Collection Performance Metrics: Measuring Your Credit Department’s Effectiveness

Speaker: David Osburn, MBA, CCRA
Date: June 14, 2016
Time: 9:00am-10:30am
Session Number: 25046
Collection Performance Metrics: Measuring Your Credit Department’s Effectiveness

Focus: Performance “Metrics”

AKA “Measuring” Performance!
How Do You Measure Your Credit Department’s Performance?

I. Technical Expertise of “Individual” Credit Professional:
   a) Credit Underwriting: Credit Report, Credit Score, Credit Matrix, Key Ratios, Cash Flows, Z-Score, Credit Memorandum, etc.
   
   b) Collection Effectiveness: Results by the Numbers, Customer Relationships, etc.
   
   c) Other Related Disciplines:
      1. Accounting (including Tax)
      2. Economics
      3. Finance (Including Financial Statement Analysis)
      4. Banking
      5. Business Law
I. Technical Expertise of “Individual” Credit Professional: (Continued): 

Practical “Grade” Rating 1-4 (4 high, 1 low)

a) Credit Underwriting:

b) Collection Effectiveness:

c) Other Related Disciplines:

Accounting (Including Tax)

Economics

Finance (Including Financial Statement Analysis)

Banking

Business Law

Composite Score:
I. Technical Expertise of “Individual” Credit Professional (Continued):

a) The Use of a “Competency” Exam that Covers all Direct and “Other” Related Disciplines

   Ex. 4 hour “Comprehensive” Exam

b) How Relevant is this type of Metric?

c) Could There Be Some “Embarrassing” Feedback from the Exam?

d) If Administered, There Must be “Actual” Follow-Up, Otherwise, No Real Improvement is Made!

   1. Classes, seminars, webinars

   2. OTJ training
II. Refining the Credit Department’s Policies and Procedures:

a) Existing Credit Policy:

1. Source? (Boiler Plate)

2. Age? (Stale Information)

3. Relevancy to Current Economy?

4. Relevancy to Industry?

5. Relevancy to Technology?
II. Refining the Credit Department’s Policies and Procedures (Continued):

Practical “Grade”

Rating 1-4 (4 high, 1 low)

a) **Existing Credit Policy:**

1. Source? (Boiler Plate)
2. Age? (Stale Information)
3. Relevancy to Current Economy?
4. Relevancy to Industry?
5. Relevancy to Technology?

**Composite Score:**

b) Should you Revise or **Completely** Re-Write Policy?
III. Increasing the Company’s Cash Flow:

a) **Traditional Cash Flow Analysis:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>EBITDA</td>
<td>$1,200M</td>
</tr>
<tr>
<td>Less: Debt Ser. (P&amp;I)</td>
<td>$500M</td>
</tr>
<tr>
<td>Margin</td>
<td>$700M</td>
</tr>
<tr>
<td>DCR</td>
<td>2.4X</td>
</tr>
</tbody>
</table>

(EBITDA = Net Profit + Interest Expense + Taxes + Depreciation + Amortization)

**Note:** Most commercial underwriters require a minimum DCR of 1.20X.

b) **The Credit Professional’s Direct Influence on the Company’s Cash Flow**

Earnings or “E” Factor!!
III. Increasing the Company’s Cash Flow (Continued):

a) How Does the Credit Professional Affect the Company’s “E” Factor?

“Effective Underwriting, Monitoring, and Collecting”

b) But How Do We Actually “Measure” the Credit Professional’s Effectiveness in Promoting Positive Company Earnings?

Can we tie this into our department bonus program?
III. Increasing the Company’s Cash Flow (Continued):

“Quantitative Measurements”:

a) **Charge-Offs (What Level?)**

b) **Days Sales Outstanding (DSO)**

\[ \text{Ending Total Receivables} \times \frac{\text{Number of Days in Period Analyzed}}{\text{Credit Sales for Period Analyzed}} \]
III. Increasing the Company’s Cash Flow (Continued):

c) **Collection Effectiveness Index (CEI)**

\[
\text{Beginning Receivables} + \frac{\text{Credit Sales}}{N^*} - \text{Ending Total Receivables} \\
\text{Beginning Receivables} + \frac{\text{Credit Sales}}{N^*} - \text{Ending Current Receivables} \\
\times 100
\]

* \(N^* = \text{Number of Months or Days}

**Note:** The Closer to 100 Percent, the More Effective the Collection Effort. It is a Measure of the Quality of Collection of Receivables, Not of Time.

d) **Cash Conversion Cycle:**

\[
\text{Inventory Turnover} + \text{A/R Turnover} - \text{A/P Turnover}
\]
IV. Increasing Customer Satisfaction:

Practical “Grade”

Rating 1-4 (4 high, 1 low)

a) Customer Surveys: “External” Customers

b) Customer Surveys: “Internal” Customers

Ex. Sales Team

Composite Score:
V. Improving Employee Morale:

Practical
“Grade”

Rating 1-4 (4 high, 1 low)

Where is our Employee Morale Today?

What Can We Do To Improve Our Employee Morale?

a) Change Department Culture (Hard But Can Be Done!)

b) Change Team “Mix” (Duties, Personalities)

c) Change Our Role from “Manager” to “Leader” or “Coach”
VI. Effective “Evaluations”:

a) **Individual:**

1. Do We Even Conduct Evaluations?

   If so, how often?

2. Are they Effective Uplifting Experiences or Are They A Formality with Little or No Purpose?

3. How to Improve Evaluations:

   - More Frequent Ex. Quarterly
   
   - Less Formal Ex. Short, To the Point
   
VI. Effective “Evaluations” (Continued):

b) Team:

How Would You Conduct a “Team” Evaluation?

1. Team “Council” Meeting Instead of Boring Staff Meeting

2. Create Atmosphere Where “True” Opinions Are Voiced and Heard

   Ex. Hold Meeting “Off-Campus”

3. Be Prepared for Some Honest “Criticism” or Feedback
VII. **Conclusion:**

a) Measuring Performance is Important but All Measurements Should Be “Balanced” i.e. Avoid Extremes!

b) Remember You are Dealing with “Real” Human Beings (Customers, Employees, Management)

c) Perfection is “Relative” i.e. Strive for **Efficiency** and **Effectiveness** In Measuring Performance But Do Not Take Extreme Measures or You Will Drive Your Employees and Yourself “Crazy”!!

d) Take Time To Celebrate Your Team’s Successes (and Your Own Successes)