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CFO Insights
March 9, 2023

For finance leaders, promoting a culture of cash could make sense

The king is back on the throne.

Cash is once again front and center for corporate finance executives, as they face a challenging economic environment. Indeed, given current economic headwinds—ongoing interest rate hikes to curb surging inflation,[1] tremors of a looming recession, and ripples from geopolitical unrest—CFOs may find it imperative to reach across the company and turn the institutional focus to rigorous liquidity management.

It's likely that some sitting finance chiefs have little or no experience managing in a high-interest-rate environment. What's more, applying a lens of liquidity to almost every decision can be more challenging than it seems, requiring substantial shifts in alignment and corporate mind-set.

Difficult or not, this renewed emphasis on managing cash isn't likely to go away anytime soon. For finance executives tasked with the job, cash-flow forecasting tools can help. Simply put, such modeling is the window into building an integrated, operations-based view of cash flow. Companies that take this approach may not have the best model or the most comprehensive assumptions to go on. But they can be better positioned to provide organizational transparency into how each function influences and measures the effect of their behaviors on liquidity. In addition, scenario-building around liquidity boosts confidence amid economic turmoil while accelerating decision-making.

In this edition of *CFO Insights*, we'll explore how CFOs can help spread a "culture of cash." By improving their approach to cash-flow forecasting, finance teams can gain a clearer understanding of how to bridge funding gaps and identify issues that are having a negative impact on liquidity. This, in turn, can help provide an all-important buffer during times of uncertainty.

Throwing off the cents

While companies can deploy a number of strategies to insulate their businesses from volatility, improving cash flow forecasting can be particularly effective. Modeling, along with working capital analytics, helps build resilience. It also addresses potential concerns about available cash and can raise management's overall understanding of liquidity. Such forecasting provides a more complete view of a company's cash situation by:

- Providing insights on how operational drivers influence cash flow.
- Projecting the liquidity impact of various downside and upside scenarios.
- Calibrating capital allocations to drive near-term goals without compromising long-term growth.

At its core, the direct cash flow forecasting method is a bottom-up exercise, designed to fill in blanks about operations, but from a cash management viewpoint. Traditionally, direct cash flow forecasting has been more commonly associated with distressed companies, but no more. The method is often seen as a "treasury exercise" to ensure that the business meets its near-term obligations. In reality, this type of modeling can be embedded in, and integrated with, the larger financial planning and analysis (FP&A) of the entire organization, using operational stakeholder input to inform the analysis.

Sustainable, value-driven forecasting requires much more than a financial model, however. It serves as the analytical tool, but a strong governance framework is necessary to activate that tool through stakeholder engagement, active dialogue, collaborative decision-making, and organizational alignment. Comprehensive foundational governance—including end-to-end engagement with departmental leaders—provides the information needed to develop the required analysis.

CFOs who managed through the pandemic may have received a difficult lesson in how tricky it can be to pinpoint the drivers of cash inflows and outflows, including payment patterns of customers and vendors. Since

the pandemic's peak, some executives have become more keenly aware of cash positions. This may partly be due to some shareholders' demands for companies to track cash more closely. In earnings calls, some analysts typically want to know from CFOs: With borrowing costs rising, is the company generating the capital required to invest and grow?

Spreadsheets may be sufficient up to a point, but cash flow modeling tools enable executives to unearth areas that are underperforming, and those that may benefit from investment. By pulling data from multiple locations, and converting various currencies, cash flow forecasting can consolidate all the numbers to enable scenario modeling. CFOs and others can factor in those models when making decisions.

Organizations also need to consider specific aspects of how they intend to operate both presently and in anticipation of future organizational changes (see Figure 1). For example, a highly acquisitive organization will need to account for the processes required to onboard new companies into its forecasting process. (For more on the tools themselves, see the accompanying story, "A head start in choosing a forecasting solution.")

Figure 1. Use case based on organizational behavior

Tool	Transactional	Restructuring	High-growth	Mature and steady-state
Characteristics	• Cash flow forecast for a specific event such as supporting an M&A, equity or debt raise process. • Likely to be driven by short time frame. • Tailored for a specific purpose.	• Typically driven by a requirement to rapidly understand liquidity. • Requirements likely to be more basic in nature with increased focus on critical payments and receipts and identifying funding needs.	• Focus on developing efficient processes and tools that can be scaled while retaining ability to flex and adapt as business strategy and operations develop. • Ability to handle changing data flows.	• Established processes and data flows. • Longer and more strategic development and implementation process. • Ability to handle more complex business needs and operating structures.

Source: *Liquidity management during economic uncertainty: Choosing a forecasting solution, Deloitte Development LLC, 2023*

For future reference

Cash flow forecasting tools are predicated on a governance structure that promotes regular dialogue to drive insights from, and accountability within, operational and finance leadership teams.

It is important from a governance perspective to have a formalized approach in which cash and liquidity levels are discussed with key stakeholders. That allows decision-makers to analyze and understand the trends and drivers of cash—a critical prerequisite to forecasting and managing cash (see Figure 2).

Figure 2. Liquidity management governance framework

Liquidity management governance framework

Create "tone" through executive sponsorship
The message tone prioritizes liquidity management for functional leaders and effective cash management.

Engage functional stakeholders
Functional leaders should be brought in early to assist with forecast design and to drive ownership and accountability.

Identify types of insights to be derived
Identifying an initial set of insights helps create a baseline forecasting tool, including data granularity and key assumptions.

Define an analysis cadence
Setting a regular cadence is essential for understanding and evaluating variances between forecast and actual cash flow.

Create action from insights
Creating a regular communication loop to understand the data and take action on insights can enhance liquidity discipline, increase working capital, and drive predictability.

Source: *In an uncertain economy, fraught with unprecedented inflation, understanding and scrutinizing cash flow through forecasting is a must, Deloitte Development LLC, 2022*

Companies that prioritize governance as the foundation of reliable, insightful, and sustainable forecasting should consider cultivating the following traits:

- **Finance leaders who promote a "cash culture:"** While forecasting is an organizational exercise, it requires finance leadership to communicate purpose, vision, and accountability across functional silos. Forecasting should challenge departmental leaders to understand the impact of every operational decision on liquidity. Messaging should include a clear articulation of why liquidity matters and the benefits the exercise can provide. A "cash culture" starts at the top to drive functional accountability.
- **Functional leaders aligned with the forecasting process:** Aligning the forecasting process requires buy-in from leadership across the board, including sales, supply chain, indirect procurement, IT, disbursements and collections, capital markets, and payroll. Such alignment connects liquidity consequence with operational decision-making and helps to avoid siloes that can often show up throughout organizations. One example: a sales organization that is incentivized by incremental volume while the collections team is often measured by customer collections. A forecasting process that is functionally aligned promotes collaboration and efficiency as it drives dialogue that focuses on analyzing the entire order-to-cash continuum.
- **An established cadence for dialogue:** Sustainable and active liquidity management relies on regular dialogue around a central forecasting tool. The cadence drives accountability and also creates a forum to understand end-to-end cash conversion issues. Accountability relies on ownership, and getting stakeholder input is crucial. A primary benefit of forecasting tools is the ability to empower functional leaders to understand how the forecasting model works, what data is being used, and what key assumptions drive cash conversion. The opportunity for input can create confidence that the forecasting tool accurately reflects departmental leaders' views on how their decisions affect liquidity.
- **Improved transparency and analysis:** A central part of the cash flow analysis is understanding the "what" and "why" behind actual and projected weekly cash flow variances. The analysis helps organizations understand whether consistent misses are due to incorrect assumptions or underlying process issues.

Council security

Typically, cash flow forecasting has been a treasury-driven exercise. But to increase transparency, finance executives may need to engage with colleagues in other functions to develop a comprehensive view of cash flows and create accountability for cash management across the organization.

That exercise usually starts with the creation of a cash council dedicated to meeting bi-weekly. The group includes constituents from across the organization capable of discussing the different elements that affect cash inflows and outflows. Below are four fundamental questions to ask when assembling such a group to help ensure that companies don't get too involved with compiling the forecast and then skimp on spending time to analyze it.

1. **Who should be involved?** A cash council requires the participation of employees in procurement, sales, and inventory management. The sales side of the business can add value as it can track order-to-cash patterns and collections, which inform the cash-flow forecast. At some companies, the head of supply chain will likely also be part of the council.
2. **What types of questions does the council need to address?** Is it a matter of when the company will run out of money—or making sure the business can fund a desired acquisition? Which specific scenarios seem more likely than others? If changes are made to the business model, how might those affect the company's cash needs? Aligning functional leadership requires finance to clearly communicate the connection between operational decision-making and liquidity consequences.

3. **How exactly does the company intend to fund future growth?** If management envisions M&A fueling growth, it needs to know, practically to the cent, the company's cash position. The fallback position—borrowing funds at zero interest—is no longer viable.
4. **What level of accountability exists for meeting cash targets?** The treasury team is traditionally responsible for tracking and measuring cash. But as a wider range of stakeholders becomes involved, measuring others' performance according to how well cash predictions stack up against actual performance on a week-to-week basis may be advisable.

Understanding cash positions through forecasting can benefit organizations that seek to seize opportunities in an economic slowdown through acquisitions, R&D investments, or product development. This especially holds true for companies that might have fallen behind on innovation in recent years. Doing so means elevating cash flow forecasting and management from a finance project into an organizational initiative.

A head start in choosing a forecasting solution

Foundational governance may be the cornerstone of active liquidity management, but the forecasting tool used to project liquidity is its centerpiece. That core element can enhance visibility, help identify root causes (internal and external), and help before improve the predictability of cash flow longer into the future.

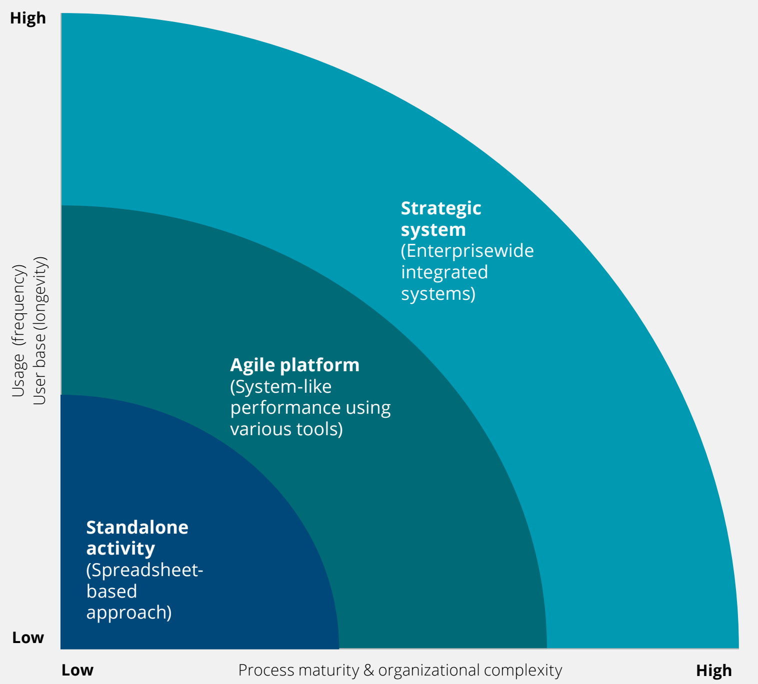
Options range from traditional spreadsheet modeling to enterprise-wide strategic software-as a-service. One attraction of the SaaS approach: the system can be integrated with other planning tools (see Figure 3).

In the case of forecasting tools, one size decidedly does not fit all. Choosing the most effective solution requires managers to consider many critical factors, including the organization's size, number of business units, ERP infrastructure, capabilities of internal data teams, timeframe for implementation, and maturity of the existing forecasting process.

Those with little experience in cash flow forecasting would be wise not to short-cut the process by jumping right onto a platform-based tool. Working with a spreadsheet-based system can help users learn the fundamentals of modeling, is likely best.

When the time does come to choose a software program, management should consider several factors:

Figure 3. Cash flow forecasting—organizational needs, complexity, and process maturity



Source: *Liquidity management during economic uncertainty: Choosing a forecasting solution, Deloitte Development LLC, 2023*

- **What's the company's current profile?** Multinationals face specific challenges in this area. Some have compensation plans that differ according to geography. Likewise, a company's products and revenue models may vary by region. In addition, acquisitive companies may bring on businesses that do not fit their existing profile—and may be selling both products and services. That situation adds to the complexity of their forecasting models.
- **How urgent is the need?** Finance leaders who have a pressing need for detailed cash-flow projections may be disappointed with their options. Typically, these software packages take months to implement. Even with the necessary structure and skills in place, the tool could provide a deeper understanding of cash flow if other departments are included in the process. Generally, the more input, the better. A CFO, therefore, may need to spend more time with the supply chain leader, for example, or the head of procurement.
- **Who else is involved in the decision?** Companies have traditionally left forecasting duties to the finance function. But liquidity management requires a broader mandate; all functions need to aligned on understanding—and making decisions based on—maximizing cash flow. Absent that commitment, the tool will be roughly as useful as GPS navigation without a destination.

End notes

1. "Inflation Cooled Just Slightly, With Worrying Details," *New York Times*, February 14, 2023

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