



ORDER TO CASH CONTROL NETWORK – *Get a grip*

Introduction

There are many indicators and measures of the effectiveness of a firm's credit management system. Each has its unique merits and offers a window on how well a firm is doing in terms of managing its accounts receivables and ultimately its cash flow situation. For many companies a particularly useful indicator is Days Sales Outstanding (DSO). DSO represents the average time, in days that receivables are outstanding. This measure helps to show if a change in receivables is due to a change in sales, or to some other factor. The formula for calculating DSO is as follows:

$$\frac{\text{Ending Total Receivables} * \text{Number of Days in Period Analyzed}}{\text{Credit Sales for Period Analyzed}}$$

When this number shows an increasing trend it often indicates there is a problem with the company's accounts receivables. A large number indicates that a larger the percentage of accounts receivables that are delinquent and need to be referred to the collections department.

Scope of the Problem

DSO figures are inseparable from trends in accounts receivables, and in recent years receivables have become an increasing issue for businesses, regardless of size, throughout the Europe. There are numerous reasons for this state of affairs, including increases in both the number and amount of trade promotions and incentives used by supplying companies as well as a sharp increase in the level of disputes raised by customers.

It is estimated that a business will have at least 30% of its receivables ledger in dispute at any given time. This not only has an impact on cash flow and higher costs of administration, customer relationships are at risk.

A worrying statistic indicates that 50% of all businesses have no reliable information relating to the precise level of invoice disputes, the types of problem, the value or the originator. Often at ground level there is a feel for the issues, but at exec level this is sadly lacking. . All of these factors combine to put pressure on the DSO figure for companies. The current state of the global economy and continued economic uncertainty will only serve to accelerate the current trends. Clearly, the prudent firm will seek to address this situation in a direct and proactive manner.



What can be done?

In the past companies looked at DSO problems in a way that linked them primarily with the collections system. Collections systems have been around for years, addressing how to cope with a problem after the fact. This type of collections approach is called reactive collections.

While there is now and will probably always be a role for collections systems, companies today must be prepared to look at DSO increases as a symptom of a problem, rather than the problem itself. Thus, in order to effectively address a problem with DSO, companies need to look beyond collections and focus on the entire sales life cycle in order to correct the issues that have led to the increase in DSO.

The sales life cycle has several discrete stages that firms should consider when thinking about how to address their DSO problems.

These stages are:

1. The sales process and the creation of agreements
2. Managing / Amending Agreements – and expectations
3. Complying with expectation
4. Managing Receivables
5. The collections process
6. Is your Business Intelligent?

1. The sales process and the creation of agreements

Firm foundations – get the sales process right!

At the start of the business relationship, an agreement is entered into between parties. At this stage the 'expectation' is set with the customer regarding what will be delivered, when and at what price. While this may sound simple, how easy is it for agreements to be made that do not conform to an organization's latest policy on product, price and service? Other questions that must be asked are: Does the customer understand the latest position? Does the customer have the right expectation?

If the contract that is developed and agreed to by both parties is in some way flawed or incorrect it will ultimately lead to a receivables problem and this will certainly lead to an increase in DSO.

To ensure that contracts that are entered into reflect the company's policy and best practice, and are clearly understood by all concerned, a contract management system should be put in place. This system would be responsible for generating only company standard contracts and entering the specifics of a given contract into the company's back-office systems.



2. Managing / Amending Agreements – and expectations

When things change – watch those amendments!

It is often the case that a customer will repeat sales orders or reorder products. These situations lead to several important questions including: Which agreement comes into effect? Is it current? Is it accurate? What was agreed with a customer a year, a month, or even a week ago is not necessarily valid today.

An organization must adapt to a constantly changing business environment. These changes can often impact customer relationships in terms of product pricing, description, function, delivery, legislation, credit policy etc. All of these issues may require amendments to existing contracts and changes to the terms of new contracts. The problem is, for many companies there is no standard way to ensure that these amendments are made in a consistent manner.

Historically the way to manage receivables has followed a reasonably standard approach:

1. Contact Customer
2. Establish when the payment will be made
3. Monitor the payment
4. Establish any reasons for non payment
5. Investigate the 'reason for non payment'
6. Identify any 'doubtful' payers – Cash at Risk
7. Escalate activity against 'doubtful' payers

The lack of this functionality can lead to invoice disputes regarding incorrect pricing, description, function, delivery, payment terms, and others? Each and every one of these disputes will have a negative impact on the firm's DSO picture.

In order to proactively address this issue, the company's contract management system should constantly update the company's contract terms and processes as well as automatically flag situations where contract amendment is necessary.

3. Complying with expectation

You must comply – don't lose customers or worse!

Once an agreement has been made with a customer it is important to ensure you comply, expectations have already been set. In our survey 70% of all invoice disputes were valid. Of that 70% nearly 35% related to incorrect price or invoice value, 15% related to incorrect or late delivery, 15% related to copy documentation being required and 5% related to faulty goods. Many of the issues could have been avoided if detected early in the O2C cycle. Fact is most of the businesses we surveyed were only aware of the problems when the customer failed to pay and a dispute was raised.

What is required is an approach that links the various parts of a business together. This linkage will allow a business to ensure that it is complying with its actual contracts. A way to help a business consistently comply with the terms of its contracts will lead to improved customer relationships, an improved accounts receivable situation and a decline in DSO.



4. Managing Receivables

Receivables – don't let them manage themselves

After a contract has been executed the amount to be paid by the customer becomes a receivable. It will remain a receivable until either the amount is paid or it is written off as a bad debt. Thus, the management of the accounts receivable ledger is of critical importance to a company's top and bottom lines as well as its cash flow position.

It's all about collecting the receivables as fast as possible.

This approach is reasonable assuming a situation where information is limited. But, companies that are seeking to proactively manage their receivables and reduce DSO are looking for tools that give them extended visibility with regards to potential payment problems. Ideally their contract management and compliance systems should already be aware of customers that have invoices outstanding where the organization has made an error that will affect prompt payment. In other words, they will know what accounts are likely to result in disputes, and rather than wait for the customer to re-act to reminder letters, their collection system handles the 'Dispute' prior to invoice due date. In fact, the situation will be handled before it even becomes a dispute.

5. The Collections Process

Be ready for when the customer bites back!

It is simply a fact of business that a proportion of accounts will raise invoice disputes. Further, a certain proportion of the receivables ledger will 'slow pay.' Finally a proportion of accounts will have either no intention of paying or no ability to pay.

These facts make it necessary for companies to maintain a robust collections capability that is fully integrated into the contract management and compliance systems. This capability will arm the company's collections teams with the information they need to work with clients and resolve invoice disputes in a fast, efficient, and ultimately satisfactory manner. This process will help to minimize the DSO impact of these inevitable invoice disputes.



6. Is your business Intelligent?

You must have the answers, but get the questions right!

You can have as many systems and processes as make sense. You can have the best people and the best technical solutions to support them. But knowing what happens and when, for how much and to who keeps the whole business and your decision making together.

You cannot underestimate the value of information within your business. Understanding the level of new agreements, when renewals are due, the value of the contract, when payment is due, the nature of a dispute that has been raised, the process in your business they relate to and having access to that information NOW is so so important.

The implementation of a Business Intelligence solution to ‘monitor’ your business and keep a watch over Key Performance Indicators is the final piece of the jigsaw in the fight to manage and lower DSO.

O2C Control Network

Our approach

Taken together the above processes and systems form what is called a Order to Cash Control network. This is in fact a fully integrated and comprehensive approach that proactively addresses all the issues that can lead to a DSO problem. It is also an amalgamation of services and technology.

Companies that deploy a Order to Cash Control network are able to realize improved financial results as well as increased customer satisfaction. In terms of financials they will not only be able to keep their DSO numbers in check, they will improve their profitability and their cash flow situations. Further, ensuring that contracts are complied with will inevitably lead to satisfied customers and repeat business for the company.

To recap, companies that want to effectively deal with their DSO situation should consider the following checklist.

Order to Cash Control network – Check List

- Management of Agreements with Customers 9
- Ongoing management/ amendment of Agreements (changes in expectation) 9
- Compliance, making sure you deliver to expectation 9
- Management of Receivables 9
- Resolution of Invoice disputes 9
- Business Intelligence 9



Conclusion

For companies throughout World the current business environment and changes in the way business is being done means that DSO is and will continue to be a major issue. In the past companies have been content to handle DSO problems in a reactive manner by combining it with the overall collections system. Today, forward looking companies are deploying integrated Order to Cash Control network that proactively targets the issues that can lead to DSO problems and thus minimize the problem, before it becomes a problem.

NEXUM helps businesses to develop an integrated Order to Cash Control Network. Reviewing and improving business processes with the addition of a Business Intelligence solution will help identify where you need to focus.

“Without the flow of credit the world of commerce will grind to a halt. You need people to manage flow of credit and systems to check against processes employed, or else you may as well stick your finger in the air, your head in the sand and hope that in the end it all just turns out ticketyboo.” Jim Stanley, Director and cofounder of NEXUM Collection technologies.

For more information relating to **NEXUM** and how we can assist your business please visit www.bwaresolutions.com