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TACKLING THE CASH FORECASTING CHALLENGE

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This article outlines some of the reasons behind why cash flow forecasting remains an inefficient area for many treasurers. What challenges do corporate treasurers face and how can they tackle them?

Cash flow forecasting has been one of the most discussed topics in the corporate treasury field in recent years. While improving cash flow forecasting has been at the top of most treasurer's agendas for several years, the results have not been as successful as expected.

A gtnews survey conducted with Exidio in 2007, Survey Reveals High Levels of Inefficiency Within Internal Treasury Operations, explored the problems faced by corporations in the relationship between business units and treasury and the related processes - the so-called business-to-treasury area. The survey revealed that 88% of the corporate respondents ranked cash flow forecasting as a high or medium priority for development.

The Hurdles to Efficient Forecasting

I believe that everyone in the treasury field understands the importance of cash flow forecasting, and I will therefore concentrate on the reasons why it is failing despite the importance of the issue. The basic concept of cash flow forecasting is simple: you collect all possible information about outgoing and incoming cash from the people who are responsible for managing those cash flows. So what makes this so difficult? Here are a few examples of the explanations I have heard:

- ✔ Our business units are not capable of providing accurate and timely forecasts.
- ✔ We have so many different ERP systems in place that it is impossible to create reliable forecasts from them.
- ✔ We haven't found a good cash forecasting system yet.

Let's have a closer look at these reasons. First of all, I do not believe that people in business units would not know about incoming or outgoing cash flows; it's their business to know these things. It's true that it can sometimes be difficult to know when the client is actually going to pay the invoice, but in most cases the person responsible for accounts receivable still has a pretty good estimation, i.e. a forecast. The real reason, therefore, lies in the business units' motivation and priorities - the lack of corporation-wide understanding of the importance of cash forecasting and the lack of clear instructions and simple tools for the business units to manage forecasting.

Second, having a fragmented ERP environment is usually a problem if the aim is to have a fully integrated forecasting solution. But even with fully integrated solutions, you should keep in mind that cash forecasting still requires a human touch. The system cannot automatically estimate when your client will actually make the payment. I agree that systems integration is important in helping to facilitate the forecasting process, but I strongly advise you to focus on integrating systems where the entire organisation's data is available and the cash flows are committed, i.e. they will happen as reported. Integration with the organisation's treasury management system (TMS) in order to get the financial flows into the forecasts is a good example of integration that reduces errors in the forecasting process and provides help to the business unit users in terms of liquidity planning.

Third, a sure way to fail in a cash forecasting project is to consider it as a systems project. Instead of starting with integration, the project should start by building a bridge between the business units and treasury. The focus should be on motivation and co-operation. Treasury needs to understand why business units act the way they do and how treasury could help them improve cash forecasting. The prerequisites for high quality cash forecasting are that:

- The people in business units responsible for cash forecasting understand its importance.
- Cash forecasting is one of their daily high priority tasks.
- They have received clear and concrete instructions for cash forecasting from treasury.

Building the Business-to-treasury Bridge

Building the business-to-treasury bridge means that you create a partnership with your business units. Just like all partnerships, this too should benefit both parties. In a business-to-treasury partnership, it is crucial that the business units understand what is required from them, and that they have all the resources needed to be able to contribute to the partnership.

Management support

The first step is to sell the idea to management. To be successful in your project, you need top management support in order to make cash forecasting a high priority for the business units. But while the benefits of improved cash forecasting are obvious and can deliver substantial savings, you should not take management support as a given. You will still need to sell the idea to them. Remember to be careful of how you sell the idea. Make sure that you describe the clear benefits and costs without any unnecessary treasury jargon, and remember to include reasons about why the reporting burden in the business units has to be increased. With well-prepared sales work you should be able to get management support, and you can start preparing to effectively communicate all information to the business units.

Treasury work instructions

Since we're talking about a motivation and co-operation project, you must understand who the people in the business units are and how they think. In short-term cash forecasting, the people responsible for managing the accounts payables and accounts receivables are your key partners. These people are usually cashiers or accountants and who often don't have expertise in treasury issues. They have a lot of other high priority tasks and treasury-related issues are seldom at the top of their agenda. In addition, they don't usually understand the corporate level benefits of cash forecasting and why it is so important that they make the forecasts according to their best knowledge. The treasury policy seldom helps. Quite often, it has been written in such a way that a person outside the treasury department finds it difficult to understand. It is, therefore, important that treasury provides the business units with a clear and concrete work instruction document in addition to the policy statement. The instructions should describe the different roles in the process and provide:

- A detailed description of what the business unit needs to do. This is usually directly derived from the policy.
- Motivation for the business unit representative to act in the desired way.
- Concrete explanation about the tools and steps to be applied in fulfilling the task.

Selecting the forecasting solution

After the framework has been created, the business units will be able to provide timely and accurate cash forecasts even with the spreadsheet and e-mail combination, which still seems to be the dominant method for cash forecasting. According to the cash management survey, Is Corporate Cash Management Changing? 72% of corporates rely on spreadsheets in their cash forecasting processes. While using spreadsheets does enable collection of the required data, in order to optimise this process, the cash forecasting system should also have the following characteristics:

- The ability to provide the business units with supporting tools (e.g. prefilled financial cash flows) that make the forecasting process as effortless as possible for them.
- Easy integration into different systems (e.g. corporate TMS and bank balance systems) in order to automate the workflow and reduce errors.
- Auditable and transparent.

Bear in mind that deploying a cash forecasting solution does not necessarily have to be a time consuming and expensive system project. There are plenty of good web-based forecasting solutions that provide a service whereby the solution can be up and running in a few weeks; ask your bank or look for software as a service (SaaS) solution providers.

Conclusion

Improving cash forecasting in large multinationals can be simple. It is important to avoid starting from a technology perspective; by building a business-to-treasury bridge you can create a framework in which business units are capable of providing reliable and timely cash forecasts. The business-to-treasury bridge is a partnership that benefits both the business units and the treasury. But for this partnership to work and the business units to be able to easily report cash forecasts, treasury must provide them with clear and concrete work instructions and the necessary tools.