CASH FORECASTING IS BECOMING IMPERATIVE AS COMPANIES LOOK TO IMPROVE LIQUIDITY MANAGEMENT AND MAKE THE BEST USE OF THEIR CASH. BUT FOR A COMPANY WITH DIVERSE OPERATIONS ACROSS THE GLOBE – OR EVEN ACROSS ONE COUNTRY – GETTING TIMELY, ACCURATE FORECASTS IS DIFFICULT. **DENISE BEDELL** SPEAKS TO CORPORATE TREASURERS ABOUT THEIR CASH FORECASTING PROCEDURES, THE OBSTACLES THEY FACE, AND THE TACTICS THEY ARE EMPLOYING TO OVERCOME THOSE CHALLENGES.

THE CRYSTAL

With lean market conditions over the past two years, and with many major economies still struggling to see some growth, liquidity management has become a central focus of much of the corporate world. Managing cash across the working capital continuum is now a core function of the finance department, and knowing when and how much cash will be available to the group is a key part of that. However, being able to accurately calculate that is no mean feat.

The bane of many a finance manager's existence is the process of creating an accurate cash forecast, gathering the information required to prepare it, and convincing business units of the value of having that accurate and timely forecast.

There are many possible approaches to take, and many issues to deal with, in looking at cash forecasting. That approach will differ depending on the nature of the organisation: the size of the company; the industry; the location; the relationship between business units and the finance and treasury functions; the uses to which the forecast will be put; existing IT infrastructure; and any budget for implementing new technology – all of this and much more will play a role in how a forecast will be put together.

The organisation of the finance functions within the parent company and business units, in particular, will play an important role in determining what type of forecasting is carried out, how often, and by whom. For a multinational corporation (MNC) with a very centralised approach, detailed group-wide forecasting, in addition to regional or local forecasts, may be desired. For those MNCs with more autonomous business units, local and regional forecasts may be the key.

Companies with a single country focus benefit from a simpler situation – with only one tax and regulatory regime, and one currency. Those with a pan-euro zone approach also benefit from a single currency and a more integrated regulatory regime, although tax issues still offer an additional level of complexity.

Jardines

'GIVEN THE DIVERSITY OF OPERATIONS, CASH FORECASTING SYSTEMS AND CYCLES WITHIN THE BUSINESS ARE MANY AND VARIED, DEPENDING UPON THE NATURE AND NEEDS OF THOSE OPERATIONS'
SIMON MAWSON, GROUP TREASURER, JARDINE MATHESON GROUP

INVALUABLE TOOL. For any treasury, management accounts or planning executive tasked with the job of either setting up new or reviewing existing cashflow forecasting strategies, the experience and techniques of others can be a valuable aid in clarifying possible approaches and issues that will be faced.

For a company with diverse operations across many countries, it can often be desirable, given the broad range of needs they have and regulatory environments in which they operate, to let autonomous groups take responsibility for their own finance operations.

Such is the case with Jardine Matheson. The Jardine Matheson Group is a conglomerate with 110,000 employees worldwide, which is run primarily out of Asia. Although it has centralised finance and treasury functions, business units operate on a standalone basis, consulting with head office on major decisions.

Simon Mawson, Group Treasurer of Jardine, says: "Given the diversity of operations, cash forecasting systems and cycles within the business units are many and varied, depending upon the nature and needs of those operations." He explains that most business units within the group monitor their cash positions on a daily basis, with forecasts of varying sophistication to support this process. "Smaller Hong Kong units, without the capability of managing their own cash position, utilise the group treasury function, which acts as an in-house bank," he adds.

With a few exceptions, most of Jardine's business units have their treasury functions carried out by general finance, so the management accounting teams handle forecast preparation. "The forecasting methods used vary but will typically comprise low level, short period forecasting, typically daily, based on known payment cycles and using Excel-based models, and strategic long-term forecasting as part of the annual budget process," he says. The long-

BALL

term forecasting tends to be relatively simplistic, he says, but takes into account seasonal variations.

On a monthly basis, Jardine's overall cash position and its year-end forecasts are monitored through a board reporting process. "The forecasts are prepared by the management accounting function and are essentially strategic estimates, rather than bottom-up forecasts," adds Mawson.

He notes that the pragmatic approach to cash forecasting used by Jardine reflects its conglomerate nature, rather than its Asian base. "The underlying challenges of forecasting in Asia are probably no different from those elsewhere in the world, although business operations may themselves be more disparate than, say, Europe or the US," he says. "Because of differing tax and regulatory regimes, including varying degrees of capital control, it does not make sense for diversified groups like ours to employ cash pooling techniques, which would go hand-in-hand with the need to employ more sophisticated cash forecasting techniques. Nonetheless, there are groups active in Asia, typically multinationals with a single product base, that have set up regional treasuries."

The experience of Jardine Matheson shows that just because a company is big, it does not necessarily use complicated or sophisticated forecasting methods. In some instances, as is the case with Jardine, the more complex the region covered and the more localised the approach, the simpler the solution that works.

CENTRALISED TREASURY. In contrast to Jardine's local method, multinational group British American Tobacco (BAT) takes a very centralised approach to liquidity management and cash forecasting. BAT is a global tobacco company with products sold across 180 markets worldwide and has the largest market share in more than 50 of those countries. The group had after-tax profits of £1.3bn in 2002.

BAT prepares two-weekly, monthly, yearly and two-yearly forecasts across the group. Central treasury handles the weekly, monthly and yearly forecasts, and additional yearly forecasts are also conducted by management accounts and the planning department, for yearly planning exercises.

Alistair Newson, Treasury Controller at BAT, explains: "The emphasis is on the regions to prepare the forecasts, and these are then consolidated up by central functions."

In deciding what was the appropriate method for forecasting, Newson says the group considered various options first. He says the key factors in deciding a method are, "access, consistency of format, completeness, ease of use, and cost". The group uses a combination of methods, including the receipts and disbursements method, which involves starting at the lowest level and cumulating known payment and receipt cycles on a two-weekly and monthly basis. The group also uses the distribution model and the strategic approach, using the income and balance sheets coming out of the budgeting and planning process.

With an international presence, BAT faces different challenges to forecasting in different regions. Latin America poses particular issues, given the exchange rate and interest rate volatilities that are seen across the region. Newson says, however, that it is possible to prepare forecasts across the region. He says the country-by-country interest and exchange rate volatilities can generally be dealt with through appropriate plan assumptions and a strong hedging policy.

PAN-EUROPEAN. RTL Group is a leading European television and radio broadcaster, and the largest independent distribution company outside the US. The group has operations across Europe, and takes a centralised, regional approach to cash management. Francois Masquelier, Head of Corporate Finance & Treasury at RTL, says the group uses short- and medium-term forecasting as an aide in managing liquidity across the group, and primarily uses forecasting to get a view on global activities.

"We prepare one day up to one year forecasts on a rolling basis," he explains. "We use daily for cross-border cash pooling management and day-to-day cash management, and 12 months forecasts on a rolling basis for medium-term funding management." Forecasts are used for managing credit facilities utilisation, funding planning, and for managing inter-company internal credit limits granted to affiliates within the group. The short- and medium-term forecasts are reconciled every six months, says Masquelier.

British American Tobacco

'THE EMPHASIS IS ON THE REGIONS TO PREPARE THE FORECASTS, AND THESE ARE THEN CONSOLIDATED UP BY CENTRAL FUNCTIONS. [KEY FACTORS IN METHOD FOR FORECASTING ARE] ACCESS, CONSISTENCY OF FORMAT, COMPLETENESS, EASE OF USE AND COST'
ALISTAIR NEWSON, TREASURY CONTROLLER, BRITISH AMERICAN TOBACCO

For RTL, the purpose of forecasting is to measure net debt evolution, and the group uses Carat, an internal consolidation and reporting platform installed by Treasury to prepare those forecasts. Masquelier says: “The model we use is based on current definition of net debt [under IAS].”

In choosing the appropriate model, there were a number of factors to be considered, says Masquelier. “Crucial factors included the definition of net debt and defining the best support to report upstream information,” he says. “By having a good system in place with internal IT specialists, the process was made easier.”

On an individual level, Masquelier says that training staff to understand the model and the system was a challenge, as was developing necessary discipline within the subsidiaries. He says these challenges were dealt with through information provision. “By being strict, by giving time to affiliates to learn and improve, and by demonstrating that the exercise is good for them, on a non-consolidated basis, we overcame these issues. It is a very useful tool once in place.”

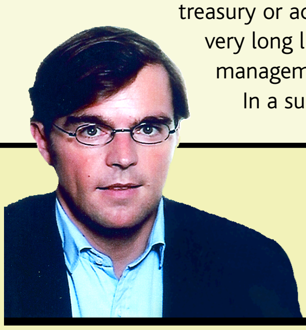
Another challenge was deciding the methodology to be used at subsidiary level on whether information should come from the balance sheet and/or from the P&L statement. The group took a strategic approach to the forecasts and uses information from the income and balance sheets developed during the budgeting and planning processes.

He adds that, for a European entity, a top-down approach to forecasting works well. “It should be a top-down approach, concentrated on significant flows and key subsidiaries, and regularly reviewed,” he says. Masquelier says RTL has plans to increase the scope and frequency of its forecasting, as it becomes an increasingly effective tool in managing both daily cash and longer-term liquidity.

INFORMATION AND COMMUNICATION. One of the biggest difficulties companies face is that of gathering information. To create a timely and accurate forecast, it requires the input of many different people across all parts of the organisation, each with their own goals and priorities. Often sending through regular data to treasury or accounts can be the last thing on a very long list of tasks for subsidiary management or finance teams.

In a survey conducted by *GTNews* and the REL Consultancy, corporate respondents felt that they lacked necessary influence over business units in order to get the information they needed, when they needed it. *GTNews* reports: “Treasurers admit to difficulties in getting business units to understand the importance of cashflow forecasting, and less than four in 10 rate their influence as high.”

The key, according to one treasurer, is accountability: “Communication between subsidiaries and central functions must be clearly laid out and policy drawn up stipulating exactly what is expected and when. Also, laying out what the consequences will be if that information transfer does not occur can be a powerful incentive.”



RTL GROUP

‘MOST TREASURERS AGREE THAT FORECASTING IS BECOMING ESSENTIAL AS A TOOL IN LIQUIDITY AND CASH MANAGEMENT, BOTH FOR SHORT-TERM DAILY CASH MANAGEMENT AND FOR LONGER-TERM FUNDING STRATEGIES AND PLANNING’
FRANCOIS MASQUELIER, HEAD OF CORPORATE FINANCE & TREASURY AT RTL

DETERMINING ACCURACY. Hand-in-hand with information gathering comes the biggest challenge of all: accuracy. In preparing cash forecasts on any level, all companies must decide how to set, and how to measure, acceptable levels of accuracy. BAT’s Newson explains: “One big issue for companies is analysing actual versus forecast reporting and the rationale for variances.”

Creating the most accurate forecast possible is, of course, essential. It can be complicated by a number of issues. For any company, the underlying processes may be extremely disparate because individual business units work to different goals in different industries, software systems for analysing and reporting may not match up and processes for forecasting within each business unit may differ. In addition, subsidiaries may not have a clear understanding of forecasting processes and may therefore fall down in data provision, and so on.

In a complex organisation that grew through acquisition, there can be extreme difficulties in matching up data across completely different businesses. On the other hand, for those companies where various businesses interact, difficulties may be down to cross-involvement of interests – and therefore of financial information for those units. Depending on the depth of forecast a group needs, this may or may not be an issue.

There are a number of strategies that companies use to increase accuracy. If there are resources available, the most effective tool is simply repeated review: review of the underlying data, how business units define and gather that data, and how assumptions match up across business units; and review of the forecasts themselves. One treasurer suggests: “We review data from the previous forecast each month and look at areas where the biggest improvements can be achieved.”

Most treasurers agree that forecasting is becoming essential as a tool in liquidity and cash management, both for short-term daily cash management and for longer-term funding strategies and planning. Different companies take a different approach to forecasting, depending on what their specific needs are and to what purpose they hope to put the forecasts.

But there are a number of common themes for most companies looking to use cash forecasting. BAT’s Newson sums it up: “The biggest issues we face are accuracy, consolidation, completeness and timeliness.” Masquelier from RTL adds discipline from subsidiaries to that list.

How those issues will be dealt with depends, once again, on the company. Looking to how other groups are dealing with these issues, and indeed how they approach forecasting in general, can help clarify these issues.

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