New Collections Performance Metrics

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"The only man who behaved sensibly was my tailor; he took my measurement anew every time he saw me, while all the rest went on with their old measurements and expected them to fit me." George Bernard Shaw

"I was going to thrash them within an inch of their lives, but I didn't have a tape measure" Groucho Marx

The problem of measurement

We rely on performance measures to tell us how well (or not) we are doing and where we need to focus efforts. These measures are only as good as the quality of the information. Some organizational functions are more fortunate than others – their measures are based on actual results and provide a high level of certainty. Collections is not so fortunate. The portfolio of accounts in arrears is a complex and moving target. Accounts come in and go, or roll, or churn. It is more like a sea with many rivers flowing in and out, and the unlucky Collections manager must accurately report not only the level of water, but the size of the waves.

The proxies that Collections uses are long-established measures. The Accounts Receivable portfolio is fragmented between Active, Final and accounts moving to Write-Offs. Measures are applied within these classifications in aged buckets. This quantity of money is then sliced and diced in multiple forms to provide roll rates, Days Sales Outstanding, Bad Debt to Sales, etc. Their difficulty lies in the fact that they are comparative ratios. In large companies the bucket amounts need to be averaged to strip out impossible complexity. This month the 30 to 60 day roll rate was reduced, compared to the month before. Good news! Or, perhaps not. Did the30 day bucket have a sudden jump in value, making the roll rate look lower? Is it merely seasonality impacting the roll rate? We are compelled to look at last year's measure to see how we compare, but the lurking assumption is that the past will be repeated and is a good predictor of today's performance. Like George Bernard Shaw, those around us expect the old measures to continue to fit when we actually need a tailor that measures us each time we come in.

The weaknesses of most Collections measures include the use of:

- averages
- ratios, masking whether the numerator or denominator has most influenced the result
- past performance to establish current and future expectations
- assumptions that go unexamined – including the assumption that accounts either roll forward or cure
- buckets, rather than account aged totals

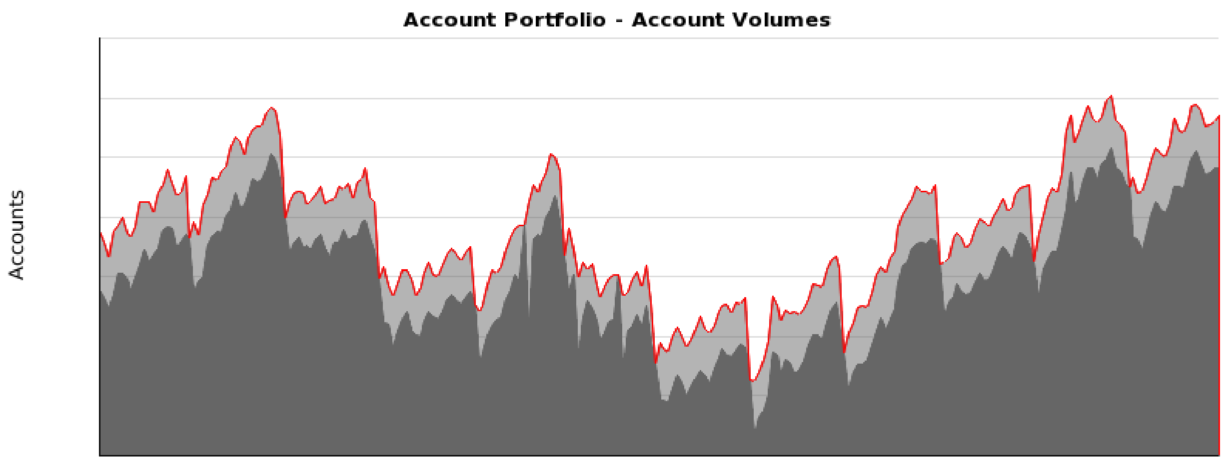
This latter bullet reflects the tendency to treat all 30 day money equally, even though a portion of it is owned by 090 or 90 or 60 day accounts, and is thus riskier money than is a true 30 day total.

These measures have their roots in a time that predates powerful computing capacity for handling complex data. It is time to rethink what is possible given the right tools.

Average Based Metrics

"HERE is Edward Bear, coming downstairs now, bump, bump, bump, on the back of his head, behind Christopher Robin. It is, as far as he knows, the only way of coming downstairs, but sometimes he feels that there really is another way, if only he could stop bumping for a moment and think of it." A. A Milne, House at Pooh Corner

The difficulty with averages, especially for large companies, is the twin influence of cycles and seasonality. Bills are sent out on a cycle basis and are usually not evenly distributed. From the graph below one can see the saw-toothed effect that billing on a cycle basis brings to financials:



In addition to the saw-toothed impact that billing cycles bring, seasonality perpetually has this company either on an upwards or downwards trend. In averaging all the bill cycles together the Collections Manager will never have more than a proxy for the actual state of affairs at any given time. Roll rates further complicate this tendency – 90 day dollars are compared to 30 day dollars two months later – the impact of seasonality will be even more severe in these comparisons. But given the complexity of measuring actual results, proxies were the best that most organizations could do. The pressures of meetings, call centres, and variances take over and like Winnie-the-Pooh, we have little time to think of a better way of doing things.

Traditional roll rates are also seriously limited. If 90 day money increases compared to the month before it is assumed that this is 60 day money rolling forward. Questions are asked and Collections are urged to do better. But the reality of the increase may be due to 120 day money becoming younger because a previously delinquent non-payer has begun paying down their debt. This is good news and an indication that Collections is having a positive impact. How can you really tell what's going on?

Cycle and Account Based Metrics

In basing all financial metrics on accounts and cycles, the Collections manager is provided an accurate measure of performance. The large quantity of data required on a daily basis meant that this approach was impossible in a manual world, and cumbersome for traditional CIS systems, set up to batch rather than process in real time. FORCE™ combines real-time data processing with significant computing power to allow the collection of data at the account level. These accounts are summarized at the cycle level, then each cycle is normalized and aggregated for the entire portfolio. Examples of reports that can be produced on this basis include Collection Effectiveness Index (CEI), Aged Trial Balance and an Account Roll rate report. The differences between these and the normal averaged reports are profound.

Aged Trial Balance:

DSO	Aged 30	Aged 60	Aged 90	Aged O90	Accounts	Total	Average/Acct.
30-59	$16,916,583	-	-	-	104,885	$16,916,583	$161
60-89	$5,544,788	$3,375,722	-	-	32,076	$8,920,510	$278
90-119	$1,890,127	$1,491,292	$1,230,522	-	11,313	$4,611,940	$408
120+	$1,774,150	$1,329,326	$1,185,891	$5,035,095	10,493	$9,324,462	$889
Total	$26,125,648	$6,196,340	$2,416,413	$5,035,095	158,767	$39,773,496	

The aged trial balance presented above provides Collections Managers with two necessary views of their portfolio. The traditional aged trial balance, shown above in the horizontal line shaded in dark green, totals dollars in aged buckets. The vertical line shaded in dark orange totals dollars as they are represented by accounts in the DSO category – this gives the Manager a quick and accurate indication of the riskiest dollars. In this case, the table shows that 90 day accounts are carrying over $4 M in arrears, with $1.9M (almost half) of that debt incurred only last month. The older accounts, in the 120+ DSO category, are carrying $9 M in arrears, with $1.8 of that recently incurred. If these accounts default (as they are very likely to) they will take all that money with them into write-off. No averages which hide an upward or downward trend – the data presented is account and cycle specific and reported on a daily, real-time basis. Average dollars per account provide a good barometer for Collections Managers to spot process issues – if the average dollars per account in the older DSO categories begins to increase you can be sure you have some internal issues to deal with – accounts on hold pending action for too long, payment arrangements which are being broken, or too much leeway from your company, allowing this risky account to consume more of your product and place your bottom line at risk.

Account Roll Rates

The report below shows the volume and percentage of accounts that 1) roll backwards by paying off the oldest portion of their debt 2) pay sufficient to avoid rolling forward but not sufficient to roll backward (churn rate) and 3) roll forward.

	DSO	30	60	90	120
Roll Rate		25.30%	21.20%	-	-
Account Volume	30	38,324	32,161		
$$ Arrears		$5,332,785	$8,369,239		
Roll Rate		26.40%	12.90%	27.30%	-
Account Volume	60	10,912	5,343	11,308	
$$ Arrears		$1,396,110	$1,173,420	$4,033,697	
Roll Rate		19.10%	18.10%	5.40%	29.70%
Account Volume	90	3,557	3,368	999	5,535
$$ Arrears		$423,066	$767,230	$324,366	$2,342,031
Roll Rate		7.60%	6.10%	3.80%	59.10%
Account Volume	120	1,109	880	547	8,571
$$ Arrears		$151,314	$180,244	$176,378	$9,449,897
	Totals	53,902	41,752	12,854	14,106

The table is best read using the DSO buckets on the vertical and horizontal lines. DSO 30 (vertical) against DSO (horizontal) represents how many 30 day accounts remained 30 day accounts at the end of the month. Each of the possibilities is represented in this matrix e.g. 90 day accounts becoming 60 (DSO 90 vertical against DSO 60 horizontal) etc.

The “boxed” figures highlight the accounts that rolled forward at the end of their billing cycle – in this case just over 32,000 30 day accounts rolled forward to 60 days, representing 21% of the 30 day accounts and taking with them just over $8 M.

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The boxes immediately to the left of the forward roll are those accounts that churned. These accounts paid enough to remove their oldest debt, but they did not pay sufficient to either cure or enter a younger DSO bucket. This can be a surprisingly high proportion of accounts – in the example above over 5,000 accounts aged 60 days paid sufficient of their arrears to remain 60 days old. That is of sufficient volume to impact a traditional roll rate, creating consternation amongst Collection Managers when, in reality, 5,000 accounts are showing the right kind of behavior. The one exception to take note of is the 120/120 box. This tends to be the oldest DSO category in most organizations, and it is where accounts can stall while customers negotiate or contend their circumstances. The accounts continue to age in DSO terms while they wait resolution or termination.

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The final 6 boxes to the far left and bottom represent accounts rolling backwards one or more buckets. These accounts are becoming younger as the customers pay off the bulk of what they owe. These are customers the Collections Manager wishes to encourage even while watching them carefully to ensure they continue to progress in the right direction.

There is great power in being able to see what is actually going on with your accounts instead of settling for an average proxy. An automated process that is focused on tracking individual accounts on a behavioural basis, such as FORCE™, can provide these insights to your organization.

About SeeWind Design

SeeWind Design provides solutions that operate inside your business and in partnership with your Customer Care and Billing organization to help you automate and optimize your efforts for collecting overdue accounts. We have over 20 years experience in revenue assurance and debt recovery problem solving and know how important and how challenging it is to get just-in-time analytics from multiple disparate systems.

Our solutions help our clients see their customers' payment behaviours, along with the impacts of their own business policies to foster better teamwork both internally and externally. Our solution's leading edge ability tracks behaviour and results providing the hard evidence at the account, product and portfolio level, both from operational and financial perspectives.

For more information about our solutions visit us at www.forcecentral.com or contact our Sales and Marketing team at (416) - 801-7025