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Operations Practice

Finding hidden value with order-to-cash optimization

Too often, organizations lose significant value in order-to-cash and inside-sales operations. A deeper understanding of process break points can unlock significant hidden opportunity.

This article is a collaborative effort by Steven Eklund, Michael Glaschke, Heiko Heimes, Vishal Koul, Kunwar Abhay Pratap Singh, and Lucas Wienke, representing views from McKinsey's Operations Practice.

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When striving to optimize their operations, many organizations defer deep investigation of complex processes and often focus solely on the quick and easy wins. But those who have taken on the harder work of reevaluating their complex order-to-cash (O2C) processes may find more opportunities to achieve lasting results.

Executive leaders and decision makers can find significant savings through improved visibility of O2C process break points and value leakage that typical metrics, such as days sales outstanding (DSO), bad debt, and perfect order, may not fully capture. A more objective analysis can also uncover failures to meet evolving customer expectations, with even greater long-term ramifications for revenue generation.

Leading companies are now recapturing profits and improving the customer experience by digging deeper into their O2C processes. For example, when one B2B industrial manufacturer applied advanced process-mining data analysis to its O2C processes, it discovered that broken processes caused leakages at multiple steps, collectively amounting to 3 to 5 percent of EBITDA—which, if recovered, would be the equivalent of millions of dollars in new business.

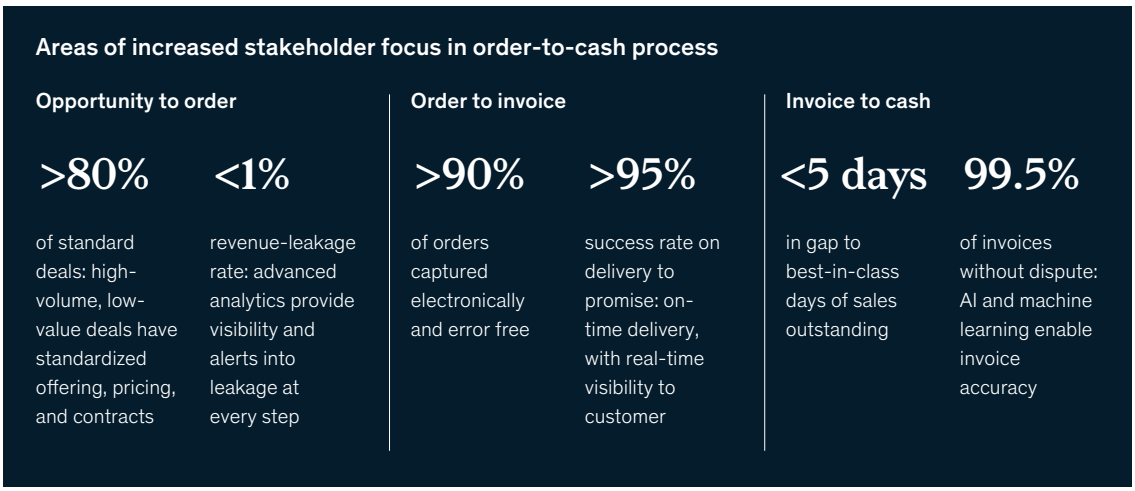
Complexity conceals value and opportunity

O2C is one of the most complex general and administrative (G&A) processes, with a base that typically comprises about 1 to 3 percent of revenue. Because O2C touches multiple functions, ranging from commercial and sales to finance, legal, and customer support, cross-functional alignment is critical to fully understand what is happening in the O2C process—yet difficult to achieve.

Higher costs, inefficiency, and margin leakages aren't the only effects of siloed functions. As a customer-facing process, O2C has a significant effect on customer experience, as well as revenue growth. Trained by their experiences as consumers, business customers increasingly want a touchless order experience, with little hands-on interaction across the ordering process. They want continual notifications and real-time updates on order status, and they expect disputes to be extremely rare and quickly resolved when they occur (Exhibit 1).

Exhibit 1

Stakeholder and performance expectations are rising for the order-to-cash process.



These expectations translate to new strains on existing O2C processes as B2B businesses adapt to newer business models, such as providing B2C-like e-commerce experiences through online ordering, or responding to the subscription-based sales now common in software.

Above all, the COVID-19 pandemic and geopolitical tensions have created many challenges and complexities. Supply chain disruptions have made delivery estimates hard to make and harder still to achieve. Pricing changes are so frequent that customers cannot keep track of updates: at a large medical distributor handling more than 150,000 daily orders, errors because of pricing discrepancies have tripled—and the company's infrastructure and resource limitations could not handle such a spike in cases, leading to a poor ordering experience.

Traditional processes and systems can no longer support the changing requirements in this environment. A significant revamp of end-to-end O2C workflow and new-age technology capabilities are needed to address the growing customer expectations and increasing business complexities.

From anecdotes to data

The good news is that while companies have typically relied on anecdotal evidence in evaluating O2C processes, they can now deploy advanced digital capabilities to extract hard data from enterprise resource planning (ERP) systems and conduct analysis at the transaction level. These new tools also enable organizations to analyze greater volumes of detail and investigate at scale.

When the industrial manufacturer analyzed its O2C data in greater detail, it discovered that its KPIs weren't providing an accurate picture of its performance. While the bad debt reported in accounts (defined as cash that was not collected) seemed to represent only 0.1 percent of sales, a deeper investigation revealed the company was giving up significant dollars in the form of credit memos by the customer services team—the result of a validation process that had weakened because of inadequate incentives for proper monitoring.

Consequently, losses materialized in ways that never reached the collections department. Had these dollars been taken into account, the company's bad debt would have been around 0.4 percent of sales. Recapturing even a portion of the value and combining it with other measures, such as working-capital optimization and productivity increases, would have offered a significant value unlock (Exhibit 2).

A three-step approach to O2C optimization

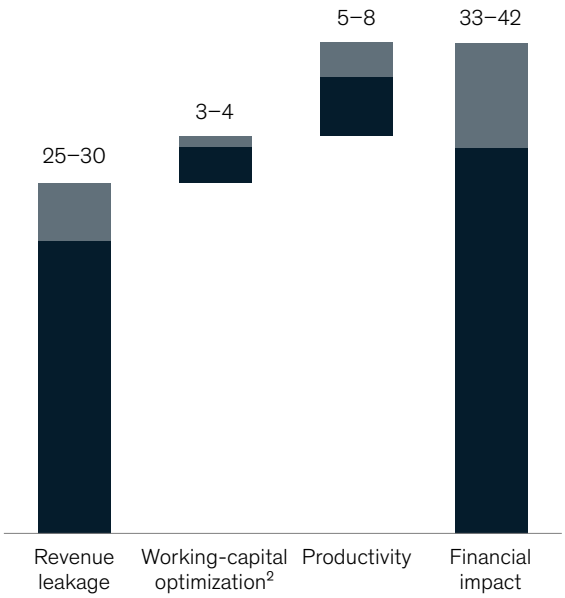
By thoroughly investigating the potential value embedded and accordingly redesigning the

By thoroughly investigating the potential value embedded, and accordingly redesigning the order-to-cash processes, organizations can significantly improve customer experience.

Exhibit 2

Optimizing quote-to-cash processes can unlock significant value.

Value at stake (EBIDTA impact) in quote-to-cash process, $ million[1]



[1]Example from ~10 billion industrial manufacturer.
[2]Recurring equivalent.

O2C process, organizations can significantly improve customer experience, impact top-line growth, and potentially avoid the next round of cost-cutting measures.

Step 1: Dig deep into the process and underlying data

The first step to achieving the unlock is *fully understanding the process and data* to extract critical business insights and impact drivers. For the industrial manufacturer, this meant using process-mining techniques on ERP transaction data to analyze O2C processes. By uncovering consistent patterns of errors and rework, revenue leakage, and customer-experience pain points, the tools generated insights that previously had been impractical to achieve because of data limitations (Exhibit 3).

A similar effort at the medical distributor focused on orders that arrived via electronic data interface (EDI). Frequent data inaccuracies caused staff to review and validate a large number of orders manually, usually via multiple rounds of coordination with both the customer and internal teams. A deeper analysis of the O2C process revealed many of the issues resulted from the lack of an accurate database and product information, such as pricing and unit quantities.

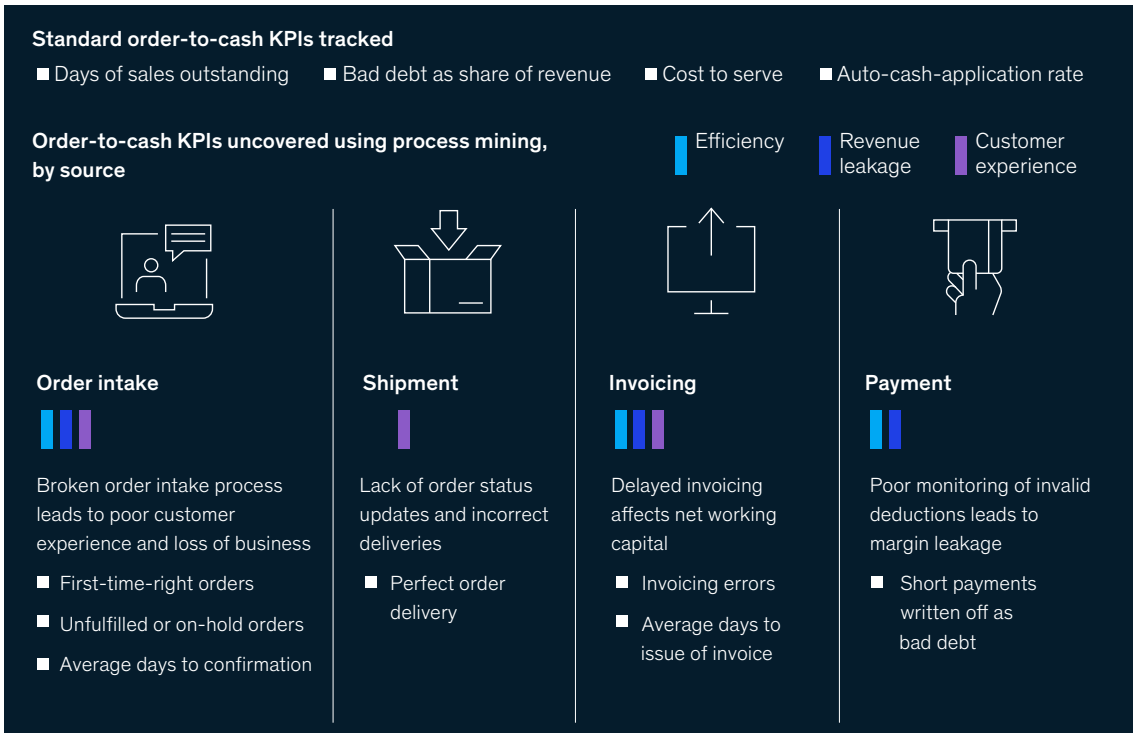
An organization could then use these insights in a targeted way to develop and prioritize initiatives to improve process efficiency, effectiveness, and customer experience.

Step 2: Deploy internal process and tech fixes

Optimizing O2C requires a purposeful approach, one that centers initially on internal measures as many

Exhibit 3

Order-to-cash process mining can uncover untapped sources of value.



of the issues related to leakage in O2C are within an organization's control (Exhibit 4).

Organizations can adopt several measures internally to solve a significant part of their O2C process challenges:

— *Digitizing order process* to improve the accuracy of order details captured from the customer, such as by expanding usage of e-commerce portals—which are now used in some companies to handle half of order volumes. These companies are finding that when portals are designed from the start with accurate and complete product information, customers prove more than willing to switch to online ordering rather than continue using analog channels, such as telesales.

— *Imposing order rigor* to validate customer details, flagging errors as early in the process as possible.

— *Streamlining order holds and credit-check processes* to minimize delays. One organization reduced order and credit holds by half by optimizing the credit-monitoring process.

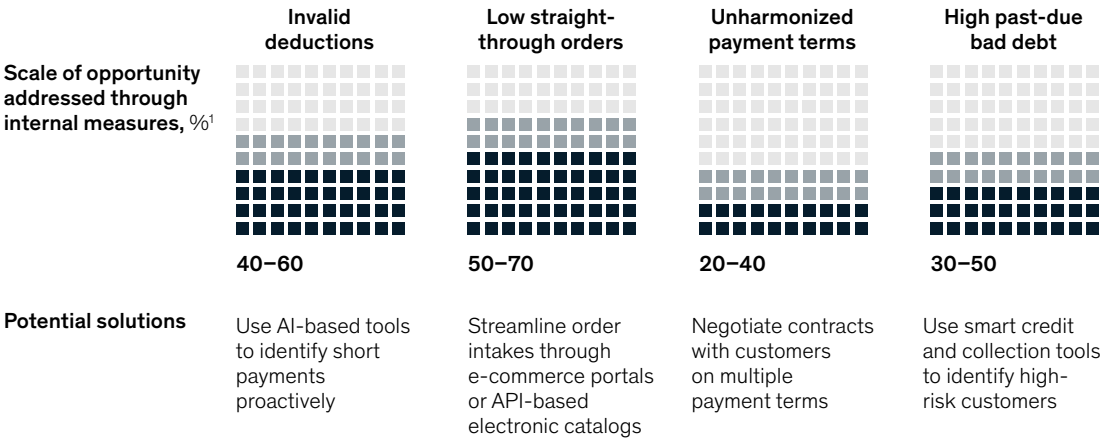
— *Ensuring robust validation and monitoring* of short payment and credit notes issued to the customer. At some organizations, setting optimal write-off thresholds and identifying cases of nongenuine write-offs can recapture 40 to 60 percent of value leakage.

These sorts of changes can have a major impact. The industrial manufacturer, for example, deployed AI-based tools that helped it identify customers

Exhibit 4

Much of the leakage in order-to-cash processes can be addressed through internal measures.

Example areas of leakage in order-to-cash process and effects of countermeasures



[1]Across 5 companies with ≥$1 billion in revenue.

with unusually high rates of payment issues. With hard data to support its case, the manufacturer recaptured 10 to 15 percent of the value of credit memos issued to the customers, and plugged leakages attributable to invalid deductions.

The medical distributor streamlined the process by deploying e-commerce order management and e-punchout catalog systems, creating a seamless ordering experience with data interchange that linked directly to customers' procurement systems. As a result, the internal order management team dealt with fewer order errors and customer calls about order status.

Step 3: Appoint global process owners to drive accountability

Technology- and process-related solutions are only part of the story. Whether the changes last will likely depend on whether the operating model and organizational structure are designed to drive accountability and cross-functional efficiencies. When O2C processes reside in disparate functional silos, with no single point of accountability for customers, they tend to break down: throughput times become longer, with too many customer touchpoints.

Some companies have found an effective countermeasure by appointing an O2C global process owner (GPO). With a strong mandate across functional boundaries, the GPO can mobilize resources to enhance efficiency across the workflow—particularly by building a common interface for customers, with minimal touchpoints. Once the improvements take hold, the GPO then drives cross-functional continuous improvement, which can nearly double the efficiency and effectiveness gains compared with optimization efforts that are limited to a single function.

The GPO role is particularly valuable when an outsourced provider handles O2C services, as was the case for the medical distributor's accounts-receivables function. A review of the arrangement found ineffective governance, with service-level agreements (SLAs) defined according to targets that were relevant only to specific functions.

Assigning a GPO helped the company align the vendor's SLAs more closely to end-customer priorities, improving customer experience. The success built the company's confidence in outsourcing more generally, enabling greater operational flexibility.

For some organizations, transforming O2C processes from a costly black box to a transparent source of value may require a commitment to additional resources. The results are usually worth the effort: on average, the industrial manufacturer, medical distributor, and similar organizations have achieved $6 in return for every $1 invested. The first step is to get to know the process well, and find just how much reimagining it could be worth: in cost savings, customer experience, and operational resilience.

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