GO WITH THE FLOW

Why promoting a cash culture should be at the top of every company’s to-do list
The financial crisis in 2008 forced treasurers in the US and Europe to take a hard look at their liquidity positions. The tepid recovery, particularly across Europe, has done little to alleviate concerns about the future. Treasurers have therefore remained – rightly – conservative when it comes to their liquidity. Attractive investment opportunities, due to low yields and counterparty risk concerns, have been lacking and the recent cut in interest rates by the ECB will do nothing to change that in the near term. These factors have resulted in record levels of cash reserves being held by companies. Towards the end of 2013, UK businesses alone were sitting on almost GBP 500 billion of cash reserves.

In this cash-rich environment, liquidity may not be an immediate concern and cash flow forecasting might take a back seat to other priorities. But having a good cash flow forecast is just as critical as before. Beyond identifying what cash is coming in and going out, it can help identify where the cash is and how that cash is used.

We asked Alvarez & Marsal’s Stefaan Vansteenkiste to explain why cash flow forecasting should still be on the top of a treasurer’s to-do-list and the importance of promoting a cash flow forecasting culture. Vansteenkiste has managed and advised many companies on their financial structures and strategies, including Diam, Vion and HSA.

Many companies in Europe are sitting on large cash balances. Why is cash flow forecasting important in this environment?

Cash flow forecasting is about ensuring the right level of liquidity for your business. Not having enough can be disastrous but excess cash, while comforting, comes at a cost and often lost opportunities. Surplus cash could be deployed more efficiently into longer-term investment vehicles, capital expenditure projects or paying down debt. An accurate cash flow forecast can help a treasurer segment cash to determine what’s really needed for operations, as against cash available for other uses.

A cash flow forecast is more than just predicting cash coming in and going out. The process can help you better identify and manage your risk by understanding where your cash is at (i.e. foreign exchange exposure) and who is holding that cash (i.e. bank counterparty risk). This information can highlight areas of potential improvement in your cash management structure.

Finally, when cash is not a concern, there can sometimes be a lack of discipline around the usage and management of that cash. If you’re not worried about cash, it’s easier to choose not to chase a customer as hard for payment, for example. Having a cash flow forecast for which people are held accountable can help manage that.

Many treasurers have started to dedicate resources to preparing a shorter-term cash flow forecast in your cash management structure. If you’re not worried about cash, it’s easier to choose not to chase a customer as hard for payment, for example. Having a cash flow forecast for which people are held accountable can help manage that.

Don’t most companies already have a cash flow forecast in place?

Yes. Typically, a cash flow forecast is generated during the annual budgeting process. That process is normally a very robust and comprehensive exercise. The resultant cash flow forecast provides long-term (one to three years on a monthly or quarterly basis) guidance for financing and investment decisions.

However, there are some issues in relying on just this type of cash flow forecast. First, the forecast is not as useful in the short term because it can miss the peaks and valleys that can occur during a month or other period. Second, it can get outdated quickly. The other problem is that it’s usually based on high-level assumptions (e.g. total sales for a month), which makes it difficult to determine what might be causing variances against actual results. As a result, many treasurers and CFOs have started to dedicate resources to preparing a shorter-term quarterly or 13-week cash flow forecast.

What makes this quarterly cash flow forecast different?

Cash is forecast on a weekly basis for 13 weeks. This allows it to capture any near-term weekly fluctuations in cash. And, unlike the longer-term forecast, the quarterly forecast is built bottom-up using a direct approach. While company sales forecasts are normally already built bottom-up from the business unit or divisional level, the focus is on sales and maybe EBIT margins. This process goes a step further, asking

“... iteration is key...”

Stefaan Vansteenkiste is a managing director and country head of Alvarez & Marsal’s Benelux Restructuring practice. He has been with Alvarez & Marsal for more than ten years and brings 23 years of experience as a general and financial manager, specialising in turning around companies either as an interim executive or turnaround adviser.
Time and resources are the biggest hurdles. Companies have downsized and the same tasks have to be performed by fewer people.

Start with senior management support. Cash flow forecasting has to be seen as a priority from the very top. Take the time upfront to structure the forecast properly. Establish what the right level of detail is based on what’s important to your business, your ability to forecast and the ability to capture the actual data. Define what entities are included, what is cash, the sources of liquidity and how you are going to deal with issues such as intercompany trading balances.

Define and establish a clear process. Set the process upfront and stick to it – make it part of the weekly routine and instil that cash culture. The variance analysis and discussions are critical. The weekly variance (forecast versus actual) analysis discussions with the businesses are key to holding them accountable and anticipating potential issues. Do not be afraid to challenge the businesses on their underlying assumptions, variances and forecasts.

Be conservative: it is always preferable to have too much liquidity, despite the cost, than too little. Don’t expect to get it right from the very start – it will improve with every iteration.

How to build a 13-week cash flow forecast

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What are the results for clients that have implemented a cash culture?

Better visibility of their cash flow and liquidity and a better understanding of their cash management structure; improved working capital management; improved ability to assess their counterparty risk and facilitated improved communication internally and with their banking partners. It may take weeks, perhaps months, of iteration to implement the cash flow forecast. If liquidity is not an immediate concern, now is a good time to start the process rather than when you have liquidity pressures.