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Unlike fine wine, Deductions do not grow better with age...

By Chris Caparon

How big of a problem are Disputes, Short-Pays, Deductions and Unearned-Discounts for American businesses today?

Using Credit Research Foundation (CRF) Survey results, Deductions negatively impact Accounts Receivables (A/R) somewhere between 1% and 5%.

Using conservative Deductions averages and taking the United States Federal Reserve 2015 Q1 calculation for "*Non-Financial Business; Trade Receivables; Assets*" of $3.422 Trillion dollars, this works out to Deductions being a $34.4B to $171.1B a year problem...in the U.S. alone.

No surprise, the Dispute "buck" stops with Credit & Collections departments to resolve it, statistically over 80% of the time. Per CRF findings, resolution includes *"the initial investigation and research of customer deductions - 84% say this group has primary responsibility for following up with customers to collect invalid or unjustified deductions as well."*

So, this brings up a lot of questions. In fact, at the end of this article there are a list of questions that you might find as an interesting Order-to-Cash (OTC) Best Practices discussion for your Credit, Collections and Dispute Resolution Teams. It might also be a good idea to invite some other departments, namely Sales, Marketing, Accounting, Contracts, Customer Support, Warranty and IT to the meetings.

The single most consistent comment we hear from Credit & Collections departments is that the teams are already too busy. Quite often a Collector, Dispute Resolver or Credit Analyst might have responsibility over 1,000 or more accounts. This does not leave enough time to even touch 100% of the A/R balance- carrying customers on a rolling 30 day cycle, let alone spend hours each day researching and resolving potentially hundreds of Disputes, Short-Pays, Deductions and Unearned-Discounts.

Quite often the majority of the "resolution" time is spent chasing (multiple phone calls and emails), securing and documenting required collaboration and cooperation from other departments, who might be the source causing the problem, namely people and systems managing up-stream processes (e.g. Sales, Contracts, Quoting, Configuring, Order Entry, Manufacturing, Shipping).

Every one of these critical steps in the Order-to-Cash (OTC) lifecycle generates information (data), and when the data is inaccurate or incomplete, customers on the receiving end of those products and services are unable to fulfill their three-way match requirements.

Every Controller, Treasurer and CFO is constantly looking to the Credit, Collections and Dispute Resolution teams to help reduce risk and improve Days Sales Outstanding (DSO), Days Deductions Outstanding (DDO), and Dispute Resolutions Cycle-time (DRC) in order to reduce overall transaction costs, optimize cash acceleration and maximize customer satisfaction.

In order to achieve these Order-to-Cash (OTC) objectives, companies have constantly invested in process improvement measures, finance and accounting technology like Enterprise Requirements Planning (ERP) systems, and custom software applications to "supplement" the ERP (because they are typically not very good at Order-to-

Cash optimization), internet web portals (Client Self Service, Payment and Internal Collaboration) and Electronic Data Interchange (EDI). These processes and technologies all help improve the effectiveness of executing OTC transactions and compressing Days Deductions Outstanding and Dispute Resolutions Cycle-Time - which directly impacts DSO.

Technology has come a long way in the past fifteen years and today there are complete Order-to-Cash lifecycle systems which are extremely astute at seamlessly interfacing with complex enterprise financial value chain systems (Quoting, Configuring, Sales Order Entry, Customer Warranty, Claims Management, Proof of Delivery, Imaging, Scanning, Fax, Telephony), as well as most ERPs and Legacy Code (e.g. IBM AS400 RPG, SAP, Oracle, Microsoft, Infor, JDE, ...etc.).

Any or all of the above systems (including paper-based filing systems) might come into play for a Dispute Resolver today. The ability to facilitate Order-to-Cash workflow automation, strategic collections management, collaborative inter-departmental dispute resolution, 7/24/365 access to client facing portals for dispute placement, and transaction inquiry with detailed reporting and analysis, are client expectations today.

Having access to all these different pieces of data (transactional information), without having to jump from system to system, and having a way to collaborate with other departments is the key to resolve problems quickly and effectively.

If there is even a 25% chance that a specific piece of this transactional data might be needed at a future date, think audits (SOX 404 come to mind for anybody?) or future dispute resolution, then there is a solid business case for the retention and an even stronger case for the pre-loading of historical data into any new Order-to-Cash system that you might consider. Equally important, these critical pieces of transactional data need to be easily accessible to everybody who is needed in the financial value chain collaboration/resolution loop.

Ask yourself, how many invoices are generated each month by your company? What is the average dollar amount of an invoice? Now, what percentage of those invoices had/have some kind of issue with any of a myriad of dispute possibilities like Co-Op Advertising; Sales Promotions, Allowances, Volume Discounts, Product Rebates; Seasonal Pricing; Contract Errors; Products which shipped late or early, to the wrong location or with required label formatting errors; Electronic Data Interchange (EDI) errors; Services delivered which do not match contract criteria; merchandise which has arrived with concealed shortages, incorrect packaging or have been damaged in transit...etc. The "Reasons Codes" list is endless.

The typical answers to these questions confirms why your company is most likely one of those unwilling, but unavoidable contributors to the $34.4B to $171.1B a year in Deductions issues in the US.

What we have been finding over the last fifteen years and with new client engagements today, is that most Disputes are not being identified within payment term. In fact, payment issues are typically being identified by a Collector 7-10 days post term. For Net 30 terms, this is 37-40 days before the Dispute Resolution Cycle even begins.

One of the greatest challenges Dispute Resolution teams face is little to no visibility. The invoice is being generated in an ERP system and if the system provides any information, it is typically "ND" (Not Defined) or UN (Unknown). There also tends to be little or no ERP tracking/resolution capability for Disputes; Disputes are recorded in Excel spreadsheets, Access databases and Pivot Tables. Disputes are hidden in complex Parent/Child relationships with no ability to roll-up to corporate levels and give you visibility to reason codes for an entire enterprise. There is little to no tracking, progress reporting or the ability to escalate resolution to management in logical workflows. There tend to be few if any collaborative tools to make it easier to cooperate with other departments to fix customers problems causing Disputes. The ability to prioritize or segment Dispute workflow with appropriate treatments based on client types or situations is not present. Disputes have long or unlimited resolution periods. There is no way to define and automatically process small dollar Disputes or track the frequency and abuse of small dollar Disputes; Manual delays are frequent and common when navigating vendor A/P portals to attempt to enter, update, resolve or retrieve status updates. Root cause analysis is difficult or next to impossible.

1. Do some of these Current State conditions exist in your Order-to-Cash operation today?

2. Do you have easy access to systems-based, current and accurate data in order to help your team review and approach Deductions analytically and systematically to create better outcomes?

If your answers are "Yes" and "No" respectively, do not feel alone, you have a lot of company.

Cash tied up in Dispute and Deductions can have a material effect on available working capital, particularly large invoices which can move the Accounts Receivable needle for your team and your company. It is very common for customers to hold significant payments hostage, predicated upon Disputes or Deductions, which might be only a fraction of the overall receivable due. There is no question that Accounts Receivable has traditionally been the cheapest source of working capital - but low interest rates have changed that significantly over the last eight years...and this is not a good thing!

These numbers are startling and the trend it represents is significantly worrisome for Credit, Collections and Dispute Resolutions teams everywhere. "Cheap Cash" has been over-used and in many companies has led executives to forego improving the fundamental processes and systems (technology) which would lead their companies to greater long-term efficiency and effectivity of better Order-to-Cash practices.

This quote is from the June 21, 2015, Hackett Group "*2015 Working Capital Survey*" by REL Consulting

> *"However, low interest rates appear to have led to a level of apathy in working capital management as very little improvement has been seen in the past year. Overall, the companies in the survey have increased total debt by 62 percent since 2007, and the cash balance at these same companies reached $932 billion, a 74 percent increase since 2007. Even with cheap debt, days' sales outstanding increased..."*

The survey goes on to point out that:

> *"Cash flow lessons not learned from the Great Recession - The cash conversion cycle (CCC) once again remained flat in 2014, only improving one day since 2007. Cash on hand continued to increase, improving a total 74% over the same period. Even though revenue has increased 39%, debt continues to be a source of investment, increasing an alarming total 62% over the same period. Companies that increased their debt 100% or more since 2007 had a 1,516% increase in cash on hand but their CCC worsened by 113%. The companies that decreased their debt since 2007 had a 336% increase in cash on hand but their CCC improved 31%. There is a $1 trillion cash flow opportunity comparing top and bottom performers..."*

The REL study's identified revenue growth since 2007, for the roughly 1,000 companies they track each year, as 39% ($4.2 trillion). At the same time the survey group's debt grew 62% ($4.6 trillion). This was being driven by the Federal Funds Rate dropping 4,910 basis points, from 5% to 0.09%. As of August 27, 2015, the Fed Funds Daily Effective Rate was 0.14%.

The Cash Conversion Cycle (CCC) measurement the Hackett Group is referring to is the basic measure of the three fundamental components which make up available working capital: Receivables, Payables and Inventory. The specific measurements REL uses for calculating these key variables are:

Days Sales Outstanding (DSO) = Accounts Receivable (One day revenue)
- – Year-end trade receivables net of allowance for doubtful accounts, divided by one day of average revenue
- – A decrease in DSO represents an improvement, an increase a deterioration

Days Inventory Outstanding (DIO) = Inventory/(One Day Cost of Goods Sold (COGS))
- – Year-end inventory balance divided by average days COGS
- – A decrease is an improvement, an increase a deterioration

Days Payables Outstanding (DPO) = Accounts Payable/(One Day COGS)
- – Year-end trade accounts payable balance divided by average days COGS
- – An increase in DPO represents an improvement, a decrease a deterioration

Cash Conversion Cycle (CCC) = (DSO + DIO - DPO)
- – Year-end DSO + DIO - DPO performance (in days as calculated above)
- – The lower the number of days, the better

Their observation, and concern, is that the Cash Conversation Cycle (CCC) for America has basically been flat for the last eight years. In essence companies have not been doing enough to focus on the processes and technological systems of record (ERP and others) to improve core Order-to-Cash capability and give support to the teams responsible for accelerating cash conversions for what is many times the single largest component of the Balance Sheet: Accounts Receivable.

This is supported in depth within the Ernst and Young "2014 Working Capital Management Survey" and the PriceWaterhouseCoopers "2014 Global Working Capital Survey," both delivered at the beginning of 2015:

> **E&Y** *"In the US, 51% of the companies included in our research reported a deterioration in working capital and receivables performance."*
>
> **PWC** *"Working capital remains an obvious and key source of cash, but relative working capital management performance has stagnated over the last five years."*

If you think about it, there are really just three "productive" levers a company can manipulate to "optimize" available working capital. I highlight "productive" because using cheap cash (debt) to fund growth has gotten out of hand for many of the companies in the studies listed. I highlight "optimize" because *maximizing* working capital is, in most business cases, a bad thing. It is akin to holding too much inventory, or even too much cash if that cash is not deployed in the process of generating revenues/profits.

For most companies (unless you have massive inventory), Accounts Receivable (A/R) is the single largest item on the balance sheet and the speed at which you can convert Receivables to cash can be dramatically impacted within the Receivables Conversion Cycles by Dispute, Deductions and Short-Pays in typical categories. In fact it is interesting to see the stats on "Reason Codes" changing.

In the last survey the top three for Sales Related were: Pricing; Advertising, Promo and Rebates; Allowances and Discounts. For Preventable they were: Fill Rate, EDI/ASN, Freight & Labeling. For Unauthorized they were: Returns; Spoilage; Concealed and Carton Shortages.

For things like Trade Funds Co-Op Advertising, your Client's accounting and your accounting might be very different. As we saw in the CRF Study, this amount can be 90% or more of the invoiced amount, requiring a Credit Memo, if fully approved. Un-earned Early Payments discounts are another very common un-earned discount practice of taking the (2%-10 Day, Net-30) terms and paying on day 40, still shorting the 2% for early payment. Falling into this same category are Time-Based or Regional Sales Promotions. We hear from lots of clients that remittance information on invoices comes in with promotional pricing on hundreds, if not thousands of line-items at promotional prices which ended in the prior billing period or were for parts of the country where the promotional item(s) were never on sale.

The good news - on average, there is a 70%+ Recovery Rate for disallowed Deductions. The bad news - it takes a lot of your team's time, collaboration and cooperation with multiple departments in many cases and accurate back-up *data* to support your denial of claim(s) - which of course takes even more time to resolve. Plus, in the case of major enterprise customers, you might be managing this denial via their Accounts Payable (A/P) portal, causing even more administrative headaches and delays for your team members.

Without accurate and easily retrievable *data*, there is often a great deal of confusion and conflicting information related to how Deductions are processed and treated. The whole process is viewed as a distracting cost-of-doing-business rather than an indicator of what is developing at the individual account level, or rolled up to the global parent level to give a single source of your Client Transactional Truth.

Ask yourself these key questions:

1. If the empirical payment evidence on your Client's Behavior (e.g. Broken Payment Promises, Slow Pays, No Pays, Disputes and Deductions percentages) begins trending to the negative, do you have the systems in place to alert you?
    a. Can you supplement this *data* with Bureau Statistics?
    b. Are you able to use this in overall Risk Analytics on Order-Hold Decisioning?

2. Do all of your global Dispute Resolvers have consistent process methodology and technology support systems to help then execute scalable, replicable and predictable outcomes?
    a. Are these supported by reporting and analytics to track and quantify?
    b. Are you able to take a Best Practice from one team and cross-pollinate to other teams?

3. Do you have systems in place today to help you automate Inter-Departmental Collaboration and Communication?
    a. Are your current dealings manual phone calls and emails?

b. After your team member leaves a call or email, what percentage of the time do they have to follow-up because there was no response or action taken?
c. Do you have a way to track Days Deductions Outstanding and let your contact's manager know if they do not respond in a given timeframe?

In addition to Resolvers benefiting from the use of trailing *data* as leading/trending indicators, this information can also mean a great deal for your company with respect to reducing DSO, accelerating cash, providing more accurate cash forecasts, be a better predictor of third party risk, help you reduce Reserve Requirements and Write-Offs - as well as improving the overall Customer Experience. Think about the fact that many Clients charge their vendors if there is a "preventable error" on the invoice, which causes the Client to execute a more stringent three-way match of discovery as to why the Quote, Invoice and Receipt of Good/Services numbers don't foot.

Okay, out of all of this is there still hope for a better tomorrow? *Yes!*

Over the last fifteen years we have been keeping track of the Return on Investments (ROIs) of specific Order-to-Cash Best Practices employed by our clients that we can share with you. Results related to Deduction/Dispute management Best Practices and some specific improvements areas include:

- 10-50% reduction in Dispute Resolution Cycle Times
- 100% Dispute and Deduction Tracking
- 30-90% improvement in Root-Cause Analytic Tracking to help eliminate chronic recurring upstream issues

One of the most significant improvements we see is related to access to *data.* Bringing together all the disparate pieces of information stored in ERPs, Systems of Record, Access Databases, Excel Spreadsheets, Customer Relationship Management (CRM) systems, Warranty Systems, Contract Systems, Sales-Order-Entry Systems,...etc., which are required in most Resolution Cycles, makes an astounding difference. Think about dramatically cutting down just the "*research*" to find the information locked away in these information silos which do not talk to each other - this really speeds things up.

Next is the ability to Collaborate with other departments and more easily communicate with clients through each step of the Resolution process, even providing them a Customer Portal. Using the Portal, they can respond to dispute Resolvers queries, pro-actively log disputes, request and find copies of needed information, generate a payment work-out and pay via ACH, EFT or Credit Card.

Here are some examples of benefits realized in bringing these processes and systems together:

1. "Pre-Term Touches" - The ability to identify past issues and proactively reach out to Clients with large invoices or complex orders, helping them avoid having to independently deal with issue recurrence. Even better is to do this prior to invoicing on material orders.
2. Accounts Receivable (A/R) Automation - This is tightly integrated with ERP and supporting systems of record providing evidentiary documents (e.g. PODs, PDFs, Digital Scans)
3. Dispute Case Creation -Tracking, Routing, Escalation, Approval, Analytics and Alerts
4. Prioritization - This is based on Working Capital Impact, Risk, Client Type Segmentation and Treatment
5. Root-Cause Analysis & Reporting - Reason Codes, Geography, Product/Service Type, Shipping/Packaging Methods Used, Seasonality, ...etc.
6. Scalable, Replicable Best Practices Resolution Cycle Compression Processes

7. Accounts Payable (A/P) Vendor Portal Automation support – This helps streamline processes
8. Database Driven Automation for Deductions, Disputes and Chargeback Management
9. Rapid Closure of Disputes Supporting Faster Cash Application Cycles

Looking at the list, it comes as no surprise that of the nine listed, "Future States" or "Business Best Practices" being employed by these companies, they all have an element of automation.

In achieving a great many of these Order-to-Cash goals and objectives, and continually improving and refining your process methodology and outcomes, you need readily available and accurate information (*data*) at the fingertips of your Credit, Collections, Dispute Resolution and Cash Application teams.

Without information automation, your teams will be forced to resort to "brute-forcing" far too many required tasks manually with the very limited support of less than efficient back-office tools like Outlook, Word, Excel, Pivot-Tables, Access Databases,...etc. There is little to no way you will ever be able to take advantage of the "multiplier-effect" of pressing a single button (Order-to-Cash program executable or workflow) and effect potentially hundreds of transactions and Client interactions to help improve Working Capital.

Consider each resource in each of your Credit, Collections, Dispute Resolution and Cash Application departments, as a full-time-equivalent (FTE) employee, and look at what an FTE can accomplish in a given work-day. For sake of this discussion, let's say that your employee's capacity for his or her job is "100 Cycles," or 100 FTE Events (tasks), that can be performed in a day. Ask yourself these questions:

1. How many FTE Dispute/Deduction tasks could I perform if I could multiply an employee's productivity through automation of specific repetitive and redundant daily activity?
2. What performance increases could I achieve if I automated the manual Dispute Resolution process with workflow, inter-departmental collaboration and external Web Portals?
3. If I could I address 100% of my High-Volume Low-Value Dispute tasks, what impact(s) would that have on my team and my company?
4. If I could identify Up-Stream Systems causing recurring Disputes & Deductions, how much time would that release back to my available FTE cycles?
5. If I could measure FTE Deductions Key Performance Indicators (KPIs) and Identify Trends, how valuable would that be to the rest of my organization?

Every day we are having these discussions with our teams, trying to continuously improve the process and methods, and releasing more Working Capital trapped within the Order-to-Cash processes and systems.

Accounts Receivable workflow and process optimization methodology and systems have been and remain the best and most reliable (sustainable) long term source of cash to run our businesses. Through better management of Disputes, Short-Pays, Deductions and Unearned-Discounts within American businesses, we will continue to reduce those $34.4B to $171.1B a year issues in the US.

About Chris Caparon

Chris is the COO of Cforia Software, a global enterprise software company, delivering Working Capital and Order-to-Cash (OTC) 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 Accounts Receivable (A/R) turnover with Cforia software. In Chris's fifteen 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 and supporting systems of record. 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.

Good discussion questions for your Credit, Collections and Deductions Resolutions Teams - and key Inter-Departmental Collaborators:

1. What percent of deductions discovery occurs 7-10 post payment term due dates?
2. Do you reset the "Aging Clock" to when Disputes are identified?
3. Do you have a time limit on how long a Dispute remains in the system?
4. Do you have a "Hard Stop" on when Disputes need to be written off?
5. Do you have a dollar "floor" for automatic write-off of Disputes and Deductions?
6. What percentages of your Disputes/Deductions are Discretionary versus Preventable?
7. How long does it take you to Adjudicate Dispute or Deductions Claims?
8. What percentage of your Short-Pays are from Unearned Discounts?
9. What percentage of your current, Short-Pay Disputes or Deductions do you reject?
10. Of the rejected Disputes/Deduction dollars, what percentage does your team recover?
11. Do you have a way to track Disputes Resolution as it leaves your department?
12. Do you have a way to "Escalate Resolution" if the assigned party in another department does not respond?
13. What percentage of Unearned Discounts are for early payment discounts, against late payments?
14. What is the calculated impact on DSO or DPT of Resolutions Cycle Time?
15. Do you have a way of separating "Clean" from "Dirty" Receivables within your A/R portfolios?
16. Do you have the tools to facilitate Dispute/Deductions Root-Causes within your Order-to-Cash cycle?
17. Do you have any dedicated FTEs for Dispute Resolution for complex issues like Contracts Terms or Pricing?
18. Can you roll-up to the parent-child level the trending of Deduction Trending?
19. Do you offer Clients a Self-Service Portal to help expedite Dispute resolution?
20. Do you have tools to help you resolve Deductions from major accounts from within their A/P portals?