

Outsourcing Your Collection Department: What You Need To Know

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The more time you spend talking with people in the credit and collection field, the more likely it is you'll hear the term "outsourcing." It has become The Next Big Thing, like the mission statements, paperless offices (that was a good one), and Quality Initiatives of years past. But is it right for you? And if it is, how do you go about actually doing it, without risking life, limb, career, and company?

First, understand that outsourcing isn't necessarily a solution to your company's cash flow woes. If you're spending too much money on cars, entertainment, and sales calls to Tahiti, a reduction in your DSO (that's Days Sales Outstanding – we'll get to that later) isn't likely to sweep you back into the black. What outsourcing *might* do, however, is improve the efficiency of your collections enough to allow you to spend less time worrying about them (OK – back to Tahiti), at a cost that is less than or equal to what you're paying now for internal staffing. No magic wand, but a chance to improve the ol' bottom line.

Second, understand that collections outsourcing doesn't eliminate the need for due diligence in your credit approval process. An outsource company isn't going to get money out of the Enrons of the world any better than you could, so going for broke on the sales side isn't recommended, unless "for broke" is where you really want to go.

Finally, understand that many outsource companies spend a lot more on their marketing than they do on their actual service, so don't let *them* do the cost/benefit analysis for you, unless you want the cost to go to you and the benefit to go to them. It's up to you to determine if outsourcing is the way to go, so do your homework, and then make your decision. It's always better to *buy* something than to be *sold*.

Is it right for me?

Is outsourcing a good idea for your company? That depends. The first thing to look at is your numbers – how is your internal collection department performing? How do your write-offs compare with last year's? How do they compare with other companies in your industry? (Comparatives can be found in publications by The Risk Management Association, Dun and Bradstreet, or can often be obtained from industry groups.) What about your Days Sales Outstanding (DSO)? This number is a better performance barometer than simple aging, because it combines all your aging numbers into one metric that can be tracked month-to-month. To get it, simply divide your company's total sales by 365. Your answer will represent one day's worth of sales. Then divide that number into your total accounts receivable figure, and you'll obtain your DSO. The higher that number is, the longer it's taking to collect your money. For example, if your terms are net 30, and your DSO is 60, then you have sixty day's worth of sales on your AR, or double your terms. Again, use comparatives to judge your performance relative to your peers, and look at the monthly trends of your staff's performance (if you are in a seasonal industry, don't forget to take that into account – your numbers are bound to look higher just after your busy season, and lower just before).

If your numbers look bad vs. your competitors, and your trend is down, then your decision comes down to this: Do you have the time, the people, the systems support, and the budget to fix your problem? For small to mid-size companies, the problem often is that no single person has complete responsibility for collections: Mary calls delinquent accounts on Tuesdays if it's not the 10th, 15th, or 30th of the month; Vince sends copies of invoices when the trucks aren't in the bays; Arlene knows all the customers, and they told her not to worry. There's not enough work to bring in a full-time person, and everybody who's already there has a job to do. Larger companies may have full-time dedicated collection staffs, but an ingrained low-productivity culture, or a misplaced management team. *Can* you fix it? Probably. *Will* you fix it? If you can't answer that one unequivocally, then it's likely that your problem is still going to be there next year. You're a perfect candidate for outsourcing.

What if your numbers stack up pretty good against the competition, and your trends are all looking steady? No problem, right? Well, maybe. Some companies take great pride in their collection performance, rarely taking a write-off, staying on top of delinquencies until the last dollar is posted. Ironically, these are actually the *best* candidates for outsourcing. A close look at the fully-loaded costs of running these departments usually shows a remarkably high cost per dollar collected; in other words, they're actually *losing* money by collecting it. A professional outsource company can probably generate significant net savings, simply by following more efficient collection procedures.

In essence, the only one who can tell if outsourcing is right for you, is you.

How do I decide what to outsource, and what to keep?

Okay, you've decided you need to move forward, but what direction is forward? Do you lay off the whole staff, or keep some; do you keep your larger accounts in-house, or include them in the outsource; do you give up control over write-offs, or keep it internal? These are just a few of the things that you'll have to consider once you've committed to the idea of outsourcing, and the answers, once again, have to come from you.

One of the things you must confront first is the difference between an outsource provider and a vendor. A vendor sells you a product or service, and you utilize it. They are the seller, you are the customer: there is an obvious distinction between the two roles. An outsource provider, on the other hand, is acting as *you*. Your customers, and even many of your own employees, will not realize they are speaking with a third party when they are contacted. Consequently, the relationship is different than the typical customer/vendor variety. Your outsource provider is more of a *department* of your company than they are a vendor, and you need to begin to think of them as such. Once you begin to recognize the difference, then the answers to your questions can be derived from this simple perspective: How would you do it if you were simply starting your own new department from scratch? For example, how much authority would you grant at the start? How many sensitive accounts would you allow them to handle on day one? As you answer these questions, your outsource program can begin to take shape. What it looks like in the first month isn't necessarily going to resemble what it looks like in the thirteenth.

How do I choose an outsource provider?

Well, you certainly aren't going to have any trouble finding one. Look out your window; there's probably one lurking. Virtually every collection agency, as well as many financial companies, provide outsource services of one sort or another. The trick is in finding the one that suits your needs the best.

First, remember that your industry is probably unique from others in a variety of ways. Your nomenclature, your credit terms, your paperwork, your very culture may be distinct. If that is the case, make sure your provider has experience in your industry – don't buy the line that collections is collections. It *isn't*.

Second, and this is a vital, but often overlooked point, remember that what you're really doing is starting a new department in your company. Make sure that the people you'll be dealing with are people whom you a) trust; and b) are the kind of people you would hire to work in your own office. In other words, if you don't think you'd like to spend a lot of time with them, then you'd better look elsewhere.

Third, make sure that your accounts aren't going to be used as filler for another, much larger client's assigned collectors. One of the ways a large outsource client saves money is by having the provider's other collectors ready as needed; when they're needed, you might be getting the short shrift. Don't be a small fish in a big pond – better to be one of your provider's key accounts (if you're small, go small) and get treated as such.

As we've shown, outsourcing is not a panacea, but it can be the right choice for many businesses. Do the proper analysis, and your numbers will tell you if it's right for yours.