial Management Association (NYCFMA) and the National Association of Credit Management (NACM), David has served as director of his local NACM chapter and chairman of industry credit groups. He has also presented workshops and spoken at both local and national conferences.

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