

# Accounts Receivable Moves to the Top of the CFO Agenda

Market disruption renews emphasis on working capital

By Nilly Essaides and Bryan DeGraw

## EXECUTIVE SUMMARY

Pandemic-related disruption and the start of a recession have intensified companies' emphasis on liquidity management. In the early stage of the outbreak, 75% of finance organizations took steps to optimize working capital practices, and 79% report they intend to make these changes permanent post-crisis, as continuing economic pressures force companies to bolster cashflow. As a result, CFOs are increasingly focused on automating the accounts receivable process in order to shorten the cash conversion cycle and track the health of the receivables portfolio.

After a decade of cheap debt and abundant liquidity, the Covid-19 pandemic has depressed corporate earnings and squeezed cashflows. Looking to enhance liquidity, finance executives are turning their attention to working capital. Specifically, organizations are prioritizing efforts to secure their receivables portfolio and accelerate cash collection.

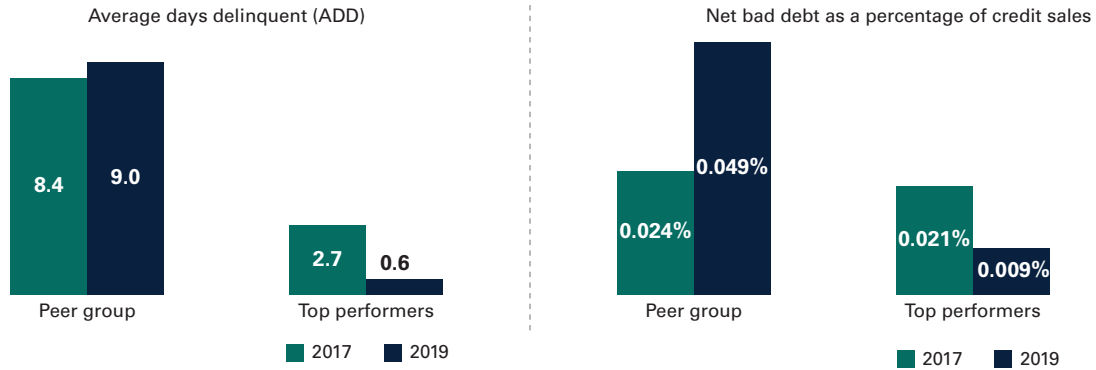
Because many companies have taken a lax approach to liquidity management, there are significant opportunities for harvesting already-available cash. Using publicly available financial data for the top 1,000 U.S. companies, we calculated that they were sitting on \$1.3 trillion in unused working capital at the end of 2019, including nearly \$4 billion in accounts receivable (Fig. 1). To extract this additional value, accounts receivable managers must

FIG. 1 Total working capital opportunity



Source: The Hackett Group, 2020

FIG. 2 Accounts receivable KPIs



Source: Credit & Collections Performance Study, The Hackett Group, 2019

improve critical elements of the process, such as credit risk management, collections and payments. There is plenty of room for efficiency and effectiveness enhancements in most organizations' customer-to-cash processes.

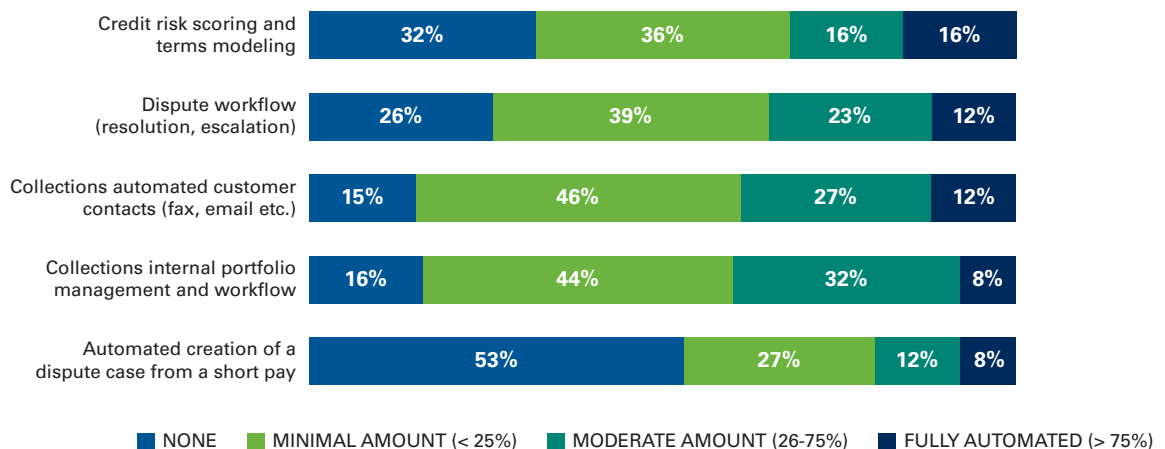
Our Credit and Collections Performance Study (2019) found that customer-to-cash top performers hold a strong lead over typical organizations (i.e., the peer group) in most process metrics. For example, top-performing credit functions employ only one-third as many staff as typical functions and spend half as much on the credit process as a percentage of credit sales. This is in large part because top performers have automated 40% of their credit reviews (versus the peer group's 15%), resulting in less need for manual intervention while increasing the completion rate for new credit reviews. Top performers' billing process is also more highly automated, resulting in 75% fewer billing mistakes, so they have much lower dispute-resolution expenses and a higher customer satisfaction.

These differences are reflected in the quality of top performers' receivables portfolios. Going into 2020, these organizations enjoyed dramatically lower average days delinquent (ADD), at 0.6 versus 8.0 days for the peer group. They also carried five times less bad debt as a percentage of credit sales. There's even more bad news for the peer group: Top performers have reduced ADD and bad debt levels since 2017, while peers' scores have worsened (Fig. 2).

**DRIVING GREATER AUTOMATION**

Traditionally, accounts receivable has lagged other areas of the customer-to-cash process in its use of automation. For example, many collectors still manage their portfolios with spreadsheet-based aging reports and decide whom to contact based on the largest aging amounts. Only 20% of accounts receivable departments have partly or fully automated the creation of a dispute case from short pay, and under one-third have automated credit-risk scoring and modeling (Fig. 3).

FIG. 3 Extent of current automation, by activity



Source: Customer-to-Cash Intelligent Process Automation Poll, The Hackett Group, 2018

## RPA vs. artificial intelligence/ machine learning

Different smart technologies play different roles in the automation of accounts receivable, so it is important to understand their respective use cases. While robotic process automation acts as the “arms and legs” of process automation, AI and machine learning are the “brains,” sending stimuli to other parts of the body. The defining characteristics of each are included below.

### RPA

- Mimics human actions.
- Applied primarily to clerical/administrative activities.
- Performs rule-based tasks.
- Uses macros and screen-scraping to automate workflow.
- Usually sits at the desktop level but can be applied at the server and application levels.

### AI/machine learning

- Augments human intelligence.
- Engages with data to identify patterns and make recommendations.
- Produces predictive output to support decisions.
- Adaptable on a dynamic basis.
- Self-managed, self-learning and self-correcting.
- Enables intelligent virtual agents (e.g., chatbots).

The coronavirus pandemic has exposed substantial deficits in finance’s digital platforms, making this an opportune time to push for new solutions within the context of liquidity enhancement. Our Covid-19 Response Poll (April 2020) found that, despite the recession, almost all finance organizations are powering ahead with digital transformation initiatives already in flight, and some are even accelerating them. Even more encouraging, 64% are launching select new digital projects. It helps that 77% of CIOs responding to the poll reported they plan a moderate or significant increase in technology investment.

Pressure to quicken the cash conversion cycle has increased interest in cloud-based digital solutions that provide real-time monitoring/alerts of the total customer portfolio, accurate details-capture from bad-check images and seamless collection of data from multiple sources. As a result, these solutions deliver efficiency and effectiveness gains much faster than other approaches, such as reconfiguring the ERP system. Even RPA tools often require customization to address process-specific needs. Moreover, because some cloud solutions come with built-in artificial intelligence and machine learning capabilities (see sidebar at left), they enable staff to swiftly process large amounts of data to extract insights for decision support.

### WHAT GETS MEASURED GETS DONE

Accounts receivable technology implementations should address immediate challenges as well as produce sustainable, long-term benefits. To ensure the new solution delivers the results expected, organizations need to establish a comprehensive set of process KPIs at the start of the project, align around them with technology partners and monitor them frequently. Because technologies today can be implemented using agile methodologies, companies can leverage changes in process KPIs to identify what is working well and what is not, adjusting course quickly by testing other approaches.

Process KPIs should include leading and lagging indicators. The latter include reduction in bad debt, percentage of current receivables, ADD, analyst productivity and cash application cycle time. But these can only tell what has already happened. In contrast, leading indicators provide insight into issues such as future credit quality and help improve the cash

FIG. 4 The “3 Es” of process performance measurement

EFFICIENCY	EFFECTIVENESS	EXPERIENCE
<ul style="list-style-type: none"> <li>• Process cost as a percentage of revenue</li> <li>• Process cost as a percentage of credit sales</li> <li>• Number of FTEs per \$1 billion in revenue</li> <li>• Number of invoices processed per FTE</li> <li>• Cycle time to process a customer order</li> <li>• Cycle time to create and deliver customer invoices</li> <li>• Cycle time to post/apply customer payments</li> <li>• Cycle time to resolve customer disputes</li> <li>• Cycle time to perform credit evaluations</li> <li>• Percent of electronic invoices</li> <li>• Percent of electronic payments</li> </ul>	<ul style="list-style-type: none"> <li>• Percentage of credit reviews completed with all required data</li> <li>• Days sales outstanding (DSO)</li> <li>• Average days delinquent (ADD)</li> <li>• Percentage current receivables</li> <li>• Percentage of receivables greater than 60 days past due</li> <li>• Percentage of disputed receivables (\$ value)</li> <li>• Percentage of unapplied cash</li> </ul>	<ul style="list-style-type: none"> <li>• Percentage of customer orders that require correction (order accuracy)</li> <li>• Percentage of customer invoices that require correction (billing accuracy)</li> <li>• Average dispute-resolution cycle time (elapsed days)</li> </ul>

Source: The Hackett Group

forecast. Included in this category are the number of risk-class changes from credit reviews, percentage of dispute/deduction auto-coded, number of outbound collections calls, and percentage of customers with confirmed delivery of electronic invoices, which can be monitored in real time.

In addition, organizations should adopt a holistic approach to measuring the impact of their automation initiatives, by looking at efficiency, effectiveness and customer experience metrics

(Fig. 4). Increasingly, digital transformation is less about reducing manual labor than it is about creating new ways of working and interacting with the end user, and freeing up capacity for staff to focus on value-adding activities. In our Key Issues Study (2020), respondents listed the ability to provide better insight to support management decisions as the No.1 expected benefit from digital transformation.

## CONCLUSION AND RECOMMENDATIONS

Economic uncertainty and Covid-19-related disruption continue to threaten revenue, driving interest in leveraging new technologies to automate the accounts receivable process. However, such efforts cannot be executed in a vacuum. The choice of solution must be strategic and aligned with finance’s overall digital transformation roadmap. It must also integrate with other parts of the end-to-end cash cycle, e.g., sales, treasury, inventory and accounts payable. This holistic perspective can help companies identify and address bottlenecks at any stage of the process, resolve them quickly and shorten cash conversion.

For example, our research shows that organizations that involve the credit function early in the sales process – during the proposal and pricing-development stages, for example – report 8.4 days lower ADD compared to those that do not. We also see a strong correlation between global, end-to-end process ownership and efficiency: Finance organizations with a high degree of end-to-end process ownership employ 30% fewer staff and spend 27% less on finance as a percentage of total revenue.

In addition, accounts receivable executives need to consider both short- and long-term business benefits when making technology choices. Examples and suggestions for each are discussed below.

### Control and visibility

The business objective is to enhance the quality of the receivables portfolio in order to pull in more cash more quickly. Real-time assessment of credit risk enables a proactive collection contact strategy and reduces DSO.

- **Short-term:** Review customer creditworthiness more frequently to minimize risk to the portfolio by pulling real-time data from credit bureaus, continuously collecting internal payments data and using AI-enabled prioritization to target collection efforts.
- **Long-term:** Deploy standardized but flexible global credit policies that are aligned with business objectives, as well as technology-enabled, proactive identification of at-risk portfolios.

### **Cash forecast accuracy**

An integral part of the end-to-end cash cycle is gaining visibility into incoming cash to reduce forecast variance. Knowing what's in the pipeline is critical for supporting management funding decisions.

- **Short-term:** Integrate accounts receivable and treasury management systems to improve the accuracy of predictable cash flows and provide more advanced forecasting and analytics capabilities.
- **Long-term:** Achieve real-time visibility into global cash to enhance the reliability of longer-term forecasts and incorporate less-predictable cash flows.

### **Value-adding work**

As we saw earlier, most finance functions rank the ability to support management decisions as the principal benefit of transformation. Increases in efficiency due to automation free up staff to focus on more value-adding tasks, such as risk analysis and customer segmentation, as well as proactive collections.

- **Short-term:** Expand the collection team's bandwidth so they can cover more accounts, using risk-based frameworks to target collection activities, automate cash application and reduce deduction overload.
- **Long-term:** Fully automate all routine work and embrace an omnichannel service delivery model that is designed around the needs of customers.

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## **RELATED RESEARCH**

[Building a Top-Performing Customer-to-Cash Process](#), March 2020

[Future-Proofing the Credit and Collection Process](#), October 2019

[Toward Intelligent Customer-to-Cash Process Automation](#), April 2019

# About the Advisors



## **NILLY ESSAIDES**

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Ms. Essaides has over 25 years of experience researching, writing, and speaking about finance and treasury issues, with a focus on the way finance adds value to the enterprise through excellence in financial management and planning processes. Previously, she worked at the Association for Financial Professionals, where she led the FP&A practice. Ms. Essaides, a prolific blogger with thousands of LinkedIn followers, writes for external publications such as Digitalist Magazine. In addition, she co-authored a book about the internal transfer of best practices, *If Only We Knew What We Know* (Simon & Schuster).



## **BRYAN DEGRAW**

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In his current role, Mr. DeGraw conducts topical research, supports client inquiries, leads member webcasts, performs client briefings, and speaks at conferences on topics including working capital, purchase-to-pay and customer-to-cash processes. His expertise includes credit/ risk modeling, customer segmentation, collection strategies, supplier risk analysis, buy/pay transactional strategy, and leverage of automation. He has over 20 years of corporate and consulting experience in business process creation and reengineering, cost reduction/management, planning, budgeting and financial analysis. Mr. DeGraw's previous experience with The Hackett Group has included managing and delivering finance, procurement and other benchmark projects for clients in both the public and private sector.

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