Improving cash and working capital management

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KPMG Lower Gulf
Managing cash remotely and making it last

The Covid-19 pandemic’s impact on the global economy continues to grow, curtailing the ability to conduct business as usual. More than ever, effective cash management is a vital practice.

Cash management can sound laborious and complex, involving huge spending on things such as information technology. However, it doesn’t have to be this way if you take a creative approach. There are four fundamental steps to building a robust cash management process and safeguarding the future of any business, regardless of the industry it operates in or its size.
Discipline

1. Establish a detailed 13-week rolling cash forecast to identify shortages as early as possible.

2. Conduct weekly variance analysis of cash flows, understanding the reasons for variation, whether due to timing or permanent.

3. Create a weekly accountability process, with participation by all function heads and aligned KPIs. Cash flow management should not just be the responsibility of the finance function.

4. Engage early with financiers to address any forecasted deficiencies and take appropriate steps to retain control of the situation.

5. Monitor and analyze the internal credit risk and initiate measures to obtain information about any of your cash pool members’ financial difficulties. This should be done in due time to avoid tainting in case of going concern problems.

Focus on the basics

1. For trade receivables, check if appropriate processes are in place so that clients are invoiced in a timely manner, in accordance with contract terms, and that there are robust credit controls in place. Use analytics to understand customers’ payment behaviors and take proactive measures to align behaviors with contractual terms. Consider whether to extend or set up receivables factoring and reverse factoring programs. These can be set up quickly (within 2-4 weeks) by using digital platforms rather than bank programs to unlock cash and deploy more rigour in the cash collection process.

2. Address slow-moving, obsolete stock. Critically examine forecast production requirements, the need for buffer stocks and SKU assortment, and avoid tying up cash in unproductive inventory.

3. Consider working capital needs in the context of overall business requirements for the weeks, months and years ahead and closely track working capital KPIs. Consider your working capital strategy holistically. For example, a decision to change payment terms with your suppliers may have a significant impact on their quality of service, affecting inventory levels and thus the quality of service to customers. That said, in our experience, most businesses are able to drive improvement and unlock cash from at least one, if not two, areas of the working capital cycle. These include trade receivables, inventory and trade payables.

4. Ensure that trade payables are paid only in accordance with contract terms. Avoid daily payment or ad-hoc payment runs. Consolidate these on a weekly or fortnightly basis. Consider your market leverage, and seek a mutual extension of payment terms to suppliers. At the same time, remain aware of the risk of supply chain disruption at your supplier level caused by their own financial health. Make use of supplier finance programs to release cash earlier to suppliers and ensure continuity of supply and service levels.

5. Monitor covenants of your financing activities, simulate stress scenarios for covenant breaches, and define an action list for potential covenant breaches.
Go beyond the basics
1. Review trapped and illiquid cash within the group structure. Make use of treasury pooling structures, to make more effective use of available cash within the group.
2. Review the opex and capex and consider leasehold/rental as an alternative, deferring significant capex outlays or releasing cash through sale and leaseback.
3. Review the tax efficiency of operations, making use of any opportunities to defer or reduce payment of tax. Ensure any potential refunds are pursued.
4. Review all other non-trading contracts/commitments that have a cash requirement over the months ahead and reconsider their necessity.

Think strategically
1. Make cash management a boardroom priority. For leading global businesses, effective cash management is a top priority.
2. Increase the centralization of finance activities in the treasury headquarter to make use of the full group scale, rather than allowing fragmented local solutions: cash and liquidity management, bank relations and payments.
3. Understand if your business model fully considers cash requirements. For example, examine the markets you operate in, the products and services you sell, and the channels these products and services are distributed through. To preserve cash, many businesses are looking to rationalize their product assortment and the markets in which they operate.
4. In reviewing and developing your cash management strategy, develop clear metrics for cash and working capital. Understand that corporates within the same industries may have very different cash management strategies depending on stakeholder requirements, brand positioning and ethical considerations, amongst other factors. For example, one corporate may pay their suppliers on 120-day terms, because it drives significant cash flow upside, whereas another corporate may choose to pay every 30 days, because they believe it is ethically important to pay suppliers in a timely manner.
5. Make use of funding and liquidity products provided by financial institutions and fintechs. These can help accelerate the achievement of strategic goals.
The importance of cash
Cash is key to the survival and growth of any business. Gaining visibility and control of cash flow and optimizing working capital can help a business do the following:

- Provide a buffer against unexpected market shocks
- Realize post-deal cash synergies
- Release cash for shareholder distribution
- Release cash to deal with rising costs
- Debt repayment and lower the cost of borrowing
- Fund growth without raising new funds
- Increase valuation of business
- Fund capex and/or acquisitions
- Improve valuation of business
Better understand inefficiencies through use of technology and analytics

Identification of cash management inefficiencies can be likened to finding needles in a haystack. Making sense of them, once found, is even harder. Very often, without the right information, perceptions of cash management performance could be very different from the reality.

In this new world, we are increasingly making use of technology and analytics to mine data, identify opportunities and problems, understand root causes and develop a plan for improvement. The root causes of inefficiencies can be attributed to four areas:

- **Policies, controls and processes** that are not aligned to overall strategy and/or no longer fit for purpose.
- **Systems** that are not flexible and don’t enable timely, accurate and insightful management information.
- **Culture**: A strategy and KPIs that drive the wrong behaviors around cash management. For example, sales teams that are incentivized by revenue targets but not cash collections, or lack of accountability.
- **People**: A lack of awareness around the importance of cash management and limited skills or understanding of what is required.

Without understanding the root causes of problems and confront them, issues will likely remain unaddressed until the situation reaches a critical stage, especially if focus is directed elsewhere.