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A/R Outsourcing— Coming of Age in the New Millennium

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Outsourcing accounts receivable has become an essential business tool in today's credit environment. The traditional, vertically integrated, self-sufficient business model simply does not apply. In its place, a new set of words defines business success—speed, expertise, flexibility and innovation.

Outsourcing is redefining the modern organization in ways few people envisioned just a decade ago. It is unlocking new ways of doing business both nationally and globally. Along the way, outsourcing has become the central driver of economic success.

A recently completed *CFO* Magazine and AMR Research study found that 68.3 percent of the companies surveyed currently engaged in some form of business process outsourcing, or as it has become to be called BPO. Traditionally, outsourcing has played a major role in the information technology function of business. However, many analysts believe the market for the business process outsourcing will grow faster than the traditional IT outsourcing market.

Today's global winners have learned to focus on a few well-chosen core competencies—those skills and knowledge sets that truly differentiate them from the competition. Through outsourcing, the assignment of critical, although non-core, business functions to outside specialists, these leaders immediately bring their entire operation up to the best-in-the-world standards at a cost equal to or less than current expenditures. At the same time, they often avoid huge capital investments.

Outsourcing demands new ways of thinking on the part of management. Executives need to move away from the notion that outsourcing implies that a particular function is unimportant or expendable; nothing could be further from the truth. Outsourcing works best when it is seen not as the abdication of responsibility but as the leveraging of talent and resources. It is the organization's ability to harness the special skills and capabilities of the outsider that produces the greatest value. Outsourcing needs to be approached strategically by the credit executive. The goal is not to get the best deal, but, rather, to get the best business partner.

One may ask, "How does outsourcing pertain to the accounts receivable function?" You only need to review the basics of the function. The primary function of the credit and collections department is to bring in the receivables that are due. The secondary functions of identifying accounts needing documentation; identifying disputes; identifying problem accounts; and identifying unapplied cash are just as important and should not be overlooked.

Credit executives need to determine the cost expenditures incurred in performing these functions. Are the expenditures consistent with the goals set by the company? Do they exceed the amount of receivables being collected?

While specific proportions of accounts receivable to assets will vary by company and industry, the accounts receivable portfolio is usually the largest asset of companies who sell on credit. On average, these portfolios can amount to 21 percent to 34 percent of a company's assets. Yet, accounts receivable tends to become the "forgotten asset."

Accounts receivable, the forgotten asset. A survey conducted primarily by Price Waterhouse Coopers found that:

- Forty-eight percent of the companies surveyed do not have formal and written policies and procedures in place to address the management of their accounts receivable and the extension of credit.
- Forty-three percent of the companies that had such policies and procedures in place did not monitor activities and adherence to their policies.
- Fifty-seven percent of the surveyed companies failed to set performance objectives for the management of their accounts receivable portfolios.
- Of the 43 percent of the companies that set objectives, 32 percent failed to monitor performance against objectives.

The main reason sited for not following through on both policies and procedures or performance objectives is that there is not enough manpower to address these issues. This explanation is only further validated through the examination of the almost daily announcements of corporate downsizing.

It is at this point where outsourcing accounts receivable portfolios works to the advantage of any company that sells on credit.

- **Bottom Line**—Increased recoveries, not cost savings, is often the number one reason companies turn to outsourcing. In accounts receivable, this is fairly easy to measure by looking at Days Sales Outstanding (DSO) and the reduction in bad debt. The quicker and more efficiently the accounts receivable portfolio is collected, the better the company's bottom line.
- **Expertise**—Partnering with leaders in non-core business functions enables companies to achieve overall excellence. Accounts are less likely to become delinquent when a staff of

professionals handles advance screening and customer contact. Fewer delinquencies within the accounts receivable portfolio translate into increased company profits.

- **Technology**—In many fields, and particularly in accounts receivable, access to the most current technology determines success. Outsourcing allows a company to take advantage of this, without the substantial and often prohibitive investment required.

- **Consistency**—Outsourcing receivables allows for consistency on two fronts. First, there is a dedicated staff to ensure that invoices are followed up on in a timely and professional manner. Second, a volume increase or decrease will not affect performance.

- **Core Business Focus**—This can well be considered the underlying benefit to all outsourcing relationships. Outsourcing allows a company to concentrate on its business—its products or services—and the reason its customers are there. The data management, customer follow-up and technology required to manage receivables can consume vast resources. The outsourcing firm can usually manage these functions more efficiently. This efficiency leads to tangible results. Prompt and efficient follow-ups significantly reduce the number of accounts that become delinquent, thereby maintaining a company's core client base, which in turn leads to increased sales.

There are many benefits to be derived from partnering with an accounts receivable outsourcing firm. These benefits include, but are not limited to, increased cash flow; reduced operating costs; improved control over accounts receivable management; increased sales to slow paying accounts; fewer delinquencies resulting in lower collection costs; and improved customer service.

Does it work? Below are actual results obtained by a company that outsourced a major part of their accounts receivable function.

Specific Results

- Unapplied cash decreased from $1,233,803.00 to $127,729.00
- Invoices aged over 360 days *decreased* from 16 percent to 2 percent.
- Invoices aged 181-360 days *decreased* from 8 percent to 4 percent.
- Invoices aged 91-180 days *decreased* from 11 percent to 5.3 percent.
- Invoices aged 31-60 days *decreased* from 4 percent to 3 percent.
- Invoices aged 1-30 days *increased* from 25 percent to 39.3 percent.
- Current invoices *increased* from 29 percent to 42.4 percent.

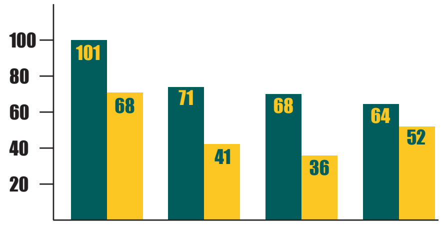
Overall Results

- DSO was reduced from 68 days to 36 days.
- Unapplied credits were practically eliminated.
- Customer goodwill was enhanced.
- No additional staff was required.

Does it work in all industries? Although I can not say emphatically yes to this question, as my experience is limited to the companies and industries I have worked with, I have yet to find one where outsourcing the accounts receivable function cannot work.

Below is a bar graph showing a before-and-after-picture of four companies in four very different industries.

REDUCTIONS IN DAYS SALES OUTSTANDING FOR FOUR OUTSOURCING CUSTOMERS



Choosing an outsourcing firm as a business partner can often be a daunting task for any credit executive. Outsourcing firms are in the business to provide accounts receivable management services. However, the services offered can be extremely varied. The credit executive should make sure any outsourcing firm they are considering as a business partner specializes in providing innovative receivable outsource management services to businesses without jeopardizing the delicate client-customer relationship.

The credit executive should look for a firm whose services are comprehensive and cover all basic accounts receivable functions; such as placing "soft calls"; fulfilling invoice requests; identifying disputes; identifying collection "problem accounts"; conducting "skip tracing"; billing; and forwarding of non-paying, problem accounts to either a collection agency or an attorney. Their services should address current and "slow paying" accounts and not delinquent or charged-off accounts. There must be a clear distinction on the part of the credit executive that an outsourcing firm is not a collection agency. All customer contacts should be made in your company's name so as to avoid your customer from wrongly assuming their account has been placed into collections. The maintenance of this delicate and important customer relationship should be the foremost consideration when choosing an outsourcing firm as a business partner.

Through the utilization of the following checklists, the credit executive can determine whether the outsourcing of their accounts receivable functions poses a viable option for their company.

Credit Cost Analysis Checklist

1. Does your current department handle both the credit analysis and collection functions?
2. Is there pressure from the Sales Department to speed up the credit approval time period?
3. Does your staff feel there is currently enough time to do a complete credit check?
4. Do you have a written Credit & Collection policy? Is it followed?
5. What is the overall cost of approving an applicant for credit?
6. When was the last time your credit policy was reviewed?
7. Are the contracts (agreements) & credit applications separate documents within your company?
8. How often are credit applications updated?
9. Does your firm require financial statements from applicants requesting credit?
10. Is your credit department staggered based on dollar amounts of credit requested? On any other criteria?

Collections Cost Analysis Checklist

1. What is your current DSO?
2 What is one day of sales converted to revenue worth?
3. How many of your customers receive an invoice each month?
4. At what point is your customer first contacted by telephone for payment?
5. Who makes the first contact for payment?
6. How many people are involved with the first contact?
7. How many of your customers can each of your people contact per day?
8. Do your people have other job functions with higher priorities than collecting?
9. What is the direct expense related to this specific time within the collection cycle?

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