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Effective Cash Management: Sustainable Growth through Accurate Cash Forecasting

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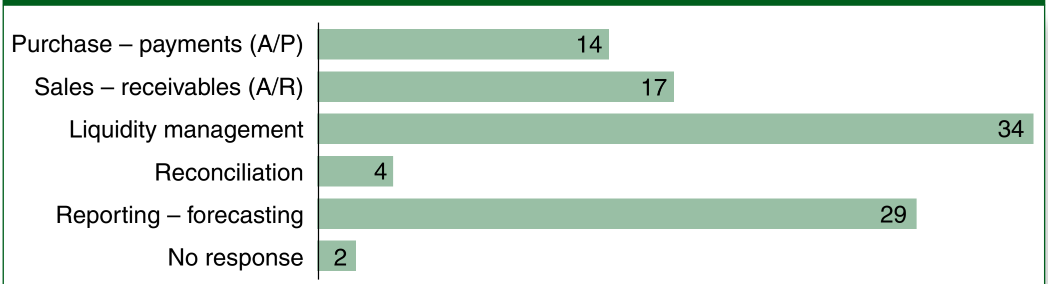
Synopsis:
Cash forecasting is a tool used by banks and corporates to identify future cash needs. Facing a combination of economic uncertainty and increasingly competitive market conditions, organisations are looking at ways to deliver more value to customers while improving profit margins. As cash volume continues to grow, cash management will gain significant importance. However, inaccurate cash forecasting continues to hinder effective cash management. This article outlines the challenges in cash forecasting and the initiatives and solutions to counter these challenges.

Introduction

Cash forecasting is a core cash management offering. It not only covers the cash in-out flow but also helps in calculating a company's liquidity position. Despite its importance, current cash forecasting methods still leave much to be desired – most notably in terms of accuracy. Forecasts often differ from actual cash needs. Most of today's corporate customers still rely on spreadsheets, and this lack of an ideal automated process further enhances the chances of inaccuracy caused by human error.

Effective cash forecasting is garnering strong interest from corporate organisations. An in-depth survey conducted by gtnews[1] (see Figure 1) revealed that many corporate respondents feel that liquidity management and cash forecasting have the highest potential for improving cash management. Though the existing credit crunch and global recession make it all the more important that banks and companies work harder to improve their liquidity management, many corporate respondents still view improved cash forecasting as a cash management priority – 29% considered it to be the process that offered the highest potential for improvement. The problem is that business units are not able to forecast effectively even when all anticipated incoming and outgoing feeds are considered accurate. It is true that no single entity can be blamed; however, certain measures can be taken by various parties

Figure 1: Potential Improvement Areas for Cash Management (%)



Source: gtnews

1. Cash Management Survey 2008, gtnews, www.gtnews.com/feature/287.cfm

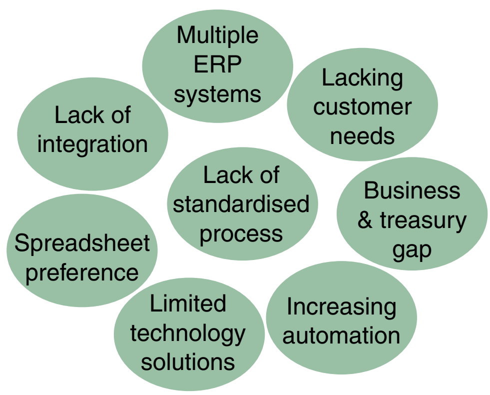
to avoid the inaccuracy. Since liquidity management and cash forecasting are interlinked, forecasting will continue to be a focus area.

As customers become more demanding, effective forecasting will become a focal point for banks and corporate organisations alike. With new developments and an increasing volume of cash, more and more banks and corporate firms are looking at ways to build a model that can help them accurately forecast and provide a better understanding of their customers' future needs.

Cash Forecasting Challenges

The cash forecasting challenges faced by banks are substantial (see Figure 2). They not only need to forecast their own cash requirements on a day-to-day basis, but they must also provide services to, and meet the cash requirements of, their corporate treasurer clients.

Figure 2: Cash Forecasting Challenges



Source: Infosys Technologies Ltd

ERP: enterprise resource planning

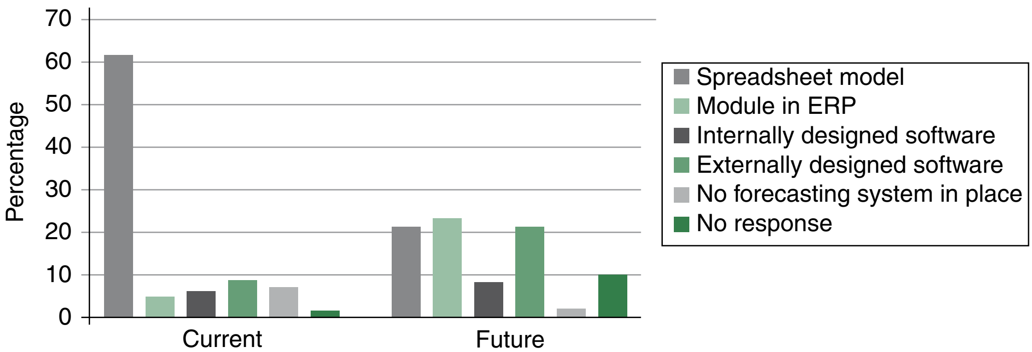
Technology challenges

Even though companies are moving towards the automation of their operations, treasurers' reliance on spreadsheets for cash forecasting is prone to human error. Additionally, various activities are done over the phone or via email between key stakeholders. The gtnews cash management survey reported in 2006 that a high percentage of corporates still used spreadsheets to send data between subsidiaries and continue to do so, and less than half of them were satisfied with the accuracy and timeliness of the received data (see Figure 3).

Corporate treasuries receive information from multiple branch treasurers and aggregate the data to generate forecasts. Banks use inputs from various applications to project cash needs. However, for both it is difficult to know whether the available information can generate a reliable forecast at a particular point in time. There is no hard and fast rule that can clearly prioritise the inputs and outputs of a cash management system.

2. Corporate Trends in Cash Management, gtnews, 2006, www.gtnews.com/feature/134.cfm

Figure 3: Systems used for Cash Forecasting



Source: gtnews

ERP: enterprise resource planning

New technological developments have led many banks and corporate organisations to integrate multiple enterprise resource planning (ERP) systems to collect information in a timely manner. Despite this, the majority are still not able to generate automated real-time data regarding a cash position. Technology solutions are not viable when multiple obsolete systems are integrated to develop a centralised repository framework. Treasurers are finding it difficult to collect data efficiently from multiple applications in a centralised framework.

Another hurdle that companies face while forecasting is a lack of a standardised process. Different banks have markedly different approaches to forecasting cash needs. What often is ignored is the importance of building a standardised approach and not just resolving short-term, tactical issues. It is true that one standardised product cannot be utilised for every corporate or bank. However, products can be customised based on individual needs. Some banks might prefer a short-term forecast based on available data, while others may prefer a long-term approach.

Business challenges

It is often noted that subsidiaries do not report cash data to treasuries in a timely manner. Often, this is because subsidiaries do not understand the importance of doing so. Treasuries must be able to analyse a broad array of corporate financial data and to do so they require support from their subsidiaries. The willingness or ability (or, rather, the lack thereof) of subsidiaries to provide accurate cash flow information contributes to the inaccuracy of cash forecasting.

Another significant challenge in forecasting is understanding the customer's needs in advance. Banks have achieved considerable success in doing so on a regional basis; however, a complete micro-level analysis for each customer is still a challenge. Though many banks have been successful in managing a wide array of products within a single application, a concrete approach has not yet been achieved that fully breaks down the customer's future needs.

Interestingly, a gtnews survey on internal treasury operations[3] reveals that the desire to achieve improved cash forecasting varies from region to region. While corporates from the central and

3. Survey Reveals High Levels of Inefficiency within Internal Treasury Operations, Sanjima DeZoysa, gtnews, www.gtnews.com/feature/166.cfm

Eastern Europe list cash forecasting as a high priority, corporates from other regions, such as Latin America, consider treasury reporting a higher priority. A split in priorities also occurs amongst corporates of different sizes. Because large organisations employ multiple systems to retrieve data, accurate reporting is usually a priority for them. However, the majority of small organisations do not have multiple systems for their cash reporting needs and thus other priorities take precedence. This is despite the fact that cash forecasting is pegged as the top priority for corporates with revenues of USD10m-50m. It is ironic in some ways that many organisations do not spend time and money in improving forecasting, though they agree that it is the top priority for them.

Strategic Cash Forecasting Initiatives

As banks offer more products, they require more sources of information to generate cash forecasts accurately. Rapidly changing market conditions coupled with unseen risks make it difficult for banks to come up with a concrete forecast for a future date. It is quite obvious that accurate forecasting requires multiple inputs at the same time. The need for a better cash demand measurement is growing but, from an effective cash management point of view, a more robust and accurate methodology has not been achieved. Innovative solutions need to be encouraged by bank managers to achieve the desired results.

Technology initiatives

There are numerous inflows and outflows of cash that take place every day. Some might argue that cash forecasting needs to move away from spreadsheets managed by people to an automated system – a good solution often is a mix of both. Human involvement cannot be ignored completely and it is required to monitor the forecasting process. A more tailored approach can analyse the duration of various elements involved (incoming and outgoing) at a detailed level. By developing a suitable formula to identify factors such as lead time, calculating the projected cash transaction date and inflation, forecasting can be improved. The information needed for this exercise includes budgets, expense reports, historical expense sheets and manually entered amounts. This information will help not only in mitigating illiquidity but also in evaluating cash needs.

A supporting technology is needed to achieve accurate forecasting. Different firms use different technology solutions to meet their needs. As mentioned earlier, a balanced approach between human involvement and complete automation is required to optimise the operation. Multiple ERP vendors have come up with different solutions to meet treasury demands. The various technology alternatives – spreadsheets, treasury management systems, ERP solutions or a best-of-breed system – might help corporates in achieving their goals. According to report by Celent[4], a multi-tenant application will be preferred in the future. Companies will offer a variety of products for their customers and managing cash will be more effective using a centralised environment. This approach ensures lower costs and strong data integrity.

Business initiatives

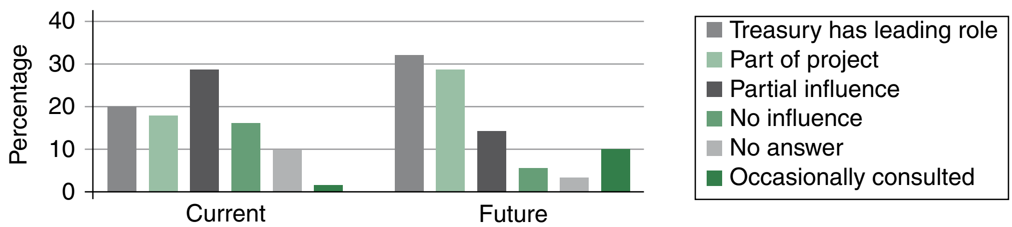
Though banks have achieved success in demand forecasting, corporate organisations are often not equipped to do the same. Corporates need to start thinking about not only taking inputs from various

4. Treasury Management Technology: Optimizing the Cash Cycle, www.sap.com/germany/media/mc_689/WP_AI_Celent_Treasury_Technolo0.pdf

systems, but also from departmental and regional sales teams. Currently, most cash forecasting done by treasurers is based on data available from various systems. In situations where conditions are rapidly changing and very little solid data exists, these systems can be somewhat unreliable. Market surveys or sales teams can help immensely in reliably gauging demand and help banks take required measures. Using a qualitative approach, corporates can understand consumer demand in a more meaningful manner, generating more accurate results.

The majority of the existing solutions provide cash forecasting for the company as a whole. Though forecasting at a location-specific level has been achieved to an extent, a point has not yet been reached where a bank can know the exact and complete cash needs of each customer. Partially at fault is the data that banks use to arrive at their conclusions. Banks analyse the usage of their products by the customer to understand the cash need; however, banks and corporates have not yet achieved a level of sophistication where data from other bank products can be collated, analysed and used to forecast cash needs accurately.

Figure 4: The Effect of Treasuries on Payments and Receivables Performance



Source: gtnews

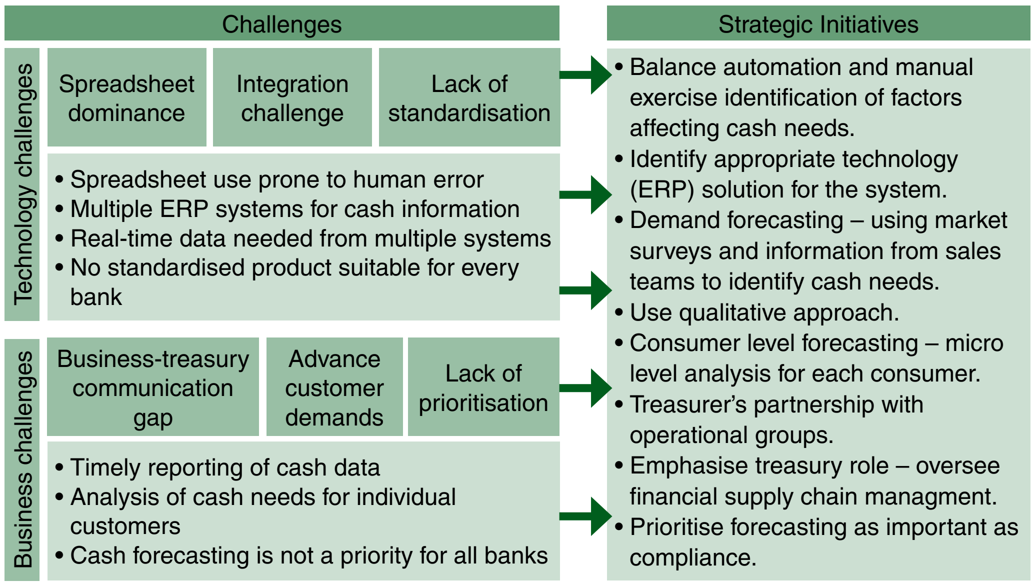
Lastly, it is apparent that organisations have realised that treasury will play a major role in improving accounts payable (A/P) and accounts receivable (A/R). The 2006 gtnews cash management survey[5] reported that treasures would play a more responsible role in managing cash for companies (see Figure 4). Treasury already plays a major part in determining cash amount and timing for inflows and outflows of cash. Even so, treasurers are looking to play a more strategic and advisory role – working in partnership with operational groups to oversee the organisation's financial supply chain management. Treasurers have further involved themselves by managing the working capital, keeping an eye on the overall cash flow for the organisation, and by closely managing transaction costs. Such measures help not only in better cash control, but also in managing the risks effectively. The 2008 gtnews cash management survey[6] confirmed that treasury departments are responsible for cash management, financial risk, corporate finance, capital markets and investment, and IT systems within treasury.

The Road Ahead

While, it may be too early to propose a complete, all-inclusive model, creative thinking can help validate traditional approaches to an extent. Many corporate organisations admit that treasury will

5. Corporate Trends in Cash Management, gtnews, 2006, www.gtnews.com/feature/134.cfm
6. Cash Management Survey 2008 Reveals Liquidity is Corporate Priority gtnews, www.gtnews.com/feature/287.cfm

Figure 5: Challenges and Strategic Initiatives



Source: Infosys Technologies Ltd

have a bigger role in improving A/R and A/P performance and cash forecasting. Multiple vendors have come to provide improved treasury offerings. SAP offers a product that is fully integrated with the general ledger for backoffice processing. This is a step in the right direction – optimising straight-through processing and improving efficiencies. Oracle product PeopleSoft Enterprise also provides a gateway for payments in a centralised framework. Similarly, banks have firmly entrenched themselves in the vanguard with tools to manage cash and liquidity, web-based portals that allow clients to view cash positions across multiple branches and treasury workstation applications that help in retrieving information from multiple banks.

This flood of treasury-oriented solutions reinforces the fact that treasurers have realised the need to move from the unsophisticated, historical practice of using spreadsheets to a more automated solution for their operations. It is expected that there will be some positive news in achieving this goal in the coming years because of growing competition, resource constraints, globalisation and adherence to compliance.

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4. "Corporate Trends in Cash Management", 2006, www.gtnews.com/feature/134.cfm
5. "Cash Management Survey 2008 Reveals Liquidity is Corporate Priority", gtnews, www.gtnews.com/feature/287.cfm