Rain or shine

ROBERT DE GIDLOW THINKS TREASURERS COULD BE FORGIVEN FOR COMPARING MANAGING CASH INFLOWS AND OUTFLOWS TO FORECASTING THE WEATHER. HE ARGUES THE CASHFLOW FORECASTING OUTLOOK IS QUITE SUNNY.

Executive summary

- **Centralisation, systems integration, standardisation and legislation have all played their part in enhancing the reliability of cashflow forecasting.**
- **Corporates have found a level of volatility has to be accepted.**
- **Internal structures are the cause of forecasting problems.**
- **While banks' services and technology are alleviating problems, issues remain over the proliferation of standards.**
- **It is a good time to review forecasting arrangements.**

Unpredictable cashflows can create a range of problems, most of them costly. But with so many variables, is it possible to foresee and thus avoid liquidity shortages and large overdraft fees? Driven among other things by Sarbanes-Oxley, the recent trend toward greater accuracy of cashflow information means the problems of cashflow forecasting are far from intractable.

TREASURY TRENDS Great strides have already assisted treasurers in making accurate and frequent cashflow forecasting a reality.

Centralisation, frequently part of a group-wide initiative, has meant treasuries have exerted greater control, often through payment factories and in-house banks which have reduced the volume of payment flows and increased visibility and accuracy of cashflows at subsidiary level. Systems integration has become a key focus for many corporates. Improvements in data flows from subsidiary to treasury to bank have resulted from better system interoperability. And use of common formats continues to enhance bank-corporate information flows.

This drive towards standardisation has developed in parallel with improvements in common processes within subsidiaries, meaning data consolidation can be centralised to a much greater extent. Legislation, especially corporate governance laws such as Sarbanes-Oxley, has been a major force for process standardisation among multinational firms and has encouraged treasurers to demand even greater control and visibility. The EU's pursuit of a unified payments market has given rise to Single Euro Payments Area (SEPA), a framework that will enable firms to rationalise the account structures of eurozone subsidiaries, potentially simplifying information flows still further.

In other words, there is simply no excuse for just sitting on your cash any more.

On the receiving end

DAVE WOJCIK EXPLAINS HOW A DISPUTE MANAGEMENT PROCESS CAN MAKE THE CASH FLOW.

One of the key elements in most companies' cashflow forecasts is receivables – the money paid by customers for goods or services. For long-term cashflow a treasurer has to rely upon sales forecasts. Since future sales may be dependent upon unpredictable variables such as politics, fashion, the weather and the price of oil, sales forecasting tends to be an imprecise art rather than an exact science. However, short-term receivables forecasts should be accurate since the value of sales is known and the treasurer has details of exactly when each outstanding invoice is due to be paid by customers. So why are these short-term forecasts so often inaccurate? The answer is, of course, overdues, which are caused by the annoying but common practice of customers not paying on time.

The reasons for late payments are many. Sometimes it is just that the customer feels they can get away with it because they see their supplier as a soft touch (a problem that would need to be resolved). But in many cases the customer will delay payment because they are unhappy with an aspect of the transaction such as quality, delivery, the wrong price on the invoice or perhaps no invoice at all. The remedy to this problem is to introduce the tool that is the most neglected in the bag of receivables improvement techniques – namely, the dispute management process.

The formula for a good dispute management process will include:

- Identifying the dispute as early as possible before the invoice due date using proactive collection techniques.
- Sorting disputes into categories and types and assigning generic time frames for resolution of each type of dispute.
- Identifying who is responsible and who is accountable for the resolution of each dispute type.
- Installing an escalation process for disputes not resolved within the allotted timeframe.
- Timely dialogue with the client to ensure that they accept that the dispute has been fully resolved.
- Periodic analysis of the dispute categories and then dispute types to identify those that are causing the largest increases in receivables.
- Undertaking a root cause analysis on those dispute types that are causing the most pain.
- Eliminating the root causes of the dispute type.

The introduction of an effective dispute management process will not only significantly improve short-term cashflow forecasting, but will also improve working capital by reducing overdues, and should facilitate better service and improved profitability by eliminating inefficiencies.

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CLASSIC PROBLEMS In frustration at the difficulties of short-term cashflow forecasting, some corporates have applied complex statistical models. However, if a company receives a large receipt earlier or later than expected, its forecast invariably goes out of the window. Whether because of sharp changes in commodities prices or unpredictable patterns in receivables, many corporates have found that a certain level of volatility just has to be accepted.

The classic issues surrounding cashflow forecasting typically stem from the internal structure of the company and the disparate local business and regulatory environments in which it finds itself. Quality of data and the degree of centralisation and integration are all essential factors but reality often gets in the way:

- **Mergers and acquisitions:** When a company goes through an acquisition, the IT infrastructure, business processes and very cultures of the different firms must be assimilated and standardised. Failure to integrate effectively after the post-merger party can lead to a big hangover.

- **Sector:** The nature of a firm's business can prove a major challenge to cashflow forecasting. Retail, for example, can be an unpredictable machine, with treasurers unable in many cases to confirm takings in advance and dealing with a large amount of labour-intensive cash and local paper instruments. Some companies have overcome this by setting up regional treasury centres to deal with local payments and receipts.

- **Ownership:** Companies that set up overseas operations via joint ventures often find that the local partner is a barrier to consolidating local revenues.

A well-established step to achieving visibility over the whole company's cashflows is cutting the number of bank accounts held by subsidiaries. Despite the short-term pain, the potential cost savings are too significant to ignore. Reality will compromise your efforts, but a combination of faith in the 80/20 rule, and, crucially, support at board-level, will garner significant results. The truth of this is reflected in the fact that centralisation and bank relationship consolidation is already common. The majority of respondents (59%) to 2004's JPMorgan/Association of Corporate Treasurers Cash Management Survey said they had five or fewer primary banking relationships, and 39% said treasury would be managed on a global basis by 2007, compared to 30% already running a global treasury. We expect these trends to be confirmed with the release of the 2005 survey – see next month's *The Treasurer* for details.

TOOLS AND SOLUTIONS For multinational corporates, the ideal situation is a single enterprise resource planning system, a centralised payments process linked to a shared service centre, and a global bank that can capture 80%-90% of its transactional flows. Even for those some way from this nirvana, today's automated liquidity management tools mean working out whether it will rain or shine tomorrow has become less important. Banks are increasingly implementing structures that automatically direct centralised flows up to a central position, through the use of automated two-way sweeps (last year's JPMorgan/ACT Cash Management Survey found that just under half of respondents used automated sweeps). Treasurers can use this position to invest in the money markets if long, and if short draw down on a short-term overdraft facility. If this is linked to a centralised payments and receivables process, the treasurer can then manage the central position, rather than having to manage all of the different positions across a region.

Current advances in bank services and treasury technology (i.e. connectivity to Swift and usage of XML-based message standards) are also helping to render classic cashflow forecasting problems obsolete. However, the trouble is the second 's' in standards: it remains to be seen which if any will become the standard across the industry. Banks can only move at the same pace as corporate clients if they are to avoid investing in this year's narrow-gauge railway.

TIME FOR ACTION With continued automation of cashflow processes, inaccurate cashflow forecasts resulting in idle cash balances and funding shortfalls must be regarded as costly and unnecessary. But why worry when a recent REL Consultancy Group survey (the REL 2005 Working Capital Survey) revealed that the largest European companies have up to €480bn of cash unnecessarily tied up in working capital. Inefficient cash management can weigh down a company's financial performance and lead to queries from auditors and other external parties. Close scrutiny by analysts and rating agencies mean any indicators of poorly managed cashflows could lead to a company's stock being marked down or becoming subject to a takeover bid.

Meanwhile, there is scope for further efficiencies on the horizon. With SEPA looming large, many consider a single bank account for the whole eurozone – from and into which all payments and receipts would flow – as a tangible reality. Some treasurers may find that a commissionaire structure, centralising the sales administration function in a single legal entity, may be the answer to some of their problems. Cashflow visibility is enhanced because all collections from subsidiaries are swept up into the centre and the treasurer is left with a net position, rather than having to look through each entity's receipts.

Unlike re-invoicing centres, the tax implications of a commissionaire structure are relatively clear: since many US multinational corporations have implemented these structures in Europe, the standards have been set by practice and market acceptance. The popularity of these kinds of organisational structures will increase with the dawn of SEPA.

Unfortunately, Europe is not a single market, and company organisational models differ considerably from country to country. Even if companies can iron out the differences between how subsidiaries conduct business, the differences in central bank reporting requirements, tax reporting formats and other regulatory issues continue to hamper the quest for standardised processes across the region. Whether or not SEPA leads to use of commissionaire structures or similar, treasurers should start reviewing their forecasting arrangements sooner rather than later. In this low-interest rate environment, corporates must focus on making cash work for them.

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