Recession and Recovery:

How Finance Leaders Can Prepare the Business for What's Coming Next

INTRODUCTION

Over the past year and a half, finance leaders have been in the vanguard of the corporate teams working to contain the impacts of COVID-19-related disruption on their businesses. Amid looming recession and severe economic volatility, CFOs and their teams focused on maintaining and boosting liquidity through creative management of short-term credit, cash flow and resources.

As the economy continues to recover, CFOs can and should start shifting their focus from keeping the business afloat back to helping it grow. This next phase requires assessing longer-term impacts and adapting to a business climate of continuing uncertainty. CFOs need to establish post-pandemic financial priorities and determine which operational methods and tools will be most useful in meeting the new requirements of global commerce.

This paper provides finance leaders with a set of concrete actions to help them navigate the transition to the recovery phase. We outline five progressive steps that will help them put their companies in stronger, more resilient competitive positions—mainly by achieving better cash flow—as we slowly emerge from the global crisis.

5 PRACTICAL, DATA-DRIVEN STEPS TO GET BACK ON THE GROWTH TRACK

STEP 1: TAKE STOCK TODAY

While some organizations are planning to reinvigorate their business once the pandemic is over, it's becoming increasingly clear that "over" is an ever-moving target. Economic indicators tend to lag by 6-12 months, so by the time signs indicate a recovery is underway, the wait-and-see approach may have caused a business to miss out on the recovery-driven growth.

For this reason, finance leaders should take stock of the health of their businesses today. How many customers are paying their bills on time? What is the overall risk profile? How does that compare to industry standards? What else can you learn about these customers? These questions can be addressed via some basic analyses—some from an internal point of view and some from an external perspective.

Internal Analysis — Accounts Receivable

One of the simplest measures of client portfolio financial health is Days Sales Outstanding (DSO). It's so commonly used that it should be readily available, both for the overall portfolio and at the individual customer level. This will quickly and easily identify customers—or even entire segments of customers—who are struggling to make payment and should therefore be treated with caution.

As useful as it is, DSO does present some limitations. First, focusing solely on DSO may obscure the bigger financial picture for businesses who rely on late payments for increased revenue. For such businesses that deliberately set their terms to boost revenue, minimizing DSO may be counterproductive. Second, since it's an internal metric, DSO provides a narrow view of a customer's ability to meet their financial obligations. We'll address ways to broaden this view next.

External Perspective — Credit Portfolio Health

Looking beyond the payment behavior data available internally, there are more challenging questions such as "How are these customers paying their other suppliers?" "Who will continue to pay?" or even "Who will remain in operation?" Importantly, these questions can be applied to both clients who currently have outstanding debt and those who do not, but have been granted an effective line of credit and therefore may make purchases in the future.

Answering these questions requires a range of third-party data—from activity indicators, to trade credit data, delinquency predictors, financial stress scores, and even legal and criminal proceedings data, just to list a few—which can be challenging to acquire and interpret. To help in this process, finance leaders can take advantage of tools designed specifically for this purpose, such as credit risk reports that both quantify current risk and highlight a few of the variables useful in making credit risk decisions. For an even broader range of variables, certain leading business data providers offer advanced tools for assessing factors such as COVID recovery status and even foot traffic, creating more actionable insights.

STEP 2:
MINIMIZE RISK

Having quantified the overall portfolio risk in Step 1, finance leaders can begin to take action at the individual customer level. At this point, ensuring a full view of a customer's activities becomes critical to uncovering potential hidden risk.

Current Portfolio

- **Immediate action:** Armed with a thorough portfolio analysis based on robust identity verification processes, finance teams can take immediate action on receivables and credit (note that credit underwriting will be covered in the next section):

  › **Receivables—collections**

  When a customer fails to make payments, specific responses vary by stage of delinquency. Early-stage delinquencies are typically handled internally via letters, calls, emails, and text messages. Using a Probability of Default model can identify the lower-risk accounts where collection efforts can be delayed. Late-stage delinquencies (beyond 60 days past due) may be assigned to a third-party collection agency which may handle all or just the highest-impact accounts. In either case, the finance team must weigh the cost of collection against the actual dollars outstanding.

  › **Credit actions—both current AR and other customers**

  Based on the risks identified in the full portfolio health assessment, credit professionals can take measured credit actions to minimize risk. For accounts flagged as high risk based on absolute or trend thresholds, adjust the credit limit. As we'll discuss later, this action should weigh the risk against potential lost revenue. As an alternative to lower credit limits, it's possible to mitigate risk by updating credit terms. Options include raising the early pay discount and/or raising interest rates to offset an account's increased predicted default risk.

- **Ongoing monitoring:** Once the current high-risk customers have been managed, they can also be continuously monitored. The same variables should be used here as in portfolio decisions. Likewise, thresholds will be similar, although they may be a bit more conservative, with the plan of pushing them through a manual review by a credit analyst.

New Customers

- **Credit actions:** As part of the onboarding process, the same rules just developed for existing clients can be applied to new clients. One key difference, of course, will be that in the absence of first-party payment behavior data, finance teams rely solely on third-party data. Options for dealing with this reduced visibility range from applying more conservative thresholds to making no adjustments—the reasoning in the latter case being that, assuming identity resolution successfully returned the right enrichment, external data tends to be more complete and therefore a fuller representation of the risk.

  As before (see the "Current Portfolio" section), the options for minimizing risk include setting lower credit limits and/or adjusting credit terms to encourage prompt payment or offset the increased risk with increased rates or fees.

Customer Identity Verification

Too often, businesses underestimate their true risk exposure due to poor identity verification. Common scenarios include:

1. Carrying duplicate records, which may create errors and inefficiency in the process of extending credit to a single customer; and
2. Failing to recognize ownership relationships between businesses, which can lead to similar issues—extending more credit than intended, or not realizing that one customer's payment behavior, financial struggles, or business failure, may impact another's.

These hidden risks can only be uncovered by having adequate identity resolution in place to identify duplicates, and implementing robust corporate hierarchy data to have a reliable view of the ownership structure and business influence of one company over another.

STEP 3:

LOOK FOR WAYS TO AUTOMATE PROCESSES

Now that Step 1 has enabled policy-level decisions in Step 2, account-level decisions can be enabled based on these policies. One of the best ways to ensure that risk-mitigation policy criteria are implemented systematically is to automate as much of the process as possible. Of course, automation also presents the added benefit of increasing the efficiency of finance operations, making it a justifiably popular initiative.

Since automation relies heavily on data, specific automation efforts will depend on how far the organization has come on its data management journey. For a quick assessment, the "Maturity Matrix" in Figure 1 can provide some orientation.

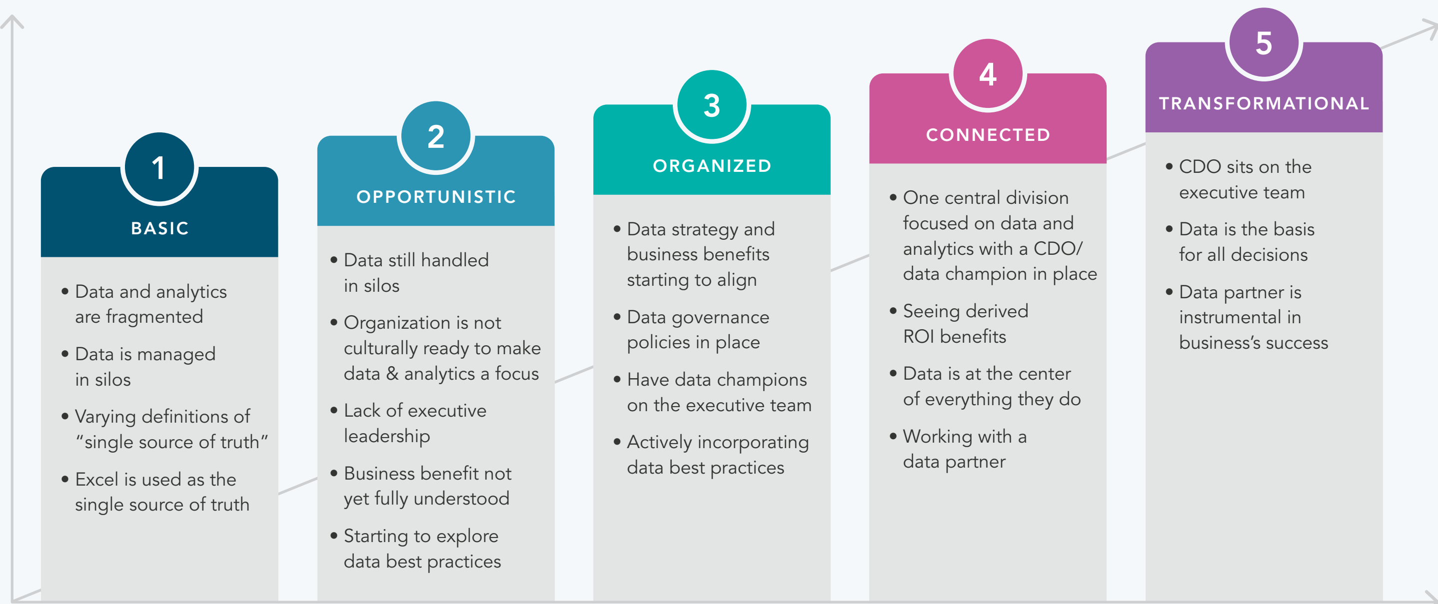

Figure 1: Data Management Maturity Matrix

Although it's common to aspire to the "Transformational" state, in which all data and analysis is connected across functions and business units, most enterprises need to start with the building blocks. This gives the entire team a chance to demonstrate early successes on which to continue building. Within the credit-to-cash cycle, these building blocks include:

- **Identity Resolution:** As mentioned above, this is a critical first step that underpins all subsequent data-related efforts. Keep in mind that different capabilities may be required for matching portfolio records vs. onboarding new customers. Best practices include setting auto-acceptance criteria to minimize manual reviews.
- **Portfolio Monitoring:** Credit alerts, or triggers, and collections are also great candidates for automation. In most cases, rather than automating the full process, rule-based alerts trigger a manual review. The credit analyst can then use web-based systems to make data-driven decisions. Even this step can benefit from automated processing, to present the analyst with the right data in a single system to increase efficiency.
- **Electronic Invoice Presentment and Payment (EIPP):** Automated systems can enable more flexible payment solutions that create a better customer experience and reduce time-to-money. Combining electronic invoicing—or e-invoicing—with the capability for customers to pay you electronically via a payment portal further reduces the risk of slow or no payment.

- **Predictive Cash Forecasting:** Automated cash forecasting systems enable rapid collection and analysis of data and trends from receivables, creating a faster and more reliable view of the future. With faster and more accurate cash forecasting, finance leaders can proactively address liquidity shortfalls before they create problems for the business. These are just a starting point; for additional insights, read more about digital transformation of credit-to-cash operations.

STEP 4:

POSITION YOUR ORGANIZATION FOR GROWTH

In addition to managing risk, finance teams are increasingly being tasked with driving revenue growth. This seemingly contrary goal presents both challenges and opportunities to foster the right type of growth.

Be Constructive, Not Obstructive

In some organizations, finance has the reputation for being an obstacle to forward momentum. Whether this is deserved or not, finance can certainly help the larger business by finding ways to operate more efficiently. The automation initiatives outlined in Step 3 will reduce turnaround time on decisions and help to speed the firm's overall operations.

Beyond the mechanics, finance can start reinforcing the growth mindset by highlighting sales results in finance communications. Better yet, finance should consider aligning its goals with those of its counterparts in sales. This will not only show commitment to these partners; it will immediately shift behaviors from potentially overly risk-averse to growth-minded.

Support Customer Retention

One of the greatest impediments to growth can be lost business. In the leaky bucket analogy, the more lost business that falls out of the bottom of the bucket, the more water is needed to keep the bucket full. Plugging the hole by predicting and preventing losses therefore becomes critical to growth. The opportunity for finance teams is then to put their modeling capabilities to use for the direct benefit of their sales and marketing colleagues: with the right historical data, they can likely predict churn. At the overall portfolio level, this new understanding can be used to set the sales targets needed to cover the gap and keep the bucket full. At the individual client level, account managers can work with customers identified by the model to attempt to retain the business.

Enable Cross-Selling

To support marketing efforts, finance teams can score current users of one product based on the rich risk-based data they already have (both internal and external). In some cases, marketing teams may also welcome help from the finance team's modeling capabilities, as they may be able to predict—or even see, based on external data—need for specific product lines.

Promote Risk-Based Marketing

To improve the efficiency of marketing campaigns, finance teams can score prospects so the highest-risk prospects can be removed from the target list. Similar to pre-approved credit, this step ensures that the organization doesn't waste resources on prospects who can't afford to pay cash and wouldn't be approved for credit terms.

Drive Sales with Limit Increases and Preferred Terms

Increasing credit limits or offering attractive payment terms for top-performing current accounts can be a lower-risk way to increase order size and profitability. Since these accounts are already in the portfolio, the credit team already has first- and third-party data on which to base the decision and potential new limit. It may also make sense to offer higher limits to new clients, provided external data is available to assess and mitigate the risk.

STEP 5:

PURSUE OTHER INNOVATIONS BEYOND FINANCE

Volunteering Services

Implementing the ideas in steps 1-4 will build or strengthen relationships with partner functions, from those who enable finance (IT for anything related to automation) to those who benefit from its efforts (such as sales and marketing). Use these new connections to learn more about their business challenges; try to identify opportunities to help them meet their goals. Finance analytics may be useful in predicting demand for a specific product from a specific account, or which marketing channel may be best for reaching them.

The IT side may need finance's expertise and access to data to help quantify the financial benefit of a project—perhaps even one that benefits the finance team. This type of outreach will not only foster a better working relationship; it will be a chance for finance to broaden its impact on the organization as a whole.

Reinvest in the Business

This next idea admittedly requires a more strategic altruistic mindset: as the steps above (particularly the automation in Step 3) reduce finance's operating costs, consider returning the newly-freed budget to the broader organization. A forward-thinking leader may favor funding strategic innovation initiatives. Examples of these are new product research and development, experiments with new business models, or even testing new markets. Funding these large, costly projects that tend to be cut first in harder times would be a great strategy for preventing stagnation, outpacing the competition, and emerging even stronger.

Embrace Open Innovation

Partner functions have already been mentioned earlier as key relationships. In the right context, customers and suppliers should also be considered as part of the business's "innovation ecosystem." Sharing your aspirations with these business partners is likely to elicit their ideas on ways to improve your operations—along with data to support these ideas and the experience to guide their implementation.

CONCLUSION

Over the course of his or her career, a finance leader may see up cycles, down cycles, and even a couple of recessions. But the global pandemic triggered a tidal wave of disruptive economic impacts that many businesses were just not capable of absorbing. In the space of a few weeks in 2020, finance teams had to pivot sharply and create strategies that would determine whether their companies survived or sank. Many did sink, unfortunately, but many also survived, thanks to their ability to sustain credit and cash flow.

Finance teams are now focusing on the recovery phase, looking once again at longer-term plans and forecasts and helping their companies balance uncertainty and opportunity. The challenges of this balancing act may convince some finance leaders that the wait-and-see approach is best right now. But while there's some merit in a conservative view, the opportunities that exist within the current circumstances are actually a gift to finance teams looking to pull their companies ahead of their competition. The five practical steps in this paper will help CFOs and other finance leaders position their operations to be fully forward-facing, with a renewed focus on capturing and promoting new growth.

Dun & Bradstreet can help, with data management, analytics, and automation solutions that enable finance leaders to work with a single provider to transform their operations.

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