

How Collections ReSourcing Can Help Credit Managers Improve Overall Business Performance and Increase Their Value to the Organization

Partial Sourcing Alternative Offers Benefits and Mitigates Risks

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Abstract

It's no longer business as usual for credit managers. While many credit professionals struggle under the weight of increased scrutiny, expanded responsibilities, and static resources, increased emphasis is being placed on their ability to contribute to the success of their organizations. Once responsible primarily for credit decisions and collections, the credit manager's role has expanded to include functions such as contract compliance and customer service. Corporate emphasis on cash and working capital management has also resulted in the need for credit departments to become more proactive and focused on cost containment.

The changing landscape of the credit management function offers tremendous opportunities for personal growth in terms of increased influence and respect within the organization. But as the paradigm shifts, and the role of credit managers expands, those that continue to rely on doing things "the way they've always been done" are setting themselves up for failure.

Bogged down with daily operations and growing responsibilities, how can credit professionals make the changes necessary to improve overall business performance, contribute to their firm's bottom line, and ensure their value to the organization? And can it be done short of a complete overhaul of the entire revenue cycle management system?

According to a survey by the Credit Research Foundation, making ongoing, incremental process improvements may hold the answer:

For the majority of companies, receivable portfolio [credit] managers are saddled with the responsibility of managing the firm's single largest asset. The opportunity to add worth through continuous incremental improvement to the receivable management process has the potential of becoming a key factor in contributing to enhancement of the firm's economic value.¹

The premise of this paper is that receivables collection outsourcing makes available incremental improvements in systems and processes that can have significant impact throughout the revenue cycle and on an organization's bottom line. And, that many of the risks associated with outsourcing can be mitigated by implementing a partial outsourcing versus a full-blown BPO (business process outsourcing) initiative.

¹"Future Trends in Business Credit and Receivable Management," The Credit Research Foundation, 2005, page 29.

Corporations Shift Focus from Income Statement to Balance Sheet

Two factors influencing the 21st century business environment have prompted corporations to take a closer look at each facet of finance and accounting, including A/R management.

First – increased demand for greater corporate accountability, financial transparency, and improved governance in the wake of the Enron debacle. Subsequent passage of the Sarbanes-Oxley Act has also “caused corporations to shift their emphasis from growth [income] to cost containment, productivity enhancement and risk management,” according to David Schmidt, contributing editor for Credit Today.²

Second – many companies have already fully capitalized on revenue generation potentials. Under continuing pressure from investors to increase shareholder equity, business owners have turned to the balance sheet to create financial gain. Thus, companies are searching for ways to maximize profitability by stimulating cash flow and decreasing costs.

Challenges Facing Credit Managers in the New Scenario

The role of receivable management is a function in transition in today’s business environment.³

Heightened emphasis on corporate accountability and the move toward a balance sheet driven business model has increased the importance of effective credit risk and revenue cycle management – creating unique challenges for credit managers.

Despite the corresponding focus on cost containment that has impacted their departments via downsizing and consolidation, credit managers are tasked with the critical responsibility to reduce costs and improve processes. Frankly, what most organizations need in order to achieve these results is complete redefinition, standardization, integration, and centralization of their technology platforms and organizational processes – a daunting, and for the most part, impractical course.

At the same time, credit managers need to move beyond managing day-to-day activities to effecting business outcomes. This shift from tactical to strategic management would boost performance and accountability by allowing managers to focus on monitoring and adjusting processes, generating meaningful reporting, and improving results.

² “Emerging Trends in Receivables and Collection Management Automation” by David Schmidt, The Credit and Financial Management Review, Third Quarter 2007, pages 5-20.

³ “Future Trends in Business Credit and Receivable Management,” The Credit Research Foundation, 2005, page 9.

Lack of Capabilities Short-Circuit Credit Department Effectiveness

A number of factors prevent the credit function from contributing full value to their organizations. And budgetary constraints linked to cost containment policies make it difficult to implement solutions.

Among the most significant of these obstacles is the lack of important A/R capabilities. Many organizations are handicapped by:

1. **Inadequate Software Systems.** Antiquated legacy systems, as well as many Enterprise Resource Planning (ERP) software do not provide the A/R functionality required to deliver needed performance. Many credit departments must also deal with multiple, disparate systems across divisions.
2. **Ineffective Processes.** Lack of standard, consistent, well-documented processes hamper productivity resulting in: increased DSO; drop in dollar value of cash collections; rising customer service complaints; higher write-offs and interest expense; added staffing costs; and, more spending on third-party collections. In many companies, A/R management remains decentralized, creating the problem of attempting to obtain uniform results by integrating multiple methods. Even where control of credit and collection functions is centralized, poorly documented procedures and/or uneven application are ongoing problems.
3. **Insufficient Reporting Capabilities.** Inability to generate accurate, meaningful reporting makes it all but impossible to deliver a true valuation of the company's receivable portfolio. Resultant inaccuracies reduce the organization's ability to meet legislative and public demands for accountability and transparency. Insufficient reporting also hinders the manager's ability to identify and correct underlying process inefficiencies.
4. **Inflexible Staffing Models.** Staffing levels out of sync with demand are a drain on profitability and resources. Because wages and benefits are fixed costs, significant dollars are wasted when permanent staff exceeds immediate need. On the other hand, productivity takes a hit when tasks exceed headcount. Companies in high/fast growth mode are particularly vulnerable. Mergers, acquisitions, or accelerated sales can cause A/R to get out of hand, overwhelming understaffed credit departments. Utilizing temporary staffing in these situations actually increases the burden on managers who must train and supervise transient help.

Receivable Collection Outsourcing Addresses Immediate Challenges of Profitability and Corporate Accountability

Faced with broader responsibilities and the internal short-comings listed above, collaboration with a receivables management specialist provides the most effective way to achieve sustainable improvement.

As originally printed in “The Credit and Financial Management Review” of the Credit Research Foundation.

The organizational benefits of outsourcing are well documented. If a stronger rationale is required, consider these results from a recent survey by The Hackett Group:

World-class companies spend a higher percentage of time on strategic vs. transactional activities. World-class companies outsource 66.6% more than non-world class firms.⁴

By providing a consistent, efficient, technologically current process, outsourcing A/R collections offers opportunities to address the immediate challenges facing credit managers. At the same time, the systemic improvements that come with outsourcing create benefits that will help the credit department achieve its broader goals.

How? The answer lies in the importance of the receivable collection function.

David Schmidt explains:

The goal for every enterprise is increasing the volume of profitable sales. As companies improve their risk management and invoice accuracy, they will be able to market to a more diverse clientele, but only if they remain confident in the collection process. Collections will therefore remain central to productivity and profitability.⁵

As a key component of the revenue cycle, efficient receivables collection brings in cash quickly, improving cash flow and working capital. Outsourcing A/R collection further improves profitability by decreasing process and administrative costs, headcount, DSO, and cost per transaction.

As the “corporate face” to an organization’s credit customers, an effective collection process has the potential to enhance customer satisfaction, thereby maintaining customer loyalty and increasing sales.

And, when the objective of collections is expanded from simply getting paid, to removing impediments to payment, receivable collection outsourcing has the power to:

1. Improve corporate accountability. Consistent, documented contact with customers by the outsourcing provider’s collections staff allows for the identification of problems and a process for setting in motion timely resolution.
2. Increase financial transparency. Transparency is the result of accurate reporting. Detail specific reporting generated by the specialized collection software systems of outsourcing providers establishes an authentic picture of the firm’s A/R position.

⁴The Hackett Group benchmarking study as quoted in “Outsourcing the Revenue Cycle – Driving More Profit to the Bottom Line,” The Outsourcing Institute.

⁵“Emerging Trends in Receivables and Collection Management Automation” by David Schmidt, The Credit and Financial Management Review, Third Quarter 2007, pages 5-20.

Receivables Collection Outsourcing Improves Overall Business Performance

The challenge of improving performance also finds a solution in outsourcing A/R collections, which:

- **Gives the organization access to specialized collection management software.** With collections as its core competency, the A/R outsourcing provider is able to focus on implementing the best in collection software applications. The outsourcing buyer has access to these systems without incurring the substantial cost of maintenance, upgrades, and personnel training. The credit manager has increased control via better systems and centralized access to enterprise-wide data.
- **Ensures consistent, effective collection processes.** Through its automated file management, scheduling, and recording capabilities, the outsourcing provider can standardize, and add consistency and discipline to the collection process. This drives improved quality, increased customer satisfaction, accelerated collections and a shortened payment cycle. A consistent process also makes it possible to accurately measure results.
- **Provides robust, insightful reporting.** The outsourcing provider's software elevates the quality of reporting by efficient management and thorough documentation of the collection process. Reports can be trusted to be accurate and to provide a greater depth of information, empowering management to:
 1. *Accurately assess collection performance.* Comprehensive data combined with Service Level Agreements (SLAs) make it possible to transform collections from a transaction-based to a performance-driven function.
 2. *Identify weaknesses up and down the revenue cycle.* Consistent customer contact and documentation regarding delinquencies makes it possible to identify disconnects in the revenue cycle process and focus resources on their resolution. Solutions developed serve to drive ongoing improvement and innovation.
- **Ensures flexible, cost effective collection staffing.** Outsourcing supplies a scalable staffing model. Costs of acquiring, training and managing qualified personnel remain the responsibility of the provider. By paying for additional staff only "as needed", outsourcing transforms the company's fixed costs into variable costs.

Note: Relying on temporary staffing to achieve these benefits is largely ineffective. While temp firms are good at providing headcount, they fall short in duplicating the specific collection and customer service skills receivables outsourcing firms consistently develop in their employees. They also lack the knowledge of the organization's internal processes and culture absorbed by the outsourcing firm in the course of their engagement.

Mitigating the Risks of Outsourcing through Partial Sourcing

Although proven effective in most situations, outsourcing is not without its risks. These include loss of control of the outsourced function and decline in internal expertise. Personally at stake for the credit executive is potential loss of credibility – and possibly their position, should the outsourcing project fail. Partnering with a well selected provider and an appropriately developed SLA will minimize much of the risk. Even so, many credit managers remain hesitant to outsource business-critical, customer-facing functions like receivable collections.

But outsourcing does not have to be an all or nothing proposition. While it may make sense for some companies to outsource their entire A/R collection function, many will not be comfortable doing so. For those, a partial outsourcing solution offers a low-risk entry into outsourcing's benefits that allows the organization to determine if it: (1) is comfortable with outsourcing in general; (2) has selected a provider with the right capabilities; and, (3) has the internal capabilities to successfully manage an outsourcing project.

Among companies that should definitely consider partial outsourcing are those that: require just a few receivable collection FTEs; have occasional need for increased staffing; or, feel their internal processes are ineffective and would like to benchmark them against a professional receivable management firm.

Mini-Case Studies Highlighting the Effective Application of Partial Collections Outsourcing

For a better understanding of how partial collections outsourcing operates to solve real-world problems, consider the following. These cases are taken from ABC-Amega's files and concern actual companies.

Case #1 – Venture Capital Firm Faces Serious Cash Flow Problem and Public Relations Nightmare

In 2006, a venture capital firm purchased a large, regional telephone company. When the final cut-over to the new corporation's billing systems took place, data errors resulted in thousands of incorrect invoices being mailed out to customers. The customer service department was inundated with incoming questions and complaints. Hundreds of callers ended up on hold for hours or dropped altogether, ultimately resulting in a public relations disaster. As customers refused to pay the inaccurate invoices, working capital (cash flow) began to evaporate. The firm faced two immediate challenges:

1. Urgent need to double customer service staff to field the increased load of calls and complaints.
2. Lack of receivable collections software to manage calls and document and categorize issues for efficient resolution.

To manage the rapidly deteriorating situation, the corporation elected to outsource 20+ new customer service positions to an A/R collections outsourcing firm. In addition, they contracted use of the vendor's collection management software for its internal customer service associates. Within a few months, the backlog of invoicing issues was cleaned up and cash began flowing in. As the dust settled and the corporation took stock of the situation, they found that outsourcing some of the receivables collection responsibilities had:

1. Saved money. The cost to outsource FTEs (full-time equivalents) was less than the cost of maintaining internal customer service staff.
2. Improved productivity. Utilizing the outsourcing firm's collection management system enabled them to benchmark their internal resources against the outsourced FTEs. They found that the productivity of the outsourced associates was more than twice that of their internal staff.
3. Increased customer satisfaction. Incoming calls were being picked up immediately, rather than placed on hold. Customers with delinquent payments were proactively called to discuss and resolve issues.

Case #2 – Lack of Effective Processes Frustrates Employment Agency Dealing with Multiple Problems

A national temporary employment agency was dealing with archaic systems, high turnover and DSO considerably higher than their industry's average. Its local offices utilized a number of incompatible A/R systems making it impossible to determine the amount of outstanding accounts at each branch. They also lacked any means of monitoring the productivity of their internal collectors.

A newly appointed Director of Accounts Receivable was determined to make an immediate impact on the situation. Through a formal RFP (Request for Proposal) process, he selected a collections outsourcing company to do a 2-month test project involving just 5 FTEs handling A/R collection for one division.

The results: Within the two-month time-frame, the outsourcing provider resolved 78% of the delinquent accounts. They also identified a number of problems in the temp firm's internal processes that were causing delinquencies. And the agency discovered that outsourcing collections was considerably more cost effective than increasing in-house staff. As soon as the internal issues are corrected, the temp firm plans to ramp up the outsourcing initiative to cover all divisions.

Caveat: Use Diligence in Selecting – Not All Providers Are Created Equal

Case #3 – Medical Technology Firm Struggles with SOX Compliance and ROI

The Chief of Credit (CoC) at a rapidly expanding, global leader in medical technology was under the gun in terms of both Sarbanes-Oxley compliance and shareholders demands for a better return on investment.

Reporting indicated a significant portion of the company's resources were tied up in aging receivables. The CoC, however, was convinced that the receivables numbers were overstated. The company's customers were private practice doctors. Credit sales to established professionals should not produce such a high level of payment problems. Yet the stack of unpaid invoices kept growing higher and older.

Lacking the ability to take on additional staff to look into the problem, the CoC had already outsourced receivables collection. He was not, however, seeing much improvement in the overall situation. A closer look at some of the collector notes turned up a surprising pattern. Many of the doctors complained that purchased equipment had arrived either broken or damaged. This suggested that the problem was in manufacturing or shipping, not collections.

Unfortunately, the current outsourcing vendor lacked the ability to: (1) contact all delinquent customers to document and categorize the real reasons for non-payment; or (2) provide a secure reporting mechanism that could map the issues to the appropriate departments. Such a system would have triggered resolution and payment, or issuance of appropriate credit memos to reduce the outstanding A/R on the books – either of which would have improved the ROI and SOX compliance issues.

The result: The Chief of Credit is in discussions with an A/R outsourcing firm that has appropriate capabilities in terms of manpower, systems and reporting to resolve the issues and provide needed results.

Credit Managers Can Increase Their Value by Accepting Their Changing Role and Embracing Creative Solutions

"Future Trends in Business Credit and Receivable Management," a survey project conducted by the Credit Research Foundation, states:

To enhance and clarify their value, credit professionals must take a leading role in cost containment, proactive cash management and process improvement...Those credit executives that develop superior capabilities in managing all the elements of this [order to cash] core process will be situated to be the business leaders of their organizations.⁶

In each of the above cases, credit professionals leveraged outside resources and embraced new methods to get the job done. They understood the importance of creating value driven receivable management processes and recognized process improvement as essential to increasing organizational worth. They adopted solutions that included systems managed by tangible metrics of success. And, most importantly, they had the vision and leadership to look beyond internal corporate resources to achieve their goals.

⁶ "Future Trends in Business Credit and Receivable Management," The Credit Research Foundation, 2005, pages 26-27.

As originally printed in "The Credit and Financial Management Review"
of the Credit Research Foundation.

In short, they refused to ride the status quo and expect the level of change needed to bring results. They embraced the opportunities opened by the new business scenario to step beyond the boundaries of managing a cost center to becoming a facilitator of profitability and operational improvement. And in so doing, they have become incredibly valuable to their organizations.

A/R Resourcing Balances the Benefits of Outsourcing while Mitigating the Risks

ABC-Amega is a global receivables management and commercial collection firm based in Buffalo, NY USA with offices in Shanghai and Beijing, China and Geneva, Switzerland.

ABC-Amega has developed a partial outsourcing solution, called A/R Re-Sourcing, that is designed for companies that need to extend their receivables management resources, but do not want to take the risk of handing off the entire customer-facing function.

Specific benefits of A/R Re-Sourcing:

- Cost reduction. FTE reduction, process and administrative cost improvements, reduced DSO, decreased time to resolution, increased number of transactions per FTE, and reduction in cost per transaction.
- Increased compliance and transparency via a rigorous quality control framework built on metrics, processes and documentation.
- More effective collections through a software system-driven process built on well-defined collection policies and procedures applied consistently across the entire credit portfolio.
- Improved revenue cycle management. Reporting provides essential business intelligence into the root causes of delinquency, thus helping repair flaws in the payment cycle process.
- Increased control via better systems and centralized access to enterprise-wide data.

As Director-Marketing and Sales Administration, Loral Narayanan heads the marketing efforts for ABC-Amega, and is responsible for the development and management of all marketing strategies and initiatives.

ABC-Amega sponsors the www.credit-to-cash-advisor website, a Credit and Collections Resource Center designed to help commercial credit, collections and finance professionals with educational articles, bankruptcy and trade receivable statistics, country risk reports, and more.