Understanding 'Order to Cash' and its Benefits for your Business

by Evelyne Legaux

As a business advisor, it often occurs to me that people in my professional circles have no idea or practical understanding of what 'Order to Cash' (O2C) might possibly be about... Regularly finding myself explaining the Order to Cash function means for a business, I can find this a little disconcerting and it leads me into somewhat outdated territories: if I mentioned 'Credit management', a light bulb might light up for some people, but if I referred to 'Credit control' then many light bulbs would light up with people saying, 'Oh yes, you do money collections!'. Yes, you've got it... It is no real surprise though since the 'O2C' terminology started to be used by multinationals and other large organizations about fifteen years ago, without it ever spilling over to smaller companies.

Why did the terminology change back then?

The answer rests in how the typical organisation structure evolved in large corporations. Until the 1990s, the 'Credit control' function was usually placed under the corporate Treasury umbrella, focusing on cash collections and bank reconciliations.

In the 2000s, however, companies started to look for ways to make Finance more cost-effective while providing better support to business operations. That brainstorming exercise led to the Shared

Services Centre, Centre of Excellence or Global Business Services organisational concept, whose rationale was to harmonise and simplify Finance processes in a central scalable structure serving multiple business streams and/or geographies, ultimately delivering economies of scale.

Also, part of this concept was building bridges between traditional functional silos to gain a holistic view of critical business processes end-to-end. As for selling, companies came up with the revenue cycle being supported by a process called O2C. Likewise, the purchasing cycle began to be supported by another process called Procure to Pay (P2P).

With costs reduction a priority, the focus also shifted towards enhanced process efficiency, risk management and compliance matters. The organisation structure thus evolved further, with the Finance part of O2C and P2P moving under the corporate Controller's wing. Following that logic, the General Accounting and Reporting function was subsequently renamed Record to Report (R2R) which, together with O2C and P2P, formed the Controllership Services organisation.

What is Order to Cash (O2C) about?

The O2C process starts with onboarding a new customer, then runs all the way up to applying cash received from that customer in the accounting system. Between these start and end points, O2C end-to-end is made up of multiple process segments (e.g. contractual agreement, Credit checking, sales order processing, goods picking, shipping & billing, collecting & applying cash) that are owned by various functional groups (Sales, Legal, Credit, Order management, Warehousing, Logistics, Accounts Receivable...).

At high level, once a new customer account has been created, the various O2C process segments get performed by the wider Operations or Finance organizations, the latter looking after customer Credit checking, approving payment and Credit terms, validating relevant contractual clauses, collecting and applying timely cash and monitoring the ongoing Credit risk and exposure with the customer.

The purpose of O2C Finance is to enable/support business growth while protecting Cash Flow generation and minimising bad debt losses. It's essentially a customer-facing function, whose mission is to keep customers happy while protecting the main asset on a company's balance sheet.

O2C Finance plays a key pivotal role

O2C Finance professionals work on a daily, monthly or ad-hoc basis, with:

- Sales and Operations teams - to agree customer Credit and payment terms and risk mitigation instruments, monitor the Credit exposure, drive speedy resolution of customer disputes and collect cash,
- Corporate Treasury - on aspects of Credit risk mitigation and Cash forecasting,
- Legal - on customer contractual T&Cs, legal collections or insolvency cases,
- Controllership - on revenue recognition matters,
- General Accounting and Business Finance - on month end close and

management reporting,

- Internal Audit, let alone external auditors - on Sarbanes-Oxley compliance and specific audit missions.

Everything they do aims at managing the 360-degree financial relationship with the customer, who sits at the heart of it all!

So, why is O2C Finance so important for your business?

Once, as a business leader, you understand that:

- O2C Finance supports growth, protects your main asset and ability to generate operating Cash Flow while managing the sensitive side of customer relationships, can you overlook it?
- Your ability to turn sales revenue into timely cash while keeping customers coming back with more orders, is at the core of successful business operations, can you undermine it?
- In a world filled with new threats and disruptions, your ability to understand, assess and mitigate evolving risk, is essential to business survival, can you ignore it altogether?

Yet, many businesses make the same major mistake… Here is a story:

A successful SME leader was very busy doing everything it takes to grow their business and, rightly so, focused resources on marketing, sales and operations activities. Their trade portfolio contained a mix of historical customers with whom a solid trust-based trade relationship had been established, and more recent ones who were relatively unknown.

A natural tendency then was for the business leader to feel confident about those historical customers' good payment habits, therefore not to worry about it.

But, here is the question: how did the business leader actually know that their historical customers were and would remain reliable? Did he/she believe, just because the payment behaviour had been irreproachable so far, that those customers would always pay well, no matter what?

The answer was a resounding YES!

Guess what… One morning, the business leader got a call from their accountant about their biggest historical customer who had missed paying their latest bill - which was already two weeks past due - and had not reacted to a call attempt… The business leader laughed and said: "Why are you so worried? They always pay, someone must be out sick over there. Let me call them and it will be sorted by tomorrow."

When the business leader called however, the customer did not pick up the phone either nor did they call back… The business leader also realised how large the unpaid invoice amount actually was, and remembered that the customer had indeed placed an unusually high-value order a few months earlier… The next day, the accountant found out that the customer had actually filed for bankruptcy… thus leaving behind a significant bad debt amount that proved distressing for the SME's own Cash Flow position…

So, what went wrong?

- No due diligence Credit checking ever performed on that historical customer,
- 60 days terms granted without any customer creditworthiness assessment or risk mitigation instrument,
- No knowledge whatsoever of what was going on at the customer's end,
- No awareness of financial distress warning signs/red flags, such as an unusually high order amount,
- No proactive steps taken to ensure the customer had no reason not to pay in full and on time, meaning no cash collections process in place,
- Most importantly, believing that the past predicts the future and just hoping for the best…

Unfortunately, in the realm of O2C Finance, there is no such thing as the past predicts the future…

Instead, Knowing Your Customers to understand Credit risk profiles across your portfolio, is KEY!

NOT just at the point of on-boarding a new customer, BUT on an ongoing basis throughout the lifecycle of the trade relationship! Due diligence Credit checking is NOT a once-off exercise BUT must be performed on a regular basis, to ensure the customer CONTINUES to have the capacity to pay you!

There is no room for improvisation here. Professionally managing trade receivables and associated risk, must be captured in an intentional Credit management policy.

Ignoring or overlooking Credit risk and cash collections process can be disastrous for your business. You DON'T want to play Russian roulette with your own Cash Flow, with collateral damage to your bottom line as a side-effect!

Best practice O2C Finance management is vital for your business. DON'T overlook it!

What does an effective Credit management policy look like?

Often times, SMEs have no Credit policy or if they do, that policy is just sitting there on a dusty shelf... Sounds familiar? Such business practice simply reveals a lack of understanding of the true purpose of a Credit policy, which can lead to unexpected damaging bad debt losses.

A Credit policy should provide a reference frame for governance and strategy, along with clear guidelines for the management of customer Credit risk and trade Accounts Receivable.

Implementing an effective Credit policy means empowering your business with:

- clear governance rules for granting customers payment and Credit terms, monitoring ongoing customer Credit exposure and more,
- a consistent approach to Credit risk assessment and insights into the risk profile of your customer portfolio,
- a flexible Credit scoring model that should reflect any newly emerging risk factors in your trading environment,
- clear guidance for your Credit/Finance team as to how frequently customers' credit worthiness should be reviewed, along with tools and strategies to detect warning signs/red flags and mitigate risk.

Unsure where you currently stand? Ask yourself these practical questions:

- Do you have a Delegation of approval Authority matrix in place that matches roles and responsibilities in your organization structure? In other words, can you clearly tell who is entitled to approve what? Does it make sense in terms of functional role, level of empowerment and customer risk profile?
- Can your Sales or Operations people commit payment and Credit terms to customers? Or release sales orders whenever held for Credit reasons?
- Do you have insights into Credit risk levels across your customer base? In other words, do you know if lame ducks are currently active in your portfolio?
- Are you using meaningful portfolio segmentation to drive customer Credit reviews and consistent decision-making?
- How do you assess Credit risk? If you have a scoring model, does it take prevalent non- financial factors into consideration?
- If you trade abroad, are you aware of the various forms political risk can take?
- Whenever faced with high-risk customers, does your team know what risk mitigation tools are available to them for negotiation?
- Whenever faced with late-paying customers, are they clear on the course of action to be taken?
- Do you know when and how to provision for bad debt? Are you subject to FRS 102 or other accounting standards compliancy?
- Does your Credit/Finance team review general T&Cs of trade and commercial agreements? If selling goods, do you have an enforceable Retention of Title clause?

The above list is everything but exhaustive, believe me...

Be sure of one thing: investing in a Credit policy can be the BEST decision you will EVER make to protect your business and enable it to thrive! I cannot stress enough how important such a document is, when times are tough and things can go wrong in the blink of an eye!

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A senior Order to Cash Finance professional with 30 years management experience in the multinational corporate world, and founder of Finance OTC Consulting Ltd helping B2B businesses protect Cash Flow generation, embrace the digital wave and transform O2C Finance to operate more effectively & efficiently.

A thought-leader who loves to keep abreast of the latest trends in Operational Finance and help business & finance leaders remain on top of disruptive shifts in a fast-changing world!