

Section Two:

Order-to-Cash Processes

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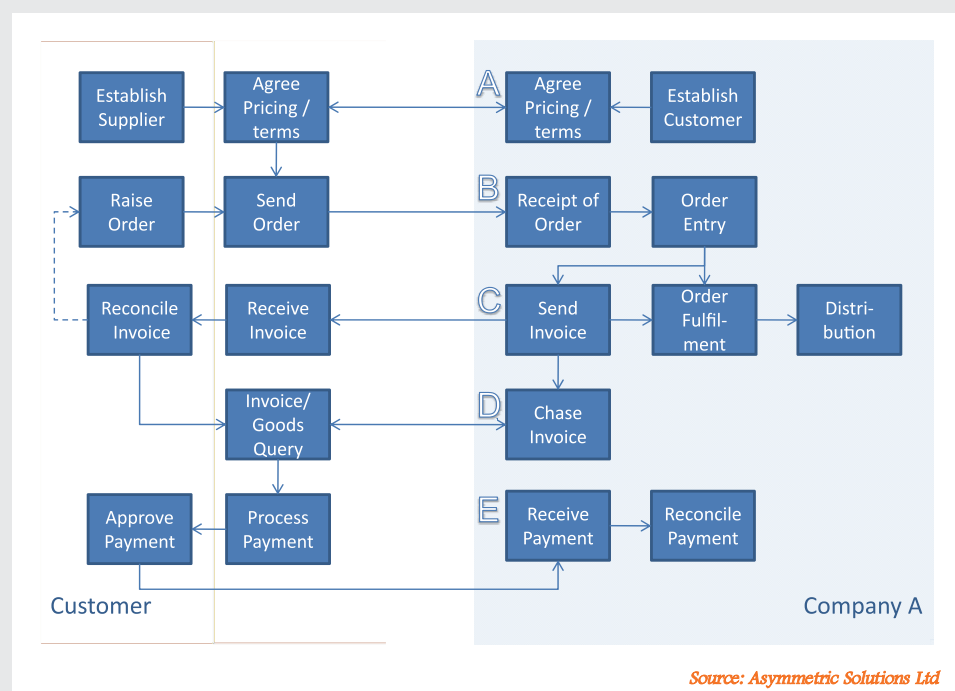
Order-to-cash and purchase-to-pay processes are closely aligned - after all, every company will be both a buyer and seller of services. In this Guide, brought to you by ING, we focus first on order-to-cash. This is deliberate - while CFOs are rarely kept awake at night worrying whether a payment has been made, worrying whether money has been received is quite a different matter. Many cash management and financial supply chain projects focus initially on payments, particularly international payments, as these can be costly unless managed effectively and there is a fear of fraudulent payments, unless adequate controls are in place. Although payments is an important area on which to focus, it may be more

valuable to prioritise collections in many companies as the benefits are more tangible, to ensure that cash is collected earlier, creating cash flow to fund the company's activities. After all, for many firms, receivables are the largest or second largest asset on their balance sheets.

Fig 4 below exemplifies a possible order-to-cash process, with the buyer to the left and seller to the right. For the purposes of this order-to-cash section, Company A is the seller; however, as we will see when we move on to purchase-to-pay, many of the techniques for automating order-to-cash processes are, of course, relevant when Company A becomes the buyer.

Treasurers frequently consider the description of 'order-to-cash' to be synonymous with 'collections,' but this does not take into account the complexity in the processes which precede cash receipt. From the perspective of Company A, the order-to-cash processes - and the challenges surrounding them - include:

- A. Agree order details, including pricing and payment terms. Depending on the scale of the order, type of customer and type of goods/services, companies may apply different payment terms to different customers eg. payment in advance; payment on receipt of goods; payment 30 days from invoice or 30

Fig 4: Order-to-Cash Process

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Order-to-Cash Metrics

Although companies will apply metrics at different stages of the order-to-cash process (eg. the number of days after order date/fulfillment that the invoice is raised, proportion of invoices resulting in a query, speed of query resolution) the most significant metric from a liquidity and working capital perspective is Days Sales Outstanding or DSO.

$$\frac{\text{Accounts Receivable} \times \text{Number of Days (i.e. 360/365)}}{\text{Total Credit Sales}}$$

Or:

$$\frac{\text{Accounts Receivable/Total Credit Sales}}{\text{Number of Days}}$$

DSO is the average number of days between point of sale and collection. Therefore, the lower the number of DSO, the fewer days it takes a company to collect revenue. DSO is calculated as:

- Accounts Receivable = Amount of Cash Owing to Company (i.e. invoiced and not received)
- Total Credit Sales = Annual sales where amounts are payable after order/order fulfillment
- Number of Days = Number of Days in the year - i.e. 365

For example, assuming Total Credit Sales = €1,000,000 and Accounts Receivable is €100,000

$$€1,000,000 / 365 = €2,739.70$$

$$\text{DSO} = €100,000 / €2,739.70 = 7.51 \text{ days}$$

DSO can vary from month to month, and over the course of a year with a company's seasonal business cycle. If using DSO, it is important to analyse trends. For example, increasing DSO may be an indication of customer dissatisfaction or that extended payment terms are being offered (perhaps for competitive reasons or sales target pressures). It could also reflect inefficiencies in credit or collection processes.

However, DSO is not the most accurate indication of the efficiency of the collections process. Changes in sales volume influence the outcome of the DSO calculation. For example, even if the overdue balance stays the same, an increase of sales can result in a lower DSO. A better way to measure collections effectiveness is to look at the total overdue balance in proportion of the total accounts receivable balance (total AR = Current + Overdue), which is sometimes calculated using the Days Delinquent Sales Outstanding (DDSO) formula.

Metrics are available for "best in class" DSO for different industries by companies such as The Hackett Group.

days from receipt of goods. Applying different payment terms helps the company to manage risk but can also make it more difficult to monitor and follow up on receipts.

- B. Orders can be received in a variety of ways depending on the industry and type of goods etc. but a frequent problem is transferring details of the order into the company's systems to be passed on through finance for invoicing and production/services for order fulfillment. Manual input of purchase orders can result in errors and a great deal of resource.
- C. When receiving invoices, many customers will require their original purchase order number so they can reconcile the invoice with the original order details. As well as details of the order, payment terms etc. this information therefore needs to be held on the company's system to be passed through to the customer. Without this, a customer's reconciliation process, and therefore payment, can be delayed.

Invoices are frequently sent by post, which is expensive and, can lose a few days, which can result in late payment. On the other hand, often customers will not accept invoices received unless in hard copy.

- D. With payment terms often extending to 30, 60 days or beyond, and payments frequently received on a date other than the due date, depending on customers' payment run etc. unpredictability of collection timing is a significant problem for companies, making it difficult to forecast accurately.

Furthermore, chasing late payment is frequently a time-consuming but vital activity, made more difficult when different people are involved in collections, or the process is dispersed across different parts of the organisation. For example, the sales team (often distributed across many locations) in many

Fig 5: Example Challenges & Remedies in the Order-to-Cash Process

	Challenge	Remedy
Payment Terms	<p>Ensuring payment terms are appropriate to the risk profile.</p> <p>Monitoring collections when different orders have different payment terms</p>	<p>Customer management system (CMS) and credit process to apply appropriate payment terms.</p> <p>Training of sales staff and processes to ensure that payment terms reflect credit risk whilst being attractive to customers. Supply chain finance solutions, such as receivables financing (please see Part Two of this Guide).</p> <p>Automated collections solution which includes this capability.</p>
Purchase Order	<p>Recording order details accurately in company's systems with limited resources</p>	<p>Electronic order processes such as order scanning and automated data dissemination.</p> <p>Remote order input by customers directly to company's order management/ERP system eg: data originating from customers' systems.</p>
Invoicing	<p>Postage can be expensive and delay payment.</p> <p>Invoices need to include customers' purchase order reference.</p>	<p>Electronic invoicing (eInvoicing) including collaborative approach with customers. For example, eInvoices able to be imported directly into customers' systems.</p>
Collection	<p>Late payment is damaging to suppliers partly due to the unpredictability of cashflow.</p> <p>Chasing payments is not always systematic when conducted on a distributed basis and/or by individuals with other responsibilities, so cash may be received later than necessary.</p>	<p>Modification of ERP or order management system to record this information and allow it to be reproduced on invoices.</p> <p>Early payment discounting encourages timely or early payment and increases predictability of collection.</p> <p>Centralised collections process, either through shared service centre or dedicated collections factory.</p>
Reconciliation & Working Capital	<p>Difficulties in identifying when cash has been received into different accounts etc.</p> <p>Impact on customer relationships and liquidity/ working capital</p>	<p>Work with banking partners to ensure that invoice number is shown on bank statement for reconciliation.</p> <p>Cash centralisation to allow greater visibility of collections and control over liquidity.</p>
Payment under Export Letter of Credit	<p>Errors in trade documentation delay receipt of cash.</p>	<p>Review and tighten internal processes, including seeking advice from trade banking partners.</p>

companies is responsible for chasing collections but sales professionals are generally incentivized to generate revenue, so these other priorities frequently prevent collections from being managed systematically.

E. Receiving payments in different banks, accounts, locations and via different payment methods means that finance managers do not always know when payment has been received,

particularly if reconciliation is a decentralised activity. This can cause problems with customer relationships - for example, a company appears unprofessional if chasing invoices, which have already been paid, or incorrectly stops future orders. Furthermore, unidentified or unpredictable collections restrict a company's efforts to manage liquidity and working capital.

In theory, the timing of cash received under the terms of an export letter of credit should be more predictable. However, with a large proportion of trade documentation being submitted to the bank with errors, often repeatedly, which need to be remedied before payment can be made, companies are often unnecessarily delaying inflows of cash which could be essential for liquidity management purposes.

Remedies to Order-to-Cash Challenges

Addressing the challenges above can be achieved in various ways, including a combination of internal initiatives, potentially with solution vendors and/or banks, and external projects working with banking partners. While every company's order-to-cash process will differ, some of the most important solutions include:

Purchase order services

Purchase order services are closely allied with eInvoicing. By connecting these processes, buyers and sellers can share a common view of data with data imported and exported electronically from/to the respective companies' systems. Typically, systems supporting purchase order delivery allow copies to be printed and/or the relevant data imported into the seller's systems in the appropriate format. This avoids the need to manually input data from the purchase order and both buyer

and seller record the same reference information. Some systems provide automatic notification to buyers of purchase order receipt.

eInvoicing

Purchase order services can be (although is not always) linked to eInvoicing by automatically creating the invoice based on the purchase order information. Data from the original purchase order is supplemented with additional information from the seller's systems, such as payment terms, and transmitted back to the buyer. Like purchase orders, these can then be printed by the buyer, or imported in the relevant format into its internal systems.

eInvoicing is used as quite a generic expression to include different types of electronic invoicing. For example, EIPP (electronic invoice presentment and payment) and EBPP (electronic bill presentment and payment) are both acronyms frequently used to describe different types of eInvoicing solutions. EIPP is typically

Fig 6: Advantages of Centralising Collections

- Reduce Days Sales Outstanding (DSO)
- Leverage technology and personnel more effectively
- More strategic global customer relationships/support sales function
- Increase Predictability of Cashflow
- Influence Timing of Cashflow
- Potential source of financing

used to describe business-to-business (B2B) invoicing, whereas EBPP is used to refer to business-to-consumer (B2C) billing such as utility and telecoms bills.

Although more relevant to purchase-to-pay, some eInvoicing solutions also include automated purchase order and invoice reconciliation, as well as invoice approval.

One trend, which has emerged in recent years, is a purchase order/invoice exchange, such as OB10, which effectively provides an intermediary mechanism for distributing, receiving, matching and converting purchase order and invoice data.

Centralised Collections

Reducing the quantity and value of overdue collections should be a priority for every CFO, now more than ever. Clearly, the earlier payment is received, the sooner that cash flow is available to the business. Furthermore, during difficult economic conditions, many firms are scrutinizing their credit risk in more detail, resulting in shorter payment terms, lower credit limits and more stringent limitations on re-order in the event of outstanding collections.

In many companies, the accounts receivable function is distributed geographically and by business line, often aligned with the sales organization. As sales departments are primarily focused

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"eInvoicing techniques are developing momentum and many companies are seeing the benefits of both B2C and B2B eInvoicing. The cost benefits in terms of reduction in paper, printing and postage is clear, but eInvoicing brings major benefits to both suppliers and their customers by enabling straight-through-processing as invoices can be processed automatically without the need for data reinput. eInvoicing is an example of a collaborative approach to financial supply

chain optimisation in which both buyers and suppliers benefit, strengthening relationships and making it easier to do business"

Ad van der Poel, Head of E-Business, Payments & Cash Management, ING

on signing new orders, monitoring collections is often a secondary activity or lacks a systematic approach. It is very difficult to ensure that collections are rigorously managed unless there is dedicated resourcing, consistent processes and management visibility over collection status. Centralising the collections function can be physical or virtual - i.e. with collections staff based in a single office or located in different sites but with a common systems infrastructure to automate processes, ensure consistency and produce standard management reporting.

There are a variety of benefits in centralising the collections function, as summarized in fig 6. However, in addition to the operational and working capital advantages, one aspect, which should be emphasized, is the ability for companies to work more effectively with their global customers. A company may engage with a customer in a variety of different locations with various payment terms, credit lines and payment currencies. By centralising the management of collections, companies can establish global credit lines, track customer activity globally and provide consistent payment terms. This avoids multiple accounts receivable communications with the same client and enables companies to give better service.

“Dynamic discounting is an attractive way of increasing the predictability of cash flow and creating working capital without the need to obtain third party financing. However, like supplier financing, trading partner relationships can be enhanced by introducing dynamic discounting. Furthermore, dynamic discounting is based on a buyer’s credit rating instead of being pegged to the supplier’s risk, further strengthening these relationships.”

Robert Dekker, Global Head of Sales Corporate & Institutional Clients, Payments and Cash Management, ING

Early Payment Discounting

Early Payment Discounting or Dynamic Payables Discounting is a process which suppliers can use to encourage buyers to pay early based on a sliding discount scale. The discount amount is calculated dynamically based on the number of days remaining until the due date. Discounting is a more economic means of financing than factoring or asset-based lending, and by creating greater certainty around payment timing, improving cashflow forecasting.

Automated Collections Solution

Whether collections are centralised physically or virtually, using a collections solution to provide systematic receivables management is essential. It is also worth noting in anticipation of Part Two of this Guide that the more discipline in this process, the greater the proportion of receivables that can be

financed. Furthermore, credit insurance is often cheaper and better pricing for receivables financing can be achieved.

Centralised Cash Management

Even if internal processes have been centralised, it is very difficult to manage collections if incoming cash is fragmented across different accounts and different regions. As we will see in more detail in Part Three of this Guide, establishing a regional approach to cash management can address many of the difficulties of achieving visibility, reconciliation and managing liquidity across different countries. Furthermore, with the Single Euro Payments Area (SEPA) payment methods now available, in which ING has established itself as an industry leader, companies can make it easier for their customers to pay them quickly and cost-effectively, wherever they are in the Eurozone. ■

Case Study: Improving Collections in a Major International Service Company

We have focused on increasing the accountability of the Accounts Receivable operation to the business, implementing SunGard’s AvantGard Receivables to deliver excellence in business processes, provide metrics back to the business and ensure that the collections process remains integral to our focus on customer service. We also have close connections with the sales teams and include them in dispute processes at an early stage to ensure that customer relationships are managed effectively. We can also log disputes and create reports by reason and time to resolve the dispute and add notes to each customer account. This has helped us improve collaboration with the customer service departments and collect on

outstanding invoices more quickly whilst ensuring that customer relationships remain a central focus.

We have achieved significant benefits in doing so, including:

- Improved our dispute resolution time by 59% over a 12 month period, together with reporting back to customer services;
- Collected past due cash an average of 3 days earlier
- 75% reduction in our “advanced” accounts receivable past due aging, delivering cost savings of more than \$300K in bad debt expense across the year despite >30% revenue growth.