BUSINESS GUIDE

CFO's Guide to Cash Management

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CFO's Guide to Cash Management

Managing cash flow has always been imperative for finance professionals but the supply chain disruptions, labour shortages, evolving customer expectations and interruptions in global trade of the past few years have brought it into sharp relief. Even as cash flow has taken on added importance, many businesses are still struggling to perfect their process.

Any business, no matter how much capital it has raised or how successful its track record, can wind up with a serious cash shortfall. This can result from deteriorating economic conditions or some other unforeseeable event that disrupts normal operations. In many cases, however, ineffective processes, inadequate controls and inaccurate information are the culprits.

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CHAPTER 1

Symptoms of Poor Cash Management

Cash management is never easy. Many circumstances can affect sales, reducing cash inflows unexpectedly. And questions concerning the best way to allocate cash don't always have clear answers. Even experienced managers occasionally make the wrong decision. But some companies always seem to struggle with cash flow, no matter what their sales are. For these organisations, there are a few common denominators.

Poor visibility into cash position. It's hard to manage cash effectively when you don't know how much you have available. Unfortunately, organisations often have limited insight into their current cash position. While checking a single account balance is simple enough, it doesn't provide a complete picture. The finance team also needs to know which transactions have cleared the bank and which one's haven't. Does the current balance include the previous day's deposits? Does it include recent vendor payments? The answer to these questions can mean the difference between making or delaying an investment.

Getting this information, however, involves comparing bank transactions to actual accounting entries. Doing this manually is time consuming, especially when there are multiple accounts, so some companies may only perform bank reconciliation once or twice a month. The rest of the time, the company won't have an accurate understanding of its current cash position. Basing financial decisions on out-of-date information generally leads to poorer results.

Unreliable cash flow forecasts. Just as important as having visibility into the current cash position is knowing how much cash the company needs in the short term to continue funding the business and the amount of outstanding receivables it is likely to collect. Unfortunately, for most organisations, inaccurate cash flow forecasts are the status quo. In a survey from AQPC, a benchmarking research firm, nearly 60% of respondents indicated that their company's cash flow forecasts aren't within 75% of the actual balance.

To stay in business, employee salaries, vendor bills and other expenses must be paid, no matter how much cash is on hand. And to ensure they can meet these obligations, most companies have a line of credit with one or more lenders. Credit charges add up if you are continually drawing against these credit lines. Poor forecasting can also lead organisations to request more credit than they actually need, which typically increases interest rates.

Forecast quality also impacts decision-making. Business leaders may become overly conservative due to a lack of confidence in the numbers, causing them to delay investments in marketing, inventory or other growth initiatives. This can create a vicious cycle in which demand falls, stockouts lead to lost sales, and revenue falls, further impacting cash flow.

Ineffective budgeting. The annual budgeting process is time-consuming and convoluted, often beginning with the desired outcomes, such as top-line revenue, annual growth rate and/or earnings target, and then working backwards to establish spending limits. Departmental budgets for the coming year tend to mirror the current budget, with slight adjustments to reflect future performance targets.

This approach tends to rely more on emotion than facts, focusing on what the CEO or board of directors wants to achieve rather than on what is actually possible given the company's market position, competitive environment and growth potential. Budget decisions may not consider which expense categories generate the most value or which investments are most likely to improve performance. Instead, some activities wind up being overfunded while others are underfunded. Financial performance ultimately suffers due to inefficient resource allocation.

People also tend to build their budgets in spreadsheets, which is inefficient and can be counterproductive. Different versions of the budget can move from the finance team to department heads and back, resulting in changes being missed and unpleasant surprises when stakeholders receive the final numbers.

Relying on spreadsheets also makes it hard for budget owners to keep track of expenses and avoid going over budget. While finance staff can see every transaction, managers in other departments rarely have the same access. In most cases, they only know which expenses have hit their budget after the fact, once accounting has closed the books for the previous month.

Difficulty controlling spending. Another cash management challenge is a lack of effective spending controls. When first starting out, entrepreneurs have complete control of the checkbook, allowing them to personally approve every purchase. As the company grows, this hands-on approach becomes unsustainable and the purchasing process gradually evolves, giving more people access to the checkbook or corporate credit card. At this point, controlling expenses becomes more difficult, increasing the risk of excessive or inappropriate spending. The effects can be disastrous, including cash shortfalls, bounced checks and even bankruptcy.

To avoid these issues, organisations typically establish formal expense policies and procedures, including spending limits and purchase authorisation requirements. While it's important to have documented processes, they're only useful if they are enforced. Inconsistent application of internal spending controls doesn't just limit their effectiveness—it creates the perception that the rules don't matter and makes internal fraud more likely.

Reactive collections. In an ideal world, customers would always pay on time and in full. Since that's not reality, companies frequently have delinquent accounts. Businesses sometimes have dedicated collections staff who have the skills and personality required to work with late-paying customers. Most don't however, so collections efforts often fall to accounts receivable staff.

Because few people enjoy asking for money, collections efforts are often performed ad hoc, and mainly focus on accounts that are long-past due, making it more difficult to secure payment. Waiting to act until payments are already late hurts cash flow.

CHAPTER 2

Cash Management Essentials

Effective cash management practices provide a solid foundation on which to build a successful business. Being effective means balancing cash inflows and outflows to ensure the company can meet its short-term financial obligations, make investments to drive growth and retain sufficient earnings to satisfy shareholders. To achieve this balance, financial managers must always know how much cash the company has on hand, how much it needs and how much it's owed.

Finance teams also need to have tools and processes in place to facilitate budgeting, keep spending in check and ensure that customers pay their bills. Spreadsheets, manual effort and poorly implemented policies and procedures won't cut it. These are the essential requirements for effective cash management.

Real-time financial data visibility. To make effective cash management decisions, companies need access to real-time financial data, including the current balance across all accounts and a complete record of all bank transactions. This information must be centrally available within an organisation's accounting system to ensure managers are working from a common source of data.

Daily and/or real-time bank feeds save time and ensure accuracy by eliminating the need to enter data manually. Having this information readily available within the financial system also facilities account reconciliation and the application of customer payments to open invoices. When these processes are automated, they can be performed more frequently, giving business leaders a better understanding of their current cash position.

Improved forecast accuracy. Finance leaders need to be able to forecast future cash inflows and outflows, ideally without spending hours gathering data. Unfortunately, many finance teams are forced to rely on spreadsheets and static data to develop forecasts. This is a labour-intensive process that has to be repeated every time the company needs an updated forecast. And while no forecast is ever perfect, with most companies reporting accuracy rates of less than 75%, there is clearly a need to improve the process.

The accuracy rate is affected by three things: the quality of the data used in the forecast, the validity of the assumptions built into the forecast and the amount of time that has passed since the forecast was updated. To improve cash flow forecast accuracy, begin by providing centralised access to real-time financial, sales and other relevant data. This will save time and ensure that forecasts are based on the most up-to-date information available.

The next step is to eliminate unsupported assumptions from the forecasting process. For instance, rather than estimating collections based on instinct or applying a standard percentage to open receivables, companies should use their own historical transaction details to determine how much is likely to be collected during a given period. It's also important to factor non-operational cash flows into the forecast, including planned capital expenditures, incremental venture investment or other activities. Finally, by automating the process, companies can save time and improve accuracy by updating cash flow forecasts more often.

Data-driven budgeting. The annual budgeting process is broken. Too many companies begin by establishing a performance target and then building their plan. This top-down approach can result in lopsided budgets that invest too much money in some areas while underfunding activities with the potential to deliver more value. Regardless of whether a company hits or misses its annual targets, it won't have deployed capital in the most effective way. Worse, if the plan succeeds, the company will follow the same process and waste even more money.

A bottom-up approach that bases plans on data, instead of desired outcomes, will deliver more consistent, more predictable results. The process should begin with an assessment of the current business environment and a review of past initiatives to determine which activities are likely to generate the most value for the business. With this information, companies have a better understanding of what results are actually achievable and can allocate budgets accordingly.

Strong financial controls. Effective policies and rules that protect organisations from financial fraud, serious errors and intentional abuse of benefits, resources or authority can also ensure compliance with government regulations and accounting standards. They also help ensure effective decision-making regarding investment of capital or allocation of company resources.

Well-designed internal controls bring greater stability to an organisation by holding people accountable for their actions. Yet, even when controls are clearly documented, they aren't

always followed. Managers and staff may skirt the rules, intentionally or unintentionally, to get things done quickly without the “red tape.” Whether for personal gain or not, even minor policy violations can affect personal safety and integrity by creating a sense of lax enforcement.

Many business management solutions help ensure compliance with financial standards, operations policies and federal, state and local regulations. Review and approval workflows are built into accounting, sales, procurement, staffing and other processes, providing management oversight that reduces the risk of financial fraud or errors. Effective control processes can also help improve company performance by ensuring that actions taken by lower-level managers have been reviewed and signed off on by senior staff.

Proactive collections. While most customers pay their bills on time, collecting from those that don’t can be challenging. An effective collections process can keep days sales outstanding (DSO) under control. Lack of automation, however, means collections efforts often consist of one-off emails and inconsistent follow up, an approach that is ineffective. Automating customer communications ensures consistent follow up on past-due invoices, improving DSO, and reducing bad debt write-offs. Automation can even improve on-time payment by alerting customers ahead of time of pending due dates.

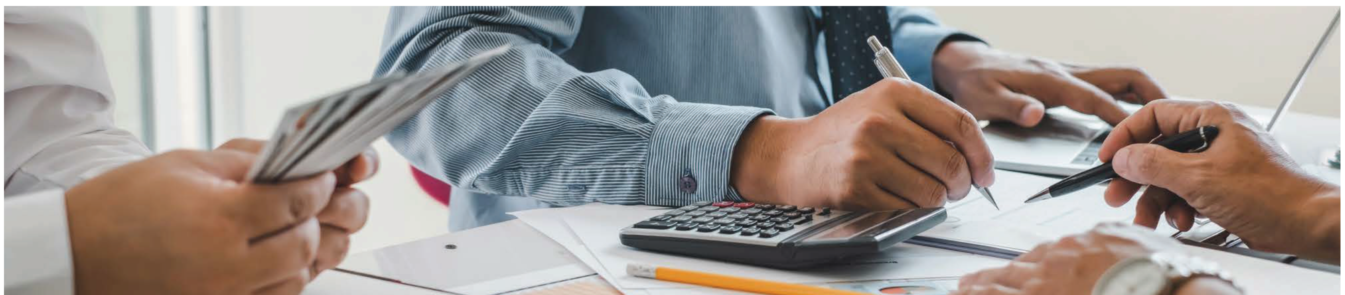
CHAPTER 3

Manage Cash Effectively With NetSuite

Finance leaders must be able to pay employees and suppliers, service debt and meet other financial obligations while also maintaining liquidity in case the economy falters. NetSuite makes this easier by helping keep cash balances up to date, increasing forecast accuracy, improving the budgeting process, and giving companies greater control of cash inflows and outflows with functionality, including:

- Automated bank feeds import account details nightly and allow for intraday updates, ensuring finance teams know which transactions have cleared and how much cash is available at any time.
- Cash 360 is a cash management dashboard that monitors cash flow trends and tracks total cash, accounts receivable and accounts payable balances in real time, and displays a rolling six-month cash flow forecast based on current transactions and historical collections and disbursement averages.
- Planning and Budgeting software automates the planning process, saves time and improves data quality by eliminating the need for cumbersome spreadsheets. It provides sophisticated modeling capabilities, predictive analytics and a powerful calculation engine that allows financial planners to quickly build and evaluate multiple what-if scenarios, leading to more informed, data-driven budgeting decisions.
- Automated dunning letters improve on-time payment by alerting customers before bills are due and help avoid write-offs for bad debt by maintaining consistent, proactive communications with delinquent accounts.
- Configurable workflows help companies avoid overspending by enforcing approval policies and holding managers accountable for staying on budget. Embedded controls help save money by automatically logging all user activity, reducing the risk of fraud, and maintaining appropriate separation of duties among finance and accounting staff.

Evolving business requirements, increasing stakeholder demands and economic uncertainty mean cash management will remain a top priority. NetSuite provides the essential capabilities companies need to manage cash effectively.



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