CORTERA

Protect your Balance Sheet with Collections Scoring

cortera.com

Maximizing Collections Results

Credit & Collections Professionals are continually faced with the challenges of a changing business landscape, economic instability, globalization and ongoing technological advances. Traditional credit and collections methods, which have previously been very labor intensive, are transforming into much more automated tasks as the technology of call centers, credit scoring, ERP systems and credit reporting are improving – and in some cases, becoming more viable solutions.

According to a 2013 Credit Research Foundation survey, there is a tremendous concern from credit executives who feel challenged to do more with fewer staff resources.

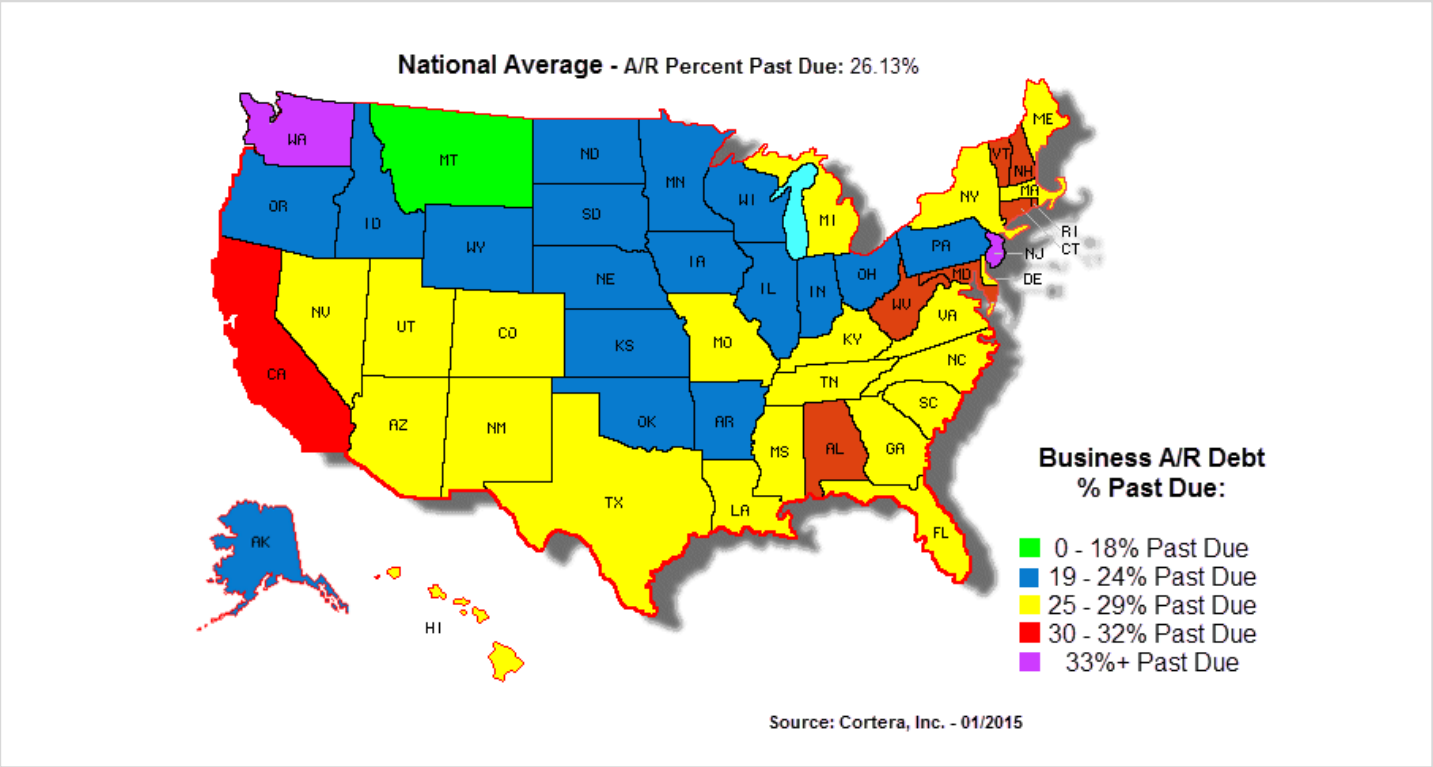
This whitepaper offers practical advice for CFOs, finance executives and credit and collections professionals alike who are looking for better solutions to help them navigate the changing waters of the credit and collections landscape.

Scoring as a Collections Performance Driver

Scoring has been a hot topic in the commercial collections world over the past several years, but still has not garnered the attention that is witnessed in the consumer debt collections space. Financial institutions, healthcare and credit card companies are far more sophisticated and analytical in their approach to receivables. The first wave of business-to-business interest developed out of trends including Sarbanes-Oxley compliance, lower technology and modeling costs, and better education on scoring through groups such as the Credit Research Foundation (CRF) and National Association of Credit Management (NACM). CRF's most recent survey (2014) of America's top companies showed that only 31% of the companies are utilizing scoring for collections prioritization. While this is an 11% increase from studies cited in the past (20% in 2008), many companies are still missing a powerful opportunity to improve cash flow and adapt to this evolving business landscape through the utilization and factoring of a customer's credit risk into its collection strategies.

The next wave of innovation is now upon us as the economy continues to pressure business cash flow at organizations of all sizes. Cortera research has witnessed the national average of commercial accounts receivables past due by state increase by roughly 1% in the last 12 months, as compared to the previous year (2013). When looking at individual states, Cortera data suggests that in the best case scenario, 18% of receivables are past due and in some states this number can be as high as 40% (see Figure 1 below). With delinquencies and bankruptcies hitting record highs, companies must tackle the A/R challenge immediately to protect one of their largest balance sheet assets: accounts receivable.

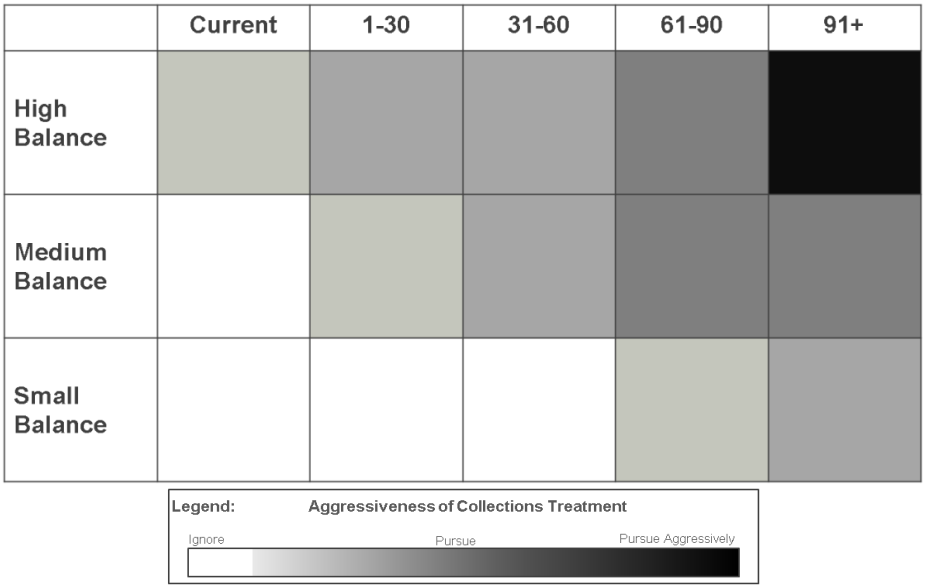
Figure 1: Business Accounts Receivable Debt % Past Due by State



Traditional Commercial Collections Segmentation

Today, many companies collect on accounts based on aged trial balances, working from right to left on the aging report, not considering the risk of the account, just the past due balance. Without risk-based analysis, this is the best strategy because the larger A/R balances will have the biggest impact on DSO **(see Figure 2 below)**. That said, there is a better way...

Figure 2: Portfolio Segmentation without Collections Scoring

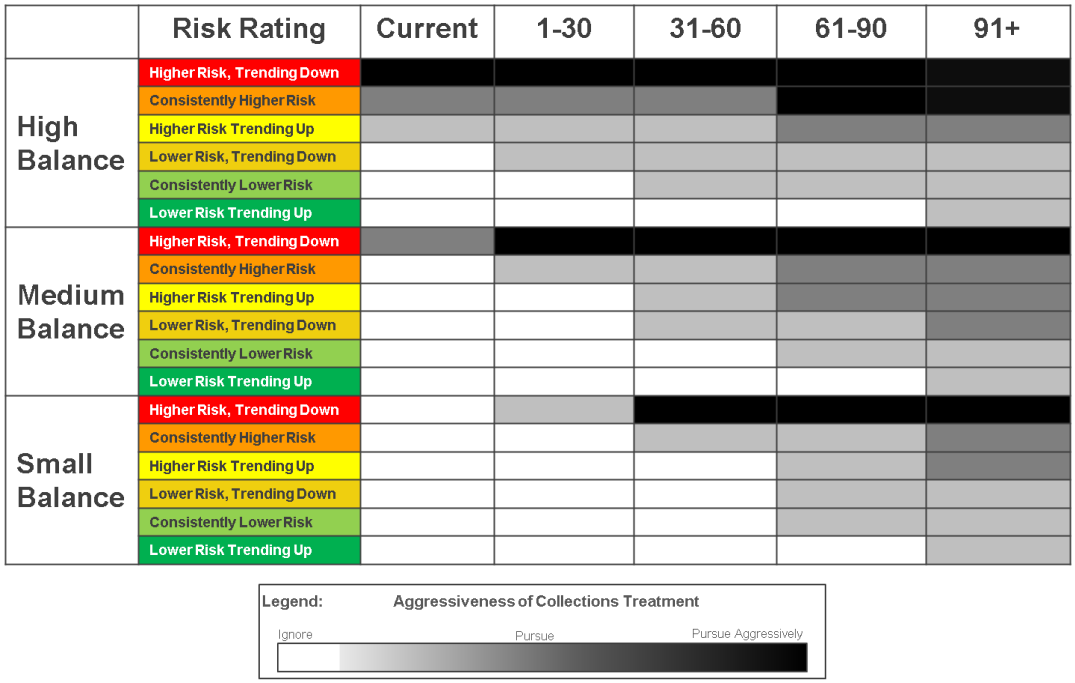


CORTERA®
cortera.com

Risk – Based Commercial Collections Segmentation

However, with risk-based collections, a company can be more strategic and focus the appropriate resources and software to touch many more accounts through phone, email, fax and letter correspondence. The collections risk scores generated today will help your organization prioritize resources and drive collection policies to help optimize recovery in the future. In **Figure 3**, you can see aggressive collections treatments can be applied almost immediately upon invoice issuance if the account is high risk and deteriorating. The key factor is risk, not balance or age exclusively.

Figure 3: Portfolio Segmentation with Collections Scoring



Risk Scoring in Practice

Utilizing scoring to prioritize your collection strategies, at a high level, requires three steps:

- Risk score your account portfolio
- Developing collection strategies to optimize recovery
- Utilize software (or even a spreadsheet) to prioritize the accounts to call (email, fax)

STEP 1 – Risk Score Your Portfolio and Do It Regularly

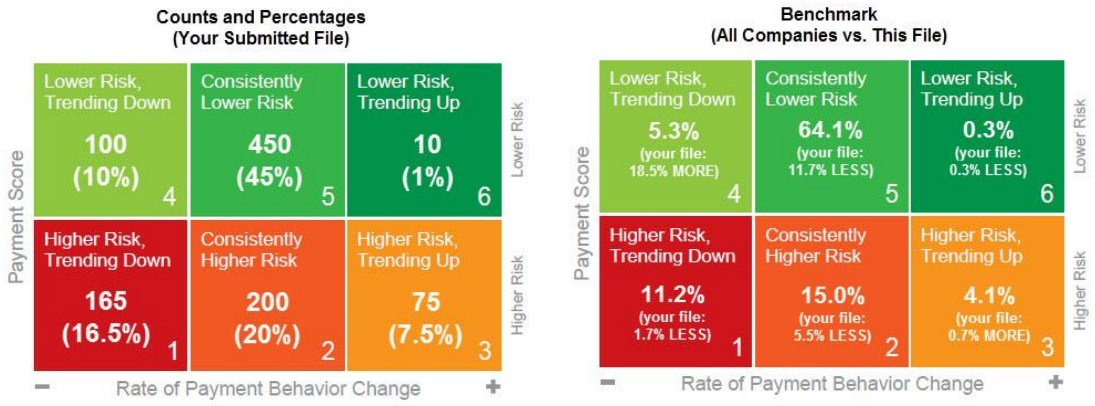
The first step is to assign a risk score/collection recovery score to a portfolio of your accounts. Risk scoring a portfolio of accounts can take many forms. Your organization can utilize its own rules/judgmental based scorecards; utilize a 3rd party to develop a custom statistical/behavioral based scorecard(s); and/or utilize a credit information provider to score your accounts. Regardless of the model used, the risk score should determine both the willingness and ability of your customer to pay its bills.

Factors used to identify risk in scoring models include:

- How the customer currently pays other companies
- How your customer pays certain industry groups (may be more relevant to understand how a customer pays bills to your competitors)
- Size and stability factors such as Years in Business and # of employees
- Public Record data such as number of A/R and Inventory secured UCC filings, suits, liens and judgments
- Financial data/ratios to determine liquidity, leverage, profitability and efficiency
- How the customer is currently paying you and historic payment trends with your organization

In Figure 4, a customer portfolio has been scored, segmented and benchmarked against a total population of companies. In this case, roughly 16% of this company's customers are high risk and trending negatively—1.7% less than the benchmark.

Figure 4: Scored and Segmented Sample Portfolio



Repeat this scoring monthly if possible. With customers deteriorating quickly, even solid payers could become your next trouble account.

STEP 2 – Develop Collection Strategies to Optimize Recovery

Once you have scored your accounts, organizing them and assigning them to the appropriate collections strategy or treatment is the next step. Like we saw in Figure 4, Figure 5 shows how a portfolio is broken down into six segments. An organization would then likely assign the most aggressive collections strategy to segment 1 (Higher Risk, Trending Down).

Figure 5: Portfolio Segmentation for Collection Strategy Assignment

Studies have shown that the more an invoice ages, the more difficult it becomes to collect on that past-due balance. Being more proactive and aggressive on your high-risk customers will improve overall collector performance and company DSO.

Today's best practices include incorporating your collections score into your collection strategies for more appropriate treatment of your accounts. This practice has been utilized by leading collection agencies for years. When they receive a placed for collection file, they immediately risk score the account portfolio and prioritize their calls based on risk; the lowest risk customers are called first and time permitting the higher risk customers. This is because the recovery rates are much higher with low risk accounts. A collection agency, similar to a collections department, knows the value of phone correspondence and through a risk strategy can maximize their call effectiveness.

The ability to adopt a more aggressive collection policy towards your high risk accounts will improve the likelihood that the account will pay its obligation.

An example of a collection strategy using risk as one of the criteria is shown below:

	Account Type			
	High Risk AR Balance > $100,000	**Low Risk AR Balance > $100,000**	**High Risk AR Balance < $10,000**	**Low Risk AR Balance < $10,000**
Collection Policy Example	10 days past due call customer 20 days past due call customer 30 days past due send credit hold warning letter 35 days past due call customer 45 days past due put account on credit hold	15 days past due send reminder letter #1 30 days past due call customer 45 days past due send reminder letter #2 50 days past due call customer 65 days past due send credit hold warning letter 70 days past due call customer	5 days prior to invoice due send invoice payment reminder letter 10 days past due send reminder letter #1 20 days past due send reminder letter #2 30 days past due send credit hold warning letter 35 days past due call customer	15 days past due send reminder letter #1 30 days past due send reminder letter #2 45 days past due call customer

As seen in the example above, a blend of phone call and letter correspondence is used to collect on certain accounts. The example also shows prioritizing calling high dollar/high risk accounts first, which is where a company should focus its limited resources. An ideal situation would be to call all past due invoices on all your accounts. The reality is that the collection department only has so many resources and number of phone calls it can make per day.

STEP 3 – Utilize Software to Increase Productivity

Studies have shown that collectors in a manual environment spend the majority of their day doing the following:

- Preparing who to call
  - Includes pulling and interpreting reports and aged trial sheets
  - Toggling between systems to get the most current information and summary level information on the account to be called
- Documentation, Reporting and Follow-up
  - Examples include: creating call notes, management reports, faxing/mailing out correspondence, follow-up reminders, dispute resolution, etc.

Depending on the size and resources, a significant amount of productivity can be achieved through prioritization. A spreadsheet organized by risk with key information coupled with the order entry or accounting system is often enough. Again the key here is to segment the accounts before any action by a collector is taken, so the entire team can work smarter and focus on the right customers.

For larger organizations, there are certainly many options from ERP to bolt-on collection software solutions that are geared to automate most of the above activities, which allows the collectors to spend more of their time making collection calls. The software tools organize a collector's day by organizing/prioritizing what accounts need to be called based on the consistent collection policies of your company. Those accounts/invoices are exposed to a collector's work queue every night and throughout the day so when the collector comes in to work they know exactly what invoices need to be called and why.

The software can also automatically generate letter correspondence to your customers based on how many days past due the invoice is. This is one way a company can "touch" more accounts using automation. Traditionally, the work is pushed out to the collectors for a manual phone call have been based on strategies that include company type (e.g. size, industry, etc.), past due balance (e.g. higher balance = higher priority) and days past due (e.g. 60 day bucket, 90 day bucket). Factoring account risk in the collection strategies will allow your collectors to spend their most productive time (phone call work) on those accounts that are the highest risk of default.

Summary

Due to compliance and the need to improve risk performance, only a few forward thinking companies have adopted frequent scoring of their receivables. While many companies are using scoring for risk analysis, very few are using it for collection prioritization, which also has many benefits. In summary, the three main benefits are:

- Allow the collectors to make more collection calls per day
- Touch more accounts and go deeper in the account base by making more calls per day and developing an email / letter / fax correspondence strategy on all accounts
- Maximize call effectiveness by always focusing on high risk dollars first
- Assign the higher risk dollars to the best collectors

The result of the above benefits is improved productivity, lower DSO, and lower bad debt. The time is now for commercial collections scoring.

About Cortera®

Cortera provides analytics and cloud-based workflow solutions that enable companies of all sizes to better understand their customers, suppliers and business partners. Our comprehensive solutions increase visibility into the financial health of your B2B customers while keeping you informed of important changes that traditional credit reporting tools miss. Thousands of companies across diverse industries use Cortera's solutions to increase revenue, improve sales effectiveness, and reduce risk.

Cortera, Inc.

1-877-569-7376

www.cortera.com