WHY CASH IS KING

RECENT CORPORATE FINANCIAL SCANDALS HAVE MEANT THAT CASHFLOW DATA HAS BECOME MORE SIGNIFICANT THAN P&L DATA AS A LENDING CRITERION. TREASURERS MUST TAKE NOTE, WARNS KEN DUMMITT.

Executive summary

- Corporate financial scandals such as Enron and WorldCom have caused banks to cut back the availability of short-term credit.
- According to a recent online poll, 64% of banks and 47% of corporates believe this will be the case for the foreseeable future.
- A company's cashflow is now considered a significant lending criterion, with 81% of banks and 85% of corporates believing it outranks historic P&L.
- Cash forecasts must go beyond two-week timeframes and just treasury cash.

The world changed forever on 11 September 2001, and the financial world – the world of business and corporate liquidity – also changed after the derivative fiascos that blighted the late 1990s and early 21st Century.

Many investors lost their retirement benefits, but lending institutions took the biggest financial hit, with household names and blue chip companies declaring bankruptcy or filing for Chapter 11.

This resulted in billions of dollars being lost by the world's lending institutions. Mergers became daily news as small and medium-sized financial institutions were acquired by global leaders willing to exchange more debt for established clients and intellectual property.

Since then, the provision of bank credit has not been taken for granted and corporate lending has changed. In April, some banks warned indirectly that the corporate segment would continue to experience a scarcity of short-term bank credit in the foreseeable future, when they responded to an online poll conducted by gtnews.com, sponsored by SunGard Treasury Systems. Of the banks that responded, 64% said a scarcity of short-term bank credit would remain. Only 47% of corporates agreed.

Corporates, empowered by new software verifying their derivative investments and eager to demonstrate their company's integrity by co-operating with financial safeguards such as Sarbanes-Oxley and IAS 39, look forward to a day when the market rights itself.

Understandably, lending institutions remain wary. No longer will they finance the economy by effortlessly green-lighting corporate credit and underwriting excessive credit risk. Embracing regulatory and market pressures, banks find security in diversifying their income and tightening the reigns on short-term loans.

ONE EYE FORWARD AND ONE EYE BACK. To ensure that history is not repeated, banks have diversified their income sources to both offset losses. Increased service fees and capital market interest means that banks can once again determine lending criteria instead of relying on standards created to match competitor offerings.

For years, financial leaders reminded the world that cash is king, and despite taking a backseat to paper money during the 1990s, it still is.

The recent survey showed that 81% of banks and 85% of corporates believe that cashflow data now outranks historical profit and loss (P&L) data as a lending criterion. CFOs, treasurers and other financial executives must understand that if cashflow outranks historical P&L, the policy for relying on short-term borrowing must be revised in response to banks and lending organisations' new and conservative approach to short-term lending.

To maximise relationships with their lending partners, corporate treasurers must assume more 'enterprise cash' responsibility and provide forecasts and guidance beyond two-week timeframes and treasury cash. They must install solutions that can extract real-time data from multiple, diverse systems in order to provide the forecasts and guidance required. This will enable fundamental organisational change. Only then will CFOs be able to hold business unit managers responsible for cash management to a degree not possible today.

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Corporate scandals – the background

International regulators realised something unusual was prompting the vastly soaring shareholder returns of the late 1990s. In fact, the US Federal Accounting Standards Board (FAS) and International Accounting Standards Board (IASB) were refining FAS 133 and IAS 92 amendments before huge losses from Enron, Adelphia, WorldCom and others hit the headlines. For example, the IASB's Accounting for Investments was first drafted in 1984, but it didn't really get up to speed until 1998.

What seemed to be unprecedented success back in the 1990s, became overwhelmingly contagious to the economy and business across the board. This was particularly the case with dotcoms. Interest rates were moderate, but bank credit remained inviting, with daily increases in stock prices. For many companies, even operating in the red did not translate into a credit rating agency disaster, lack of investor confidence or the denial of readily available bank credit. Doomsday predictors said the bubble had to burst but their warnings were not heeded.

With greed guiding what led to 'creative accounting' in firms that were later exposed, the sky, it seemed, was the limit. But what appeared to be was not so, and by early 2000 news of a pending recession loomed on the horizon. Investors stopped throwing their money at the 'less predictable' stock market and sought more positive returns.