PRIVATE EQUITY PERFORMANCE IMPROVEMENT

# Creating a Cash Culture: A CFO's Guide to Leading in Uncertain Times

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As the pandemic continues to drive economic instability, it's imperative that management teams, led by the CFO, focus on cash management to meet the unforeseen trials; weather the current crisis; and position organizations to invest in growth opportunities as the economy recovers.

CFOs have a unique position within the organization that allows them to drive the creation of a cash culture, arming a company with new strategies to bolster liquidity and meet extraordinary challenges in the current economy. A cash culture requires speed, intensity, and focus on improving liquidity in all aspects of the business and embedding cash flow optimization in all decision-making processes. The CFO must provide energetic leadership to ensure alignment throughout the organization; drive performance culture to increase cash flow and succeed in these times; and unite the management team and employee base behind this mission.

## Cash is King

Cash is the lifeblood of any business, and the CFO must communicate that message relentlessly. Particularly during these times, every decision must consider the impact on the company's cash flow — whether that's determining a new customer's payment terms, financing capital expenditures, or filling a position. Everyone in the organization must understand and buy into the goal: optimizing cash flow. Ultimately, the CFO can't make every decision, which is why creating a cash culture is a necessity.

To adopt the "cash is king" mindset entails shifting management focus from only EBITDA to equal importance on cash. While team incentives are generally tied to EBITDA (which is appropriate during a period of growth), EBITDA is not cash flow because of its exclusion of such items as capitalized expenditures or changes in working capital that often fail to provide an accurate picture of a company's cash flow. Moreover, Adjusted EBITDA contains exclusions such as credit agreement driven adjustments that often impact cash yet are excluded from the calculation. Ideally, to ensure everyone in the organization is in sync, the incentive program would incorporate a new emphasis on cash management. With incentives aligned, each decision will be evaluated on the basis of improving cash flow. In this new environment, leadership will also have the opportunity to revisit dated assumptions and evaluate improvement opportunities.

Implementing a cash culture should be a holistic endeavor, impacting every area of the organization. A robust cash flow forecasting process and working capital improvement initiatives

serve as a starting point in developing a cash culture. These actions quickly improve cash flow and may be a springboard to developing a broader cost transformation program. However, improving working capital to cash must evolve from “project” to “process” to effectively transform the culture. The focus must be a part of the everyday activity and not just another side task. The benefits will show up in a naturally nimbler organization, improved capacity to absorb swings in demand, and the ability to fund growth initiatives.

## Recalibrate Cash Flow Forecasting

The CFO’s main tool to manage liquidity is an accurate cash flow model. Building a reliable cash flow model begins with three actions: understanding the business top to bottom; data driven analyses to support all key assumptions; and obtaining stakeholder buy-in. Additionally, the model needs to be capable of dynamic scenario planning that would allow the CFO to evaluate multiple cases. This will arm the CFO with the necessary data to make key decisions, drive accountability, and protect liquidity in these uncertain times.

A CFO should focus on the following items to ensure a robust cash flow model:

- **Ownership.** Step out of the finance department and engage the rest of the business. Ensure department leads understand the focus on cash and their role in achieving the forecast. Additionally, solicit their feedback on potential cash flow improvement opportunities. The best ideas typically sit outside the finance function.
- **Accounts Receivable (AR).** Don’t rely on current sales forecasts because they’re likely based on past assumptions of recoveries during historic downturns – the current crisis is unparalleled. Even if the organization is hitting the sales forecast, customers may not pay within stated terms, and a plan must be developed to quickly identify and resolve these issues.
- **Inventory and Demand Planning.** Identify leading indicators of changes in demand. A well-run S&OP meeting with cross functional buy-in should drive improved purchasing decisions. Reducing the amount of capital tied up within inventory is critical to improving cash flow.
- **Outliers.** Department heads should be on the lookout for any outliers that may throw a wrench in the cash flow forecast. These may include significant one-time expenses, such as a legal settlement or a customer signing bonus.
- **Hidden Cash.** There may be hidden cash in unimaginative areas such as insurance, risk management or accrued liabilities. The more forensic you are, the more accurate your forecasting and the more the organization appreciates the sense of urgency.

One of the most important steps CFOs can take is commanding the attention of organizational leadership. Once the heavy lifting of developing an accurate cash flow forecast is in place, creating a weekly process is critical to review the results, align key executives and drive accountability. Management needs to own the new cash culture, and the frequent report cadence will galvanize the team’s focus on achieving the forecast and ultimately improving liquidity.

The end goal is a reliable forecast that management uses for all key decisions. If done well, it will improve leadership's ability to immediately understand the cash implications of every decision, and this timely, data-driven practice will evolve into the organization's operating rhythm.

## Working Capital Improvement to Drive Culture Change

With an accurate cash forecast in hand, the CFO must develop a working capital improvement program that will unlock cash; allow the organization to quickly adapt to varying levels of demand; and capitalize on opportunities in the market. This is a two-pronged approach: A tactical, short-term plan to quickly free up cash, and a strategic plan for long-term, sustained improvement.

***Near Term Improvements.*** Quick wins will energize management and build momentum for more challenging improvements.

- **Order to Cash:** This unbroken chain — from booking sales to receiving payment — typically has areas for improvement. By shortening this timeline, organizations can speed up cash flow and trim costs, while also improving customer service. Communicating to the team what a day of days sales outstanding (DSO) equals to dollar benefit is an easy way to motivate them to reduce cycle times. One simple example of shortening the timeline can be seen by employing automatic invoicing that reduces time consuming manual processes.
- **Inventory Management:** Performing a rapid evaluation of inventory levels and segment into slow, medium, and fast-moving segments. For slow and medium segments, evaluate the appropriate level of safety stock required to meet customer demand and align purchasing decisions accordingly. By simply reducing order quantities of slow-moving inventory, the company will be able to unlock meaningful cash trapped in inventory.
- **Procure to Pay:** Implementing this tactic can expose inefficiencies and aid in managing suppliers in a more effective, and cost-saving way. Ideally, all supplier, contract, compliance and other procurement tasks operate under one umbrella. Using automation and management systems software, organizations can track and analyze a large spectrum of payment terms, looking for money-saving efficiencies. Management can spot opportunities for contract negotiations, improved supplier competition and other benefits. Keep in mind, communication is key to working effectively with vendors, to negotiate better terms over time, and to avoid any potential disruptions to the business.

***Strategic Improvements.*** These actions will benefit the company over the long term and keep it agile in order to capitalize on other opportunities.

- **Sales and Operations Planning:** Double down on improving sales and operations planning to ensure your organization meets customer demand efficiently. This means evaluating every step from sales to procurement to distribution in order to find opportunities to improve cash flow. It requires significant cross functional alignment to accomplish but can produce real results.

- **Margin and Cost Transparency:** Understanding where the business is making and losing money is a critical starting point to determining the root cause of liquidity issues and to creating meaningful change. Current margin profiles and breakdown of labor and non-labor costs must be clearly understood via transparent baseline leveraging the cash flow model. Significant improvements in cost structure require utilizing this analysis to change how the business is managed through a comprehensive and holistic approach.

## Conclusion: CFO Leadership Critical to Implementing a Cash Culture

Uncertain times create challenges but they also create opportunities and CFOs are uniquely positioned to capitalize on this period to implement a robust cash culture and drive performance improvement. To that end, strong leadership is critical to rallying the entire organization around this new mindset: “cash is king.” The CFO’s enthusiasm, focus, and authenticity around this message must be felt from the management team to frontline employees. Success will come from developing an accurate cash flow forecast and corresponding timely cadence, driving cash flow improvements, and efficient capital allocation. Done well, this endeavor puts management in a position to not just weather the storm but to create a sustainable competitive advantage during an unstable time.