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OTC Best Practices in a Financial Shared Service Center (FSSC) Environment

by Chris Caparon, COO Cforia

Oddly enough the person who wrote "The more things change, the more they stay the same" (*paraphrased*) was a French author, Jean-Baptiste Karr, in 1849. But, as a 2015 order to cash (OTC) finance process axiom, this saying still holds true today...for many things, including Shared Services.

The 1980s - You might remember back in the '80s, the leading business analyst firms (*and their predecessors*), including folks like Accenture(www.accenture.com), KPMG(www.KPMG.com), BoozAllen Hamilton (www.boozallen.com), The Hackett Group (REL) (www.thehackettgroup.com), PriceWaterhouseCoopers(www.pwc.com), and Deloitte (www.deloitte.com), reported on driving the principles and processes compelling companies to reduce their traditional centralized finance and accounting staffs and moving them "closer to the customer."

This made sense. The basic objective was to make your company easier to do business with; provide better, faster, more responsive customer service; deliver geographically desirable regionalized and specialized services through existing infrastructure in the operating business units (BU's) - particularly where "In-Country" advantages were tied to Culture, Language, Currency, and Client Data in legacy ERP finance and accounting (F&A) systems.

The fatal flaws ultimately uncovered in the "distributed approach" are that in the end it raised overall F&A operating costs. This ended up creating: 1) A great deal of duplication of global F&A efforts; 2) Built even more manual redundancies into an already complex set of disciplines; 3) Made it next to impossible to see real-time client Parent/Child hierarchy roll-ups globally to get a 100% clear picture of overall credit and receivables portfolio exposure; 4) Collectors from multiple BU's were all calling the same Client payables department contacts -*multiple times a day;* 5) Customer Service related to efficient Dispute and Deduction Resolution was a nightmare and led to unhappy customers, higher reserves, more write-offs and too many Credit Memos issued for unearned discounts, which the global OTC team simply did not have time or available information to chase effectively; and finally 6) Accurate and global Client Aged Trial Balances, represented in a Base-Currency and visible in Transaction-Currency and Trading-Region Currency, was only possible from huge Microsoft Excel Pivot-Table spreadsheets and were typically weeks if not months out of date.

The 1990s - In the '90s we started to see the OTC methodology pendulum swinging back toward a new set of scalable, replicable and predictable outcomes, which could deliver high Internal Client (the BU's) and External Client responsiveness, while minimizing the counterproductive, redundant and labor intensive manual processes of a distributed model - thus was born the concept of Shared Services Organizations (SSO) and ultimately Financial Shared Services Centers (FSSC).

Shared Services are basically an operational business model which enables resources of a common operational discipline, to be utilized and leveraged across an entire organization, whether that organization is regional, national or global. The end result should be about delivering better customer service, lowering operating costs, eliminating duplication, simplifying procedures and processes, enabling measured satisfaction through analytic analysis using things like Net Promoter Scores or Service Level Agreements (SLA's) and deliver better overall analytics so you can work on continuous improvement.

In general Shared Service Organizations (SSO) are particularly well suited for back-office operations, like Order to Cash (OTC) - especially Collections Prioritization and Cash Acceleration, Dispute and Deductions Management, Credit Management (Provisioning, Decisioning, and Risk Analytics) and Cash Application.

What differentiates Shared Services Organizations (SSO) from the centralized method of the '70s and '80s, is the basic business approach. The processes and the underlying technology facilitate better operating results and ultimately better service to your internal and external clients.

The SSO today is accountable for delivering business impact and derived value, cost effectivity and service level increases. It is also responsible for identifying and creating new ways to leverage the new operating model.

Financial Shared Services Centers (FSSC) are intended to find a happy medium between traditional centralized finance and accounting services and disjointed financial services, thus eliminating many of the six fatal flaws of the "distributed approach" mentioned above.

<u>The 2000s</u> - Since 1999 Deloitte has conducted a biennial survey of over 1000 Shared Service Centers (SSC's) in 35 countries. Their latest installment "*2015 Global Shared Services Survey*" was published in February and there are some very interesting findings and stats.

One of the surprises (*or perhaps not if your company falls into this category*) is that companies with revenues of less than $5B represent 56% of those who have adopted Shared Services models. Of that 56%, nearly half (48% of the total) are actually companies with less than $1B in annual revenue. This tells us that just about any company operating globally is already realizing or poised to realize advantages from a shared services business model. The Deloitte findings also show that companies are expanding their shared services organizations at an increasing annual rate - *SSO and FSCC adoption is accelerating.*

SSC and FSSC benefits are not isolated to any one industry. In just the Deloitte survey there are over a dozen Industries represented. The top five are no surprise; Manufacturing, Technology & Telecom, Financial Services, Consumer Packaged Goods and Life Sciences. Another non-shocker is that over 70% of the respondents will be increasing the number of business functions covered by their Shared Service Centers in the future.

Every SSO and FSSC business model is based on three key elements that you need to get right: The resources used, scalable-replicable-measurable processes and the underlying technology which makes it possible. There is definitely an element of centralization involved in building an SSO, but the bigger picture is gaining collective advantage and operational efficiencies through processes which are in a constant state of continuous improvement.

Globally, the distribution of SSO's are where you would expect to find them; India, Eastern Europe, Latin America, Asia/Pacific and North America. Another surprise is that the largest concentration of Shared Service Centers in the Deloitte survey is in Western Europe.

Their findings on distribution identify that geographic barriers are decreasing and companies are finding ways to address finding talented resources and addressing Multi-Language, Multi-Currency, Multi-Time Zone, regulatory and the ever-challenging technological hurdles.

SSO's typically start as single function operations like Order to Cash (e.g. Accounts Receivable, Credit, Dispute/Deductions Management, Cash App) or other accounting functions like Payables or General Accounting. Once a company is comfortable with managing single-function SSO's, they tend to roll-up into additional operational services areas like Purchasing, Customer Service, IT and HR.

Kathryn Kienast and Robin Rudy from Booz Allen Hamilton (www.boozallen.com), released a nice whitepaper at the beginning of this year titled "*Making Shared Services Work for You*". While the paper focuses primarily on the federal government (*as does Booz Allen itself*), it give us some keen insights that apply in the private sector. In their conclusion, they point out that there are "examples of successes resulting in cost savings, reallocation of resources to mission and quality improvements in service delivery." A very good thing for our government as their primary revenue source is you and me.

The introduction had a great perspective on several critical make-or-break elements of a successful Shared Service operation: "*Technological capabilities and economic constraints enable and necessitate, respectively, achieving economies of scale and operational efficiencies that will lead to greater adoption of shared services as a model for high-performing organizations.*"

Let's take a look at them one at a time. First: *Technological Capabilities.* How many of you reading this have unlimited IT resources? OK, silly question. How many of you have an IT staff that tells you they have a very long list of business critical issues on their plate and your departmental request will simply "*Just have to wait?*" Or, they tell you that gathering the data you want to access is simply not possible in a real-time aggregation today.

One of the very best examples we see of the latter today, is this: "***We want to see a real-time roll-up of our credit and receivables portfolio exposure with the XYZ Corporation globally, across all BU's, across all geographies, across all ERP systems of record and secondary supporting transactional systems, across all Parent/Child roll-ups***." Does that "*Sorry, real-time data is unavailable,*" reply from IT strike closer to home than you care to admit? Unfortunately this is true for most companies.

Take heart, there is an answer for that painful "technology" element...which does not entail three to four years and millions of dollars bringing all operating BU's onto a single ERP (Enterprise Requirements Planning system) instance. Oddly (*or unfortunately*) enough, most of us know firsthand that even being on one ERP instance (e.g. SAP, Oracle, JDE, PeopleSoft, Infor, ...etc.) does not guarantee having a single source to view "the truth" about all open Customer financial transactions, in all their Order-to-Cash stages.

Let's look at the second Booz Allen business driver "*economic constraints*". There is no confusion about what that means. Global competition is rising for all companies. This increase in available global sourcing options, for everything from toasters to oil tankers, is driving margin pressure up and prices down, by its very nature this "*necessitates...achieving economies of scale and operational efficiencies that will lead to greater adoption of Shared Services as a model for high-performing organizations."*

This is a self-fulfilling business prophecy, which if not responded to, will lead to the reduction in our global, national and regional business success. I love their conclusion, "*There are many potential customers on the fence today—they must be prepared for the migration and implementation of Shared Services either by choice or by mandate in the future."*

Ms. Kienast and Ms. Rudy borrowed a good definition for Shared Services from the Gartner Group IT Glossary: Shared Services or Shared Services Center (SSC) refers to a dedicated unit (including people, processes and technologies) that is structured as a centralized point of service and is focused on defined business functions. These functions are supported by IT and IT services for multiple business units within the enterprise. Shared services may come from several different physical locations, and may involve numerous business functions and IT processes. The definition, structure and scope of an SSC start within the enterprise. Enterprises sometimes engage external providers to consult with various elements of the design, structure, location options and execution options. Execution and long-term delivery may be by internal enterprise personnel or by service providers, or some combination thereof. Consequently, the definition of Shared Services is independent from the sourcing option for delivery."

The challenges they write about in setting up Shared Services models are focused on Shared Services Providers (SSP's). Today we are going to focus on "in-sourcing" for delivering OTC Best Practices in a Financial Shared Service Center (FSSC) Environment in-house.

As those who have embarked down the SSO and FSSC path can tell you, ultimately the SSO or FSSC "must do no harm" to your current ability to delight (service) customers efficiently and effectively. The last thing you want to do is end up hurting your existing ability to deliver on-target, on-budget and on-time when it comes to fulfilling you company value proposition. The fundamental business concept that all processes are ultimately about Customer Service, is not a revelation.

Let's switch gears now and look at the specific areas of Order-to-Cash that need to be effectively addressed by a SSO or FSSC, in order to impact your company's working capital.

There are really just three main levers any company can pull to improve available working capital: Inventory, Receivables and Payables. For services companies, without physical inventory, there are only two. In most companies around the world, Accounts Receivables (A/R) typically accounts for about 60% of a company's working capital. Improvements in A/R clearly make a very large impact on working capital via Cash Acceleration and Cash Risk Mitigation.

How big of a working capital problem (*or opportunity, if you are an optimist*) are we talking about?

PriceWaterhouseCoopers, in its annual "*Cash for Growth – PwC's global working capital survey 2014*" concluded that total available working capital for businesses has stagnated for the past four to five years at around $2.6 trillion dollars. The five weakest sectors identified are those consuming the most cash in their business operations. These include Farming, Healthcare, Transportation, Aerospace and Pharmaceuticals manufacturers. PWC feels that there are "significant opportunities" for these identified sectors for working capital optimization processes, people and technology.

PWC positions the working capital challenge (*opportunity*) like this:

"*Working capital remains an obvious and key source of cash, but relative working capital management performance has stagnated over the last five years. Companies that had focused on improving working capital immediately after the credit crunch have made little gains since then. This is despite the fact that our analysis shows that companies that have sustained working capital improvements have also outperformed in terms of EBITDA*."

Only 9% of the companies in the PWC annual working capital analysis have sustained three consecutive years of working capital improvement. Between the companies surveyed there is an 11 Day DSO delta between best performing companies and average performing companies. There is also a 4% EBITDA margins delta, which PWC and Wall Street consider strong indicators of a company's management efficiency and the degree to which a company's products and services are meeting customer expectations. A best possible DSO stat gives the Street visibility into how well companies are reducing receivables delays, disputes, deductions and unearned discounts.

Most of the analyst firms agree there is between $1.4 and $1.8 Trillion which can be released from working capital tied up in DSO, POT and inventory. With Accounts Receivable accounting for nearly 60%

on average, that is over $1T unnecessarily tied up in Order-to-Cash (OTC) people, processes and technology.

Consider that $1T trapped in Accounts Receivable would be the equivalent of a 6-7% increase in sales revenue for the global 2000 companies. How much of an "equivalent impact" could your Collections, Dispute and Credit departments have on your company bottom line with that kind of effect?

The conclusions from Ernst & Young's (E&Y) annual global survey "*Working Capital Management 2014*" *were "In the US, 51% of the companies included in our research reported a deterioration in WC performance, while 53% of those based in Europe showed an improvement."* This survey also points out that that DSO is trending higher in the US and was basically flat in Europe.

The E&Y working capital analysis is based on surveys from over 4,000 companies: 1000 in the US, 1,150 in the Euro Trading Zone, 570 in Asia, 100 in Australia and New Zealand, 300 in Canada, 400 from India, 230 from Japan and 250 in Latin America. This report covers both "large" companies, those with revenues of over $1B US and small to medium (SME) businesses with sales under $1B US.

E&Y also set expectations for the key working capital programs occurring this year, not the least of which is billing and collections initiatives. These fall into one of the critical four OTC operational segments of: Collections, Dispute/Deductions Collaboration, Credit and Cash Applications - all of which accelerate Cash and improve a company's largest single Balance Sheet Asset, Accounts Receivable.

More than half of the US companies (51%) in the E&Y showed deterioration in working capital performance and nearly 60% reporting weaker receivables performance overall. The 45% of companies in the US that showed an improvement in WC performance in the previous year's report were achieving further progress in the 2014 E&Y report...so people, process and OTC technology success seems to breed more OTC success.

With working capital performance deteriorating for over half of companies being surveyed, and nearly sixty percent (58%) identifying that the time it takes to convert receivables into cash, as measured by Days Sales Outstanding (DSO), is trending up. The vast amount of ready cash, over $1T in Accounts Receivable, continues to increase to the highest levels in nearly three decades.

Over 75% of US and European companies today identify working capital improvement as one of their highest operating priorities. Industry experts like Accenture, KPMG, Booz Allen, The Hackett Group (REL), PWC and Deloitte, all agree there is an urgent need for globally competitive companies to release additional liquidity from internal working capital, to avoid paying an average weighted cost of working capital of 4% and higher.

Most state that there is a large amount of trapped working Capital (WC) in order to cash processes, due to inefficient business information systems and the redundant, repetitive manual processes necessitated by these inefficiencies. This includes the lack of corporate visibility and business intelligence, inadequate root cause analytics for exception management and the inability to roll-up numerous data points from disparate information systems for timely and precise decisioning.

With the uncertain future of global credit markets as a ready source for working capital (*and guaranteed costs*), many companies are investigating the means to unlock working capital internally, leveraging technology and new SSC and FSSC models. An approach we highly recommend to our clients.

Alternatively some companies have adopted the riskier path of significantly drawing down production inventories, shutting down production on lower demand or slower moving product lines, delaying supplier payments (*Is your DPO a little higher these days? - For most companies it is...but your company is also on the receiving end of this working capital lifecycle*), reducing Credit Limits on existing customers and setting more strict Credit Provisioning Guidelines and Risk Procedures, making it very hard for new clients to obtain new or expanded credit lines.

While the latter path may provide some short-term working capital benefit, ultimately it is not a sustainable model and can significantly damage long term customer-supplier relationships and jeopardize the company's future annuity streams from its long-term clients. This is indeed a very risky proposition as global competition and barriers to exit a relationship with your company continue to erode.

Most of the experts agree that the lowest cost source of ready cash today, exists as working capital within the global business units (BU's) and the biggest portion of that is in receivables. The A/R "loan pool" for many companies averages around 10% of sales revenue, in some cases A/R might actually top 25% of a company's revenues, for the vast majority of companies this is the single largest source of pent-up working capital for you to target.

When considering critical path focus areas for optimizing Order-to-Cash results in a in a SSO or FSSC environment, you have to be able to measure and control five (5) critical areas essential for unlocking working capital in Accounts Receivable:

1) **A/R Portfolio Accuracy**: You need to be able to see the full client portfolio through/on all systems of record. You need to know exactly how much A/R is Clean (collectable) today, in 30 days and in 60 days and who is responsible for the next internal or client facing action to control the global portfolio. You need to be able to report on the information from one consolidated view of the "true" A/R and these critical calculations and assignments need to take seconds, not hours, days, or weeks to complete. Consider just one aspect of what we call "Clean Receivables". Every single call your collectors makes to a client cannot begin without knowing exactly what is clean, undisputed, unpromised, not in a payment work-out plan, not part of Trade-Funds and involved in a short payment scenario. Would you like to know exactly how much time is taken by these calculations day-in and day-out in your credit and collections operation?

2) **Accurate and Real-Time A/R Metrics**: Having access to this information is always critical to manage your processes and teams, but it is critical when you set up remote SSO's or FSSC's to service a trading regions like the Americas, EMEA or Asia-Pacific. At a minimum you need accurate days sales outstanding (DSO), days past term (DTP) or days past due (DPD), days deduction outstanding (DDO), percent portfolio disputed (PPD), Percent Credit Line Used and Credit Available calculations - globally for all Parent/Child Roll-Up exposure, across all transactional Systems of Record. This data needs to be accurate and complete for each business unit, region, division and individual customer and easily accessible to your OTC teams in the SSO or FSSC.

The only way you can hope to execute "first call resolution" in an SSO or FSSC, while your resource is on the phone with your customers, is having that key transactional data at their fingertips. This will give you greater SSO and FSSC effectiveness, better ROI on your team's productivity and happier customers with shorter cycle-time for every aspect of OTC. Additionally, in some companies, the difference between best possible performance and actual can exceed 100%. Best practices companies with effective SSO and FSSC's will typically have only 15% to 25% deltas between best possible and actual metrics. Naturally, every efficiency gain can mean millions of additional dollars released from working capital tied up in OTC processes and systems needed to fund your operations.

3. **100% Accounts Receivable portfolio touches every 30-Day cycle**: Your FSSC needs to be intelligently and proactively "touching" (contacting) each and every single receivable balance carrying customer, every 30 day cycle. They need to be leveraging prioritized treatments and methodology and automating routine reminders and tasks. Think about the fact that some Collectors on your team have 500 and in some cases 1000+ accounts they are responsible for each month. No amount of "algorithmically generated statistical analysis" is going to give you more phone-calling cycles out of your already over-burdened teams - you need a five-tiered holistic and technological strategy to facilitate an effective 100% Portfolio coverage. In order of generating impact on Working Capital priority, they should be: 1) Broken Promise Collections Prioritization; 2) Cash Acceleration Collections Prioritization; 3) Automatic calculation of Clean versus Dirty Receivables; 4) Parent/Child Portfolio Exposure (Risk-Based Collections); 4) Treatment and Segmentation Prioritization with Dynamic Strategies tied to empirical payment data analytics; and 5) Zero-Touch Portfolio Management, which is an efficient HTML reminder & dunning templates engine tied to client self-service portals.

4. **Material Changes and Trends in Empirical Payment Behavior**: An effective SSO or FSSC is based on your ability, remotely, to track changing payment behaviors and calculate the associated credit risk exposure with deteriorating client remittance conditions. Broken payment promises, late-pays and short-pays, unearned discounts, percentage amounts of disputed invoices, percentage of receivables portfolios being disputed, changes in historical and seasonality of payment patterns; These are all examples of things which should send up electronic red flags visible to the collections

staff, management, sales and support teams (*if appropriate*), dispute and deductions resolvers, credit analysts and executive dashboards aggregation in Parent/Child roll-ups.

5. **Effectivity in Handling Deductions and Dispute Management**: Deductions, Disputes and Unearned Discounts impact not only available cash, but client profitability rations, specific regional and product/service profitability, as well as core working capital rations like days sales outstanding, days past due, days disputes outstanding. Getting these processes right in an SSO or FSSC will make a significant impact on working capital leakage and increased operating expense when they are not optimized. If deductions and disputes are increasing in absolute or relative terms with a client-site, subsidiary (Child) or corporate (Parent) level, or are trending as percentage of overall receivables, you need the tools to rapidly identify and diagnose the claims or underlying issues, resolve the issues efficiently throughout your required collaborative networks and put corrective actions and process measures in place based on root-cause analytics in order to minimize and promote continuous process improvement.

6. **FSSC Technological Effectivity - How Good Are the Tools:** One of the largest inhibitors to the success of an SSO or FSSC, is its inability to unlock working capital trapped within Order-to-Cash processes and systems. For global Accounts Receivable located across a worldwide or even regional enterprise, with many operating units, many countries of operation, doing business in many languages with support personnel operating on different ERP systems of record which are incompatible...this leads to many manual and off-system processes supported by disconnected spreadsheets and Pivot tables, which create islands of critical finance data that only the local teams have access to. This leads to a very low FSSC *Technological Effectivity* environment, which impedes progress, provides limited visibility for accurate consolidated metrics and fails in establishing the framework for services consolidation and focus of employees and management on ways to better serve your customers or improve working capital. There are better ways available today and modern bolt-on solutions which offer very compelling Order-to-Cash project opportunities to quickly and economically leverage your existing ERP investments, improve business intelligence and decisioning, optimize OTC processes, increase service levels internally and externally and fundamentally improve your FSSC impact.

At the 2015 CRF Spring Forum in Tucson, Bill Balduino and Lyle Wallis allowed me to present the Order-to-Cash best practices of over 230 enterprises clients and the OTC improvements they realized in the critical areas of working capital improvement in: 1) Accounts Receivable (A/R)Collections Methodology; 2) Invoice Dispute and Deductions Resolution Handling; 3) Order Hold/Release Decisioning and Processing; 4) Application of Invoice Payments (Cash Application); 5) Lockbox Handling; 6) Generating Reports and Departmental Performance Analytics; 7) Billing Process Methods; 8) Multi-ERP Consolidation & Global Parent/Child Customer Management; 9) Credit Provisioning, Decisioning and Risk Management; and finally 10) OTC Organizational Effectivity.

Drop me a line at ccaparon@cforia.com or call me at 818-871-9687 x 104 and I will send you a copy of the CRF Tucson presentation and corresponding OTC Best Practices Session Hand-Out.

About Chris Caparon

Chris is the COO of Cforia Software, a global enterprise software company, delivering working capital and accounts receivable (A/R) automation software for individual companies, global enterprises, Shared Services Organizations (SSO) and Financial Shared Service Centers (FSSC) for fifteen years. Over 230 enterprises today are managing $240 billion in A/R turnover with Cforia software. In Chris's fourteen years with Cforia as one of its founders, his methodologies have driven successful outcomes based on superior technology integrated with proprietary real-time data integration tools across complex and disparate ERP systems. Cforia Collections Snapshot(SM), Credit Risk Analytics, Order Management, Clean vs. Dirty Receivables Tracking, multi-languages/currency, global Parent/Child risk roll-up and multi-business unit solutions are available in Hosted or On-Site delivery.

Chris and his OTC team offer a comprehensive suite of order to cash (OTC) products and services to maximize A/R performance through a full enterprise suite which includes Auto Cash Application, Credit, Collections and Deductions/Dispute Management Workbench, Electronic Billing and Online Payments, Internal Collaboration and Client Self-Service Portals. For more information visit http://www.cforia.com.

Additional discovery questions from Chris to discuss with your SSO or FSSC teams:

- Do you have a way of separating "Clean" from "Dirty" receivables within your portfolios?
- How long does it take you to adjudicate dispute of deductions claims?
- How long does it take you to prepare for an internal or external audit?
- What percentage of your team's current activity is paper based?
- How do you set calendar reminders for tracking your client's payment commitment?
- Are you using DSO to measure payment terms compliance?
- What percent of deductions discovery occurs 7-10 post payment term due date?
- Do you have the tools to facilitate root-cause analytics in your order-to-cash cycle?
- What percentages of your deductions are discretionary versus preventable?
- Do you have any dedicated FTEs for Order Decisioning (review/release)?
- How difficult is it for you to see the rolled-up parent-child exposure for a client?
- Do you offer Clients a Self-Service Portal?
- What percentage of your inbound client calls are about receiving copies of invoices or statements?
- Do you specialize your Credit, Collections or Dispute Resolution teams?