# *New Collection Analytics – Producing Greater Value within OTC (Order-to-Cash) Processes*

*By: Chris Caparon*

***Abstract:***

*Friar Luca Bartolomeo de Pacioli (1447–1517, Tuscany), was a contemporary, collaborator and teacher of math in Milan, Italy in 1497, to Leonardo da Vinci (1452-1519). Friar Luca is also considered to be the "Father of Accounting and Bookkeeping." He was the first person to publish a work on the double-entry accounting system and is credited with the accounting formula: Equity = Assets – Liabilities*

*Now, roll forward to 2017 and think of Friar Luca when you are calmly trying to explain, to your insistent customer, why they simply can't take another unearned discount off their already past due Accounts Receivable balance!*

*There is hope. Finance management is finding ways to "move the working capital needle" and they are changing how order-to-cash teams operate in very material ways with new and very different approaches.*

In this article we explore a topic: What is changing in how Collections Departments are measuring and managing their individual books-of-business and how they are finding more efficient ways to convert past due invoices into available Working Capital? I am willing to bet, that a guy who taught math to Leonardo da Vinci, would find all this new technology swirling around the 'balancing of books', five hundred years later, all quite fascinating and exciting.

Traditional "oldest & largest balance" collections approaches within order-to-cash (OTC) lifecycle management, are simply just not producing the results they used to, *or need to*:

> *"I am only covering 50% of my portfolio, there is simply too many things to do each day"*
> *"Busy-work is killing our team productivity and the ERP system is only making it worse"*
> *"If I have to provide just one more $125 invoice reprint…I am going to become a Friar"*

Old accounting and bookkeeping systems (*picture Friar Luca*) and OTC processes are being replaced because these legacy systems (*although better than green-bar ATB printouts, there are many of you who remember those days*) are outdated, inefficient, non-user-friendly, incomplete, inaccurate, don't take into account things which actually make invoice balances not due or overdue (e.g. Disputes, Earned Deductions, Credit Memos, RMAs, Workouts, Promises-to-Pay, Sales Promotions, Trade Funds Co-Op, Contract Terms,…etc.). Every one of those reasons creates what is referred to as "Dirty Receivables".

When *Dirty Receivables* happen (*every hour of every day*), the OTC teams can't trust the numbers they are seeing on their computer displays, which drives non-value-add activity, repetitive redundant hand calculations, manual efforts of every kind, spreadsheet extractions and pivot table runs. All of this "off-system" activity creates tremendous inefficiency, kills the team's capacity to produce and is completely non-scalable, non-replicable and produces unintended consequences results across OTC team functions.

Worse, if you use *Dirty Receivables* numbers on any type of Customer facing communications (e.g. Customer Self-Service Portal, Payment Reminders, Dunning Notices, Monthly Statement Summaries), you create customer dissatisfaction generating more high cost and resource capacity constraint, via all the increased inbound and outbound phone traffic. These self-imposed, high cost (time, money, Customer satisfaction) interactions are very counterproductive.

Basically, if you do not have an OTC productivity platform with an accurate and up-to-date single view of customer 'truth' (*harmonized and accurate data across parent/child hierarchies*) for your OTC teams to efficiently function and cooperate with interdepartmental constituents, your efforts are being undermined.

This legacy system *undermining effect* is especially true when it comes to adjudicating complex customer deductions/disputes. A classic example is the inability to create assignable internal Dispute Cases, particularly for things like the multiple small dollar deductions from major Customers, perhaps across hundreds (or thousands) of invoices.

What is found over and over again, is that major organizations (*not just in the Consumer Packaged Goods space anymore*) are perfectly fine with a single Dispute Case, which might cover potentially thousands of invoices/transactions…*provided* your Dispute Case has evidentiary back-up (*is well documented*) and the Dispute Case is auditable, compliant and created utilizing replicable methodology. This is especially true when complying with internal or Customer based SOX 404 fiduciary requirements.

The "**New Collections Analytics**", which is explored here and in a Credit Research Foundation Webinar, are much more refined than what you can generate from spreadsheets, and they are directly tied to producing greater value per order-to-cash (OTC) resource activity.

If you have read my articles, heard me speak at Conferences or on a Webinar, you know we call these individual resource activity FTEEs, or Full Time Employee Events (FTEEs). FTEEs take the form of any action an FTE does that consumes time. Be it an invoice reprint, a collection call, a dispute, etc., the goal of order-to-cash process is to maximize the working capital results/impact, or the value-per-touch of each FTEE. What moves the working capital (WC) needle for the CFO and Treasurer impacts and benefits everybody in your company….cash is the life blood of every business and you control what in many cases is the #1 line item on your company's Balance Sheet.

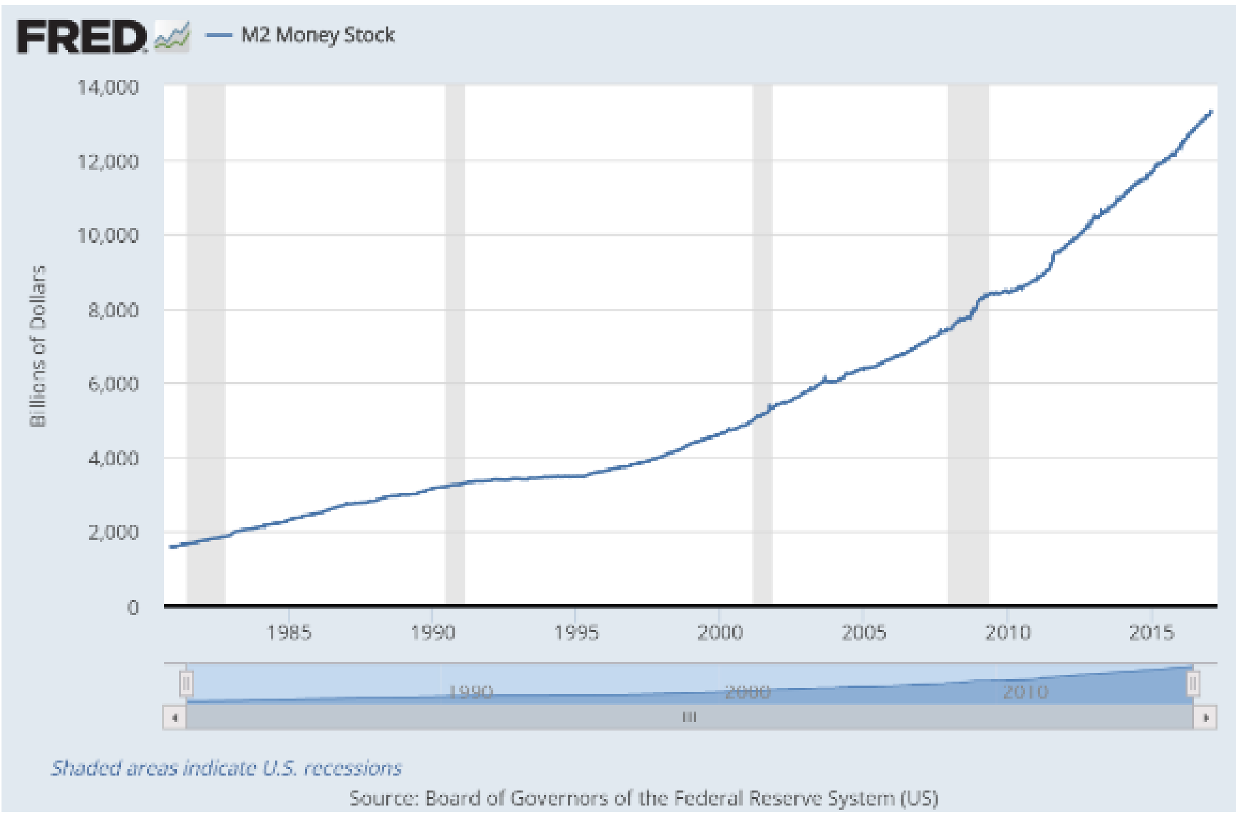
Some key concepts we will explore here and through CRF Webinars are as follows, but not limited to:

- Integrated OTC Metrics, Best Practice & KPIs at the OTC database level
- Better visibility and control over Parent / Child hierarchies and exposure
- Measuring *Days Since Last Touch* and what effect this has on Invoice Conversion
- How many times has that $250 invoice, versus the $25,000 invoice, been touched
- What is the DBT (Days Beyond Term) of the oldest *non-disputed* (clean) invoice
- Can I proactively give input to Sales like the *Days Since Last Order – Last Shipment – Last Payment*

We will explore each of these and what implications these and many other *New Collection Analytics* are having on OTC departments and the performance improvements they are realizing as a result.

First, let's look at the impact from a decade of Federal Reserve Monetary Policy, driving down interest and lending rates to "below market levels", by keeping the Fed Funds rate artificially low. Pile on top of this Quantitative Easing (QE), which started in Nov. of 2008 with QE1, then QE2 and finally QE3, all tolled US QE amounted to over $4.5T in Fed "purchases of financial assets" from financial institutions (*and added to US Debt*) by November of 2014. But, this also freed up (reserve ratios) lending by banks who just had debt burden taken off their books.

You can see the effects of basically creating US dollars "out of thin air" by looking at the accelerated M2 Money Stock (Supply) curve, from the US Board of Governors Federal Reserve System FRED chart. As of 02/06/2017, M2 amounted to $13.29T, up from $11.82T just one year earlier. That represents a 12.44% increase in M2 in just one year.




Here is a very interesting corollary. Look at the Hackett Group's "***2016 US Working Capital Survey and Scorecard***":

> "Last year, the 1,000 US companies tracked by The Hackett Group's working capital division borrowed another $413 billion, adding 9.3% to their overall debt level, even though cash on hand stayed essentially the same (up 0.4%).
>
> Today, these 1,000 companies are $4.86 trillion in debt, more than double their level of indebtedness in 2008."

There is a direct parallel of doubling corporate debt and doubling M2 growth over the same period. Naturally our patron, Friar Luca (*I assume being an inquisitive type*), might want to know…*is there a working capital downside to all of this amassing of debt?* Short answer: Yes

For the 1,000 companies Hackett tracks, the price these companies paid for debt accumulation came in "…the form of the worst working capital performance since the 2007-2008 financial crisis." Plus the key metric Hackett tracks, cash conversion cycle (CCC = DSO+DIO-DPO), is at 35.5 days, *the highest it has been since 2008*.

**"Lax working capital management habits learned in easy credit years are starting to take a toll"**

This is the opening sentence in the Hackett Group's "2016 US Working Capital Survey and Scorecard". The Hackett Group (NASDAQ: HCKT) is a global working capital consultancy and they create the working capital survey to share their benchmarking and best practices findings from global companies.

Like many of you, Hackett looks at "the four key working capital metrics: days sales outstanding (DSO), days inventory outstanding (DIO), days payables outstanding (DPO) and cash conversion cycle (CCC)."

If you think about it, there are really only three (3) working capital levers that a company can manipulate: Accounts Receivable, Accounts Payable and Inventory. Typically 60% of a company's working capital is tied up in Accounts Receivable (A/R). For companies with "light" Inventory, A/R is commonly the #1 item on their balance sheet.

Naturally, A/R is really where market leaders focus their time and attention, and there are some very interesting tactics companies are using to improve their ability to measure different things (*new metrics*) and to use those *new analytics* to drive OTC process change. You have heard me speak about DMAIC Six Sigma methodology - this all fits in with creating measurable, scalable, replicable, more predictable financial outcomes.

Let's take a look at just a few of the new collection analytics being used to produce greater value within OTC lifecycles.

In the CRF article titled "***Order to Cash (OTC) / Billing-to-Cash (B2C) Resource Capacity Planning"***, we discussed "***The Scale Paradox***" written by John Lucker, Jerry O'Dwyer and Ryan Renner at Deloitte.

A great read where they point out that "*Disruptive technologies continue to change how companies innovate and compete. Combined with the power of analytics, they allow small companies to achieve insights once afforded only to large enterprises. At the same time, large enterprises can use these disruptive forces to shorten the time-to-insight and innovate in ways that used to be the sole domain of much smaller and more agile startups*."

I like the sound of that, *disrupting the status quo in OTC processes* and releasing working capital trapped in dated systems and manual processes.

Clearly everything the OTC team does is impacted by their ability to complete work quickly and efficiently. Each full-time employee (FTE) on your team has a finite amount of capacity, or number of things (*events*) they can accomplish in a given day. These FTE Events (FTEE) are completed tasks like Collections phone calls, Dunning Letters sent, Invoice Reprints delivered, Risk Calculations completed, Disputes resolved, Orders released, etc.

The trick: "How do I increase FTEE capacity, while making sure that each completed OTC task is generating greater impact to my available working capital?" I am glad you asked.

Here are six analytic measurements which are helping to generate greater command, control and value within OTC lifecycle management:

**1 - Integrated OTC Metrics, Best Practice & KPIs at the OTC database level**

The key here is "at the OTC database level". We have all heard the term Master Data Management (MDM), but what does MDM really mean relative to OTC? Take for example DSO – for simplicity and the fact that most companies do it this way, of the many different ways to measure DSO let's use the Dun and Bradstreet Receivables Management guideline for "Regular" or straight-line DSO.

DSO is widely used by executive management and Wall Street, but how good is it at evaluating the effectiveness of any of the departments involved in the Order-to-Cash (OTC) life cycle?:

*First*, DSO is fundamentally a flawed financial metric as it does not take into account vastly different Customer terms, especially if your book-of-business includes international markets. A much better measurement is Days Beyond Term (DBT), which measures the actual delinquent days for each and every customer transaction, based on their individual payment terms. There may be 20 or more different terms for a single customer who you serve in multiple countries. Many legacy ERP systems we find do not have a "terms" field! I know that is crazy, but true.

*Second*, DSO does not take into account seasonality. There are many companies who have huge order/demand spikes during the year. As an example, there are two companies who do 80% of their sales in less than one quarter – every single year. DSO is horrible at taking this into account.

*Third*, DSO is based on aged trial balances (ATB) and the ATB is almost always based on 'absolute' invoice values, which are almost always overstated (WRONG) by the *Dirty Receivables* we explored earlier.

**2 - Better visibility and control over Parent / Child hierarchies and exposure**

This is one of the most common complaints about ERP systems. Most of them, including very expensive ERPs like SAP and Oracle, simply are not designed to support Grandparent, Parent, Child hierarchical relationships. This is also true for supporting multiple contacts at each of the hierarchical levels. In fact, often the system of record is limited one or just a couple contact names, which does not help the OTC team do their job. The other big drawback is lack of visibility to global exposure of all the rolled up subsidiaries. On top of this, without visibility into the *whole* Customer relationship, you really do not have a way to see how things are trending and what your exposure is over time. The other challenge is when you have multiple teams, perhaps in different locations, collecting into the same company. Quite often we see multiple collectors call the same A/P person.

**3 - Measuring *Days Since Last Touch* and what effect this has on Invoice Conversion**

**4 - How many times has that $250 invoice, versus the $25,000 invoice been touched**

Let's look at #3 & #4 together. First, do you have a way of measuring how many times a particular invoice has been touched, by who, or how long it has been since it was touched by anybody? Are you measuring invoice touches and conversions per touch, by clients? Does your system even have the capability to do this? What we find is most of this is happening, if at all, in complex spreadsheets off system. Another key metric is the Value/Touch. Can you measure how many times a $250 invoice is being touched versus a $25,000 invoice? How many "touches" are actually unnecessary? How many times are Collectors actually calling "Volunteers", who are customers that pay 3-5 days late, without a touch? These metrics reveal a great deal about the operational effectivity and priority of an OTC team's efforts.

**5 - What is the DBT (Days Beyond Term) of the oldest *non-disputed* (clean) invoice**

This brings up the concept of *Dirty Receivables* again. If your system is not calculating *Clean Receivables*, many things fall apart. You cannot send out automated reminders with *Dirty Receivables*. You cannot use a Customer Self Service Portal with *Dirty Receivables.* Collectors cannot make effective calls using *Dirty Receivables* numbers on what is overdue. Your overall dunning strategy is ineffective (*useless*) if it is making its calculations using *Dirty Receivables*.

**6 - Can I proactively give Sales the *Days Since Last Order – Last Shipment – Last Payment* input**

I really like this new metric. Think about this: The A/R Department has the ability to proactively identify Customers with good Credit, good payment behavior, available Credit Balances, insight into their Order buying patterns, knowledge about when product or service was last delivered to the Customer and when they made their last payment. These empirical behavior analytics open up a whole new door for the finance team to provide valuable insights not currently available.

There is a new paper out titled "The CFO Agenda: Finance's Top Four Strategic Priorities in 2017" published in January 2017 and prepared by Nilly Essaides, Tom Willman and Jim O'Connor. They understand the need for 'new analytics' and their key finding: "*In 2017, companies intend to shift gradually away from the defensive growth strategies of the past few years in favor of more aggressive growth through innovation.*" The gauntlet is being thrown to companies to find ways to support this move toward innovation.

The four key strategies and recommendations are in perfect alignment with what we have been discussing here:

> *"1) **Supporting Enterprise Strategy:** To do so, finance must improve its analytics ability and access to information using digital technologies such as collaborative planning tools and advanced analytics.*
>
> *2) **Confronting Cost Pressures:** In reaction to tighter budgets and a riskier business landscape, finance must become more efficient through strategies such as moving activities to a shared services environment. This will lay the foundation for deploying existing staff into higher value tasks.*
>
> *3) **Preparing for Digital Transformation:** Dramatic changes are being ushered in by digital transformation. Finance must be prepared for its impact on the company's and its own performance and service delivery model.*
>
> *4) **Reshaping the Finance Organization Talent Profile:** Staff with analytical and business partnering skills are needed to handle a more digital and competitive business environment."*

At the end of the day, each of our companies expect world class cash flow performance at the lowest cost possible.

One path leads to business process outsourcing (BPO), which does address the cost side of the ledger, but sacrifices several aspects of financial performance and Customer Satisfaction. Another path leads to business process insourcing (BPI) using better technology, analytics and workflows, which take advantage of DMAIC Six Sigma methodology to increase FTE Capacity and significantly reduce cost, while actually improving financial performance and Customer Satisfaction. That is a win-win-win for you, your customers and your company.

The critical step for finance management is to take action, implement best practices and use proper analytic measurements to track both cost and delivered benefits.

The ultimate goal for management is to answer the question:

> "*We know we have a good OTC team. Now how do we help them with better tools to continue to give us a competitive advantage and delight our customers at the same time?*"

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***For over fifteen years Cforia has delivered superior technology integrated with proprietary real-time data integration tools across complex and disparate ERP systems of record. Cforia.autonomy(SM) delivers enhanced versions of Cforia Collections Snapshot(SM), Credit Risk Analytics, Order Management, Clean vs. Dirty Receivables(SM), Multi-Languages/Currency, Global Parent/Child risk roll-up and multi-business unit solutions. The comprehensive Cforia.autonomy(SM) software suite maximizes Order-to-Cash (OTC) performance through an enterprise software suite which includes Zero-Touch OTC Lifecycles(SM), Credit Lifecycle Management, Strategic Collections Management, Deductions Collaboration Portals and FTEE Resource Optimization. Cforia.autonomy(SM) empowers Finance Departments to independently manage their order to cash workflows, electronic dunning correspondence, credit and collections business logic and business analytics, without relying on an overburdened IT staff or expensive external resources.***