Six questions every treasurer should ask about their cash forecasting process »»

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Introduction

Consistent accurate cash flow forecasting is arguably the holy grail of corporate treasury. From securing liquidity to internal customers to support their local business, to providing free cash flow guidance and variance analysis to the board of directors and investors, to preparing scenario cash flow analysis to support future M&A, share buy back or dividend strategies, corporate treasurers are tasked with a tremendous responsibility to predict the future cash flow performance of their organization.

In this eBook, Kyriba introduces six questions every treasurer should ask about their cash flow forecasting process. By successfully addressing these challenging questions, treasurers are well positioned to improve the accuracy of the cash flow forecast while optimizing the overall process and primed to realize several benefits including greater confidence from senior management, reduction in interest expense / increase in interest income and improving the effectiveness treasury resources.

1. What am I solving for?

Don’t waste your valuable resources (or “can I see the forecast through the trees?”)

Cash flow forecasting involves significant input, time and effort from across the organization. Before requesting complex itemized forecast submissions from the throughout the business, and requesting yet another deliverable from your already busy staff and colleagues, it’s critical to clearly determine the decisions the cash flow forecast information will facilitate and benefits this will bring to the organization.

The challenge however is organizations often focus on excess detail in a cash flow forecast exercise, and loose sight of the forest through the trees. Therefore, it is essential to define the objectives of cash flow forecast, what problems the cash flow forecast will solve and how the cash flow forecast result will benefit treasury’s customers; both internal customers including CFO, board of directors and internal legal entities who depend on treasury for adequate liquidity to support their businesses.

2. Am I making the same forecasting mistakes?

Fool me twice, shame on me

One certainty with any forecast is it will not be 100% accurate. As the cash flow forecast an iterative process, variance analysis and understanding the root causes responsible for forecast error is an essential step in the forecasting process in order to avoid same mistakes next period and improve forecast accuracy going forward.

Once forecast objectives clearly defined (see item), measuring the effectiveness of the forecast is a critical subsequent analysis. Establishing clear and relevant variance attribution analysis is an effective foundation to identifying the root cause of the forecast error. Variance attribution analysis often focuses on several items, including regional cash flow performance, changes in working capital and timing considerations. Inclusion of simple yet comprehensive variance analysis technology can often reduce the time and stress of identifying culprits of the forecast error and reduce the likelihood or repeating similar cash flow forecast errors in the future.

3. Do I understand my business?

Corporate strategy will drive the flow of corporate cash

Treasury is that unique corporate finance department that balances the interaction with external counterparties (e.g. banks and credit agencies) with corporate fiduciary responsibilities. However, corporate treasury should not operate in corporate silo. Understanding corporate strategy, financial targets and regional growth objectives is a critical exercise to any successful cash flow forecast.

As companies introduce new product lines, execute M&A strategies and expand internationally, it will greatly impact the future cash flow needs and performance of the organization. From increases in inventory balances to secure a new product launch, to expansion to higher DSO regions, understanding the underlying business for which your treasury department supports is a critical step in securing an accurate cash flow forecast, and enabling treasury as a strategic internal business partner.

Risk: lack of insight to underlying corporate strategy will increase probability material variances

4. Why fund your business with external funds?

Stop leaving money on the table and reduce interest expense

Internal cash is cheaper than external financing. With an accurate and comprehensive cash flow forecast, treasurers are able to confidently manage global cash balances at the optimal level to support their locally businesses and consolidate incremental excess cash at the corporate or regional levels.

This enables corporations to better utilize their cash balances to pay down credit lines and short-term debt, and fund external expenses and corporate capital allocation strategies including share repurchase, dividend and M&A activity, without taking on additional external debt and interest expense.

5. Direct or indirect?

...that is the question

In addition to serving as vital liquidity planning tool to ensure global working capital requirements are met, treasury can serve a vital role in the contributing and measuring the performance of the global cash budgeting plan.

By aligning the indirect method commonly used to budget operational and free cash flow from a FP&A budget perspective, against the traditional treasury direct method, treasury has the unique strategic opportunity to align these methods and provide guidance to executive leadership and board-level audiences on cash flow performance, risks and opportunities.

Also, how does the FP&A plan translate to global currency risk management objectives and aligning global business plans to FX cash flow programs.

6. Do I have real-time insight to free cash flow performance?

Sleep peacefully at quarter-end

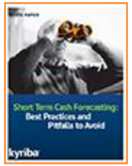
Having real-time cash visibility and cash flow allocation automation can ease the quarter-end concern of "will we hit our free cash flow target?" These targets are increasingly tied to executive compensation and public guidance provided to the investor community. A comprehensive cash flow forecast, and ability to measure actual performance from bank statements, provides greater assurance to treasurers, CFOs and CEOs alike that previously committed operating or free cash flow targets will be me and executive compensation bonuses will be paid.

Additionally, the ability to measure forecast accuracy within the quarter provides CFOs and treasurers with "actionable information," from which other cash flow techniques can be deployed, including working capital techniques such as supply chain financing and receivable financing, to shorten the cash conversion cycle and improve free cash flow for the current quarter.

Similarly, if cash flow is ahead of target, treasurers and CFOs may elect to speed up vendor payments at quarter end to ease the cash flow pressures of the following quarter.

Risk: Possibility of missing quarterly cash flow targets, negative investor reaction, executive compensation risk.

Further reading



White Paper: Short Term Cash Forecasting - Best Practices and Pitfalls to Avoid

White Paper: Achieving Maximum Cash Visibility - A Best Practice Guide

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About Kyriba

Kyriba is the global leader in cloud-based Proactive Treasury Management. CFOs, treasurers and finance leaders rely on Kyriba to optimize their cash, manage their risk, and work their capital.

Our award-winning, secure, and scalable SaaS treasury, bank connectivity, risk management and supply chain finance solutions enable some of the world's largest and most respected organizations to drive corporate growth, obtain critical financial insights, minimize fraud, and ensure compliance.

To learn how to be more proactive in your treasury management and drive business value, contact treasury@kyriba.com or visit kyriba.com.

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Contact us

North America
9620 Towne Centre Drive, Suite 250
San Diego, CA 92121
Tel: +1 855 KYRIBA-0
E-mail: treasury@kyriba.com

United Kingdom
55 Bryanston Street
London W1H 7AA
Tel: +44 (0)20 7859 8275
E-mail: info-uk@kyriba.com

France
247 Bureaux de la Colline
92213 Saint-Cloud CEDEX
Tel: +33 (0)1 77 92 17 17
E-mail: infofrance@kyriba.com

Dubai
703 Icon Tower
Tecom
Dubai, UAE
Tel: +971 (4) 420-7898
Email: info-ae@kyriba.com

Japan
JR Ebisu Bldg. 11F,
1-5-5 Ebisu Minami
Shibuya-ku, Tokyo 150-0022
Tel: +81 3 6321 9454
E-mail: info-jp@kyriba.com

Singapore
9 Temasek Boulevard
31/F Suntec Tower 2
Singapore 038989
Tel: +65 6559 5330
E-mail: info-sg@kyriba.com

Netherlands
Herengracht 282
1016BX Amsterdam
Tel: +31 (0) 20 521 93 52
Email: info-nl@kyriba.com

Brazil
Praia de Botafogo, 501
1º andar Torre Pão de Açucar, Botafogo
Rio de Janeiro, RJ, 22250-040
Tel: +55 21 3523 4180
E-mail: info-br@kyriba.com

Hong Kong
Room 1708, Dominion Centre
43-59 Queen's Road East
Wanchai, Hong Kong
Tel: +852 6383 2472
E-mail: info-hk@kyriba.com