SUNGARD AVANTGARD INSIGHTS

MANAGING DURING THE CREDIT CRUNCH:

Five Best Practices for Effective Credit & Collections Management

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INTRODUCTION

In these trying economic times, companies all over the globe are seeking alternatives to borrowing and at the same time are looking to improve their cash collection practices. While challenging, these goals can be met by leveraging best practices and automated order-to-cash solutions.

By automating workflows around credit and collections processing and management, a company is empowered to unlock hidden cash, enhance compliance management and improve customer service with greater response time. Furthermore, through combining collections efforts with a risk-based strategy, a company can see great benefits such as a increased control and lower days sales outstanding (DSO).

The largest asset on most companies' balance sheets is their accounts receivable (A/R) and the goal of the credit & collections department is to manage this asset through the proper evaluation of customer risk and the timely collection of outstanding invoices.

Efficient collections ensure ongoing cash flow streams that meet a company's financial objectives including reduction of DSO, bad debts and write-off's. To achieve these goals, many companies have implemented strategic plans that combine workflow automation technology with statistical-based credit scoring using the company's internal A/R data as the critical risk evaluation factor, thereby allowing departmental labor to more efficiently manage inherent customer risk, internal resources and improve the performance of the receivables portfolio.

This paper investigates five best practices for improving credit and collections management that every company should be concentrating on, particularly in the face of the credit crunch.

1. INSTITUTE A STRATEGIC & AUTOMATED APPROACH TO CASH COLLECTIONS

Many companies continue to rely on manual processes surrounding cash collections. This can present problems, including high error rates related to data processing by hand, drained employee resources, low productivity and a lack of control over cash. By implementing technology that can automate workflows relating to collections efforts and prioritization, companies are enabled to unlock hidden cash, enhance compliance and improve customer service with greater visibility.

A couple of the largest challenges related to manual cash collections are detailed below:

> **a. Manual and Time Consuming:** The effort involved in processing what is essentially a manual process for most companies is astonishing. A collections agent often needs to access many different systems and print, fax and mail various documents while making telephone calls internally and externally to address each past due invoice. This drain on time creates a very costly process.
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> **b. Drained Cash:** Most companies will be shocked when they calculate the fully weighted unit cost of collections processing. When this cost is taken into account and multiplied by the volume of past due invoices, the scale of the hidden cash can be judged. With a focus on better, automated processes and systems the overall cost per past due invoice can be reduced. The efficiency and effectiveness is seen in a number of financial measures and has a positive impact on bottom line profit.

Credit and collections technology can help combat the traditional challenges related to manual cash management by putting into place an automated and strategic system that can work to optimize working capital and streamline collection processes. Corporations are therefore enabled to see improved staff productivity, enhanced visibility and increased cash flow, among other benefits.

This is accomplished by segregating customers by type (small business, government, large retail etc.) and by risk class and then implementing a strategic approach for each bucket. Collections activities can also be automated using system generated reminder notices and a strategic approach to building call queues. By establishing prioritized call queues, collectors can focus on the highest risk items, helping to mitigate bad debt expense and reducing DSO.

CASE IN POINT:

Company: Henkel
Industry: Manufacturing & Adhesive Technologies
Location: Germany
Solution: AvantGard Receivables

Henkel currently utilizes AvantGard Receivables solution in its shared service centers to help drive cash flow and to support operational efficiency across the order-to-cash life cycle. With a single centralized view of credit and cash collection efforts, Henkel was able to significantly increase cash flow while gaining improved visibility for forecasting.

SOLUTION BENEFITS DERIVED:

- Decreased past due account receivables by 20%
- Achieved return on investment (ROI) within two months
- Centralized operations for improved visibility & performance

2. LEVERAGE CREDIT DATA FOR RISK BASED COLLECTIONS

The main objective of credit and collections departments is to effectively manage A/R through the proper evaluation of customer risk and the timely collection of outstanding invoices. Efficient collections ensure ongoing cash flow streams that fufill a company's financial objectives.

Today, in most credit and collections departments, collection prioritization is based on aging, meaning that there is not a strategic process in place for collections, so staff is forced to simply contact the oldest invoice first. This is often ineffective and can result in the wrong treatment being applied to a customer at an inappropriate time. For example, under the aging method, high dollar accounts or high risk, low dollar accounts may be ignored, even though they are the most costly for a company. In fact, by not taking into account the customer's inherent risk the wrong strategy may frequently be applied.

If 90% of a credit and collections department's time and resources are spent managing the customer portfolio and collecting money, shouldn't they be better allocating their time and more efficiently managing the company's largest asset by applying risk based credit scoring as the basis for developing optimal customer management strategies? Collectors must put into place specific rules for how they contact and deal with different types of customers, if they wish to achieve efficient credit and collections management. For example, it is not effective to treat a privately owned business with 10 employees the same as it is a large chain business. Rules have to be put into place to recognize that each customer segment is different and has specific needs.

Risk-based collection methodology uses statistical-based credit scoring to determine inherent customer risk and uses that risk level as the primary driver for determining collection strategies for the ongoing management of the customer portfolio. Research has shown that the age of an account and the amount due are the wrong criteria to use if the desired outcome is to optimize collection efficiency, improve DSO and reduce write-offs.

To help better prioritize customer contact and improve A/R efficiencies, many companies have opted to implement strategic plans that combine workflow automation technology with statistical-based credit scoring. By drawing on internal A/R data as the critical risk evaluation factor, a company is enabled to more efficiently manage inherent customer risk, internal resources and improve the performance of the receivables portfolio. The risk-based collection methodology uses statistical-based credit scoring to determine inherent customer risk and uses that risk level as the primary driver for determining collection strategies to help with the on-going management of the customer portfolio.

"Adopting automated technology has allowed for increased efficiency in processes surrounding the order-to-cash cycle, as well as invaluable tracking and reporting capabilities that have provided us with an enhanced means of forecasting and monitoring financial trends."

- Scott M. Miller, vice president of finance, order-to-cash, Henkel of America

3. EMBED & MANAGE RISK POLICY ACROSS THE ENTERPRISE

Credit scoring is one of the most powerful tools available for automating the risk analysis that is needed to evaluate the collectability of a company's A/R portfolio. Reasons for this include the rapid evolution of technology, as well as the tremendous amount of downsizing that has occurred in corporations, which is requiring credit and collections departments to do more with less resources—and make better decisions in the process.

However, too often companies are operating at a business unit level which translates to unexposed credit risk. If each business unit independently evaluates and assigns credit limits the total exposure at the top level is far more than the company realizes. It is for this reason that companies should look to centralize credit risk analysis.

When it comes to determining corporate credit risk, companies need to perform ongoing risk analysis through credit scoring and systematic review of accounts based on key indicators or triggers. This approach requires the use of external factors gathered through third parties combined with internal data such as payment history, disputed invoice history and industry credit comparisons.

In the face of this volatile economy particularly, it is important for organizations to beware of the corporate customers that they take on for risk that they have bad payment history. Companies that are using a credit & collection workflow automation application that can combine judgmental scorecard capabilities with the power of statistical-based credit scoring are more likely to combat this directly. Data such as the customers risk category and the probability of bad dollars and dollars at risk (DaR) can be utilized to help drive credit line scorecard analysis, thereby bringing greater accuracy to the model. Benefits for organizations that choose to implement automation combined with credit-scoring functionality can expect to see a substantial lift in system performance and potentially a 5% to 20% reduction in DSO.

Today's receivables management systems are equipped to allow users to find out pertinent information about potential customers and assess their individual risk based on their past payment performance. From this, management can then decide how they should go about following up for payment with specific types of customers. For example a high-risk customer may need more frequent contact, such as two or three e-mail notifications and a call reminder in the days leading up to a bill being due, whereas a low-risk customer who consistently pays their bill on or ahead of schedule each month may just need one e-mail reminder a few days before the bill is due.

By knowing and using the probability of occurrence of specific credit and collection events, it is possible to optimize the allocation of available resources in a given credit and collection environment, thereby developing strategies that mitigate the possibility of negative results, while at the same time, increasing the credit lines of low risk accounts and providing the opportunity for additional revenues.

"Thanks to the AvantGard Receivables solution we have been able to dramatically lower DSO, as well as reduce the number of past due payments."

- Donald Callahan, director of cash management and treasury, FCI USA, Inc.

4. SEGREGATE DISPUTES FROM THE COLLECTIONS PROCESS

The timely management of invoicing problems can make a dramatic difference in your ability to collect outstanding balances, as it can affect your customer relationships and help tighten your operating ratio.

This segregation of disputes from the standard collections process can be accomplished by instituting a system to help manage and track such problem invoices. With less disputed transactions, collection activities will be more effective, decreasing the carrying costs of receivables. Increased customer satisfaction and a more proactive approach to dispute resolution will also result in less relationship deductions, contributing more to the bottom line.

To do so effectively, there needs to be distinctive strategies in place that dictate how collections departments deal with these acknowledged transactions as opposed to the ones that are in question or disputed. For example, say a customer's total bill sums $10,000, but they claim that there their sales person promised them a 10% discount, therefore they really only owe $9,000. The collector need not place the entire amount in dispute, but rather take payment for the $9,000 and then place just the $1,000 into dispute. By simply requesting that the customer pay on the money they certainly owe and then leave the remainder to be handled and investigated within the organization, companies can significantly reduce their exposure to bad debt.

As simple as this may sound, most companies do not have the systems or technology in place to execute on this strategy. With an automated order-to-cash solution, the collector can take payment and then place the disputed amount into a workflow process for review and approval. As such, responsibilities to resolve can automatically be assigned to respective employees. When a new problem is logged in the system, the receivables management system will be able to link the specific problem, such as a disputed pricing discount, to an owner. Upon problem assignment, the system will automatically notify the problem owner. The owner can access the system to view and resolve the problem.

Corporations that choose to implement technology with the ability to separate disputes and automatically prescribe strategies to resolve problems can expect to see significant improvements in the collections process in the forms of more timely resolution of disputes, as well as a reduction of bad-debt expenses.

CASE IN POINT:

Company: Future Electronics
Industry: Wholesale Distribution
Location: North America
Solution: AvantGard Receivables

Future Electronics implemented AvantGard in North America and then later extended the usage throughout Europe and Asia. Future Electronics was able to increase productivity without adding headcount and has improved the effectiveness of their worldwide credit and collections operation. They have also gained visibility into their collections performance and cash forecasting. By segregating disputes and using root-cause analysis, the team has been able to identify process improvements leading to decreased dispute volume in Europe and Asia.

SOLUTION BENEFITS DERIVED:

- Centralized operations
- Organized workflow
- Decreased past due account receivables by 20%

5. MANAGE BAD DEBT RESERVES AT THE CUSTOMER LEVEL

For many companies, managing and quantifying deductions, disputes, chargebacks and claims is difficult. However, implementing automated systems that can expeditiously route & resolve disputes will significantly help corporations to better manage bad debt reserves, or the funds that they must set aside to cover when a customer does not pay their bill in full. By reducing these bad debt reserves, companies have more liquidity available to them to invest or impact their bottom line profit.

More efficient collection procedures and applications not only give a company more value for each dollar it has been spending, but will actually reduce the number of dollars it spends in the future. Automating collections is no small undertaking, and it will cost the company a few dollars upfront, but the payback period can be quite short considering that future expenses have been greatly reduced.

By gaining more accurate accounts receivable portfolio monitoring, more precise estimates of bad-debt reserves and improved forecasts of monthly cash flow can also be achieved. A major component of this is taking stock of customers' past payment performance, which most likely will directly correspond to their future payment habits. By managing bad debt reserves at the customer level, corporations can more strategically allocate funds in this area.

Over the long-term, corporations can count on bad debt expenses being greatly reduced with automation. Automated collections will enable a company to reduce the average age and risk of its accounts receivable. Down the road, there will simply be fewer and smaller bad debt write-offs. In fact, a 50% reduction in bad debt expense is not uncommon for companies that automate collections. Such improvements will add significant profits to a company's bottom line over time.

Automation will give companies the tools needed in order to accurately plan out their bad debt reserves, rather than just allocate a certain percentage of their funds without basing it on hard facts, like credit risk, etc. This will help corporations to keep their hands on liquidity at a time when it is so very important.

"After we implemented AvantGard, we lowered our DSO, decreased past due A/R, and reduced our bad debt reserve by 20%. With the increase in cash flow, Dresser improved working capital and paid down debt."

- Bill Uhrich, director of corporate credit, Dresser

CONCLUSION

As outlined in this paper, corporations can take powerful measures to ensure that that their credit and collections department are run more efficiently and effectively—even in the face of the Credit Crunch. Through implementing automated systems that are intuitive enough to embed receivables workflow with risk management functionality, organizations will be enabled to unlock cash that may have been tied up in such activities as covering bad debt. This in turn will have a positive impact on bottom line profit and help companies to rise above the turmoil.

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For more information on AvantGard please visit us at www.sungard.com/avantgard
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About AvantGard

SunGard's AvantGard is a leading liquidity management solution for corporations, financial institutions and the public sector. AvantGard provides chief financial officers and treasurers with real-time visibility into cash flows and increased operational controls around treasury, receivables and payments management. The solution aggregates data for a single view of cash, drives productivity through automation, and fosters collaboration between trading partners. For more information, visit www.sungard.com/avantgard.

About SunGard

SunGard is one of the world's leading software and IT services companies. SunGard serves more than 25,000 customers in more than 70 countries, including the world's 25 largest financial services companies.

SunGard provides software and processing solutions for financial services, higher education and the public sector. SunGard also provides disaster recovery services, managed IT services, information availability consulting services and business continuity management software.

With annual revenue exceeding $5 billion, SunGard is ranked 472 on the Fortune 500 and is the largest privately held business software and services company on the Forbes list of private businesses. Based on information compiled by Datamonitor*, SunGard is the third largest provider of business applications software after Oracle and SAP. Continuity, Insurance & Risk has recognized SunGard as service provider of the year an unprecedented five times. For more information, please visit SunGard at www.sungard.com.

* January 2009 Technology Vendors Financial Database Tracker http://www.datamonitor.com