White Paper

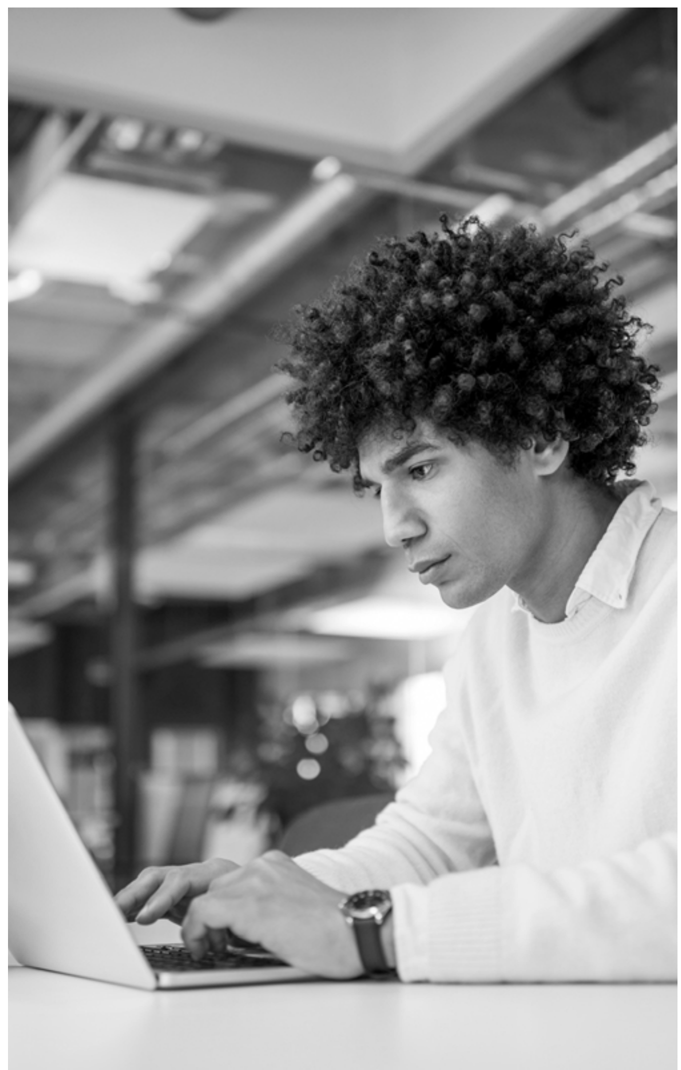
AR Optimized

Drive better outcomes from your accounts receivable (AR) process

For any business, a well-functioning accounts receivable (AR) process is not optional – it's a necessity. Cash flow is the lifeblood of an organization, and AR sits at the heart of it. However, even with significant effort, time and resources dedicated to optimizing AR processes, the results often fall short. Companies frequently deal with challenges such as high Days Sales Outstanding (DSO), uncollectible debts and strained customer relationships that ultimately hinder growth and sustainability.

In a Gartner analysis of 796 financial statements, provisions and write-offs for bad debts increased by 25.8% year over year, from $9.75 million in 2019 to $12.62 million in 2020[1]. These figures highlight just how urgent the need for AR optimization is.

Rather than blaming customers for collection challenges, businesses can benefit from a systematic evaluation of their AR processes. This approach doesn't just address inefficiencies – it creates better business outcomes. By identifying stress points and streamlining workflows, companies can turn AR into a strategic enabler of efficiency, sustainability and competitive advantage.



Why AR efficiency matters

A poorly managed AR process negatively impacts more than just cash flow. It creates significant ripple effects that can disrupt your entire organization, including the following undesirable outcomes:

- **High write-offs:** Uncollectible debts can account for 0.5% to 4% of revenue
- **Elevated DSO:** Excessively high DSO compared to industry benchmarks drains working capital
- **Failed customer relationships:** Dispute resolution and collection litigation deteriorate customer goodwill
- **Employee burnout:** Teams spend too much time chasing overdue payments instead of adding strategic value

Optimizing your AR process mitigates these pitfalls, paving the way for long-term financial health and stronger customer relationships.

Measuring and improving AR performance

The first step toward better AR outcomes is understanding and benchmarking key metrics. What gets measured gets done. By comparing your organization's performance to industry "best-in-class" benchmarks, you can identify areas for improvement and set realistic quarterly targets for progress.

Key AR metrics to track:

1. **Days Sales Outstanding (DSO).** Tracks the average time required to collect receivables, providing a key measure of accounts receivable efficiency. This metric is crucial for assessing collection performance, frequently highlighted by CFOs during earnings calls and closely scrutinized by investors.
2. **Days Deductions Outstanding (DDO).** Tracks how long it takes to resolve deduction-related issues. Faster deduction resolution reduces delays.
3. **AR Turnover Ratio.** This measures how quickly receivables are converted to cash. A higher ratio is better, showing faster cash conversion.
4. **Write-Off to Sales Ratio.** Reflects bad debts as a percentage of total revenue. Lower ratios improve profitability.
5. **Collections Efficiency Index (CEI).** It evaluates the efficiency of collections within a defined time frame, often aligned with end-of-quarter or year-end campaigns, where performance-based incentives are typically offered to drive results.
6. **Disputed Invoices to Total Invoices Ratio.** Monitors the percentage of disputed invoices, typically arising from issues like incorrect or damaged products, inaccurate billing or delayed deliveries. Such disputes can significantly disrupt key metrics within the accounts receivable cycle.
7. **Average Days to Close Disputes.** Tracking the time it takes to resolve disputes provides valuable insights into their root causes, enabling organizations to minimize both their occurrence and the time required to address them in the future.
8. **Ratio of Chargebacks to Total Card-Based Sales.** With the rise of eCommerce fraud, this metric monitors chargebacks, placing the financial burden directly on merchants.
9. **Adoption of Digital Processes.** This ratio represents the proportion of customers utilizing digital payment methods, such as online payment portals, relative to the total customer base. It serves as a key metric, especially as businesses invest heavily in digital transformation. However, some customers continue to rely on traditional methods, such as physical checks, which can hinder the full advantages of digitization.

By using these metrics to identify improvement opportunities, your AR team can implement targeted strategies to address inefficiencies.

Common stress points and how to address them

The Order-to-Cash (O2C) cycle is a complex process fraught with potential friction points. From onboarding customers to accounting reconciliation, each step offers opportunities for both issues and innovation.

1. Onboarding and credit management

Challenge: Credit limits and terms are often established once and seldom reviewed, yet a rapidly changing business environment can significantly affect a customer's financial stability and creditworthiness. Relying on outdated information to extend credit increases the risk of future write-offs.

Solution: Leverage data-driven underwriting and risk monitoring tools to enable accurate, real-time credit decisions. Tailor strategies to different customer segments based on their creditworthiness, risk classification and payment history. To streamline collections, secure credit card authorization for the full order value at the time of order entry. Embedding the payment process directly into the order entry system – particularly in call center environments – can further simplify operations and reduce follow-up efforts. Alternatively, tagging the order as "Cash on Delivery" can achieve a similar outcome while ensuring payment reliability.

2. Order fulfillment

Challenge: The "pick-pack-ship" process is usually managed by an ERP system, but errors in shipping or missing payment confirmations can lead to downstream receivables challenges.

Solution: Implementing extra checks before shipment can prevent downstream issues. For instance, reauthorizing credit cards during the pick-pack-ship process can halt shipments if authorization fails. Similarly, deploying advanced fraud detection algorithms – such as flagging P.O. Boxes or blacklisted addresses – can significantly reduce chargebacks, especially in eCommerce transactions.

3. Invoicing best practices

Challenge: Invoice disputes and delays are often the result of inefficient delivery or miscommunication.

Solutions:

- Send invoices promptly after shipment or in accordance with the agreed terms
- Deliver invoices electronically, whether through email or in advanced formats like XML for customers with sophisticated systems
- Notify customers proactively through email or text when invoices are sent
- Implement a dispute management system that allows customers to log issues, enabling swift resolution by customer service. Addressing disputes early helps prevent payment delays
- Provide a customer portal where invoices can be downloaded on demand, reducing delays caused by misplaced or lost invoices

4. Receiving payments best practices

- **Offer flexible payment options:** Provide a variety of payment methods such as ACH, credit cards and digital wallets. Giving customers more ways to pay enhances convenience and satisfaction
- **Reduce reliance on physical checks:** Processing physical checks is inefficient, costing around $1 per check, adding two to three days to DSO and increasing the risk of mail fraud. Reconciling checks to open invoices can also lead to errors and disputes. Encourage customers to transition to an online payment portal by implementing incentive programs
- **Incorporate embedded financing:** Go beyond traditional payment options by integrating financing solutions directly into your payment portal. Modern financing tools can deliver near real-time rates and terms, offering customers more flexibility while lowering your AR risk

- **Streamline the payment experience:** Build a user-friendly payment portal that allows customers to pay instantly, schedule payments in advance or enroll in "autopay." Businesses that successfully get most customers on "autopay" often see notable improvements in AR metrics such as DSO, reduced write-offs and fewer late-stage defaults

5. Accounting: maintaining accurate and organized books

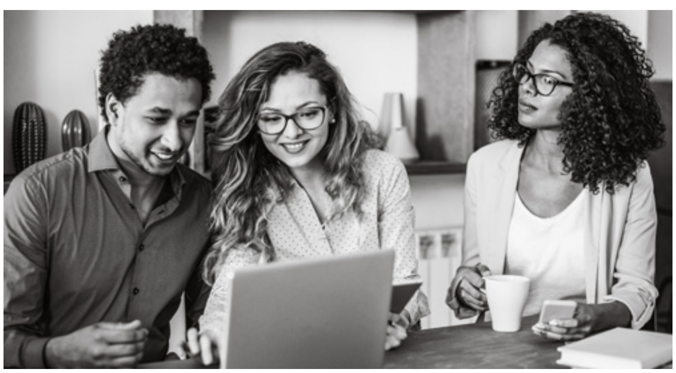
Keeping your books clean and accurate is essential for efficient financial management. This means ensuring open invoices are properly closed, minimizing unapplied cash (payments without matching invoices) and keeping the AR ledger fully aligned with the AR control account in the general ledger.

These practices streamline monthly and quarterly book closures, reduce errors and enhance transparency – key factors in building trust with investors and Wall Street.

To achieve this, consider the following strategies:

- Automate the matching of payments to invoices for seamless processing
- Implement automated reconciliation of bank funding reports to ensure accuracy
- Enable automated posting of AR entries directly to the general ledger (GL)

By adopting these approaches, you can simplify reconciliation, avoid disputes and bolster your company's financial credibility.



Advanced solutions with AI and ML

Deploying artificial intelligence (AI) and machine learning (ML) is a game-changing way to optimize AR. These technologies automate tasks such as invoice matching, and predict risks at the customer level, enabling teams to focus on high-priority accounts.

AI/ML benefits:

- **Customer risk prediction:** Predict default probabilities based on payment history, disputes and external data like bankruptcy filings
- **Proactive intervention:** Identify customers trending toward late-stage default and intervene early to preserve relationships
- **Efficiency gains:** Enable customer service teams to focus on resolving disputes rather than mundane tasks

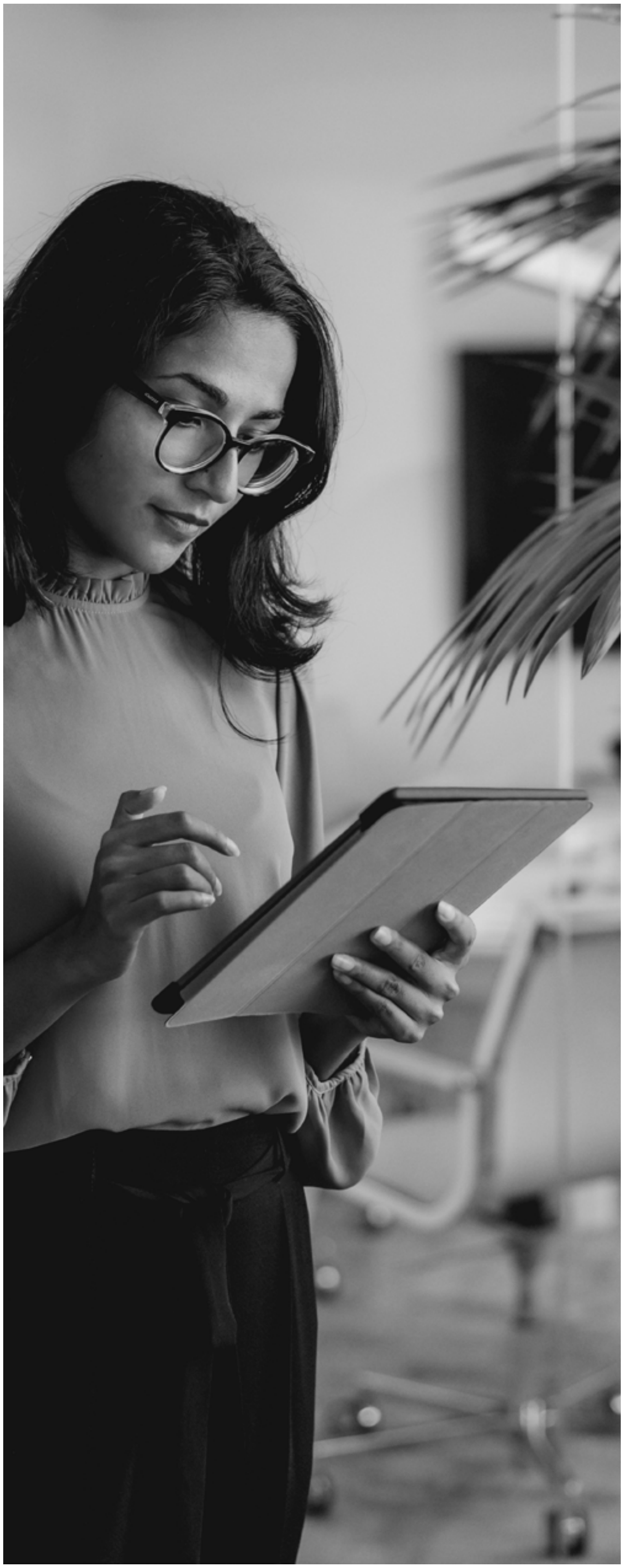
By integrating AI and ML, your AR team can increase both operational efficiency and customer satisfaction.

A digitized future for AR

Digitization is no longer a luxury; it's a competitive necessity. Transitioning to digital payment methods not only improves AR operations but also enhances security and scalability. Beyond automation, leveraging insights from digital processes helps organizations fine-tune strategies and build stronger customer relationships.

Steps to digitize AR processes:

1. Invest in intuitive payment portals with multiple payment options and autopay capabilities.
2. Use real-time dashboards to monitor AR metrics and track digital adoption.
3. Integrate advanced analytics for actionable insights into customer payment behavior.



Final thoughts

The accounts receivable process is a critical business function that directly impacts cash flow, customer relationships and overall financial health. By understanding key metrics, addressing stress points and leveraging technologies like AI and ML, organizations can unlock the potential of their AR processes.

A streamlined AR process is more than an operational improvement – it's a strategic advantage. Focus on optimizing your AR system today to drive better business outcomes tomorrow.

Milind Joshi is a seasoned expert in business-to-business payments and a recognized thought leader in the industry. With over 40 years of experience in IT, he has excelled in a variety of leadership roles, showcasing versatility and expertise. His career highlights include serving as Head of IT for a leading oil company, General Manager, Management Consultant, Head of Sales and Head of a Payment Product.

Milind's global experience spans Europe, Asia, Latin America and the United States, giving him a well-rounded international perspective. Currently, he serves as Vice President at Fiserv, a global leader in fintech, where he oversees a diverse portfolio of responsibilities including Product Management, Distribution and Solutions Engineering.

References:

[1] gartner.com/en/newsroom/press-releases/2021-07-07-gartner-finance-research-shows-bad-debt-increased-26-percent-in-2020

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