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Cashflow and Forecasting Management

5 & 21 October 2015

Cash Flow Forecasting

- Process of collating cash flows from across the business
- Can be from one or more entities, in one or more currencies
- Goal is to create a picture of cash flow requirements or surpluses over a defined period.
- Simple concept – but one of the most challenging treasury function

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Cash Flow Forecasting

- Need to collate all treasury related in flows and out flows including:
  - Accounts receivable
  - Investments
  - Loans
  - FX and Derivative transactions
  - Accounts payable
  - Tax payments
  - Dividends
  - Salaries
  - Expenses
- This information is used to manage the group's working capital, liquidity and risk requirements

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Cash Flow Forecasting

Treasury's core objectives include

- Liquidity
- Risk
- Cost

A complete and accurate cash flow forecast is critical for each of these objectives.

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Liquidity

Cannot calculate / manage the company's liquidity without cash flow forecast information

- Cost implication if get them wildly wrong
  i. Implication of holding more cash than required
  ii. Implications of not providing enough

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Risk

- Cash Flow forecast used as basis for hedging risk
- If cash flow inaccurate – company may be under or over hedged which may actually add to risk rather than reducing. It may also have cost implications

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Cost

- Holding excess cash has both a financial and competitive implications – Company is not investing this in future growth

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Types of Cash Flow Forecast

- Cash flow forecast is critical to all treasury activities
- However type of forecast required may differ for different activities e.g.
  - i. Long Term Activity Planning
  - ii. Cash management
  - iii. Risk Management

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Types of Cash Flow Forecast

In this regard, in order to address these various cash flow forecasting needs, many companies create three or four different cash flow forecasts:

- Long Term Forecast (3-5 years strategic forecast)
- Medium Term Forecast (Annual or rolling 12 months)
- Short Term Forecast (Up to 30 days short term forecast)
- FX Forecast – (Annual or 12 months FX Forecast)

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Context of Cash Flow

- Nature, detail and time horizon of cash flow forecasts will vary according to the needs of each entity
- Essential that a business funds bank accounts each day to avoid failed payments, or invests surplus balances that would not otherwise generate a return
- Level of detail required will differ from company to company

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Challenges of Cash Flow Forecasting

- Is it possible to create timely, accurate cash flow forecasts
- Systems across organisation not being aligned and not reporting data in the same way
- Contributors motivation
- Contributors understanding

Dealing with Challenges of Cash Flow Forecasting

- Implementing modules of treasury management system or enterprise resource management that produce cash flow forecasts in required level of detail
- Integrate the TMS with other business systems
- Provide business units with a window into TMS
- Educating contributors from both central departments and business unties to the importance of cash flow forecast and the value to the business
- Align KPIs across the business so that contributors are motivated to provide cash flow information

Company Incentives

Make cash flow an important metric for measuring financial performance

Metrics:

- Targets for
  - Cash Flow
  - Net Working Capital Rotation
  - Return on Invested Capital
  - Returen on Capital employed
  - Economic Value Added

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Business Planning Cycles

- Makes sense and most effective to be align cash flow forecasting with the rest of business planning cycle
- Need to factor in working capital processes as can have a major impact on cash flow forecasting
- More centralised the better the timeliness, accuracy and consistency of cash flow forecast information

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IT Systems

- Specialist systems
- Integration
- Spreadsheets - Problematic!

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Cash Flow Forecasting Methods

- Consolidation
- Integration
- Extrapolation

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Extrapolation

- Key Statistical Methods
  - Moving average
  - Regression
  - Distribution
  - Seasonality
  - Heuristics
  - Modelling
  - Scenarios

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Scenario Forecasting

- Can be challenging
- Large number of contributors – motivation, experience
- Education and Communication is key
- Close work with IT an other departments to resolve data consistencies
- Keep it Simple
- Understand the data and check it personally

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Guidance to Preparing Cashflow Forecasts

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Purpose of a Cashflow:

- To Plan and Manage Income and Expenditure.
- Identify what your future bank balance is going to be over a set period of time.

Good Practices for Cashflows:

- Update running balance regularly – minimum monthly.
- Projections to be a minimum 12 months in advance.
- Forecast can be as simple or as complicated as business needs dictate.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

- How often management should update a forecasted cashflow is dependent on the financial security of the business.
- If the business is struggling the business should be forecasting and revising cashflows on a daily basis.
- If the finances of the business are stable then forecasting and revising cashflows weekly or monthly is enough.
- External stakeholders, such as banks, may require regular forecasts.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

- Methods of Cashflow Forecasting:
- Direct Method: Scheduling of a businesses cash receipts and disbursements.
- Indirect Methods:
- Adjusted Net Income Method: Begins with Operating Income then adds and subtracts changes in the balance sheet, such as Receivables or Payables to project cashflow.
- The Pro-Forma Balance Sheet Method: Creates a projected cash book account. Cash projections will be correct if other balance sheet accounts have been correctly forecast.
- Accrual Reversal Method: Similar to Adjusted Net Income Method however accruals are reversed and cash effects are calculated using statistical distributions and algorithms.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

5 steps to preparing a Cashflow Forecast:

1. Prepare a list of Assumptions.
2. Prepare anticipated Sales Income.
3. Prepare a list of Other Cash Inflows.
4. Prepare a list of Expenses.
5. Bringing it all together.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Prepare of list of Assumptions:

- Forecasts are driven by Assumptions – Must be appropriate to the business.
- Base Assumptions on Research, Past Performance, Correspondence with Suppliers and Customers.
- Consider Impact of Seasonality, Timing and Quantum of price increases for your business and suppliers, provision for wage increases, provision for general cost increases.
- Listing the assumptions with the forecast adds credibility to the forecast.
- Refer to the assumptions when comparing actual results.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Prepare Anticipated Sales Income:

- Can you compare previous years sales? Take one-off sales into account or developing relationships with your customers.
- Refer to your market research – what sales are your competitors making?
- Identify Internal and External Factors that may effect Sales – make adjustments for these factors.
- When will payment be received for sale? What are your credit terms? Will everyone pay on time?

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Prepare a list of Other Cash Inflows:

- Capital Invested – Issue of Shares.
- Directors Loans.
- Bank Lending.
- Grants.
- Tax Rebates.
- Sale of Assets.
- Insurance Claims.
- Royalties / Commissions.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Prepare a list of Expenses:

- Consider Direct and Indirect Expenses.
- Payments to Suppliers – What are their credit terms?
- Wages and Salaries.
- Purchase of New Assets.
- Loan Repayments.
- Directors drawings.
- Tax Payments.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Bringing it all together:

- The forecast is a rolling calculation: Opening Balance + Inflows – Outflows.
- Test the Cashflow with what-if scenarios.
- Determine the businesses margin for error.
- Compare Projections with last years actual performance.
- Compare the Projections to this years figures while updating the forecast and Adjust when appropriate.

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GUIDANCE TO PREPARING A CASHFLOW FORECAST

Bringing it all together:

Simple Example:

Month	1	2	3	4	5	6
Opening Balance	€1,000	€6,000	€11,000	€21,000	€36,000	€51,000
Inflows	€20,000	€ 20,000	€ 30,000	€ 40,000	€ 40,000	€ 40,000
Outflows	-€ 15,000	-€ 15,000	-€ 20,000	-€ 25,000	-€ 25,000	-€ 25,000
Closing Balance	€6,000	€11,000	€21,000	€36,000	€51,000	€66,000

Month	7	8	9	10	11	12
Opening Balance	€66,000	€81,000	€91,000	€101,000	€111,000	€121,000
Inflows	€ 40,000	€ 30,000	€ 30,000	€ 30,000	€ 30,000	€ 10,000
Outflows	-€ 25,000	-€ 20,000	-€ 20,000	-€ 20,000	-€ 20,000	-€ 15,000
Closing Balance	€81,000	€91,000	€101,000	€111,000	€121,000	€116,000

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Business Cashflow Analysis

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BUSINESS CASHFLOW ANALYSIS

- The key to any successful business plan is the cashflow projections which will show the expected cash inflows and their expected returns.
- The projections need to be realistic and need to be in line with other businesses in the same industry.
- For that reason it is advisable to get someone with experience of business plans in your industry to assist you.

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BUSINESS CASHFLOW ANALYSIS

Understanding how to read the Cashflow Statement:

- Analysis of how a business has earned it's money and spent it's money! And the Projections are how it intends to earn and spend next year.
- Is there money in the bank at the end of the month? Is there liabilities you should have paid/accounted for?
- Use the cash flow statement to check off your purchases v's payments and sales v's lodgements/receivables.
- Identify your Working Capital requirements.

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BUSINESS CASHFLOW ANALYSIS

Working Capital:

- The amount of money needed to facilitate business operations and transactions.
- Working Capital is calculated as current assets less current liabilities.
- Quick analysis of the liquidity of the Company: How capable the business is of generating cash from their current assets, or at least, generating the cash required to pay the businesses current liabilities.
- Cashflow projections become more important for a business with insufficient cashflow.
- Working capital funds the general operations of a business.

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BUSINESS CASHFLOW ANALYSIS

Difference between earnings and cash:

- A large turnover or profitability doesn't necessarily mean a business has sufficient cashflow.
- Businesses close because they cannot pay their bills/creditors.

  Examples:

  Invoice large sales and incur costs in relation to sales but can't get paid.

  Vicious circle in the downturn in the Construction Industry.
- Cashflow: Shows Cash Inflows and Outflows.
- Profit and Loss Account: Sales and Expenses

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BUSINESS CASHFLOW ANALYSIS

Cashflow from Investing:

- Capital Expenditure for Plant, Property and Equipment, Business Acquisitions, the Purchase of Investment Securities, etc.

Cashflow from Financing:

- Borrowings and repayment of the debt.

Cashflow from the Issues of Shares:

- Share Capital and Dividend payments.

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BUSINESS CASHFLOW ANALYSIS

Ratio Analysis of Cashflows:

- Operating Cash/Sales x 100:

  Percentage of cash generated for business per Euro Sales.

Is the business recovering the full value of sales in cash?

Why is it not?

Who is not paying? Why are you selling to people who are not paying?

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OTHER FINANCIAL STATEMENTS

Cashflow cannot be looked at in isolation:

- Profit and Loss Account
- Balance Sheet
- Ratio Analysis

All must be combined to form a comprehensive picture of the businesses performance.

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Managing Cashflow to Avoid Business Failure

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

- First Step in Managing the Cashflow of the business is preparing the cashflow projections, and maintaining it.
- Badly prepared cashflow will be of little use in identifying a business needs – Ensure the cashflow is as accurate as possible.
- Use prudent estimates – Overestimate Payments & Underestimate Income.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

- Cashflow Projections allow you to see at any point what your bank balance is going to be.
- If your bank balance goes below zero then your cash flow projections are alerting you to critical times where you are running out of funds or credit.
- Definition of Insolvency: Not being able to pay your bills as they fall due.
- Section 214(a) of the Companies Act 1963 – 21 day notice prior to application for the winding up of a Company.
- In general, it's not a good strategy to drag out payments to creditors if you haven't got approval from the creditors.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Know your Timelines:

- What is your suppliers credit terms?
- When are your debtors due to pay you? Remind your debtors.
- When are your taxes due to be paid? Avoid Interest and Penalties.
- Don't write cheques when there is no funds available.
- Does your business have a peak/low season?

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Independent Verification of Cashflows:

Professional Advice:

- The business should engage an accountant who is proficient in preparing cashflow forecasts to prepare or review the businesses assumptions, cashflows projections and advice of errors.
- Prepare answers to queries that may be raised by stakeholders.
- Take advantage of an accountants industry knowledge and general business knowledge over a wide range of industries.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Using the Cashflow Projections to Plan Strategically:

- Strategic Plans cannot be made without knowing if the cash is available to implement the strategy.
- Strategy may be expansion – Costs of Expansion – Refer to your Business Plan.
- Strategy may be contraction – Contraction also comes with costs. i.e. redundancy.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Planning Pitfalls when Forecasting Cashflows:

- Overstating Sales Forecasts.
- Underestimating Costs and potential delays.
- Ignoring historic trends.
- Making unduly-optimistic assumptions.
- Seeking spurious accuracy whilst failing to recognise matters of strategic importance.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Monitoring of Cashflows:

- Cashflows must be maintained regularly. If they are not up to date they can't help you.
- Cashflow performance should be discussed a management/staff meetings – Is there a delay with payment or is there an error in the assumptions?

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

- What to do when your cashflow falls below zero?
- Review were savings can be made.
- Attempt to speed up payments from debtors.
- Consider additional funding options.
- Concentrate your resources to most essential activities.
- Prioritising creditors essential to the continuation of the business.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

- Should the business continue to trade?
- Will the position of the creditors be worsened by the business continuing to trade?
- Is there a plan in place to return the business to profitability?
- Is the business able to enter a formal or informal arrangement with it's creditors?
- Scheme of Arrangement / Examinership / Liquidation
- Informal Write Downs of Debt / Personal Insolvency Arrangement

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Talk to your creditors:

- Is there a possibility of additional credit time/amount?
- Explain your difficulties.

Settling Debts / Liabilities:

- Consider agreeing write downs on debtors owed to the business.
- Request full and final settlements from creditors that are affordable.

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MANAGING CASHFLOW TO AVOID BUSINESS FAILURE

Fully consider all material decisions:

- What is the reputation damage from a decision?
- Will the business be able to continue to trade?
- Will the business/directors be able to attain creditor in the future?
- How will the creditors be effected?
- How will your staff be effected?

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Methods of Improving Cashflow

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METHODS OF IMPROVING CASHFLOW

Payment Periods:

- Set your credit terms around your suppliers terms. Ideally you get paid before your payment is due with the suppliers.
- Is payment upfront possible?
- For long/substantial contracts – request a deposit.
- Ask for a retainer.

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METHODS OF IMPROVING CASHFLOW

Payment Periods:

- Consider offering an early payment discount. It may be more valuable to the business to accepted a discounted amount early.
- Supplier offers: Consider the consequences to the businesses Cashflow:

  Bulk Purchases – Storage and Time to sell the products.

  Early payment discounts: Will you have sufficient cashflow if you make an early payment to suppliers.

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METHODS OF IMPROVING CASHFLOW

Terms of Service:

- Have your customer complete a credit application or an engagement letter.
- Request a personal guarantee in writing from the directors/business owners.
- Include a Retention of Title Clause:

  All Monies Clause: The stock remains the property of the supplier until such time that all monies owing to the business are paid in full.

  Simple Clause: The stock remains the property of the supplier until such time that this invoice is paid in full.

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METHODS OF IMPROVING CASHFLOW

Separate Sales from Debt Collection

- Sales Team will look to build relationships with your customers.
- Good relationships will generate sales, and hopefully payment.
- Set credit limits.
- Debt Collection Team will need to be firm and diligent in order to collect the debts.
- Debt collection should be organised and contain full back up to all debts.
- Take note of all contact or efforts to make contact.

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METHODS OF IMPROVING CASHFLOW

Know your customer:

- Links in with Anti-Money Laundering legislation:

  The Criminal Justice (Money Laundering and Terrorist Financing) Act 2010.

- Do a CRO Search!

  Review their last filed accounts!

  Are they on time with their CRO filing?

  Do a Judgment Search!

- Are they a Limited Company/Soletrader/Partnership.

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METHODS OF IMPROVING CASHFLOW

Debt Collection:

- Customers should order with a purchase order number.
- Work orders should be sent in writing.
- Delivery dockets should be signed.
- Issues with deliveries or orders should be in writing (as part of your terms of service).
- Warranties should be defined clearly.
- Take action if payments are not forthcoming.

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METHODS OF IMPROVING CASHFLOW

Business Wide Communication:

- Sales Team, Management Team and Debt Collection Team must be in sync.
- If a decision is made by the Debt Collection Team it must be implemented by the business as a whole.
- No benefit in the Debt Collection Team threatening to refuse service if the Sales Team continue to send out.
- Not all customers are treated evenly. Are you going to stop service/risk losing a customer over a small outstanding debt? The business as a whole must be involved in a decision.

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METHODS OF IMPROVING CASHFLOW

Take Action against Debtors who don't pay:

- Enforce your Retention of Title Clause – take your stock back.
- Take legal action – be aware of costs of legal action. Way up the gains v's the costs.
- Build a reputation for your stance on debt collection.
- Avoid making Idle Treats – follow through with a treat.
- Consider a Section 214 letter to wind up the Company.

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METHODS OF IMPROVING CASHFLOW

Stock Control:

- What is the businesses Operating Cycle?
- Avoid holding stock for long periods of time.
- Ideally you will have sold and been paid for stock before you have to pay for it.
- Operate a stock rotation system, First In First Out. Avoid stock wastage from out of date stock.

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METHODS OF IMPROVING CASHFLOW

- Beware of becoming over reliant on promotions:
- Marketing through special offers that are not sustainable. Such as Living Social / Pigsback. Is the promotion profitable for the business?
- Will your customers begin to only purchase when they are receiving a discount or during a promotion?
- Will the new customers attracted by the promotion improve your reputation as a whole?
- Restaurants received complaints and poor reviews over customers not reading/agreeing with the terms of a promotion.

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METHODS OF IMPROVING CASHFLOW

- Beware of Overtrading:
- Know your limitations.
- Stretching a business trying to expand too quickly could result in its downfall.
- Assess if you have the capacity to complete an assignment before agreeing to it.
- Consider the level of training and hours being worked by staff prior to agreeing an assignment – avoid burnout.

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Final Thoughts

- Refer to your original business plan and strategy to ensure the business is keeping on track.
- Ensure your cashflow projections are as accurate as possible.
- Ensure your cashflow statement is updated as regularly as the business requires.
- Consider the consequences of your business decisions.
- Get a second opinion on your strategy and projections before making a business decision.

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Thank you!

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