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# Cash Application Today: Avoiding Cash Traps In a Time of Financial Crisis

**Improving 6 key activities can speed  
your liquidation rate by up to 20%**

**By Michael Baldwin**

Cash. These days, it's not only king; it's practically the emperor of the universe. Amid a continuing global financial crisis that shows little sign of abating anytime soon, companies are searching high and low for sources of working capital. And increasingly, they're looking at their own receivables operations.

What they're uncovering there is generally not a pretty sight. Since A/R is traditionally a back-office function, it easily falls victim to neglect. The result is receivables processes atrophy over time, and the resulting inefficiency translates to cash falling through the cracks.

During good times, cash spillage can be overlooked. But in the current credit crunch, with companies scouring every nook and cranny of their processes for working capital, there can be dire consequences for breakdowns in cash application.

## **Cash traps and cash application**

Cash application is, conceptually, a simple process: applying customer payments to open receivables. When done properly, it forms the cornerstone of an efficient collections effort, providing an accurate representation of what customers truly owe you. When the cash app process breaks down, however, you lose time and efficiency that negatively impact sales, cash flow and cost of capital.



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“Cash traps” are a significant problem, because they usually go undetected until a severe issue surfaces. When that happens, they can affect multiple cash applications. There are six primary areas where cash traps typically emerge. By identifying these areas and addressing issues within them, financial professionals can sidestep the land mines and uncover the additional working capital that is so critical in times of economic strain.

In my experience, making solid improvements in these six areas has enhanced cash liquidation by **as much as 20%** — and in some cases, even more. They are as follows...

## 1. Order Entry & Billing

This, the first step in the receivables process, is rather straightforward: creating invoices, whether manually or via automated processes, based on client orders or contracts.

Because Order Entry is step one, any breakdown here necessarily affects every subsequent step in the cash application continuum — specifically in Lockbox and other applications.

When an order or invoice includes a mis-entered price, address, product or payment terms, the immediate result is often that the invoice is disputed and goes unpaid.

This leads to compounding consequences. Faulty order entry and billing result in unnecessary, cost-wasting reconciliations, as well as deterioration of customer confidence (and increases in time-intensive customer service calls).

Fortunately, there are proven successful ways to identify and quantify systemic Order Entry and Billing problems. A solid, Six Sigma-type audit methodology, implemented by a cross-functional management team, can pinpoint root causes, repair areas of inefficiency, initiate automated audits and alerts, and establish an ongoing maintenance regimen.

What should that methodology include? Certainly the establishing of key metrics, such as Order Entry accuracy scoring (if there's more than a 1% error rate, it's a problem area) and variance analyses (for example, what percentage of invoices accurately reflect a PO when required by your customer, or have pricing errors).

Our recommended approach is to include a deep-dive review of the Billing process. This review — which includes detailed process maps of your current state, future state and plan for implementing remedies — should contain recommendations for automating certain controls and alerts, such as when an invoice is delayed by X number of days. It should also include recommendations for updated policies and procedures.



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Some of these steps might be taken internally. But the sheer sophistication of many of these steps, and the tools required to implement them, may require an outside expert who specializes in defined cash application process improvements.

## 2. Lockbox

In theory, the Lockbox should be a simple component of the cash application process. Customers write checks and mail them to your remit address. Period. But what happens when, as is frequently the case, your lockbox match routine is faulty or ill-designed? (Some checks, wires and ACH have the necessary data to support prompt processing/payment, and some do not.) A payment can sit in an “exceptions” or “unapplied” account for days or weeks, contributing to an age-inflating, cash-crippling bottleneck. That backlog, in turn, can result in artificially overstated A/R aging, unnecessary reconciliations, customer dissatisfaction, and resulting drain on internal resources to address these chronic problems.

What causes Lockbox problems? Anything from unclear check image scans, to missing data from wires or ACH transmissions, to liberal Bank Letters of Instruction terms, to unsophisticated match routines. These and other faulty processes result in increases in exceptions, unapplied partially applied payments, and excessive cash on account.

The solution to these cash-robbing roadblocks is a strong process for expedient research and resolution. Tracking just a few key metrics can make a substantial difference. What, for example, are your hit rates — the percentage of payments that the bank posts to the invoice or account level? What are your error ratios? How closely are you adhering to prescribed file upload processing times? And how timely and responsive is your bank’s IT support function?

These questions should be tackled in an exhaustive audit of the Lockbox function. Bank Letters of Instruction should be addressed and modified if needed. A formal calibration session should be set up to review root causes of problems. Current Lockbox providers should be re-evaluated and alternate options explored. And certainly, a rigorous analysis should be initiated into your Lockbox match routines and processes.

A proven effective tool for gauging the effectiveness of your Lockbox operation is a “Lockbox Report Card” — essentially a customer satisfaction survey and detailed review. Best conducted by an outside consultant to ensure honest responses, this review assesses the capability and performance of your current lockbox providers, covering such areas as service, notifications, accuracy and quality.



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### 3. Exceptions and On-Account Payments

Some degree of exceptions will always exist within the cash application process. However, many companies are incurring high volumes of unnecessary exceptions, due to poor Lockbox match routines and payment investigation methods.

One unfortunate result of mismatches in one's Lockbox routine is unnecessary payment investigations and reconciliation of unapplied suspense or exceptions. This type of work drains resources and hinders throughput, leading to an exceptions backlog as well as inaccurate account aging results. Those issues, in turn, often result in collection calls that should never happen (with ensuing customer anger).

As in the previous two steps, the remedy here is a best-in-class methodology that can enhance productivity (for example, measuring keystrokes per hour) and accelerate throughput and associated turnaround time.

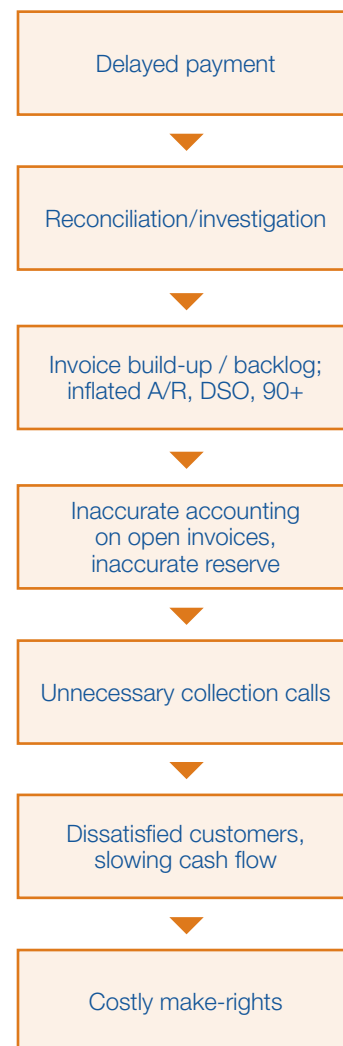
A good place to start is with a solid Value Stream Mapping exercise that follows a successful Six Sigma template. This exercise identifies weak process points and helps you prepare a future state map and implementation plan. The analysis should focus on two areas:

1. Identifying unnecessary exceptions and providing feedback upstream to the Lockbox provider, as discussed earlier
2. Conducting a detailed review of your current exceptions resolution process

A detailed process review ensures that the best methods for payment investigations and resolution are being employed and monitored. That can help improve invoice level hit rates, minimize backlogs of exceptions, and boost overall accuracy and quality scores.

Typically, these kinds of sophisticated processes are best left to an outside expert. One advantage of external resources is personnel optimization. They have the predictive modeling expertise to forecast workload peaks and valleys — weekly, monthly and/or seasonal — and develop a successful load balancing strategy. They can then implement a strategy for daily maintenance of ongoing exceptions inventory, while clearing out existing backlogs. For maximum effectiveness, the strategy should include skills-based routing and a load-leveling workflow approach.

#### The snowball effect of exception build-ups



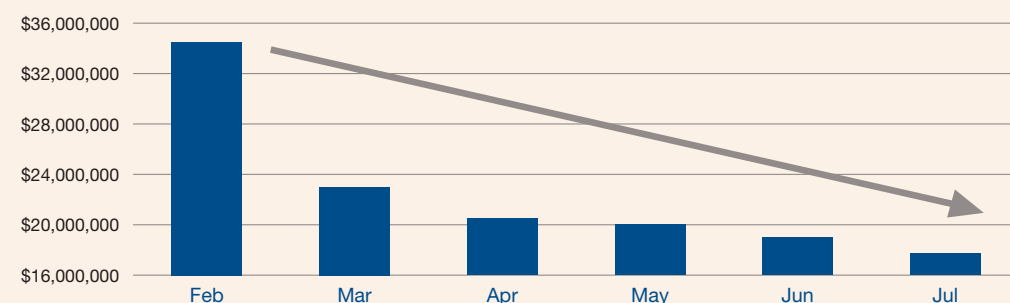


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### A tale of suspense: How one company reduced cash and wires by 70%

An organization was weighed down by more than \$35 million in suspense and unapplied cash. By calling in a cash application expert, they reduced the backlog to under \$10 million in 6 months' time — an improvement of more than 70%. The new cash application process also streamlined payments and handled customer care requests within 24 hours



## 4. Misapplied Split Payments

One of the most common errors, and subsequent traps, in the cash application arena is the mishandling of Split Payments. In some cases, payments are applied to the wrong account by the Lockbox provider or cash app team. In other instances, payments cannot be applied by an automated match routine, and are subsequently lost in the cash application sauce.

Many Split Payments cannot be resolved through improved match routines, but can be minimized by modifying customer payment behavior and improving exception processing. Weak and/or slow resolution of these payments will result in costly rework to correct inaccurate aging. The soft costs here can be high as well; when Split Payments are misapplied, customer satisfaction usually takes a hit, and considerable time and effort are generally expended to get relationships back on track.

How does one determine if there's a Split Payment problem afoot? Some key metrics can tell the story. Inventory levels of problem payments can be an indicator of confusing invoices. Throughput and turnaround time quantification are other telling statistics.

If these metrics substantiate your suspicion that there is a problem in this area, a number of remedial steps can be taken. Among them: Daily production quality checks. Monthly lockbox scorecard maintenance. And better training of associates, using the latest testing and live monitoring techniques.

Perhaps the most critical fix, though, is simply better, more streamlined communications between your A/R and Customer Care teams. (I'll speak more specifically to this momentarily.)



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## 5. Dispute Resolution

Here it is. The #1 reason for cash application problems: issues in resolving customer disputes. Now certainly, customer disputes — returns, dissatisfaction with service, etc. — are unavoidable. The true cash trap, though, is not in the disputes themselves, but rather, upstream root causes and downstream management inefficiencies.

Here's how it typically unfolds: A payment is applied to the wrong account, or a credit or debit memo is improperly applied. This results in a customer dispute or refund request. As the dispute awaits resolution, the customer withholds payment on all other invoices. That, in turn, creates a compounding effect on future payments and a continual degradation of aging until the dispute is resolved.

Now throw in a management scenario that compounds the problem: Customer Care is slow to resolve a dispute. Or the dispute is resolved, and it's A/R that's slow to process a credit to the customer's account — which translates to additional Customer Care time with the customer.

The fact is, because the scenarios for faulty dispute resolution are nearly endless, there is probably no organization that hasn't fallen prey to it at one time or another.

The mess is avoidable. Of all activities in the cash application realm, Dispute Resolution is the one that can benefit most from enhanced processes (as well as solid metrics to gauge the effectiveness of those processes). Among best-practice processes are an automated dispute workflow system. It can identify the upstream root causes of open disputes and link processes to turnaround time for SLA purposes.

Speaking of best Dispute Resolution practices, consider an interactive workflow tool that links up with your company's ERP platform. This tool can establish and monitor performance benchmarks, including average processing time by dispute type, average days open/closed by dispute type, and dispute aging and volumes.

If this sounds sophisticated, well, it is. For that reason, few companies have established such a system in-house. But given the potential return on investment, hundreds have gone outside their walls to team up with outsourced cash application experts who specialize in processes and automated tools to fix what's wrong with their Dispute Resolution.



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## 6. Customer Care

The Customer Care category covers a lot of cash apps ground — processing refunds and transfers, applying credits, investigating payments, placing stop-payments on refund checks, and other activities. And when problems emerge here, the reason generally comes down to one word: communications. Or rather, problems in same.

### Sidestepping the cash traps: A checklist

#### What you may be able to do internally

##### Order Entry & Billing

- Pinpoint root causes, repair areas
  - Use Six Sigma-type audit methodology
  - Use process maps to implement remedies
  - Automate controls, alerts
- Establish ongoing maintenance regimen
- Establish key metrics, variance analyses

##### Lockbox

- Audit Lockbox functions
- Track key metrics (hit rates, error ratios, etc.)
- Implement expedient research/resolution process
- Evaluate, modify Bank BLIs
- Establish calibration session to review root causes
- Re-evaluate Lockbox providers, explore alternatives

##### Exceptions/On-Account Payments

- Implement best-in-class process to enhance productivity, accelerate throughput

##### Misapplied (Split) Payments

- Perform daily production quality checks
- Maintain monthly lockbox scorecard
- Improve A/R-Customer Care communications

##### Dispute Resolution

- Develop, establish enhanced processes
- Employ metrics to gauge process effectiveness

##### Customer Care

- Improve communications with A/R and customers

#### What you should consider outsourcing

##### Order Entry & Billing

- Review process and provide additional automated solutions

##### Lockbox

- Perform analysis into match routines, processes
- Initiate “Lockbox Report Card” survey of key bank partners and consider switching providers

##### Exceptions/On-Account Payments

- Perform Six Sigma Value Stream Mapping
- Complete detailed process review of resolution steps and throughput and workflow
- Utilize cross-trained staff to handle critical peaks in inventory levels

##### Misapplied (Split) Payments

- Track key problem payment, throughput metrics
- Establish associates training program using latest testing, live monitoring techniques

##### Dispute Resolution

- Implement dispute workflow system to ID root causes
- Deploy interactive workflow tool that monitors performance
  - Average processing time by dispute type
  - Average days open/closed by dispute type
  - Dispute aging, volumes
  - Utilize an automated dispute resolution workflow tool+

##### Customer Care

- Deploy state-of-the-art workflow tools that can:
  - Prevent duplications
  - Avoid incomplete requests for refunds, transfers
  - Effect skills-based routing, staff load-leveling
  - Utilize Schedule of Authorization that ensures adherence to standards



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Slow communications in key Customer Care activities can be found at multiple levels of the organization, from inefficient handling of inbound calls by customer service personnel (how long does it take to deliver a refund, or to supply a requested copy of a check?) to mismanagement of collection calls by the A/R team. By failing to address these problems, Customer Care issues can impact open invoices as well as future billing.

The key to preventing these issues is to speed up and improve the communications process. By assigning, tracking and monitoring both internal and external (customer) communications, you can accelerate throughput/turnaround time and improve quality control in such areas as requests for aging and requests for scrutiny of refunds.

There are some very good automated tools out there to help. And I do mean “out there,” because the most effective of these tools generally reside with outsourced experts who specialize in cash application. It’s their livelihood, after all, to build state-of-the-art real-time workflow tools that can help prevent duplications; avoid incomplete requests for payment investigations, refunds and transfers; and effect skills-based routing and load-leveling among staff to speed turnaround times.

In addition, such a tool can include an embedded Schedule of Authorization that ensures adherence to standards such as Sarbanes-Oxley and ISO 9000 when managing refund sign-offs.

## Solutions within, solutions without

When the cash application process breaks down, organizations forfeit valuable time and efficiency, which translates directly to loss of cash flow. By addressing chronic issues in the aforementioned six areas, financial professionals can sidestep the cash traps that bedevil organizations time and time again.

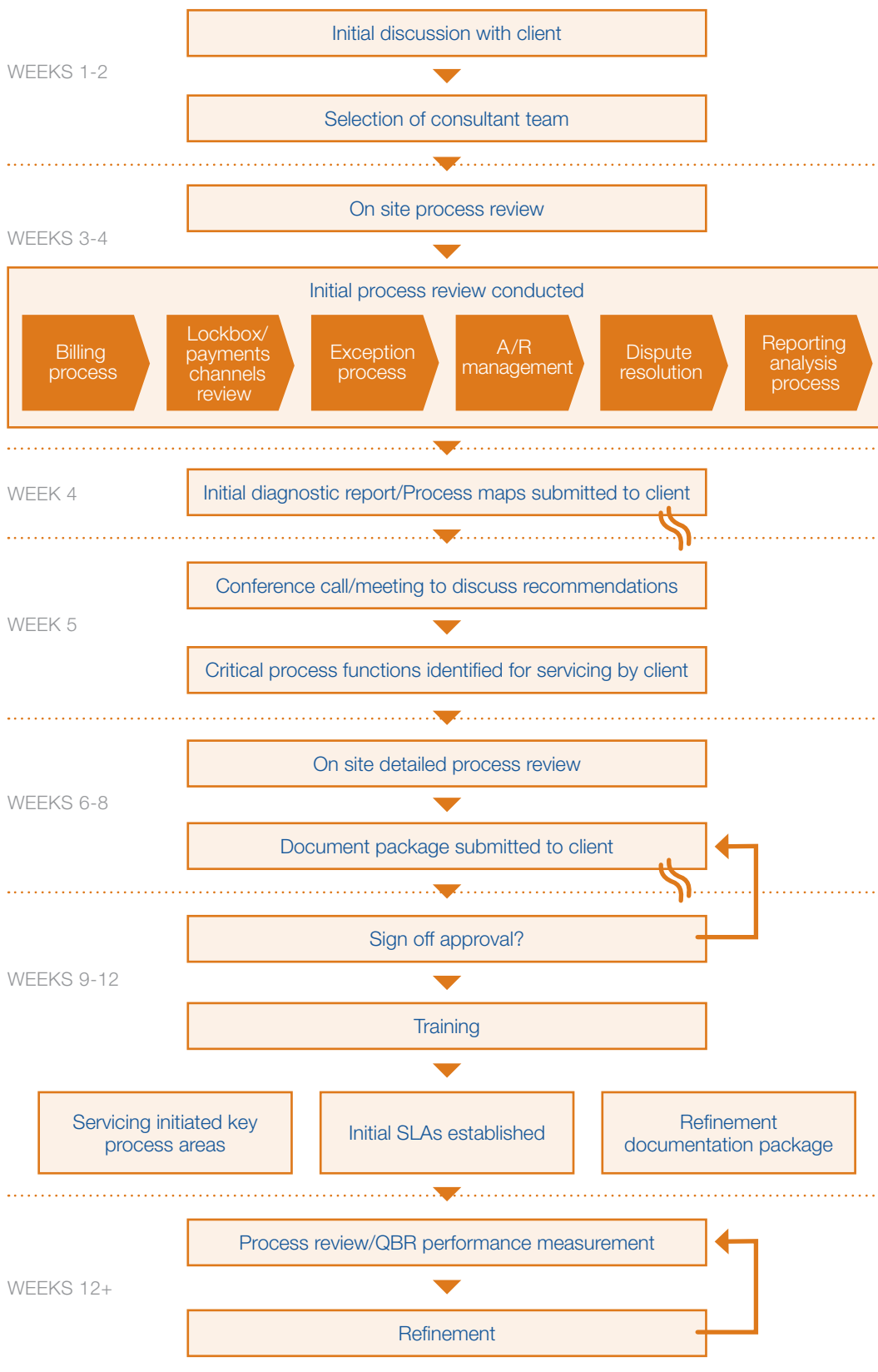
As stated, some of the remedies can be implemented internally. Others are best left to an expert in cash application tools and solutions. Such an expert can show you how making improvements can enhance cash liquidation by 20% or more. In times like these, with companies examining nearly every part of their operations for hidden cash, that is valuable indeed.



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## A typical engagement with an outsourced cash application expert





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### **About the author**

Michael Baldwin is President and CEO of Receivable Management Services Inc, a leading outsourcer of cash application and A/R optimization solutions. RMS's proven success and expertise in DSO reduction and cash flow management dramatically and cost-effectively accelerate the order-to-cash cycle. Its global operations include three U.S. locations, as well as facilities in Mexico, Canada, India and China. A 25-year veteran of the credit and receivables industry, Mr. Baldwin also served in multiple roles at Dun & Bradstreet Corporation, including Vice-President of Sales for D&B's largest sales region, President of Market Data Retrieval, and Senior Vice-President of Sales.