



*2002 Virtual Education
Cash & Working Capital
Management Series*

The 3Ms of Order to Cash



*2002 Virtual Education
Cash & Working Capital
Management Series*

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Management Applications

May 9, 2002

Agenda

- **Introduction and housekeeping**
- Concepts in working capital management
- The 3M's
 - Model
 - Manage
 - Minimize
- Diagnostic ideas
- Questions



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Alfonsi is responsible for engagements focusing on benchmarking and process improvement in finance, with particular emphasis on working capital management, treasury management, cash management, and financial risk management in both the domestic and international arenas. He specializes in financial organizational design and workplace performance measurement systems. Alfonsi's consulting and management experience includes: working capital management restructurings, design and implementation of treasury, cash management, and general ledger accounting processes, feasibility study and warranted establishment of financial shared service centers, evaluation and implementation of procurement and T&E card programs, risk identification, quantification, and mitigation, and the selection and implementation of financial software packages in treasury applications.



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Daniel Blumen has more than 20 years of domestic and international treasury operations experience most recently as founder and managing director of Knowledge Management Applications. He has domestic and international experience with Citicorp and Bank of America. He is an executive program faculty member for cash management programs at the University of California and the University of North Carolina. He is a contributor to Treasury Management International, International Treasurer, Cash Management Handbook, Corporate CashFlow, Bridge Guide, CEO Magazine, and Corporate Finance. Blumen has an M.S. in Industrial Administration from Carnegie-Mellon University, a B.A. in economics from Syracuse University, and is a permanently certified cash manager.



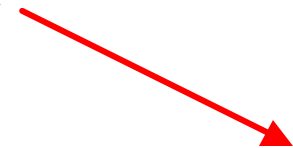
Housekeeping

Slide Title



- We will let you know when it is time to advance to the next slide and give the title of the slide and the number
- There will be two question and answer breaks; in the middle and at the conclusion of the session
- There will be several opportunities to interact with the session leaders using our polling feature
- You may follow-up with either of the session leaders by email

Page Number



Polling Question 1

How many listening to this session are employed by:

- For profit companies
- Not for profit companies
- Financial institutions
- Not sure

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What's Driving OTC?

- Development of functional and enterprise system solutions, such as ERP and CRM
 - Examples: Oracle, PeopleSoft, SAP, GetPaid, eCredit, and internally developed applications
 - Systems enable process redesign and improve efficiency of key activities
- Evolution of client and supplier relationships
 - Movement from price-only, transaction-based relationships to strategic alliances
 - Better integration enables more efficient inventory control, reducing carrying costs and resulting in higher profit
- Process centralization in shared service centers for credit, billing, collections, payments, and customer service
 - Enables consolidation or outsourcing of back-office processes
 - Scale, reduced overhead, and focus on key competencies drives down costs

The Payoff

- Cost
 - Less time required per FTE to process transactions
 - Optimize use of all resources
- Customer Service
 - Lower cycle times, eg. dispute resolution
 - Ability to manage to key performance indicator metrics
- Productivity
 - Increase number of transactions per FTE, eg. invoices issued, collections
 - Greater automation of transactions, eg. ACH, receivables matching
- Cash Flow
 - Improved DSO
 - Reduced writeoffs

Polling Question 2

Killen & Associates* estimate that the Financial Supply Chain of the Global 2000 have a 2002 cash excess of?

- \$478 million
- \$8.3 billion
- \$123.5 billion
- \$260 billion

*The Impact of 9/11 on the Financial Supply Chains of the Global 2000
©November 2001, Killen & Associates

Business Value Cycle

❑ Strategies and tactics adopted here create value reflected in financial accounts

❑ Some are intrinsic to the business, others are necessary by not intrinsic



Some Definitions

- Working Capital = Current Assets minus Current Liabilities
 - ✓ Balance sheet approach
- Working Capital = (Accounts Receivable plus Inventory) minus Accounts Payable
 - ✓ Business process approach
 - Order to Cash
 - Purchase to Pay
 - Order to Delivery
- Both process and financial account approaches are integrated by treasury when it participates in management of the Financial Supply Chain (FSC)

The Financial Supply Chain

- The financial activities and processes controlled by the CFO and her subordinates on an intra and extra enterprise basis.
- Order to cash
 - Consists of key financial activities and processes associated with the sale and delivery of products and/or services. These include order management, credit analysis and approval, invoice and billing, cash collections, dispute resolution, cash application, and financial analysis and reporting.
- Purchase to pay
 - The key financial activities and processes associated with the acquisition of products and services for use by the enterprise.
- Order to delivery
 - The financial and operational activities associated with the creation and delivery of enterprise products and services.

Typical FSC Processes

Order to Cash

Customer strategy
 Sales management
 Risk management
 Contract management
 Sales order processing
 Credit check
 Order fulfillment
 Billing
 Customer service
 Cash collection
 Cash application
 Cash management

Order to Delivery

Product development
 Product range management
 Forecasting
 Sales order processing
 Production scheduling
 Raw material planning
 Production planning
 Production
 Warehousing
 Distribution

Purchase to Pay

Purchasing strategy
 Budgeting and forecasting
 Requirements specifications
 Selecting and negotiating
 Ordering and contracting
 Receiving and inspecting
 Discrepancy management
 Invoice processing
 Payment issuance
 Cash management

$$\text{Accounts Receivable} + \text{Inventory} - \text{Accounts Payable} = \text{Working Capital}$$

Observations and Implications

Observations

- Chief Operating Officer
 - High level of overdue receivables (DSO)
- Accounting Manager
 - Spending time on exceptions, not collecting cash
- National Sales Manager
 - Poor customer service
- Receivables Manager
 - High level of disputed invoices

Implications

- Poor customer satisfaction/service, lack of management focus
- High level of customer disputes and lack of accountability with respect to pricing and transportation
- Poor order fulfilment, ineffective pricing adjustment process, and lack of accountability with respect to pricing and fulfilment
- No process to manage disputes, high backlog of customer disputes, and no support from sales and fulfilment

Polling Question 3

Does treasury participate with other areas of your organization on OTC initiatives?

- Not involved
- Usually consulted
- Participate in planning
- Key contributors
- Lead the effort

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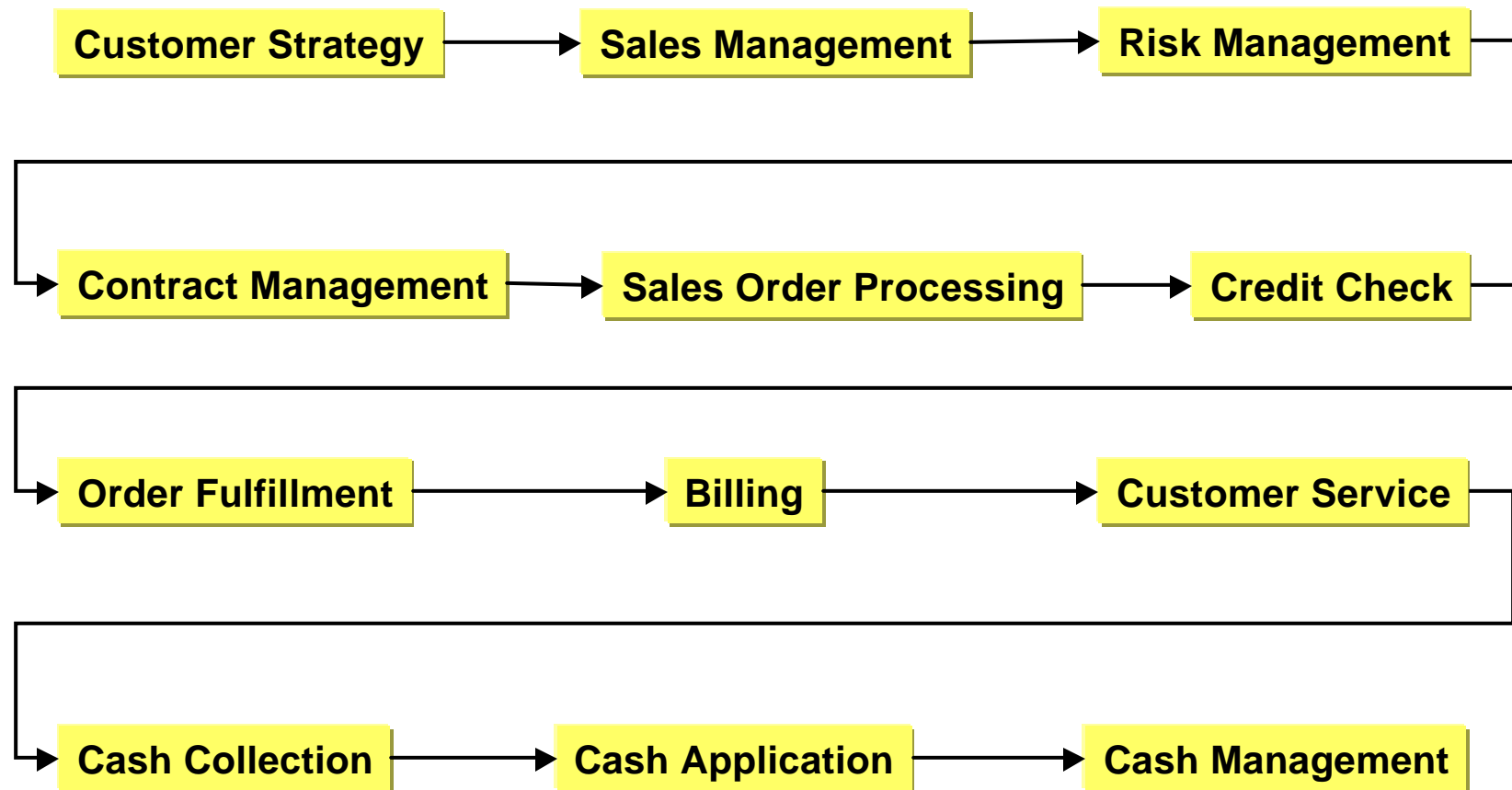
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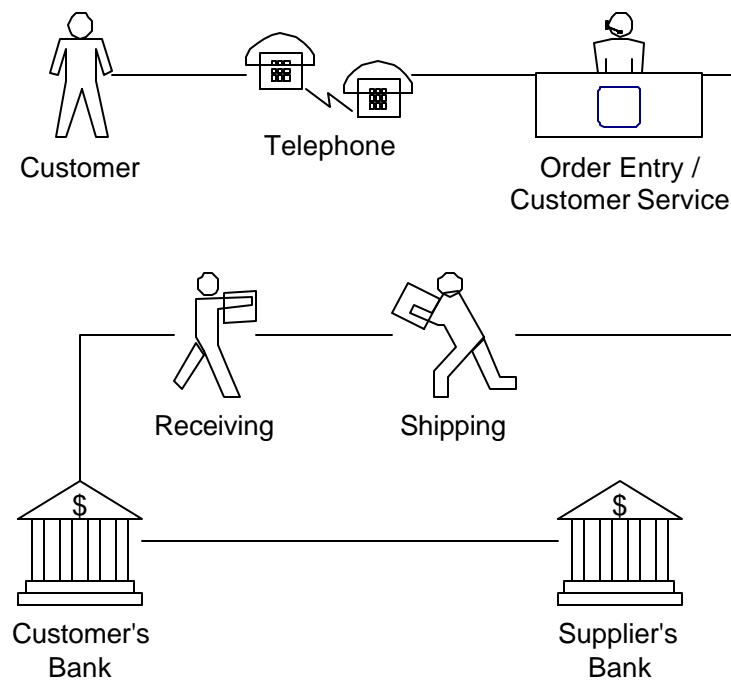
The 3M's

- **Model**
 - Develop enterprise specific model of processes and activities
 - Obtain agreement on model validity
- **Manage**
 - Identify problems and their source
 - Solve problems through benchmarking / best practices
- **Minimize**
 - Specification and measurement
 - Transformation and outsourcing

Basic Elements

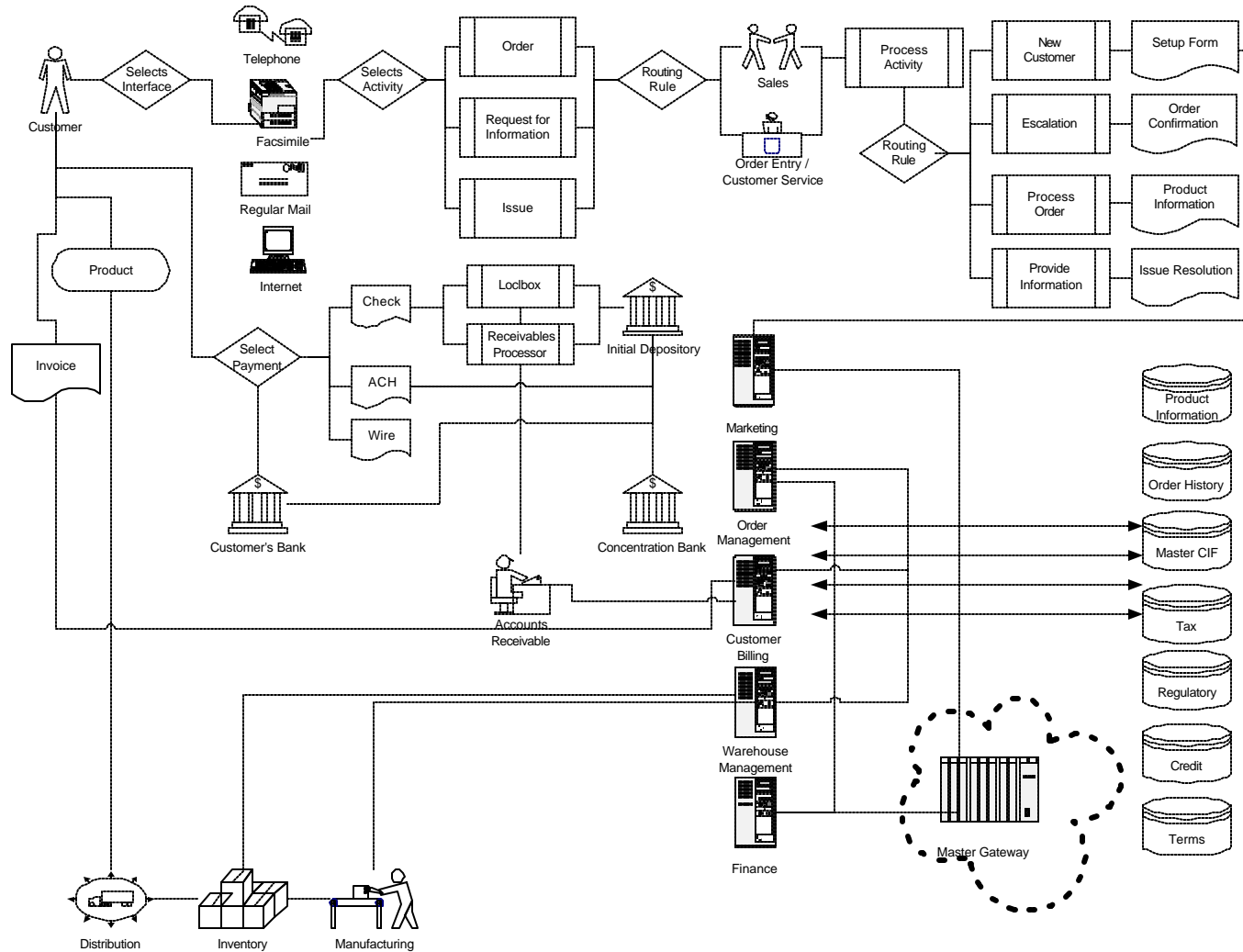


A Simple Model



- Model uses:
 - Elevator speech for OTC initiative
 - Starting point for a programming level model
- Aggregation and simplification of processes and activities minimizes usefulness in taking action

A More Detailed Model

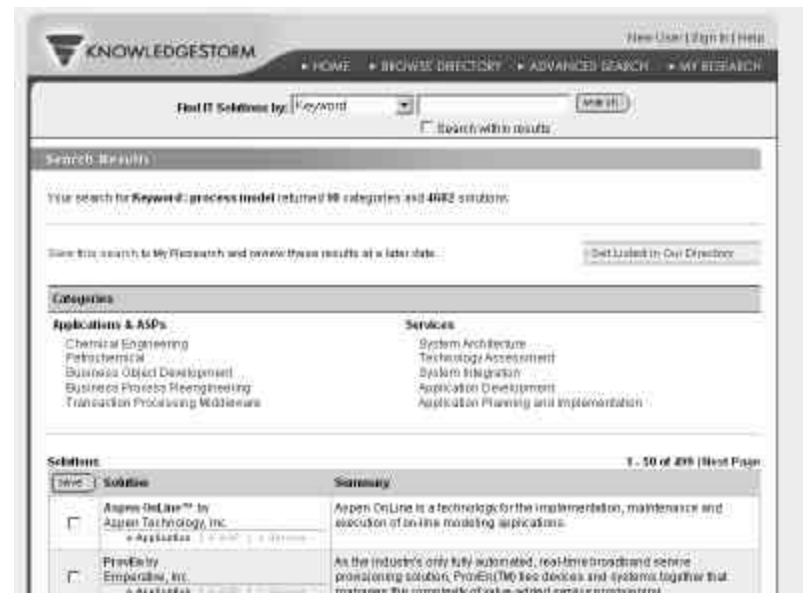


Purpose of The Model

- Documents processes and activities in the context of OTC
- Ensures understanding of the current state
- Permits identification of issues and opportunities
- Forms basis of OTC transformation project plan
- **Validation of the model with all stakeholders is essential**

Modelling Tools

- MS PowerPoint
- MS Visio
- And 4,682 others
- Need to balance:
 - Ease of use with scalability
 - Cost with benefit
 - Templates / wizards versus original thought



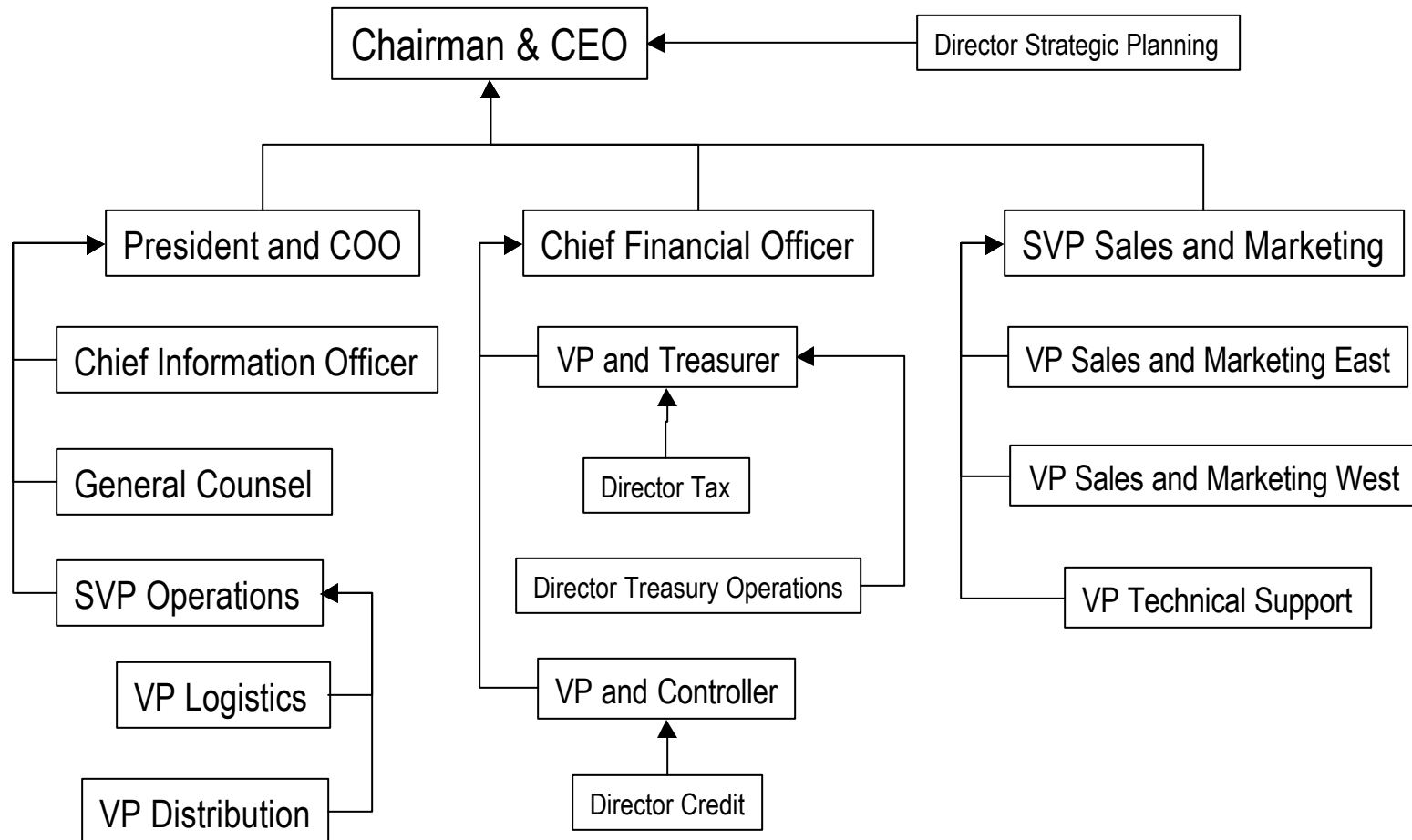
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Functional Organization



OIA by Function 1

- Sales and marketing
 - Observation
 - Multiple sales terms and extended terms
 - Sales unaware of cost of extended terms
 - Inconsistent incentives for sales to assist with collection
 - Ineffective communication between Sales, Credit, Collection
 - Implication
 - Difficult to set meaningful DSO targets
 - Lack of concern when cash is received increases DSO
 - Action
 - Enforcement of policy requiring approval for extended terms
 - Sales compensation should incent force to assist with collection efforts
 - Regular, scheduled and documented meetings of sales, credit & collections
 - Provide sales with information necessary to assist in collection efforts
 - Measure sales performance pertaining to cash collection
- Operations
 - Observation
 - Lack of consistency among sites
 - Absence of reporting measuring accuracy and cycle time
 - New customer account set-up can be time consuming for some divisions
 - No manager with overall responsibility for Order Entry
 - Implication
 - Inaccurate invoicing
 - Unsatisfactory customer service
 - Customers delay payment
 - Lack of visibility regarding accuracy and cycle time
 - Action
 - Create owner with responsibility for quality of order entry
 - Report & measure accuracy and cycle time
 - Train on customer account set-up where needed

OIA by Function 2

- Controller
 - Observation
 - Mailing from multiple sites is inefficient and costly
 - Absence of individual with overall responsibility for Billing
 - Absence of metrics detailing cycle time
 - Invoices can be mailed late preventing timely payment
 - Implication
 - May be incurring more cost per invoice than necessary
 - Lack of visibility regarding cycle time
 - Action
 - Create plan to assess business case for mail bills from one sight, may involve outsourcing
 - Create owner of Billing with responsibility for quality of billing
 - Implement metrics detailing cycle time
 - Establish task force responsible for developing and implementing billing process improvement initiatives
- Treasurer
 - Observation
 - Uneven lockbox performance by banks
 - Low autohit rate Extra costs associated with not using Shared Service Center
 - Implications
 - Payments being posted late
 - High costs of applying exceptions All divisions should use Shared Service Center for cash application
 - Action
 - Set specific improvement targets for laggard banks - research alternatives to poor performers
 - Set auto hit rate performance improvement targets
 - Increase automatic write off levels based on statistical thresholds

OIA by Function 3

- Controller
 - Observation
 - No DSO targets
 - Absence of proactive calling
 - Inconsistent collection processes across divisions
 - Absence of consistent metrics focused on calling effectiveness
 - Collection strategy is on an invoice basis instead of utilizing a “customer or portfolio management” approach
 - Implication
 - Uncertainty regarding effectiveness of activity
 - Sub optimal customer service by failing to call proactively
 - Settlement process can have several voices to the customerSet DSO and cash collection targets for each division - communicate targets
 - Action
 - Train collectors on proactive customer service oriented calling - and initiate proactive calls
 - Create advisory board with representatives from the divisions served
 - Create systems project plan to move towards customer focused settlement process
- Sales and marketing
 - Observation
 - Not identifying disputes proactively
 - Categorization of disputes is inadequate
 - Absence of consistent escalation protocol
 - No formal communication loop for resolved disputes
 - No cross functional teams to eliminate root causes
 - Absence of cycle time measures
 - Implication
 - Long dispute resolution cycle times contribute to past due receivables
 - Failure to eliminate root causes
 - Action
 - Proactive identification of disputes
 - Use detail tables to categorize disputes
 - Draft consistent escalation protocol
 - Institute formal communication loop for resolved disputes - including regularly scheduled meetings with action registers
 - Create functional teams to eliminate root causes
 - Implement cycle time measures

Polling Question 4

Are empty seats on an airplane part of an airline's working capital?

- Yes
- No

Mission

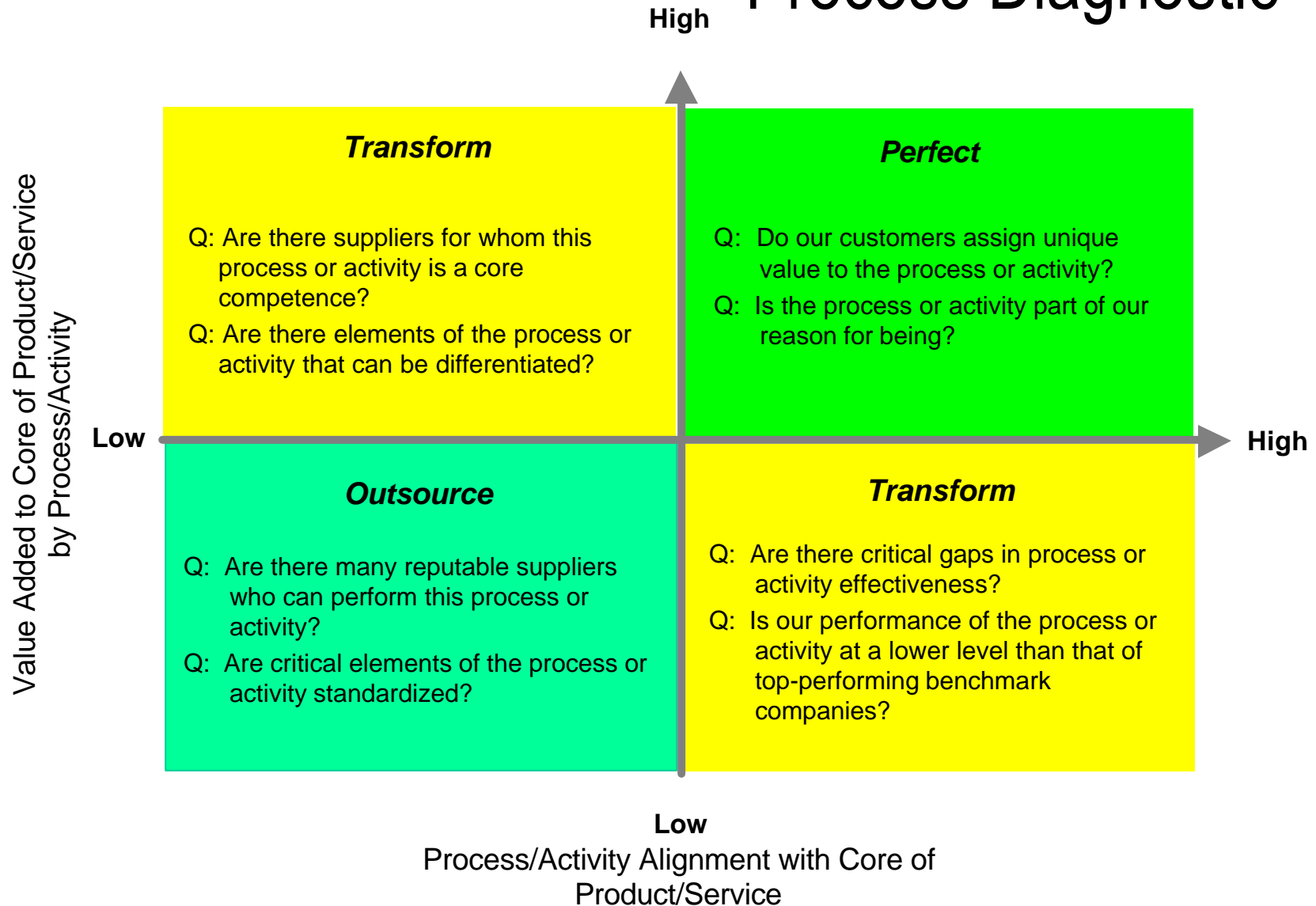
Achieve an end-to-end transformation of the “Order to Cash” processes, activities, and related systems consistent with our operating model and corporate values.

“Order to Cash” encompasses the following processes and activities:

- *Order Entry*
- *Billing*
- *Accounts Receivable*
- *Credit & Collections*
- *Commissions*
- *Revenue Recognition*
- *Contracts & Agreements*



Process Diagnostic



Process Classification

Perfect	Customer Strategy	Sales and Marketing	Risk Management	Contract Management
Transform	Sales Order Processing	Credit Check	Order Fulfillment	Billing
Outsource	Customer Service	Cash Collection	Cash Application	Cash Management

Agenda

- **Questions**

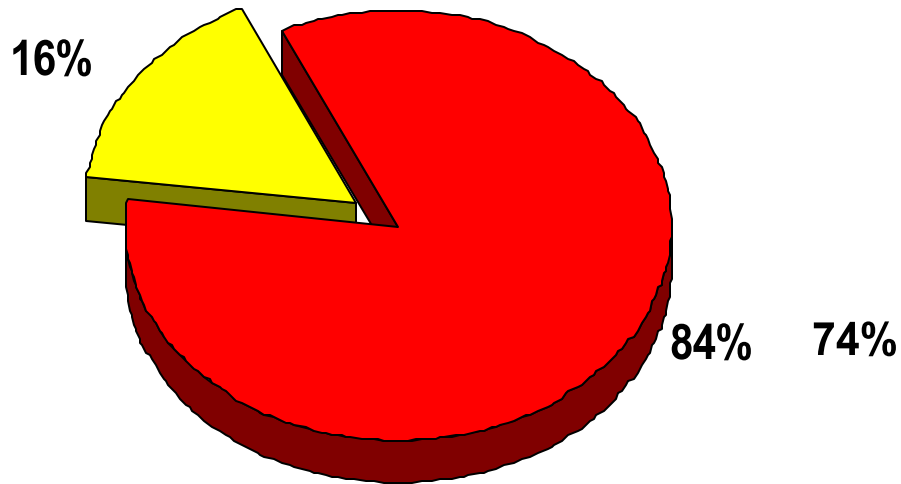


Best Practices

- Fundamentally change a process or activity
- Optimize return on investment
- Provide acceptable level of control
- Exploit current technology
- Are proven effective
- Describe a superior way of working

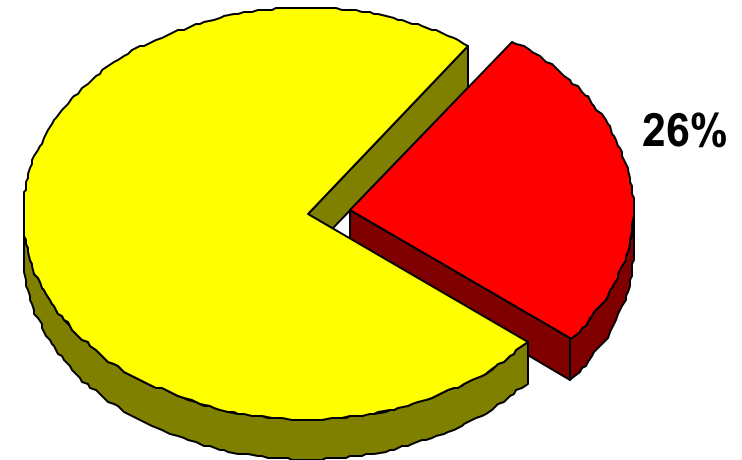
ERP has not been leveraged

Percentage of Companies in Database with ERPs



■ Have ERP Applications
■ Do Not Have ERP Applications

Percentage Functionality Leveraged Across ERPs

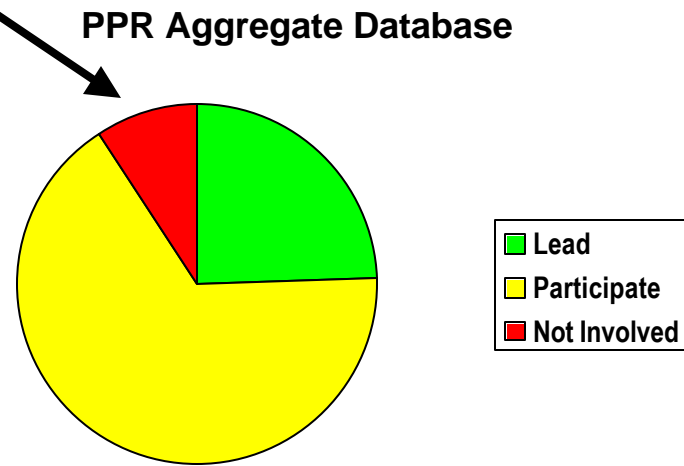


■ Leveraged ■ Not Leveraged

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How do you stack up?

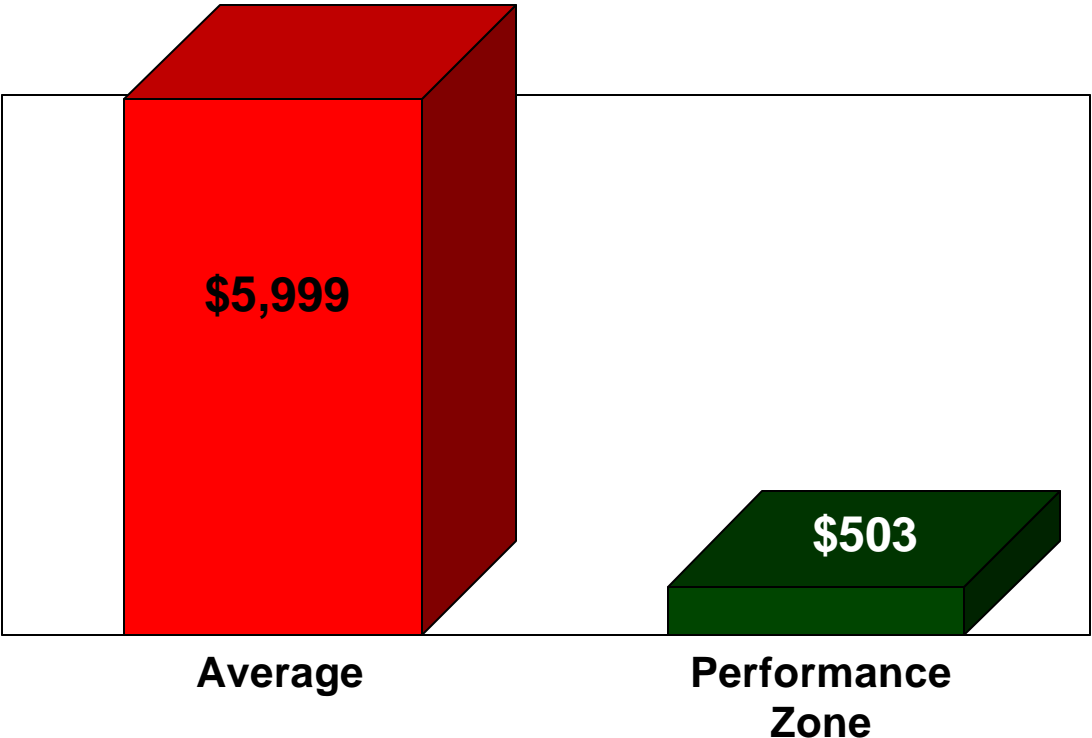
- Sample Company reports that its treasury group is not involved in projects, company wide, to improve performance or reduce costs
- Implication: Treasury is not seen as an important function or is perceived not to be a team player
- Action: Survey company wide initiatives and identify ways for treasury to participate and add value



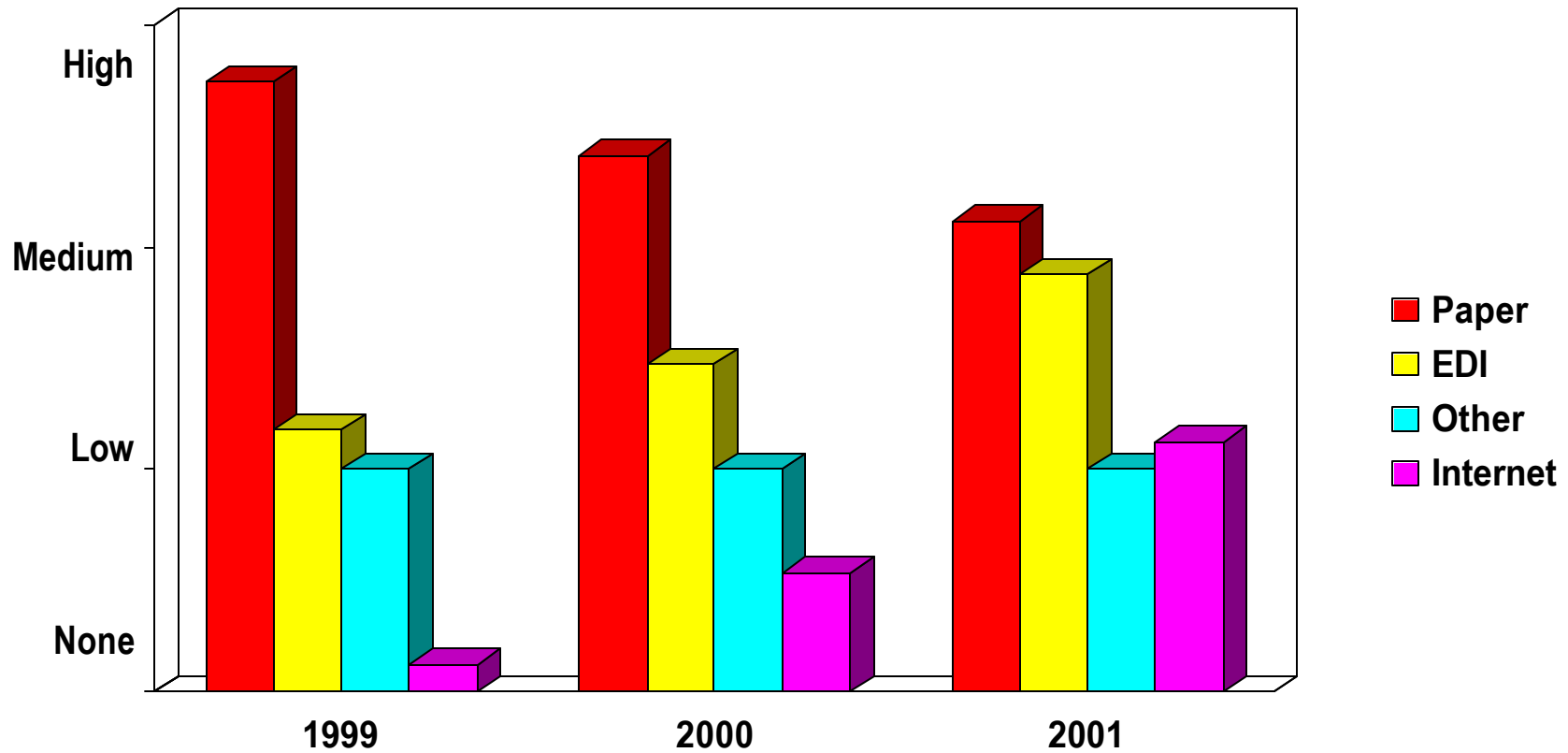
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There is a treasury impact

Average Daily Collected Balances Per \$ Billion Of Revenue (\$000)



Electronic Remittance Trends



Source: NACHA

Best Practices by Process

- Customer Strategy
 - Working capital strategy
 - Customer management structure by product, channel, market
 - Customer profitability measurement
- Sales Management
 - Formal price amendment process
 - Best practice skew moderation methodology
 - Structured payment terms
- Risk Management
 - Best practice credit policy
 - Corporate co-ordination of credit exposure
 - Regular review of customer credit limits
- Contract Management
 - standardization of :
 - Terms of trade
 - Payment channels
 - Performance standards
- Sales Order Processing
 - Electronic order interface
 - Best practice administration of back orders/substitution
 - Tracking of lost salesCredit Check
 - Automatic receivables matching
 - Formal and consistent stop order policy
 - Credit limits strictly adhered to
- Order Fulfilment
 - Proactive matching of delivery note with invoice
 - Clear hand over between warehouse and distributor
 - Effective delivery documentation process
- Billing
 - Electronic bill presentment
 - Alignment with customers payables process
 - Accurate customer master-filesCustomer Service
 - Proactive reconciliation of transaction documentation
- Cash Collection
 - Proactive cash collection
 - Customer contact prioritisation
 - Formal cross functional escalation process and Dunning letter cycle
- Cash Application
 - Automatic matching of receivables
 - Electronic receipt of cash
 - Low level of deductions and reconciliation issues
- Cash Management
 - Immediate application of funds
 - Accurate cash forecasting process
 - Predictable change in cash requirements

Transformation Dimensions

- Measurement
- Policies and procedures
- Processes and activities
- Organization and people
- Systems and applications



Policies and Procedures

- Develop a standard policy for converting and supporting legacy products
- Standardize the procedure and simplify the source for sales commission information and timeliness of reporting
- Develop a procedure for handling cancelled or withdrawn products
- Standardize and simplify the contract formats and enforce “no exception” policy

Processes and Activities

- Focus on getting data integrity “right” at source not through exception
- Ensure consistent and logical information requirements to process all orders
- Evaluate need for separate input streams for invoicing and maintenance orders
- Improve the process for re-launching products

Organization and People

- Designate a single process owner for OTC
- Align processes with functional organization to improve process handoffs
- Create accountability for every process and activity within OTC

Systems and Applications

- Purchase printers for all billing units and automate mail handling
- Create an automated price quotation system
- Begin building toward standard package technology architecture

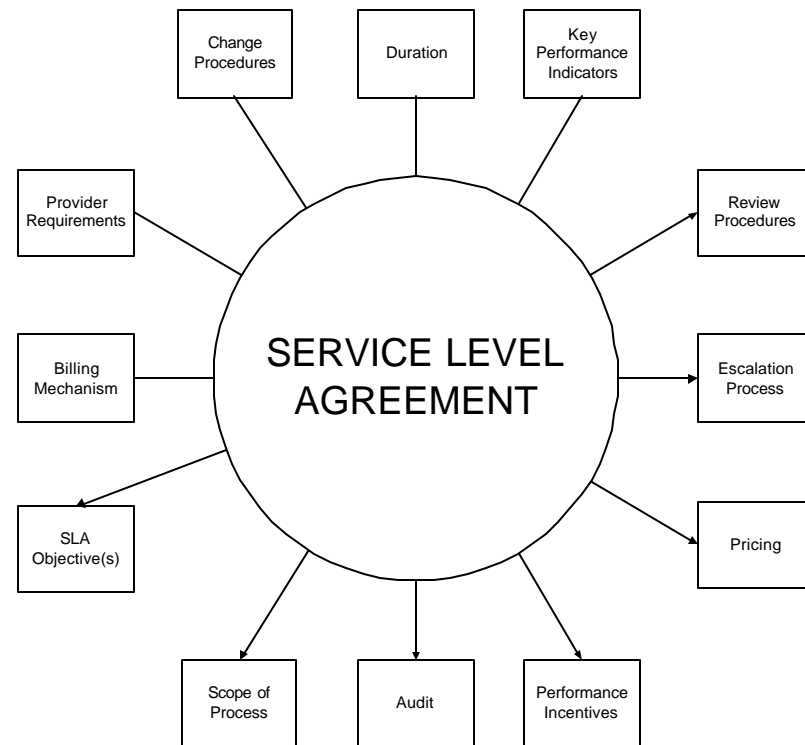
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Service Level Agreement

- Can be measured with well defined process boundaries
- Costs typically established on an annual basis
- Can be used internally or with third parties
- Not so discrete that they encourage micro-management
- Establish “burning platform” for change



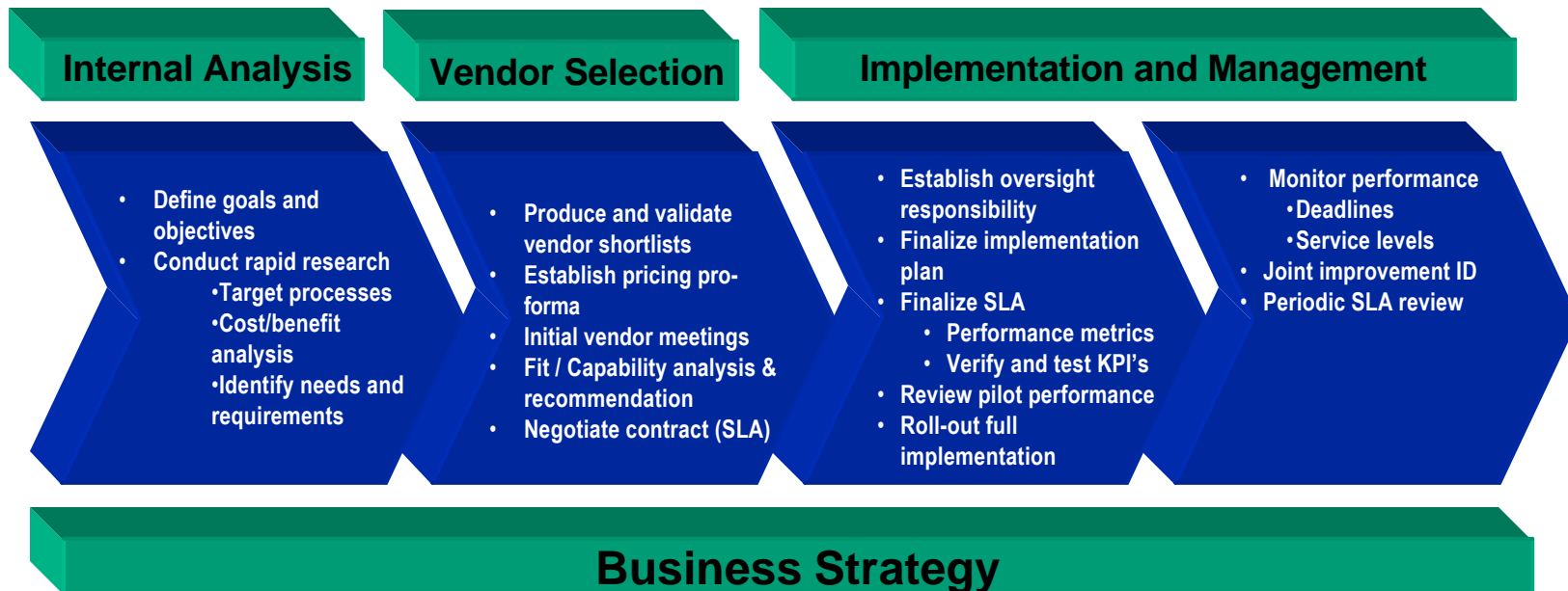
SLA's Include

- Background and partner business description
- Details of relationship structure including
 - Characteristics
 - Boundaries
 - Roles & Responsibilities
 - Commitments
 - Investments
 - resources
- Clearly stated SLA Objective(s)
- Duration
- Provider Requirements
- Customer Requirements
- Services/Products Provided (by process)
- Ad Hoc Request Procedure
- Performance Measures
- Performance Incentives & Credits
- Review & Change Procedures
- Review & Feedback Process & Schedule
- Issue/Problem Management Procedure (escalation protocol)
- Charge-back / allocation mechanism
- Pricing of Services Issue/Problem Management Procedure (escalation protocol)
- Charge-back / allocation mechanism
- Pricing of Services
- Audit Procedures
- Confidentiality, non-disclosure, non-compete or non-exclusivity clause
- Outline of marketing communications, collateral and PR plan
- Statement of anticipated benefits and financial goals
- Account planning, revenue generation and pipeline management plan
- Procedures for performance monitoring, contract renewal and negotiations
- Term and Termination statement
- Warranty, Indemnification and Limitation of Liabilities Clauses
- Contact information, authorized signatures, solicitation and governance clauses

Key Performance Indicators

- Process Improvements
 - Number of users
 - Cycle time reduction
 - Increase in inventory turns
- Staffing Levels
- Quality
 - Errors by company personnel
 - Errors by customers
- Supplier Management
 - Reduction in number of suppliers
 - Increase in suppliers with consigned inventory
- Financial
 - Reduction in cash balances
- Distribution
 - Reduction in use of premium shipment methods
- Staffing Levels
 - Reduction in number of W2 employees
 - Total reduction of FTE

Sourcing Model



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Questions and Implications

- | | | | |
|---|--|---|---|
| ? | Is there a well defined sales and marketing strategy? | ✓ | To coordinate with Credit & Collections activity |
| ? | Do you have established working capital targets and metrics? | ✓ | To achieve goals & promote improvements |
| ? | Do you focus on high value accounts or on high volume activities? | ✓ | To improve cash flow & minimize bad debt |
| ? | Is there a program for risk assessment and control to minimize company's exposure? | ✓ | To maintain balance sheet & portfolio quality |
| ? | Is there an active collection process to deal with key customers? | ✓ | To minimize non-payment & address discreps. |
| ? | Are revenue management systems fully integrated? | ✓ | To streamline & consolidate information flow |
| ? | Does the dispute management enable the elimination of discrepancies at the source? | ✓ | To understand & resolve process breakdowns |
| ? | Do you trust your own customer data? | ✓ | To ensure accurate billing & effective collection |
| ? | Have you automated the handling of low value, high volume transactions? | ✓ | To focus activities on value added functions |
| ? | Does the reconciliation program focus on past due accounts? | ✓ | To maintain accurate customer portfolios |

Diagnostics by Process

- Customer strategy
 - No product, channel, or market strategy
 - No working capital strategy
 - Unclear on customer profitability
- Sales Management
 - Driven by poorly aligned incentives
 - Poor customer intelligence
 - Inefficient pricing communication process
- Risk Management
 - Overly conservative credit limits
 - No regular review of credit limits
 - No corporate coordination of credit exposure / policy
- Contract Management
 - No formalization of terms of trade
 - No formalization of payment channels
 - No formalization of performance standards
- Sales Order Processing
 - Late or inaccurate order capture
 - Poor administration of back orders or substitution
 - Lost sales not recorded
- Credit Check
 - False alarms due to delay in cash receipt
 - No clear stop shipment policy
 - Credit limits ignored by sales
- Order Fulfilment
 - Discrepancies between delivery and invoice
 - Late deliveries
 - Poor administration of delivery and return documentation
- Billing
 - Delayed or inaccurate billing
 - Mismatch with customers payables process
 - Invoice sent to wrong person or place
- Customer Service
 - No active surfacing of customer issues
 - No formal dispute resolution process
 - Lack of authority delegation for causal disputes
- Cash Collection
 - Reactive approach to customer contact
 - Poor customer prioritization and contact tracking
 - Ineffective use of dunning letters
- Cash Application
 - Labor intensive cash allocation process
 - Low adoption rate of electronic collections
 - Low receivables match rates
- Cash Management
 - Delayed application of funds
 - Inaccurate cash forecasting process
 - Large swings in cash requirements

Critical Success Factors

- Business understanding and support for new processes, activities, policies, and procedures
- Selection of integrated system that meets current and future business requirements
- Creation of a business partner relationship with IT to ensure resource support and guarantee success
- Finance organization and performance metrics aligned to support the new culture and strategy
- Effective group-wide communication strategy
- On-line enterprise-wide standard policies and procedures
- Visible commitment and support from all levels of management and stakeholders
- Continual training and follow-up

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