Plugging a Hidden Profit Drain: Expediting the resolution of disputes and exceptions

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Resolving disputes takes time … and the right information

A large percentage of aged receivables are created by disputes and discrepancies. In order to resolve these disputes, accounts receivable (AR) staff often need information that isn’t readily available through enterprise resource planning (ERP) systems. The delay in accessing necessary information has a large, and often hidden, impact on a company’s bottom line: not only do day sales outstanding (DSO) climb, but the company also ends up taking higher deductions and write-offs. These disputes and discrepancies result in client satisfaction issues, which also affect the bottom line. The problems related to dispute management cost major corporations huge sums each year—probably much more than the company realizes.

However, now there are practical ways to give collection managers desktop access to all the information they need to resolve disputes more quickly and easily. The underlying solutions are tightly integrated with existing IT infrastructure and do not impose significant change for AR staff.

These solutions result in improved dispute management processes that produce lower DSO, deductions and write-offs, and ultimately higher client satisfaction. The savings and increased productivity add up quickly when this profit drain is plugged.

The high cost of disputed transactions.

Every CFO is looking to the accounts receivable function to reduce DSO, minimize unnecessary deductions, reduce transaction costs and improve client satisfaction.

To achieve these goals, companies have invested massive amounts in technology and process improvements, including ERP, electronic data interchange (EDI) and electronic funds transfer (EFT) systems. These technologies can improve the efficiency of executing standardized transactions. In fact, most large companies have typically standardized—and even automated—80 to 85 percent of all order-to-collection transactions using these technologies and process improvements.

But no matter how automated the order-to-collection process becomes, there will always be exceptions and problems that require human intervention. These nonstandard transactions include disputes, claims, special arrangements, credits and many others. Exceptions like these can represent 20 percent of all business-to-business transactions. And in some manufacturing companies, exceptions or nonstandard transactions can even represent in excess of 50 percent of all transactions.

It is in these transactions that true opportunity exists, because nonstandard transactions drive the majority of a company’s transaction costs, account for most of the deductions and write-offs, and significantly impact DSO.

Exceptions will always exist.

The accounts receivable function doesn’t create these exceptions and receivables problems— it discovers them. In fact, operational or external factors create most exceptions.

Some common causes of disputes and exceptions are:

- Advertising, promotions and rebate claims
- Pricing errors
- Returned or refused merchandise
- Lost or damaged goods
- Concealed shortages
- Transportation, freight or routing disputes
- Post-audit claims
- Vendor compliance
- Billed, not shipped
- Order-writing errors
- EDI errors
- Early or late shipments
If we place each item in the list above within the context of a generic order-to-cash process, represented in Figure 1, disputes typically result from activities upstream from the AR function—which usually starts during the billing and payment process.

![Figure 1: Exceptions can occur at any point in the order-to-collection process, creating a nonstandard transaction that will impact profitability.](image)

For example, pricing problems often occur during order receipt or order processing, but the issue doesn’t become apparent until the client receives an invoice from AR. It is fallible human nature that will continue to cause these types of mistakes and inevitably cause disputes inside the AR function.

Even automating order entry, invoicing and collections functions can’t eliminate the mistakes that cause disputes and discrepancies. There will still be fulfillment problems, delivery problems, product problems, contract pricing issues and slow-paying clients, and, worse, they often aren’t discovered or investigated until after a bill is already past due.

**Case in point: A representative example.**

What is the impact on receivables when a transaction falls outside the standard process? To illustrate how a nonstandard transaction can disrupt the order-to-collection process, consider an example of an incomplete or damaged shipment of goods.

As with most nonstandard transactions, the collections management team doesn’t discover the problem until it’s near the end of the order-to-cash cycle. In this particular example, the ERP system flags an invoice for multiple items because there’s no record of payment or client communication for this invoice. By the time Collections receives the exception report containing this transaction, the receivable is five days past due, or 35 days old, assuming net-30-day terms.

The collections team goes into action, immediately calling or e-mailing the client. A few more days go by as the client and collections communicate back and forth to articulate the issues and understand the situation. Collections logs a formal dispute and opens a file containing a copy of the communications to date, notes on facts and actions, and a copy of the original invoice.

Now the investigation begins. And the time and costs begin to add up.

**The search for missing information.**

The collections team shifts into investigative mode, collecting the facts related to the dispute in order to close it out. In order to resolve this issue, Collections will eventually need to involve many stakeholders: the client, the sales department, the third-party shipping company, legal, IT, the warehouse and more. Also, it’s not enough to just understand what happened—the collections administrator needs documented proof in order to resolve the dispute.

“Cross-departmental cooperation is by far the biggest internal challenge faced by companies when trying to effectively manage the deduction process. Almost 40 percent of all survey respondents identified this as their top internal challenge.”

In this example, the collections team requests several key pieces of information from the various stakeholders: original invoice, documentation of client dispute, proof of delivery, bill of lading, pricing contract and original order documentation. There are numerous delays in obtaining this information, because it’s scattered among paper, electronic and ERP files, while other files reside in separate legacy systems.

Collecting this information takes time. In fact, it can often take weeks. Internal stakeholders don’t share the collection team’s urgency to resolve the issue. External stakeholders, such as shipping companies, don’t necessarily have compatible systems or record-keeping processes and may be slow in responding. In fact, internal and external stakeholders often point to each other as the source for such vital information as shipment verification or proof of delivery. In some cases, vital documents simply can’t be found—or don’t exist.

In this hypothetical case, the seller believes that the full order was shipped from its docks, but the staff can’t find the paperwork to verify this assertion.

The shipping company doesn’t have a copy either. The client’s receiving dock has produced a document that validates the receipt of an incomplete order. At this point, no one knows the disposition of the order.

The company with the best information wins.

Once all available documentation is received, the collections team must analyze the data and make a decision about this particular transaction:

- Does the collections team have strong, documented evidence of its position versus the client’s position and versus the shipping company’s position?
- Does the client have a history of disputing transactions?
- What impact will the collections team’s decision have on the overall client relationship?
- What impact will the collections team’s decision have internally with other stakeholders, such as sales?
- And ultimately, should collections accept the client position and take a deduction or a write-off?

The caliber and integrity of the information are critical. The information trail greatly influences whether the company will get paid in full. In almost all cases, the burden of proof lies with the seller because the seller doesn’t want to damage the relationship with the buyer.

After 73 days, a resolution.

In this hypothetical case, the collections team decides to deduct the missing goods and adjust the invoice to reflect the proper pricing. Because the deduction is beyond the approval level of the team, it must also receive approval from a senior manager. Finally, with the proper approvals, the client is contacted and informed that adjustments will be made, conditional upon immediate payment of the new invoice. The client agrees and indicates that the invoice will be processed as soon as possible upon receipt.

Figure 2: Seventy-three days elapsed before receipt of payment in the hypothetical collections example.
Given the complexities involved in processing the revised transaction, this has turned into a 73-day aged receivable from a net-30-day receivable. Figure 2 details the high-level steps involved in resolving this transaction and the delays at each step. Even if the collections team could have proven that the client’s claim was invalid, another 60 days would likely have been added to this cycle to collect any revenue owed.

…”the median deduction cycle, the time from receipt of deduction until ultimate resolution, is 105 days, or three months.”

The cost of all this effort is more substantial than most companies realize. Labor is an obvious cost—and not just the collection team’s hours, but also the time spent by all of the other personnel involved in piecing together what happened and gathering documentation. In addition, the seller receives less revenue because there was insufficient proof that the goods in question were shipped and received, even though internal parties strongly believe that they were.

There’s a better way to resolve exceptions.

While many companies invest to make transactions more efficient and to increase the percentage of standard transactions that can be automated, most of these same companies still manually process exceptions and other nonstandard transactions. Today, companies around the world are looking to reduce the average number of DSO from 73 to 60 and then from 60 to 45.

There’s a better way to find the information needed to resolve exceptions. In fact, companies can compress the cycle, eliminating as much as three to four weeks of processing time. It is now possible to provide collection agents with the means to identify and retrieve most, if not all, of the information they need for exceptions resolution—right from the desktop. AR can link and access information records from various departments, disparate legacy systems, third parties and other sources through a single interface. Even paper documents can be digitized as full images, and AR personnel can extract critical information to populate structured databases linked to ERP and other systems.

Know the type of information you need … and then get it.

Consultants specializing in business-process improvement have found that inquiries and disputes have predictable patterns in most companies. That is, within a specific company, there are typically a finite number of causes for the vast majority of disputes. And for each cause, there are procedures for resolution—some formal and some informal.

Using a Six Sigma-based approach, consultants can help companies define the information and documentation needed for favorable resolution of common dispute types. The analysis identifies the information gaps and work processes that result in excess cycle time and poor outcomes, such as unnecessary deductions and write-offs.

In addition, today there are product suites that manage the entire financial value chain and interface with any ERP or AR system to facilitate workflow automation, strategic collections, collaborative dispute resolution, online account inquiry and detailed reporting and analysis.

Knowing the types of information a company needs to resolve problems is the key. If there’s a 20 percent chance that a certain record or piece of information will be needed at a later date to resolve a payment dispute, then there’s a strong business case for ensuring that the requisite information can be located and produced whenever it’s needed. Just as important, the critical piece of information should be easily accessible to all the people who need to collaborate on the resolution.

But capturing information is only part of the process. It’s important to categorize the information and records for retrieval, comprehending the many different ways others will search for it later.
In addition, to further expedite problem resolution, it’s critical to put the information and records online in easily searchable formats. While developing repositories is easy to accomplish with structured databases of information, it’s more challenging when dealing with paper information, stand-alone legacy systems, one-time electronic data, such as print streams, or unstructured information, such as e-mails or conversation records.

Fortunately, with advances in document imaging, optical character recognition software, content management applications, search engines and collaborative work-process tools, companies can now construct and/or link various content repositories so that searching and accessing takes place through a single portal.

The result is a one-stop shop for virtually all of the information needed to resolve the vast majority of discrepancies and disputes, quickly and efficiently. For collections managers, this type of records system will not only reduce cycle times, but also significantly improve the probability of successful outcomes. Even better, the complete solution may not be capital-intensive, especially if a company uses a shared service model.

**Accommodating users is key to your success.**

The power of the solution depends on the simplicity and integration of the interface, combined with the complex web of technical components and automated business rules in the background. The real challenges, however, lie in the softer elements of the solution, as Figure 3 indicates. After all, the best-designed information systems and work processes won’t succeed if the solution doesn’t accommodate the people entering the information and doing the work. The portal itself must be highly integrated with the workers’ existing environment, while at the same time it must deliver timely and accurate information that enables rapid processing of inquiries and discrepancies. Equally important, the ways in which a company captures, indexes, stores and shares required information must blend seamlessly into the existing work process.

![Figure 3: Biggest internal challenges](Image)

**Source:** Customer Deductions: Impact on Receivables, 2006 Edition

There are many points in a typical work process where a company can capture information consistently and accurately without requiring behavioral changes. For example, a company can redirect its mail streams; it can reconfigure multifunction devices to capture and route image data to a repository; and it can intercept print-stream data. But if workers perceive the processes a company uses to electronically capture paper-based information as burdensome or inconvenient, they won’t follow them consistently. And experience shows that even small error rates in capturing and indexing critical documents can undermine the business case.

In fact, all the supporting systems must be precisely executed for the entire solution to work. Metadata needs to be accurate. Users need simultaneous access to multiple documents by multiple parties. Capture processes need to be robust so that stakeholders—internal and external—have confidence in the data. Automated processes must identify and retrieve missing data so the information is available if and when it’s needed.

Individually, these details aren’t a significant challenge—if companies identify and address them when designing the solution. The real challenge is less about IT and more about managing and integrating the system of people, processes and technologies so that they all work together as an integrated whole. It’s here that third-party expertise greatly increases the likelihood of realizing the full potential of a new and improved dispute-management workflow.
The result? Extensive savings, year over year.

What is the real impact of streamlining and automating the processes a company uses to resolve disputes and discrepancies?

Based on the experiences of consultants who work with multinational companies, the benefits are easy to measure and add up to substantial sums each year. Less tangible, but no less valuable, are the higher client satisfaction levels that result from speedier and more factual responses to company inquiries.

The hard-cost benefits come from four sources, each of which can be measured tangibly: (1) working capital reductions achieved by reducing DSO, (2) reduced numbers of deductions and adjustments, (3) lower transaction costs, and (4) increased income for investment or capital improvements.

1. **Working capital reductions:**

   If as much as 20 percent of transactions include discrepancies, then accelerating the resolution of disputes and discrepancies by two to six weeks can really add up. It’s not uncommon to improve a company’s overall DSO by three to five days. And for many companies, a single day’s improvement in DSO translates into large sums in financing costs, year to year.

2. **Reduced deductions and adjustments:**

   The earlier example of an incomplete or damaged shipment highlights a common outcome when a company can’t verify a transaction and must adjust the client’s invoice. Figure 4 shows other common causes for customer deductions.

   Even small reductions in the number of deductions and improvements in the deduction “win rate” of discrepancies can translate to large amounts in recaptured revenue. This flows directly to the bottom line while it improves client satisfaction. Resolving issues quickly and effectively also reduces overall client cost.

   In today’s marketplace, it’s also clear that establishing a system to address discrepancies quickly and with the requisite facts and information not only captures previously lost revenue, but also allows continuous improvements in the overall order-to-cash process.

**Figure 4:** Companies take the largest deductions in both numbers and dollars in five categories, according to The Credit Research Foundation’s updated 2006 study.

<table>
<thead>
<tr>
<th>Top five categories in customer deductions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Price or Price Difference</td>
<td>47%</td>
</tr>
<tr>
<td>Advertising, Promotional, Rebates</td>
<td>42%</td>
</tr>
<tr>
<td>Allowances, Discounts</td>
<td>34%</td>
</tr>
<tr>
<td>Returned or Refused Merchandise</td>
<td>33%</td>
</tr>
<tr>
<td>Shortages</td>
<td>31%</td>
</tr>
</tbody>
</table>

3. **Lower transaction costs:**

   Streamlining and automating the dispute management process can significantly reduce the associated back-office costs. Two of the most significant cost reductions are related to labor and document handling and storage costs.

   How many of the people in accounting functions are typically working on client inquiries and discrepancies? Experts estimate that the majority of actual labor cost in receivables management for many companies is dedicated to these tasks—and much of that can be saved.

   While the financial impact is not as great as reducing DSO or recapturing the amount lost to invoice adjustments, it is still very significant.
Many companies are paying others to store or convert paper documents and other critical records. Depending on how a company generates, stores and retrieves its business-transaction information, there are likely opportunities for cost reduction in this area as well. Again, while not of the same order of magnitude as some other business case drivers, the costs avoided are real and tangible.

4. Increased income for investment or capital expenses:

There’s no question that the additional funds companies can capture through expedited disputes and resolutions can improve the bottom line in a variety of ways. Extra capital can be available to invest in the acquisition of other companies or clients; it can be available to buy down needed financing at more favorable interest rates; and it can be used to purchase new equipment. By plugging the holes where profit previously disappeared, companies of all sizes can benefit through increased opportunities to expand and grow their business.

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Prior to joining Xerox, Chris worked as the sales and marketing manager for CTMS Asset Management, a software and consultancy house based in Reading, UK. Chris has also worked as a management consultant with the Israeli Investment Corporation, assisting senior management with bringing the company’s PSINet BV acquisition to profitable status prior to its sale in mid-2005.

Previously, Chris worked for Hewlett Packard as a principal consultant, where he set up and ran a TCO practice (Gartner Certified) specializing in working with major corporate organizations such as Motorola, British Airways, DHL and Nortel.

His early career includes heading financial sales teams for Hitachi and Transamerica in the finance and leasing markets, along with many years in the insurance industry as an accountant with Allianz Cornhill. In this role he represented the Finance Division and was part of the team that reengineered Allianz Cornhill’s business operations throughout the UK.

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