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SEEING IT MORE CLEARLY: IMPROVING LONG TERM CASH FLOW FORECASTING

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Introduction

The ability to forecast cash availability and cash usage is an art form but ill-defined discipline, and when you attempt to forecast cash movements over a long-term horizon it becomes even more challenging. In 2005, 79% of treasurers surveyed by the Financial Executives Consulting Group indicated that cash flow forecasting was the first or second most important issue for their treasury department. Despite this, many companies have not yet focused on developing a more robust cash flow forecasting infrastructure. For those which have, they tend to focus on short to medium term forecasting and fail to implement a sound long-term forecasting methodology. Unfortunately, there is no such thing as a magic eight ball capable of determining when customers will pay or even when our own business will pay its suppliers.

Research has shown that the more effort applied to cash forecasting, the more accurate the resultant picture of the future cash flows of your business will be. Ultimately, this will result in better decision making capabilities. Treasury Strategies' Corporate Liquidity Survey 2004 indicated that companies which forecast beyond a one month horizon achieved on average a 30 basis points improvement on their cash portfolio, which is particularly significant in a low interest rate environment.

Over the past couple of decades, organizations have invested substantially in improving the management of the vast amount of information both generated by, and required to operate a business; yet there are still critical enterprise functions that have not been optimized such as Global Cash Forecasting. Software providers are gradually providing a number of new tools which are laying the foundation for a new generation of cash flow visibility solutions that will shape the future of treasury and financial operations. For example, with the Collaborative Financial Management (CFM) suite SunGard offers a product called "AvantGard Liquidity Express (LEX)" which focuses on collecting data from remote affiliates, and extracting information from both external and internal systems to present an enterprise wide Global Liquidity picture.

"What we have been seeking with AvantGard Liquidity Express (LEX)" says Ken Dummitt, SunGard AvantGard CEO, "is an end to end collaborative financial management thus giving the senior management unprecedented tools to enable it to drive maximum value from forecasting and at the same time providing tools to reduce risk."

Long-term cash flow forecasting has both operational and strategic value to an organization as the integration of financial information enables management to have global visibility, reliability and predictability of its cash position and the cash flow dynamics of the business.

Despite the benefits of forecasting and the increased availability of technology to assist in collating and analyzing data from across the business, companies still have issues with forecasting accuracy when the time horizon extends beyond three months.

Throughout the remainder of this article, we examine the following topics in our effort to start *"Seeing It More Clearly."*

- What could cause a forecasting process to become ineffective?
- How can you avoid having another failed forecasting project?

- What steps can be taken to improve accuracy in your long-range forecast?
- How can remote subsidiaries be encouraged to participate in the process?

Reasons a Forecasting Process Becomes Ineffective

Forecasting processes become ineffective when focus is lost on getting better forecasts from the participants. The owners of the data are the best source for obtaining information, whether it is collected by way of a system interface or manual entry. There are many reasons a forecasting process could either fail or produce inadequate results. Some of the typical causes include:

- Lack of resources
- Poor initial design
- Lack of accurate and complete data
- Complex cash management banking structures
- Multiple source systems, including multiple ERP vendors or different versions of a single ERP
- Decentralized domestic and/or global operations
- Inadequate level of communication with subsidiaries
- Inaccuracy of information provided by subsidiaries
- Disparate or fragile collection methods of data from subsidiaries
- Inability to consolidate information collected

How can you avoid becoming one of the statistics?

While forecasting is a very specific activity to your organization, there are various ways in which you can increase the likelihood of the project's success. Successful cash flow forecasting projects typically incorporate common factors such as:

- Senior management sponsorship
- Detailed project stages and scope definition
- Realistic and usable forecasting time horizon
- Clearly defined reporting levels
- Strategy for obtaining and collating data
- Availability of tools to simplify the forecasting process

Senior management sponsorship is a critical first step towards ensuring that business units and other "owners" of the data buy in to the project.

Having a **detailed project plan** and definition of milestones will be critical to keep the project on track and avoid any scope creep. Projects are more likely to be successful if benefits both from senior management and business unit perspectives can be achieved along the way, to maintain project momentum.

A **realistic and usable time horizon** is important, which must be consistent with the needs and dynamics of the business. For example, a five year forecast will be relevant for some companies, but not for others; it is more important to establish a forecasting framework that suits the needs of the business as opposed to assuming that "one size fits all". Interview the ultimate users of forecast information, and find out what time frames and reporting content they require.

Determining the **correct level of reporting** is essential but often overlooked when scoping a project and establishing its complexity. The reporting level is the amount of detail at which the ultimate users of the forecast information require. For example, an insurance company may want to view the information by portfolio, whereas a manufacturing company might want it by part number, and a retail company may need to view it by Store ID.

A **strategy for obtaining data** is also critical. How are you going to collect and populate the forecasting system with data? Are you going to input everything manually? Use a treasury workstation? Excel spreadsheet? Do you have data available in multiple systems that would allow you to interface them into a single database? This is not a small undertaking, and the likelihood is that there will be many sources of information. The successful collation of data is as much to do with commitment from the owners of information and IT personnel as a technical integration issue.

And finally, you need to **evaluate your forecasting system**, at minimum it should provide for the following functions:

- Web-based deployment
- Revisions to forecasts should be easy to make and to track
- Users should be able to analyze discrepancies or anomalies in the information
- Users should be able to analyze forecast versus actual cash flows
- Management should have visibility over the global cash position

Steps to improve accuracy in your long-term forecasting

Financial Professionals need cash flow projections to be as accurate as possible in order to make well informed cash, liquidity and foreign exchange management decisions. The problem encountered by most organizations is in gaining access to enough accurate information early enough to use it efficiently; this is one of the challenges of reporting on long-term financial forecasts. Collecting accurate data in the required format from different business units, branches and departments can be complex enough, but when subsidiaries are dispersed globally, this problem is even more difficult.

There are many ways to improve the accuracy of a forecasting process. Some of the typical methods include:

- Demand senior management sponsorship to the process
- Allocate both enough people and adequate financial resources towards project
- Spend the time and effort upfront during the design phase
- Ensure data is derived from a known source
- Receive data from different sources but make sure it is reconcilable at the detail level
- Evaluate and modify banking structures prior to commencing the forecasting project
- Collect data that is recognized as consistent at each level of the organization
- Provide business users with necessary cash information via a web portal and make sure they know how to access it.
- Consolidate global cash flow data from disparate applications
- Standardize the way data is entered or interfaced from remote locations

How can remote subsidiaries be encouraged to participate in the process?

One of the most difficult aspects of a cash flow forecasting project is encouraging participation from business units, particularly those located remotely. However robust the technology solution, it will have no value unless the users of the system can utilize the system effectively. As we established earlier, the first step in achieving better participation from subsidiaries is support from Senior Management. Other ways of ensuring better participation include:

- Education of business unit users, not only on how to interact with the system, but more importantly, to understand the value of the data they are inputting to the organization
- Providing regular feedback to users on the accuracy of their forecast versus the actual cash position, and the value to the company (or cost) of high (or low) quality data

- Establishing a dialogue with users so that if anomalies occur, a telephone discussion can easily resolve or explain the issue
- Providing tools which are easy to use
- Linking users' compensation to high quality forecasts, in a similar way to sales, production or EBITDA targets.

Successful cash flow forecasting, particularly long term forecasting, is a combination of both technology and people. Achieving clarity, visibility and better decision-making cannot be done using systems alone, but by using technology as the link between those who originate the information and those who make decisions based on it.

Hopefully this article has provided you with some information to help you "See It More Clearly."

About AvantGard

SunGard AvantGard is a financial management software solution suite that allows corporations and financial institutions to manage cash coming in and out of the enterprise at every point along the financial supply chain.

AvantGard solutions give CFOs, treasurers, cash managers and credit and collections managers the tools to derive maximum value from working capital while also providing the capability to reduce risk. The suite helps automate and optimize the end-to-end financial supply chain by incorporating Treasury, accounts receivable and account payable for accelerated cash collection, improved payment cycle time and cash optimization on a global basis.

AvantGard's scalable, customizable solutions connect directly to corporations, banks, customers, partners and suppliers via a secure data connection and present aggregated financial data via an executive dashboard for maximum cash visibility and control.

For more information, visit www.sungard.com/avantgard

About SunGard

With annual revenue of $4 billion, SunGard is a global leader in software and processing solutions for financial services, higher education and the public sector. SunGard also helps information-dependent enterprises of all types to ensure the continuity of their business. SunGard serves more than 25,000 customers in more than 50 countries, including the world's 50 largest financial services companies.