The Complexity of Global Collections: How to reconcile centralized collections for global portfolio visibility with local payment practices

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Abstract

Seventy-eight percent (78%) of countries display poor payment culture and 54% have excessive DSO according to the Euler Hermes study "Debt Collection 2018". Figures like these show that diverging levels of debt collection complexity across the world are a real challenge for accounts receivables (AR) managers. That is why many organizations have or are in the process of centralizing AR activities in shared service centers, oftentimes on a global level, to achieve global debt portfolio visibility. However, regional and local payment practices need to be taken into account as well. Collection strategies that might be effective in your home market might fail completely or be considered against local customs in other countries. These differences are what makes debt collections on a global level so difficult. To master this challenge, organizations need a smart mix of technology and standardized measures that can be flexibly applied depending on the collection environment in which they operate.

Global Divergences in Collections

There are no global standards for collections management. The non-litigious collections process is not regulated by law. And it is within the supplier's discretion to decide how to organize and implement the process. The litigious collections process is regulated by law; however, legal collections can differ extremely, depending on the local legislation.

To get an idea of the range of collections complexity in different countries, it makes sense to apply the collection complexity score developed by Euler Hermes. The score is based on the judgment of collection experts from the credit insurer. Additionally, it takes over 40 administrative indicators from the following three areas into consideration: local payment practices, local court proceedings and local insolvency proceedings. Based on this information, the score determines how complex debt collection is in different markets. According to the Euler Hermes global ranking from 2018, the following clusters emerge:

- **Group 1 – notable but low complexity:** 15 countries analyzed fall into this category. Most of them are located in Western Europe, the only exception being New Zealand. Sweden and Germany are the best in class, just ahead of Ireland and Finland.
- **Group 2 – high complexity:** 9 countries have a high level of collection complexity, notably in Asia, such as Japan and Singapore. Eastern and Southern European countries, such as Poland, Italy and Greece also fall into this group.
- **Group 3 – very high complexity:** This category appears to be the standard in most regions, including North and Latin America, Africa and Eastern Europe.
- **Group 4 – severe complexity:** The group of countries in which debt is most difficult to collect is similarly diverse. It includes countries such as Russia, China, Malaysia, Mexico, with the highest degree of collection complexity found in UAE and Saudi Arabia.

Although some countries have the same score, the local collection environment is not necessarily identical. For instance, insolvency proceedings are more complex in Germany than in Sweden. If we look at North America, the US and Canada both possess a very high level of complexity. The similarity in scoring for the two countries is due to the multi-level system, including county, state and federal levels, in which protection mechanisms are generally impractical. The countries have a general lack of efficiency in recovering unsecured debt and ownership protection could also be stronger (although retention of title clauses is mostly recognized in both the US and Canada). Repossessing goods is often disregarded, even though repossession would grant creditors priority over other debts during insolvency proceedings. Furthermore, as secured creditors, banks are often given primacy over unsecured creditors, such as businesses.

Does High Collection Complexity Equal High Default Risk?

The question is: If the complexity of debt collection is high, are local companies more likely to default on payments? If we compare the findings of Euler Hermes to the results of the Country & Sector Risk Handbook 2019 by the global credit rating agency Coface, we find some similarities and some differences. The Coface report analyzes the risk of default and insolvency in different regions and sectors, thus providing useful insight for international business and investment decisions. The report offers an eight-level business climate rating, ranging from A (very satisfactory business climate) to E (extremely difficult business climate). The ranking is based on indicators such as the availability of company reports, the reliability of the legal system regarding debt recovery, institutional stability and access to domestic markets.

While countries such as Germany, Austria, Sweden and New Zealand with low complexity scoring also have a positive business climate rating, other countries such as the US and Canada have a high complexity scoring but have a low risk of default. In some cases, countries with a severely high level of collection complexity, such as UAE or Malaysia, still have a solid business climate ranking. However, we see a strong accordance between collection complexity and default risk in most countries. China, Russia, Mexico, South Africa, and Saudi Arabia, for example, have a high degree of debt collection complexity and fairly high default risks. So, although debt collection complexity and default risk are not always directly correlated, we can assume that a higher complexity comes with a higher default and insolvency risk.

Global Collections Require Centralization…

The previously mentioned reports clearly state how strong debt collection complexities and default risks diverge on a global level. International corporations need to take this into account and reconcile their need for centralized visibility with their need to react to local payment behavior. But how can this be achieved?

First, there is no alternative to centralization. Data needs to be accessible throughout the organization to ensure portfolio and cash visibility, financing, reporting and accurate decision-making. The global shared services (GSS) model has proven to be a highly effective approach for concentrating essential and high-volume activities in centralized business units. Shared service centers support corporate goals and deliver the harmonization, standardization and cost efficiencies needed to enhance the company's performance as a whole. Benefits gained by a shared services environment include the following:

- Standardization and harmonization of processes, leading to enhanced levels of efficiency, accuracy and throughput, error reduction and quality improvement.
- Improved cost-effectiveness through economies of scale resulting from the centralized management of technology, communications and human resources. This includes the benefits of digitization, business intelligence, advanced information management and powerful analytics.
- Reduced operational risk through the adoption of best practice processes and the central management of resources, such as IT, minimizing redundancy and improving disaster risk management capabilities.
- More dependable and faster process performance in areas such as management reporting, accounting period closes and the implementation of major corporate changes. This includes mergers, acquisitions and divestments, as well as handling strategic changes in ERP and accounting systems and structures.

- Superior staff performance through centralized and standardized recruitment processes and training and development facilities. This approach enables finance staff to be cross-trained, leading to better management of volume peaks and troughs. It also leads to improved handling of personnel turnover, vacations and unplanned absences.

…But Localization is Valuable as well

Centralizing accounts receivables in shared services centers makes a lot of sense for every globally operating business. But does an AR manager in a GSS in Bulgaria know the most effective strategy to successfully collect debt in Brazil or Japan? What if certain measures, such as payment reminder letters, will simply will not work in certain countries where collections are usually done by telephone?

Organizations need to find the right balance between standardization and flexibility for individual cases and different regions. Yet localized approaches should not compromise centralized structures and processes. It is counter-productive to have local collection teams managing overdue accounts in de-centralized documents and spreadsheets if they are disconnected from the central data flow within the organization. CFOs need a centralized structure to provide visibility into the status of the customer debt portfolio. Treasurers require centralized information to determine the actual state of liquidity and incoming cash. And finally, credit managers want to have a clear understanding of payment behaviors to accurately determine credit limits and payment terms for future sales. Global visibility and centralization of data is, therefore, a must. But organizations must also be able to choose the most efficient collection strategy in any given market. So how do we reconcile the two? The answer lies in an intelligent application of best practice measures and technology.

How to Reconcile Global Standards with Local Requirements

How can we combine the perks of centralization with the need for locally applied collection strategies? To answer this, organizations should implement a smart mix of process and technology. They require best practice collection measures that can be applied flexibly according to circumstances in the target market. They also shall use the right technology to enable the centralization of data and processes. What would such a mix, such a solution, look like?

Central Data Storage: An advanced collections solution needs to be able to store all data centrally – be it in a central file structure or any other way. It should be integrated with the existing enterprise resource planning (ERP) system of the organization as well. This way data on local accounts is not lost and is accessible at any time on a global level. Users must have access to all agreements, documents and files that are related to the individual customer case and they must also be able to manage and upload all related documents into the system.

Intelligent Automation: Effective collections require a solution that provides some level of intelligent automation. Collections management is a lot of work, especially if the process is highly manual. Therefore, the solution should be able to automate the more repetitive and rulebased collection activities to unburden the collection teams. With intelligent automation, the collection manager will not have to look up the due date, check if the payment has been received, research the information of the individual case or set up a reminder letter. Instead, the system will automatically complete these tasks. With this level of automation, the collection manager merely needs to adjust the due dates and possibly add fees. A process like this can already be executed by robotic process automation (RPA) today. It is also possible to automatically escalate cases to different account managers depending on the severity of the debt and set thresholds.

Global Standards: Collection managers cannot start from square one each time they encounter an overdue account. That is why AR teams should build up a set of global standards that are derived from collection best practices. With global standards in place, the account manager can choose from and apply the collection instrument which is most effective in the given case. The measures should be executed within the ERP system to ensure standards and the centralized access to data is maintained. Best practice collection measures, supported by intelligent software, may include:

- **Reminder letters:** If appropriate and effective in the local market, you can implement an escalation-based collection letter strategy. This strategy can start with sending proactive reminder letters for specific cases, such as high-dollar invoices or habitually slow payers, and can be followed up by a first, second and final-demand collection letter. It makes sense to automate the entire process, with the system automatically setting due dates; calculating late fees and interest, when and where applicable; and creating follow-up reminder notices.
- **Telephone collections:** Notes and agreements from customer communications are captured in the system. This ensures a complete audit trail of and central access to information regarding the status of the overdue account.
- **Promises to pay processing:** Promises to pay are noted within the system and automatic alerts are set if payment has not been received at the due date. Reminder letters to the debtor as well as escalations can be included automatically.
- **Deferred payment agreements***:* In case a customer is not able to pay the whole amount at once, a deferred payment arrangement makes sense. Automatic alerts and follow-ups ensure the collections team do not lose track of these agreements and is reminded when the next installment is due.
- **Bankruptcy processing:** Status, claims and all communication with customers, courts and lawyers during the insolvency process should be organized within the system. Court and correspondence documents need to be uploaded, ensuring centralized access to information at any time.
- **Internal review of past-due accounts:** Aligning customer accounts with other departments, such as audit, sales or credit management becomes easier with a centralized access to and availability of all data in one system. Tasks can be set and delegated between the teams as well.
- **Allowance for doubtful accounts:** Adjusting the value of overdue accounts on a weekly, monthly and annual basis delivers accurate assessments to accounting and reporting. Results can then be fed directly into the record-to-report process from one system.

- **Write-offs:** If a debt cannot be collected, the write-off needs to be documented centrally to prevent future sales and subsequent losses with the same debtor, possibly flagging the debtor.
- **Legal collection procedures:** Managing and documenting the entire litigation process, including the storage of all necessary documents, correspondences with customers and courts, and any evidence in case of a lawsuit.
- **Outsourcing accounts to collection agencies:** Organizations that outsource collections to external service providers need to keep track of all cases, monitor the quality of the providers and document all agreements and results within the system.
- **Selling accounts to factoring institutes:** If debt is sold to a factor, the entire process of factoring needs to be managed and documented within the centralized system to ensure traceability and compliance.

With a sufficient set of different collection strategies, AR managers are well equipped to take local requirements into account and document all challenges they encounter within a central system. Which collection approach makes sense depends greatly on the environment in which a company operates. While reminder letters might be the standard procedure in one country and telephone or private messenger collections would be considered rude, it might be the complete opposite in the next country. Globally operating AR teams need to have a solution that empowers them to react flexibly to the different local settings. In addition, they should also manage every account within a central system for complete accountability.

With a practical set of different collection strategies within a centralized system, debt collection in local markets can even be executed from GSS. This works as long as there is an understanding of which measure is effective in which market and with which customer. This knowledge can be taught to the collections team using specialized training.

Conclusion

As we have seen in this article, AR teams can face different levels of complexities depending on the market and country in which they try to collect debt. Centralizing AR activities in GSS is a sensible approach. But when it comes to collections management, an intelligent mix of standardization and flexibility is necessary. By implementing a solution that flexibly applies standardized collection measures and supports integrated and centralized processes and data, AR teams are empowered to manage the complexities of collections on a global scale. This type of global collections solution must be powered by intelligent automation, such as RPA. This gives account managers more time to focus on the complex cases that require nuanced judgment and decision-making.

About the author: Michael Köhler, Senior Solution Architect Order-to-Cash, Serrala specializes in the field of credit management. Furthermore, he has in-depth knowledge in the areas of information management and supplier rating. Michael leads and executes complex projects for renowned companies and was involved in many implementation and rollout projects in different countries around the world.