



A CFO's Guide to Optimal Cash Flow Planning

Moving Beyond Stand-Alone Spreadsheets for
Forecasting Cash Needs



CFO
An argyle Company



Introduction

Cash remains king, providing well-funded companies with opportunities that capital-strapped organizations are forced to pass up. While cash fuels growth, there is a flip side: too much cash on hand is a sign that your cash flow planning processes need some tweaking.


While CFOs live in their profit and loss statements and their balance sheets, these only provide a look in the rear-view mirror. Organizations need to focus on what lies ahead. Stand-alone spreadsheets may provide a comfort zone for the finance team but they have significant limitations in terms of accuracy and timeliness and they aren't efficient forecasting tools.

Progressive finance chiefs keep their eyes on the road in front of them. An organization's cash flow plan – including a solid revenue forecast and a budget for expenses – should be a future-looking exercise with metrics along the way to track progress.

It is the job of the senior finance executive to instill organization-wide financial discipline and develop a comprehensive working capital optimization strategy. While this should be “table stakes” for a CFO, many companies lack the ability to predict their cash requirements to enable timely, data-driven decisions.

The finance team must collaborate with business leaders to assemble accurate forecasts and plan for future billings, collections, payables, costs, and expenses. Having a detailed cash roadmap empowers CFOs to manage debt effectively and plan for the use of excess cash.





This white Paper will look at the role of CFOs in developing comprehensive cash management strategies that are clearly communicated throughout the organization, plus the modern tools needed to optimize cash management. It includes:

1

Reasons to make cash flow planning a priority.

2

An overview of best practices for cash flow planning. How often should you forecast? How far into the future do you need to plan? What is the appropriate level of detail?

3

How can CFOs foster a culture of cash flow management throughout their organization?

4

The cash planning tools senior finance executives need to fund new projects, manage debt, maximize interest income, and minimize unproductive cash.

5

The strategies for measuring success.



Why cash flow planning matters

Organizations tend to focus on cash flow planning when money is tight. When cash is plentiful, there is frequently little need or desire to focus on cash optimization, as there is minimal return on the effort to change cash management practices.

But even in good times, there may be pockets of cash shortages and surpluses due to inadequate cash flow planning, experts noted. “Every organization has both short- and long-term cash flow needs,” said Kenneth Fick, Senior finance leader, MorganFranklin Consulting.

Good cash management planning requires organizations to match their various sources of funding to their capital needs. “Organizations with good cash flow planning will require less short-term borrowing or have less excess cash in bank accounts spread throughout their geographic footprint,” Fick noted.

Some key indicators of suboptimal cash flow planning include:

- Excess cash over required minimums in multiple non-interest-bearing bank accounts.
- Use of short-term borrowings to meet operational expense needs.
- Error-prone invoices.
- Lack of follow-up on collections.
- Missed vendor discounts or trade spend initiatives.

If there is a wide disparity between cash flow projections and actual cash flow, it is time to take a serious look at the issue. “If you compare your cash forecast with what actually is happening to your cash position, and the forecast is wildly off without some unexpected, short-term event as the cause, an examination of your cash flow plan is in order,” said Paul Barber, Co-Founder of Prophix, a global leader in financial performance management.

A lack of information, or inaccurate information, about the company’s cash position will harm the finance chief’s credibility.

“As the CFO, if you’re unable to answer questions about what has happened to the cash and what is about to happen to the cash, you have a cash flow planning problem,” said Philip Campbell, author of **A Quick Start Guide to Financial Forecasting and Never Run Out of Cash**. He is also a CPA and the Senior Vice President of Planning at AMCON Distributing Company, a distributor of consumer products.



Best practices for optimizing cash flow

You've done some digging, and the signs that your cash flow planning needs an overhaul are staring you in the face. How can you improve? Examining how frequently the organization performs cash flow planning, and who is involved, is a good start.

How often an organization forecasts its cash needs and how far into the future, depends on the company, industry, and current business climate, among other factors. However, organizations that succeed at cash flow planning make it a collaborative effort. "Cash forecasting is not something that finance can do alone," Barber said. He noted that finance teams need to work with business leaders to determine some of the most volatile expenses and how often they change. "If your business has a good number of long-term contracts with predictable payment terms with a high degree of vendor compliance, quarterly cash flow planning may be appropriate," said Felix Mann, Senior Manager, Business Solutions Group, Prophix. "But if the business is less predictable, or in a start-up or high-growth mode, taking the pulse of the cash flow on a monthly, weekly, or daily basis at some points may be necessary."

A general rule of thumb is to have a three-to six-month forecast that provides a high-level view of cash needs. Mann said that farther-out forecasts can sacrifice accuracy. However, the business cycle of the industry plays a role in determining cash forecast

frequency. Understanding how long your organization's business cycle is and what key line items are affected will determine the rolling forecast time horizon.

The level of detail in a cash flow plan should correlate to the level of flexibility and insight it will provide, Fick said. "If the external environment is very certain and expenses can be easily quantified to the general ledger line item, then a G/L level forecast may be appropriate. For most organizations, a semi-detailed summary level forecast is sufficient."

In terms of metrics, monitoring days sales outstanding (DSO) and days payables outstanding (DPO) – and days inventory on-hand (DIO) for companies that carry inventory – can help track and measure enterprise cash flow and make tactical changes to keep key performance indicators in line with goals, Fick noted.

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Paul Barber
Co-Founder, Prophix

Tools to improve cash flow planning and culture

While understanding the factors that influence cash flow is important, it is also essential to have the appropriate technology in place to provide visibility and seamlessly share information to ensure that cash flow forecasts are informing strategic business decisions.

Progressive organizations are migrating from spreadsheet-driven processes to comprehensive corporate performance planning tools. While spreadsheets are sufficient for some tasks at smaller organizations, too many spreadsheets make the cash flow planning process difficult to manage and update with the latest data as the company grows.

Cloud-based solutions are essential for modern finance teams, Prophix's Barber noted, as there needs to be a link between cash flow planning tools and the company's CRM and sales management systems. "This provides an early warning sign of activities, such as a large contract or a drop in sales, that will impact cash flow."

Dashboards provide a powerful visual tool to provide leaders across the organization with an understanding of the importance of diligent cash flow management.

Specific metrics that are important to the organization's cash flow should be included in a dashboard and shared with the leadership team, Campbell said. "The dashboard should focus on the top three to five drivers of profitability. Sharing goals, targets, and cash flow projections with people who can make a difference can help shift the cultural view of cash."

Senior managers need to reinforce the company's commitment to cash flow metrics and management. "Everyone in an organization should be asking themselves, 'What are the cash implications of this decision?'" Fick said.





Conclusion: Measuring success of your cash flow planning

A critical measure of cash flow planning success is the level of confidence that senior executives have in the forecast. “One of the most important signs that your cash flow planning is on target is that senior management is relying on the accuracy of your cash flow planning to make important strategic business decisions,” Campbell said.

Companies don’t invest in a new product or purchase expensive equipment unless they are sure that they will have the necessary cash.

While no cash forecast is going to be perfect, it is critical that it be aligned with the company’s overall objectives regarding its cash position. “If you want the least amount of cash held in the business, success will be one thing, but if you want to minimize the organization’s weighted average cost of capital, then portfolio optimization may be the best measure,” Fick noted.

Optimal cash flow planning requires the right tools, focused metrics, and an organizational culture that emphasizes the importance of cash flow planning for better decision-making and higher returns.



Key takeaways include:

While cash flow planning tends to get overlooked when capital is plentiful, savvy organizations know that superior cash flow management results in less short-term borrowing and a reduction in excess cash in bank accounts spread throughout their geographic footprint.

Spreadsheets and other manual processes for cash flow management do not provide the visibility and accuracy needed to forecast cash to inform strategic business decisions. Cloud-based systems and visual dashboards offer a snapshot of the company's cash position, as well as a view of the future.

Organizations that make cash management a priority are better positioned to take advantage of changing market conditions that require investments in equipment and other capital-intensive initiatives, as well as to optimize the return on excess cash.

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