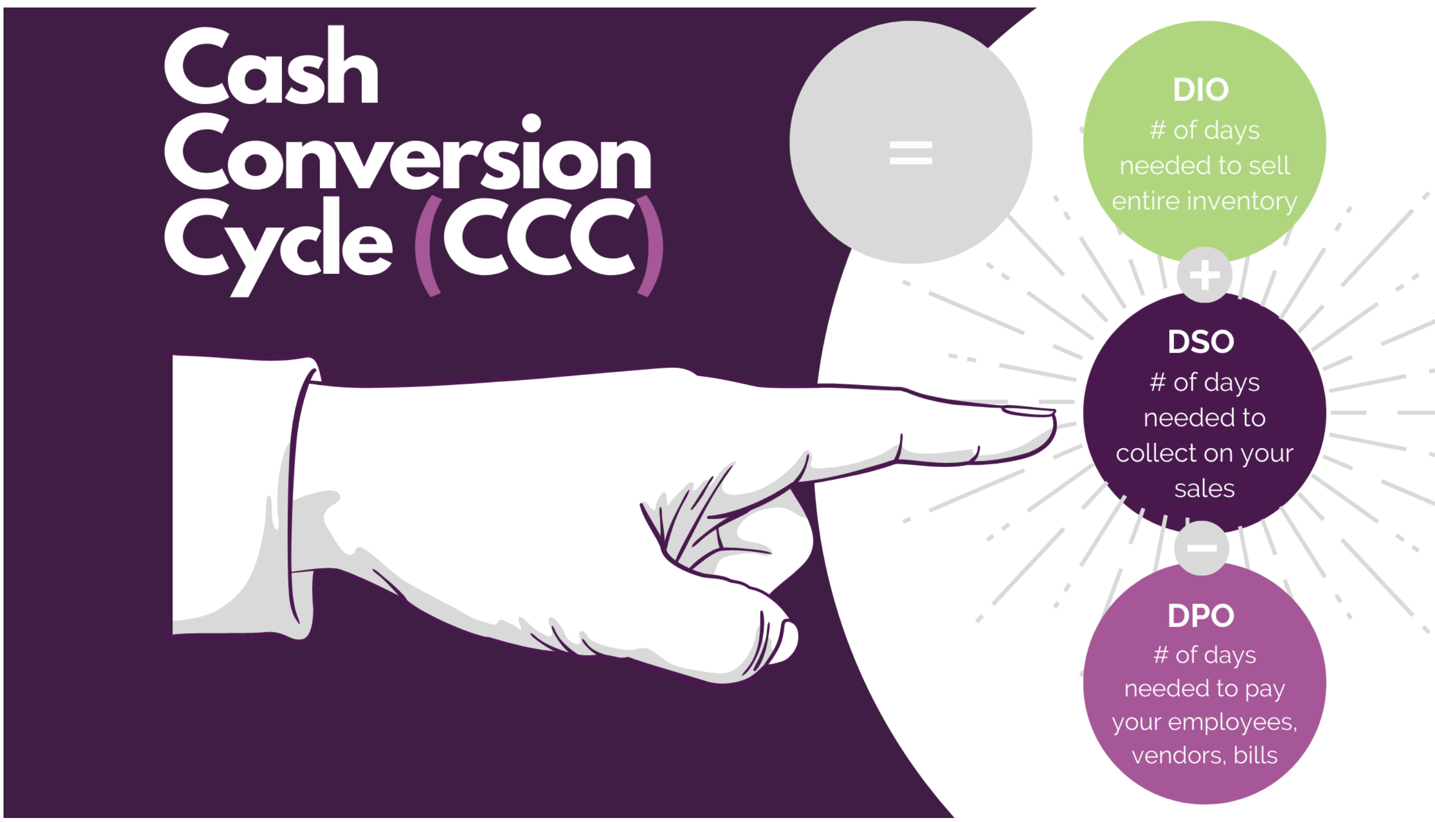
BUSINESS SERVICES EXPERIENCE CASE |

Progressive Accounts Receivable (A/R) Management



ACCELERATING CASH CONVERSION CYCLE WITH A/R

Aging is just the beginning

EXPERIENCE CASE | Progressive A/R Management

A data-driven, coordinated approach to cash flow acceleration

Introduction

Our beloved Finance professors taught us many lessons but none more powerful than TVM—time value of money. Essentially, cash in hand today is worth more than the same amount in the future because a firm can benefit from investing at a specific rate of return over a given time period. We have been fortunate enough to work with clients who take cash in hand to heart and focused on empowering their own teams to reduce aging receivables (A/R) and accelerate cash flows through operational and organizational changes (in addition to financial engineering options such as factoring).

While the journey may have started with a crisp goal of reducing outstanding receivables, our experience has shown teams soon realize they will need to alleviate customer and employee frustrations along the way to get those aging dollars back into the fold.

When pursued with diligence and conviction, tackling aging A/R provides more than cash value because a firm has to fix underlying problems and cash flow constraints in order to get balances current and converted to cash. Our forthcoming words will touch upon several common cash constraint themes and cash acceleration lessons we have learned working with A/R teams on Order-to-Cash (OTC) improvements over the years.

Data Unearths the Skeletons

When teams first start chipping away at their A/R mountain, most engagements began by simply and naively asking the Finance & Accounting team, "Why is this customer falling behind in payments?" No surprises here, we'd get the usual responses: "They always slow-pay us", "we're not a priority for them", "they're mad at us", "that's not my responsibility"—interspersed with honest answers like, "That's a good question—I don't know why X is not paying us on time".

To begin to get arms around underlying causes for late payments, teams benefitted from a simple but mighty pareto analysis visualizing and categorizing the magnitude of various reasons why customers are on aging A/R lists.

One recent experience with a Business Services team illustrates the power of the pareto nicely: analysis of this B2B firm showed about 40% of past due customers were attributed to the willful, slow-pay column, about 10% of accounts were locked in some type of legal transition inhibiting timely payment (such as bankruptcy or company acquisition). However, the rest of their customers were late for more nuanced, less readily understood reasons. The data told us the remaining 50% of late-payers were struggling with constraints other than brazenly paying outside of terms or operating under a suspect definition of "on time" differing from agreed contractual stipulations.

Business Services

Composite Case Synopsis

- Understanding and controlling your Accounts Receivable processes, departmental roles, customer experiences, and technology usage will produce far more than aging dollars collected on time. A/R is a window into cash constraints slowing your Order-to-Cash (OTC) cycle but also surfacing frustrations your customers and employees fight on a daily basis

Client Profiles

- Business-to-business technology services provider
- Business-to-business legal services
- Consumer marketing services firm

Financial Benefits

- 10% to 22% improvements in cash through a faster cash conversion cycle

Favored Measurement Method

- Past Due to Total Billed baseline over 2 to 5 year periods

Operational Benefits

- Improved data warehousing and data marts employed in cash conversion
- More robust cash analytics and dashboard visualization capabilities
- Cash-conscious, well-trained Billing and Collections teams
- Reduced A/R constraints
- Upgraded cash management system, processes, and procedures
- Enhanced cash control application and continuous improvement impact

Organizational Benefits

- Reduced employee and customer frustrations while freeing up cash to fund future growth
- Agile organizational design structure and clear cash management roles
- Aligned employee incentives with cash position needs
- More seamless, cross-functional customer service interactions

Making Matters Worse

Now, here's where the tale usually got interesting. Inevitably, there were several reasons why our clients found their customers' names on "The List"—some can best be categorized as inherent problems within the customer's organization (such as changing A/P responsibilities, inability to get on wire transfers, "Billy the Check Cutter" is on vacation that week, etc.). The surprises often arrived when clients saw how many self-inflicted wounds were being proliferated by their own team—having a hand in forcing customers to pay late. And yet, if you asked, most key employees with A/R roles were painfully aware broken processes, misunderstood responsibilities, and underleveraged technologies were causing problems for customers and for their own teams.

Most teams were also so overwhelmed with day-to-day responsibilities, they could not get out of their energy-draining, short-term flurry to get cash collected every month—too many fires precluding them from coordinating resources to understand the chain of issues and investing the time to fix them. In some companies, the team slogged through using creative "work-arounds"—getting them moving but not building up any structural changes capable of alleviating frustrations long-term for their team or remaining useful beyond an employee's time in a particular role.

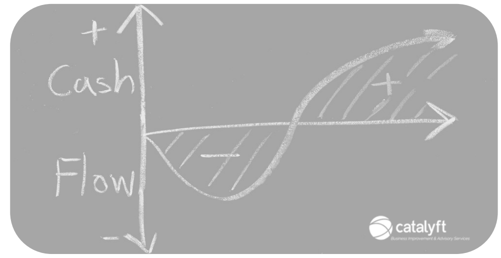
A/R constraints tended to build up over time in environments struggling with role identities, improvement inertia, and a communal sense of being powerlessness to make a dent in the problem. It's not too much of a stretch to say most organizations unwittingly created barriers for their customers to pay on time and stressed out their internal teams across departmental lines (including Sales, Operations, IT, Accounting, Billing, and Collections) during their monthly battle. Now, let's touch upon a few commonly observed cash constraints causing repeated strife for both customers and team members.

Customer and Employee Frustrations

Unhappy with Goods or Services Bad news...your customer is not happy. Good news...your customer is conveying this by not paying as agreed. If our clients didn't know there was a service problem, late payments became the wake-up call teams needed to get on with uncomfortable but necessary conversations with customers, understand where products or services were missing the mark, and fixing the problem before buyer's remorse ages as ungracefully as the customers' invoices.

Abandoned or Ineffective Financial Disciplines At a point in time, most companies had healthy processes and controls to keep A/R from unnaturally rising. However, these cash-influencing processes were no longer working due to a bevy of reasons: employee turnover, training gaps, changing work priorities, misaligned compensation plans, obsolete tool sets, separate IT systems, unplanned changes overwhelming the process (and the list goes on). Growing A/R should be a call to action that something is amiss and the organization needs to get back to winning ways of being in control.

Billing Errors Scrutiny of A/R patterns usually uncovered billing errors adding to shared misery. Whether it was incorrect invoice information, wrong payment terms, or the means of invoice delivery being problematic, billing processes got in the way of a customer's ability to pay on time. Simple invoice audits uncovered constraints leading to aging A/R. Past examples of corrected billing constraints included payment terms



Catalyft Team's Collective Business Services Engagements

40+
Engagements
(Team Total)

90%
Collaborations Involving Finance & Accounting Departments

60%
Services Engagements With Remote Work Components

3
Finance & Accounting Systems Leveraged to Consolidate Reporting

5.2 to 1
B2B Services Return On Investment

not matching up with contract terms (ex. Invoice says Net 30 but contract says Net 45), outdated billing contacts, incorrect addresses (email and physical), and even unclear payment submission instructions.

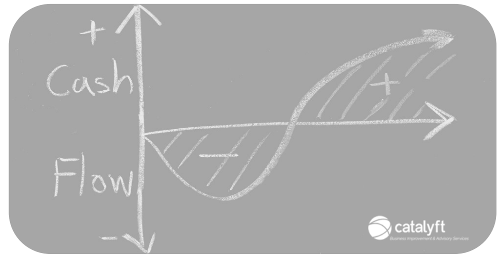
Misapplied Cash Working on OTC improvements allowed teams to see process disconnects across departments. We've seen repeated challenges in applying payments to correct accounts in a timely fashion. The customer thinks all is well because they sent their payment; however, Accounting has yet to make the right journal entry to the correct account number. Companies may use multiple internal finance and billing systems to generate invoices for the same customer. Some firms had different process steps and workflow routing depending on the way customers paid the invoices. For instance, there was one team handling cash in lock boxes in one location that had nothing to do with Automated Clearing House (ACH) transfers, online payments, or checks received across multiple geographical locations. The more billing permutations within the company, the greater the chance of payments being hung up in internal process jumbles.

Disconnected Internal Relationships Our engagements have been a powerful impetus to surface frayed internal relationships and mysterious roles & responsibilities, too. Yes, "Ice Cream Day" and "CEO Dunking Booth" also create some cross-departmental bonds and laughs but these are fleeting compared to a proper OTC overhaul. Most companies we've worked with assigned A/R management to folks in their Finance & Accounting teams. Some firms had a dedicated Collections team as a subset of Accounting; most firms asked their teams to wear multiple hats managing A/R along with budget developments, financial reporting, and ad hoc projects.

While Accounting teams knew the numbers and understood the current sense of urgency, it was usually the Sales or Operations teams who had the true relationships with the customer. Without clarifying who's contacting the customer, A/R activities could devolve into ill-timed, confusing, and off-putting nightmares for customers. Making matters worse, most of the Sales and Operations folks freely admitted they would rather discuss anything but aging A/R with their customers. Lacking the relationship strength of their Sales and Operations colleagues, Accounting teams did not consistently understand the context and business practices of the customer base as intimately as their Sales and Operations counterparts. There was also the on-going challenge of "I thought you were handling this".

Most Sales and Operations teams saw A/R as an accounting function while Finance & Accounting teams thought Sales and Operations should be actively involved with A/R management. To put a finer point on it, Sales and Operations tended to understand the customer base more deeply, knew who to speak with, selected the most effective customer communication channels, and had a better sense of timing (when and where to broach an issue). Departments were not working together on A/R goals, correctly acknowledging all the customer relationship hand-offs occurring, or seeing the repercussions of miscommunication when asymmetrical information remained welled up in particular departments.

(Unfounded) Sense of Helplessness Our times working with Finance & Accounting teams have always been very rewarding collaboration experiences. The nature of these positions attract very analytical, data-savvy, well-structured, and reliable individuals. (Talk about great partners!) However, most teams we've worked with were also bogged down with an unhealthy predisposition—the teams thought they were



Constraints in B2B Services

Key Challenges

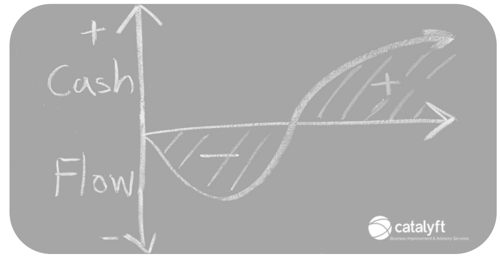
- ⇒ Customer payment timeliness impacted by macroeconomic environment and industry-specific constraints
- ⇒ Disparate, disconnected information systems
- ⇒ Most firms rely heavily on "tribal knowledge" and a handful of overextended employee experts rather than on systematic cash management
- ⇒ Complex role assignments across functional groups
- ⇒ Data analytics & visualization timeliness and usability
- ⇒ Fragmented, inherited processes
- ⇒ Applying a firm's specific collective wisdom to cash
- ⇒ Misaligned performance incentives tying up cash

limited in their ability to make a difference in the realms of process optimization, service levels, and customer relationship management (exhibiting an external locus of control). They tended to define their positions to the letter and stay within the confines of financial job descriptions. Finance & Accounting improvement teams should be tackling A/R and upstream OTC functions—but they also have the data and organizational insights to help in redefining roles, influencing customer relationship management, aiding in data visualization, providing IT with their needs list, and sharing cash flow training with the rest of the organization.

Contract Compliance Woes Remember the aforementioned disconnect relating to payment terms on invoices versus contractual agreements? This example was relatively minor in impact and easy to fix compared with other issues uncovered on our OTC optimization quests. Digging into contract compliance, we compared "what we said we would do" with "what we are actually doing". Working with compliance teams turned up all sorts of issues ranging from potential risks to customer relationships to legitimate fees and revenue sources that should have been billed. Yet again, roles and responsibilities across departments tended to be obscure and there were disconnects, even hesitancies, in sharing information. For instance, Sales was aware of the potential for additional charges, Operations completed the work without the add-on charges in place, and Billing was not equipped with proper triggers to add legitimate but unseen charges to future invoices once services were rendered. Missing out on a stellar educational opportunity, most teams needed to build organizational awareness and a feedback loop of cash-constraining issues when drawing up future contracts. The more prescient teams learned from unprofitable mistakes and prohibitive contract language. They fed these bits of wisdom back to Contracts and Sales—now wiser due to the contract having some actual miles on it.

Challenging Data Aggregation and Visualization Data played a crucial role in creating calls to action. Just seeing where to invest time in cash collections activity helped to solve part of the problem. Some clients retained several finance & accounting software systems as they grew but had yet to consolidate the data flow, hence, no single A/R report to rally the team around and get to work. Other clients had data aggregated within one system but reporting was cumbersome to produce and even more perplexing to interpret. We've witnessed clients who reviewed A/R with reports so outdated and untrustworthy, they might as well have reviewed each and every customer status line by line. Without an easy-to-interpret A/R report, the teams were worn out with painful, time-consuming reviews. When cross-functional teams could not easily see which customers would provide the largest cash infusion, they were overwhelmed, unfocused, and uncoordinated in their efforts. Most needed to be able to see A/R trends faster than they thought previously practical, accounts needed to be prioritized in a meaningful, highly visual way to ply their efforts in more lucrative actions, reporting access needed to be opened up for all team members contributing to A/R collections, and the reports needed to provide data for future OTC improvements (such as A/R reason codes to watch moving constraints or "Coming Due" projections for "Past Due" clients).

Collection Skills Gaps Whether the organization assigned part-time responsibility to A/R collection or employed a full-time team dedicated to nothing but following up with "Past Due" customers, most teams needed improved tools, better process understanding, and more meaningful skills training to get better at getting more aging balances off "The List" every month. We touched upon system access and



Team Performance Enablers

- ⇒ Education on how day-to-day management decisions impact a firm's cash position and the power of freeing up cash for reinvestment
- ⇒ Cross-functional role assignments for A/R management
- ⇒ Finance & Accounting systems integrations
- ⇒ Internal workflow redesign
- ⇒ Clean data hierarchy powering integrated "Past Due" and "Coming Due" dashboards
- ⇒ Comprehensive Cash Conversion Cycle management system
- ⇒ Updated, on-demand Collections, Cash Management, and Cash Application training modules
- ⇒ Robust internal Knowledge Management system
- ⇒ Cash Management compensation incentives

reporting support earlier—all necessary but not sufficient to empower your A/R team. Stronger teams ensured their employees understood their role within the total customer relationship. Some Collections teams were isolated from the rest of Sales, Operations, IT, and the rest of Finance & Accounting. This type of set-up inhibited collaboration on a unified approach to engage and take care of customers in a consistent manner. Some Collections managers did not understand the difficulty inherent in asking people for money—or the fact that just making contact with the right person on the customer side was a puzzle in itself.

Contact activity levels needed to match communication channels preferred by customers. Collections teams needed to have escalation points—right up to CEO and CFO—to ensure they had leverage in getting the invoices paid. Teams not considering their collections approach within the context of an integrated customer experience and pre-existing customer relationships struggled with increasingly aging dollars and higher employee turnover.

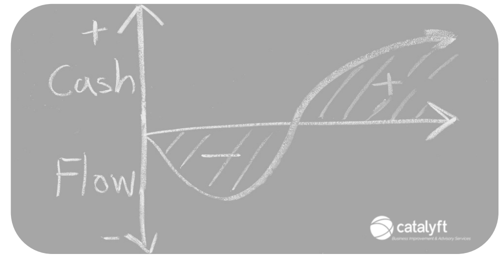
Twelve Ways to Make Cash Matters Better

Depending on the complexity of the swamp you're draining, OTC improvements can be months to years in the making—but cash acceleration can be sped up in weeks. Aging A/R is a great starting point because it lends itself well to prioritizing structural changes and process improvements upstream. While every organization has unique needs, our collaboration experiences taught us several avenues to improvement. Here's a somewhat simplistic A/R punch list culled from time on cash teams.

Encourage and empower your team to:
1) Understand the reasons behind past due balances beyond the usual assumptions and excuses for "why"? Make sure your team can see the reasons behind the past constraints to A/R, current reasons popping up, and the common reason codes changing as they implement their attack plan to remove customer and employee frustrations. As Eli Goldratt impressed upon us, constraints will move. Previously insignificant reasons will become the future's dominating cash constraints. The team will have to tap them back down with customer-centric process optimization, new tools, and a healthy dose of cash flow vigilance.

2) Prioritize impactable fixes. Don't waste time worrying about what's out of your hands. (This may sound like we're advocating a firm grasp of the obvious, but it's value in winning back time is worth the risk.) Your team is bound to have differing perspectives on prioritization, a continuum of beliefs around one's ability to make an impact and control outcomes, and varying levels of patience. Some guidance: people tend to overestimate their capacity for change when thinking about a task in isolation of all the other "to do's" that must be done concurrently. Structure a prioritization workshop with multiple departments representing stakeholder interests, hash out the details, and emerge with one list of opportunities (include expected constraint removal value, necessary resources to stick with the prioritized list, preliminary task owners, and targeted timelines to implement agreed solutions).

3) Do not leave cash flow responsibilities to a default, uncoordinated group of employees. Define cash collection process inputs and outputs within the context of the customer's perspective. Get all necessary departments and expertise involved in A/R relationship management



Our Way of Collaborating

Identify
2-4 meetings at no cost
- Discussion of issues
- Alignment around probable causes
- Framing of analysis scope

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Qualify
3-6 weeks at cost
- Qualify opportunities with Trapped Value Analysis (TVA)
- Quantify anticipated results
- Initial engagement design
- Key meetings: Launch, Opportunity Review, Solution Review, and Final Framing of analysis scope

Modify
4-8 months
- Final engagement design
- Execution of engagement design
- Realization & measurement of results
- Ownership & sustainability

Office Locations

NYC
One World Trade Center
Suite 8500
New York, NY 10007
212 220 3897

CHI
444 West Lake Street
Suite 1700
Chicago, IL 60606
312 260 9907

MIA
200 South Biscayne Blvd
Suite 2790
Miami, FL 33131
305 925 8112

SFO
101 California Street
Suite 2710
San Francisco, CA 94111
415 636 7999

TOR
20 Bay Street
11th Floor
Toronto, ON M5J 2N8
647 725 9662

(Contracts, Sales, Operations, IT, Finance, and Accounting tend to be the collective keepers of the keys).

4) Agree on a simple graphical representation of your A/R transformation engagement. Include baselines, cash target, and frequent actual performance updates to see incremental results on your arduous journey. Most definitely, track all customer and employee frustrations your team is solving while herding the dollars. This list, by checking off the wins, will affirm you're quite serious about longer-term enterprise excellence and not just making the quarter look prettier. One nicely-planned, well-vetted, clean and simple graph showing progress compared to historical baselines can be more communicative and even more elegant than a legion of update emails, videos, and chats.

5) Aggregate data through your data warehouse or data mart subset to be able to see all A/R on a weekly basis as well as "Coming Due" balances for "Past Due" customers. With the team now seeing both "Past Due" and "Coming Due", they will get in front of future dollars spilling over into "Past Due". Equally important, they will approach the customer and payment solutions in a more holistic, coordinated fashion rather than focusing just on oldest dollars, largest outstanding invoices, or the customer with the friendliest A/P department.

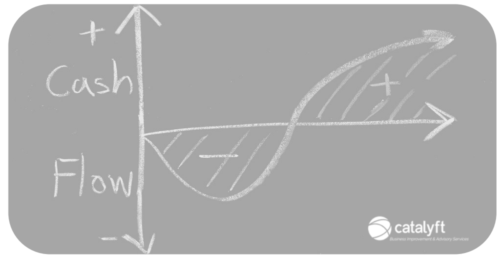
6) Simplify your reporting structure —generate and distribute "The A/R Report" not multiple versions. Make sure the report distribution list is updated regularly with an owner and a scalable maintenance process in place. Be very vigilant in keeping data flow clean. Invest time and resources in faster reporting technologies to keep the team diligent about getting "The Report" updated and out to the cash team.

7) Design dashboard reports with easy-to-read visuals and straightforward calls to action. This is an art just as much as a science. Make your dashboard the centerpiece of your reviews. There's so many software-as-a service (SaaS) business analytics / business intelligence packages to choose from that your team may not need to build anything from scratch. Most teams appreciate high-level visual summaries with drill-down capabilities across cascading data components. Work with the team to understand the lowest level of data needed to contact the customer. Collections Agents must be well-prepared and ready to answer questions with facts.

8) Speed up your reporting distribution. Weekly A/R reports work well because the team has time to see issues and correct them before customers wallow in the usual 30 - 60 - 90 day categorization purgatories. Word of warning: the team will groan at this frequency if they have gotten into the habit of looking at A/R on a monthly or, perish the thought, quarterly basis.

9) Train your team to go about their daily | weekly | monthly collection activities with the customer experience in mind. Share with your team customer service and experience metrics along with cash-related contact activities. Design and support cash activities with the customer experience guiding team interactions, sitting next to your team in spirit during performance reviews, coloring future decisions, and maintaining an organizational presence-of-mind.

10) Make sure every person on your team understands their respective role in generating future cash flows. Educate your team on the power of controlling your firm's capitalization destiny by having multiple funding options for future growth. Do not assume this is just a "Finance & Accounting responsibility" or your smart, well-educated employee



Interesting Cash Metrics To Trend

OPERATIONAL
- ⇒ Order-To-Cash (aka Req-to-Check) Cycle Times
- ⇒ Pareto Analysis of Top Cash Constraints
- ⇒ Pareto Analysis of Billing Constraints
- ⇒ Past Due to Billed Ratios
- ⇒ Coming Due to Future Billed Ratios
- ⇒ Cash Application Cycle Times
- ⇒ On-Time Billing Percentages
- ⇒ Collections Relationship Management Contacts To Collected Ratios
- ⇒ Cross-Departmental Cash Management Time Allocations

FINANCIAL
- ⇒ Cash Conversion Cycle (CCC) Days
- ⇒ Days Sales Outstanding (DSO)
- ⇒ Days Payable Outstanding (DPO)
- ⇒ Days Inventory Outstanding (DIO)
- ⇒ Accounts Receivable Turnover Ratio
- ⇒ Weighted Average Cost of Capital (WACC) for Cash Flow Discount Rates Exhibiting Similar Risks to Overall Firm
- ⇒ Free Cash Flow (FCF)
- ⇒ Levered Free Cash Flow (LFCF)

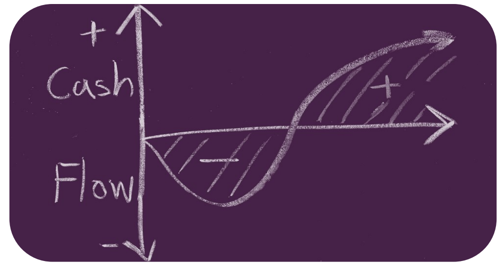
base understands their own cash preservation and generation capabilities within the context of the firm—ensure team members are educated regarding their own practical, day-to-day influence on cash. And keep experimenting with new OTC improvement mechanisms and consistently educate your entire team on collective, evolving cash wisdom.

11) **Pay your folks for hitting cash targets.** If cash is important to your organization (and you know it is), then structure the compensation program to reflect this high organizational priority. Most companies we've worked with had bonuses based on revenue or cost savings goals but needed to add cash flow targets as well. Of course, the viability of a cash goal compensation plan will be contingent on an employee's role within the organization.

12) **Last, but not least, celebrate successes along the way.** Managing rising A/R balances and all the litany of reasons spurring lateness will take time. Your team will need, and will earn, a few pats on the back along the way. With definitions and measurements of success set up correctly, forward progress will be seen with clarity and certainty by all key cash influencers. (Thanks to the well-designed, simple visual your team put in place via recommendation #4 illustrating where the team started, what's been achieved to date, and where the team is headed). By designing customer and employee needs into a comprehensive OTC system, transformational progress will be accelerated well beyond cash flow statements.

You're On the Right Track

If your firm's cash conversion push leaves the team with a new-found reverence for cash, a deeper understanding of their respective roles, an agreed process to thoughtfully coordinate multifunctional energies, and a way to ensure cash-constraining frustrations become less painful (for the firm's cash position, for employees, and for customers), then your A/R balances were worth far more than stated dollars.



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Business Improvement & Advisory Services

Turning
Organizational Energy
Into Results
That Matter

Services Sector

A/R Management
Capability Build-Up

US-Based
Collaborations