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TIP SHEET

Collection Effectiveness Index: Telling the entire credit and collections story

Your Collection Effectiveness Index (CEI), when coupled with Days Sales Outstanding (DSO), tells a holistic credit and collections story.

Defining Collection Effectiveness Index

Defining Collection Effectiveness Index CEI is a calculation of a company's ability to retrieve accounts receivable (AR) from their customers. In other words, CEI compares the amount collected in a given time period to the amount of receivables available for collection. A CEI near 80 percent or above indicates a highly effective collections process, while a CEI 50 percent and below is considered low and should be further evaluated.

Why does tracking CEI matter?

CEI can directly show you the speed it takes to convert AR to a closed out, paid account. DSO, is simply an indicator of how many days of sales are tied up in receivables.

Let's take a look at an example to further explain how DSO and CEI are different. Two companies could have the same DSO, but the state of their collections risk could differ. A business can have a percentage of their receivables in newly or recently passed due buckets and a percentage of their receivables in higher aging buckets including 90+ days. The breakdown of those receivables and what aging buckets they're in then determines the likelihood that they'll be able to collect and ultimately get paid.

To better explain this, assume a business had two overdue invoices, one for $100 that was one day overdue and the other was $1,000,000 that was 45 days overdue. It wouldn't be completely accurate to say that the average for the overdue invoices was 23 days. This is simply because their age and amount are drastically different.

Breaking down CEI

Now let's go through an example of how to calculate CEI. First, let's define some terms we'll use to explain the formula beforehand.

- **Beginning receivables** is a company's open receivables at the start of the month. It's also the ending total receivables for an organization from the previous month. For example, if a business had an ending total receivables of $30 million on February 28th, the beginning receivables for March 1st would also be $30 million.
- **Monthly credit sales** is how much money is made via sales in that month.
- **Ending total receivables** is all of the open receivables including current and overdue receivables.
- **Ending current receivables** are strictly the open receivables that are not overdue.

With those terms now in context, below is the formula that you would use to calculate CEI for your company. dependence on a large staff and manual processing.

Calculating CEI

To provide even more context, let's look at an example with real numbers below.

$$\frac{\text{Beginning Receivables} + \text{Monthly Credit Sales} - \text{Ending Total Receivables}}{\text{Beginning Receivables} + \text{Monthly Credit Sales} - \text{Ending Current Receivables}} \times 100$$

CEI nirvana would be as close to 100 percent as possible. Although, a more realistic CEI of 80 percent or 90 percent, would also be preferable compared to a score like 50 percent.

$$\frac{\$40M + \$30M - \$50M}{\$40M + \$30M - \$30M} = \frac{\$20M}{\$40M} \times 100 = 50\%$$

Making ROI tangible

Companies are always going to be focused on ROI and for good reason. Yet for a collections analyst, the faster they can get an invoice paid in full, the quicker their company can realize their cash flow and impact top-line revenue. While metrics like DSO and CEI help tell part of the collections story on their own, together they are more impactful and help share a full financial view.

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