SAP Executive Insight
Leadership in Times of Crisis: A Series

MANAGING CASH FLOW IN TIMES OF CRISIS

SOLUTIONS FOR IMPROVING CASH AND LIQUIDITY MANAGEMENT

Cash is the lifeblood of any business, and with the turmoil in the financial markets, many companies are struggling to ensure the cash flow and liquidity needed to maintain normal operations. Once primarily the domain of cash managers and treasury managers, today's critical cash-flow and liquidity concerns are demanding executive-level attention.

With credit restrictions and an overall decline in demand for most goods and services, chief financial officers are witnessing business drivers change from sales growth to liquidity coverage – and from return-on-capital-employed to cash-to-cash cycles. Now, liquidity flexibility must be protected first and foremost. Long-term goals will not be achieved if short-term liquidity obligations cannot be met.

Against this backdrop, most companies must increasingly depend on their commercial cash flows to sustain operations. This has critical implications for executives across all industries and geographies. By answering the following questions, this *SAP Executive Insight* explores specific actions companies can take to ensure high cash-flow velocity and vital liquidity:

- How can I protect the health of my commercial cash flows?
- How can I gain better visibility into sources and uses of cash?
- How can I increase control over my global cash balances?

EXECUTIVE SUMMARY
AT A GLANCE

Protect Your Cash and Liquidity

With the global economy in crisis, companies are seriously challenged to maintain desired profit margins and generate the cash and liquidity required to fund normal operations. There are strategies, however, that can help you cope:

- **Ensure healthy cash flows.** Because it is the company's primary source of cash, you must manage your accounts receivable to make sure that the amount and timing of critical cash flows are not compromised. For example, you can accelerate the cash conversion cycle with process improvements that streamline the receivables cycle.
- **Gain greater visibility into the sources and uses of your cash**. Get a complete view of your entire financial value chain. The resulting insight can improve your ability to forecast cash and optimize overall cash management.
- **Increase control over cash on hand.** Manage the cash you have to provide maximum value for your business. Such control, however, is particularly challenging for companies with global operations that have cash balances fragmented across many banks in different geographies. Get better connected to your banks, and pursue the best cash strategies for your company.

The right technology can help your company achieve these objectives by streamlining the critical business processes that keep your cash flowing.

Leadership Makes the Difference in Times of Crisis

One thing is for sure: with every economic crisis comes opportunity. Some companies will go from good to great, and others will just fade away, making room for more innovative competitors. To be among the winners, executives should strongly consider best practices that provide a balanced approach to moving forward by including both cost reductions and smart investments. SAP has developed a series of *Executive Insights* that highlight strategies your business can use immediately to run more efficiently and improve the customer experience – even in today's economy.

Benchmarking – The Facts of the Matter

The insights presented in this paper are based on decades of experience in helping our customers become best-run businesses. An important tool in these efforts is the understanding gained from measuring and comparing the actual performance of companies across a wide range of sizes and industries.

SAP conducts benchmarking and best-practice studies in many business areas. Analyzing the performance of industry leaders offers executives the metrics needed to assess their own company's past successes and guide today's crucial decisions. For example, benchmarking reveals that companies with the capability of making real-time credit decisions have on average 40% lower days sales outstanding (see the figure). In addition to financial best practices, executives would be well advised to consider the efforts in recent years to optimize the physical supply chain. Cash cycles have similar upstream and downstream implications.

For more information about the SAP® benchmarking and best-practices program, visit www.sap.com/usa/solutions/benchmarking or contact benchmarking@sap.com.

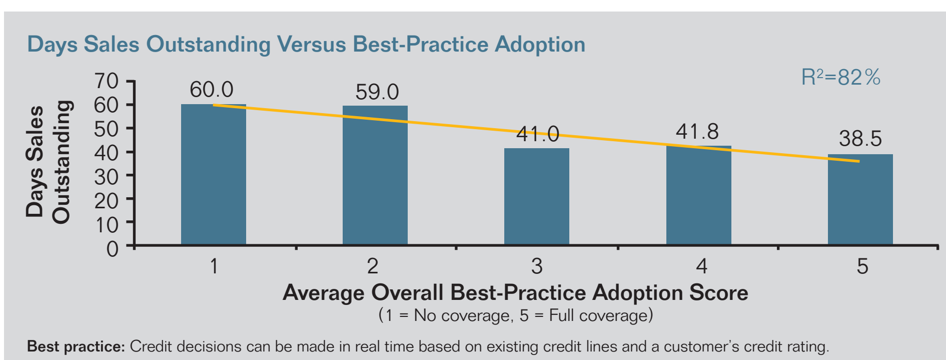

Figure: How Real-Time Credit Decisions Impact Days Sales Outstanding

ENSURING THE HEALTH OF COMMERCIAL CASH FLOWS

BEFORE AND AFTER THE SALE

Accelerate the Cash Conversion Cycle

With external financing from capital markets and banks increasingly difficult to obtain, companies must rely on their commercial cash flows to provide adequate cash and liquidity to fund normal operations. Since most firms don't have the option of "stretching" their payables due to the risk of alienating suppliers, a company should focus attention on its order-to-cash cycle. This in turn places great emphasis on how companies manage the main source of incoming cash flow – their accounts receivable pipeline.[1]

To optimize the order-to-cash cycle, your company must:

- Extend your order-to-cash cycle to focus on the "up-front" credit decision when selling to customers on account. This will help ensure low days sales outstanding (DSO) and prevent bad-debt write-offs.
- Ensure that accounts receivable are converted to cash as quickly as possible once the sale has been made.

Adopt a Credit-to-Cash Model

You can manage cash-flow risks even before a sale is made. Here's one example. This challenging economy may well affect a company's ability to meet current obligations, such as payments to vendors. Your customer may delay payments and drive up DSO, or default on payment altogether and trigger a bad-debt write-off. For the selling company, this means increased risk. To better manage this risk, many companies are expanding the order-to-cash cycle to become a "credit-to-cash" cycle by taking the following steps:

- Add an up-front credit evaluation. For most companies, this type of credit evaluation is done manually through the judgment of seasoned analysts. However, human effort alone is often inadequate to keep up with credit request volumes – and this approach might fail to spot early signs of a potential customer's deteriorating financial situation. In addition, a selling company must evaluate each credit decision in terms of its cumulative effect on exposure to the buying company. This is particularly difficult for global companies or those selling through several channels. Sophisticated analytic applications can augment internal skills and are key to gaining greater control over trade credit risk.
- Do not rely on a single before-sale evaluation. You should continually monitor the customer base for signs of worsening financial conditions and make adjustments to your credit policies accordingly. Is a customer taking longer to pay? Is its financial condition showing other signs of stress such as rising days payables outstanding (because it is stretching out customer payments to preserve cash), growing inventories, or decreasing cash balances? Ensure that you have visibility to these kinds of issues before they affect you.

Ensure Liquidity After the Sale

After the sale, companies must ensure the customer's payment is received and converted to cash quickly:

- Monitor outstanding accounts receivable closely to drive timely collections and ensure low DSO. Make sure your systems alert you as problems arise.
- Conduct careful receivable aging analysis. For many companies, exceptions such as billing disputes and past-due accounts constrain cash flow, drive up DSO, and increase the risk of profits due to potential bad-debt write-offs. Consider research showing that even in relatively good economies, up to 25% of a company's accounts receivable can be tied up in billing disputes. In this economy, it's critical that you can analyze your exceptions easily and prioritize your follow-up.
- Systematically pursue follow-up collections on overdue accounts. Disjointed internal communications can hamper the resolution of past-due accounts and billing disputes. Typically, dispute and collection coordinators must verify details of the claim with coworkers in sales, shipping, billing, or operations to get to the bottom of the issue. Ensure that everyone has access to the same view of the problem, and provide reminders and workflow capabilities to push for timely resolution.

Technology can help streamline the entire receivables cycle by consolidating vital information and enabling employees across the company to collaborate more effectively.

1. This assumes the company sells to its customers on account, rather than receiving payment at the point or time of purchase.

GAINING VISIBILITY INTO SOURCES AND USES OF CASH

BETTER FORECASTING AND CASH UTILIZATION

End-to-End Views of the Financial Value Chain

Forecasting, control, and stewardship of a company's cash flows are vital functions. And to manage cash and liquidity precisely, corporate treasury departments require accurate and timely visibility into the company's sources and uses of cash. Lack of visibility, on the other hand, hinders forecasting and prevents companies from taking immediate action on emergent issues and opportunities.

Traditionally, companies have focused more narrowly on cash management. However, due to the increasing importance of commercial cash flows as the company's primary source of liquidity, treasury departments need to:

- Gain a more comprehensive view of the entire financial value chain. This includes the customer- and supplier-facing business processes that represent the sources and uses of a company's cash. **Sources** include accounts receivable (AR), investment income, and payments from subsidiaries. **Uses** include accounts payable (AP), payroll, debt payments, and payments to subsidiaries. This is very important to the ability to better manage short-term cash requirements.
- Achieve greater forecasting precision with visibility into the processes and data that are upstream or downstream of these typical applications. For example, sales order management systems and purchase order management systems both contain critical data on transactions that eventually find their way into AR and AP, triggering a payment inflow or outflow.

Obstacles in the Way

Treasury analysts need access to up-to-the-minute financial data to assess cash requirements and build more accurate cash forecasts – especially for short-term requirements. Often standing in the way are:

- A lack of data integration. In many cases, analysts must gather data from a number of different systems and in varying data formats. These include AR, AP, and treasury management systems, as well as cash and bank ledgers. Moreover, if the goal is to extend the forecast's time horizon, other data sources such as sales order management and purchase order management systems are also required.
- Manual operations such as the use of spreadsheets to manage forecasts. Gathering information and performing complicated modeling manually are very labor intensive and time consuming. According to a leading authority on finance practices, treasury analysts can spend up to 51% of their time simply gathering information.

Benefits of Integration

Today treasurers must make critical decisions quickly. The information-gathering time lag can be a significant liability. How can we streamline the information cycle?

- Start by integrating systems. Treasury departments that manage critical information in enterprise software applications can shorten their information gathering cycle. Further, companies can eliminate stand-alone systems and spreadsheets used to manage their information and produce reports on which critical decisions depend. Real-time information feeds from integrated systems can reduce information latency and reporting time lag. In addition, real-time information feeds, via electronic bank integrations, that flow directly to a company's cash management systems significantly reduce reconciliation times and provide a near-real-time view of cash balances and their location.
- Ensure greater visibility to more precisely match sources and uses of cash. This allows treasury professionals to improve decision making, act quickly on cash requirements, and invest surplus cash for optimal returns.

CONTROLLING CASH ON HAND
A GLOBAL CHALLENGE

Get Closer to Your Money

During difficult economic conditions, treasury departments want even more control over cash balances and the receipt and disbursement of cash across the company. This is particularly crucial to global companies that typically collect, hold, and disburse cash from multiple locations around the world.

To achieve greater control over cash balances:

- Gain real-time visibility. For companies with accounts disbursed across multiple geographies, the need for daily or even intraday information on cash balances is imperative.
- Get connected with electronic communications that link a company's banks and its enterprise cash management and enterprise resource planning systems. Electronic bank interfaces help eliminate manual rekeying of the same data from a bank portal into a company's cash management systems. They also reduce errors and the need to manually reconcile bank data with internal systems.

Delivering up-to-date bank data directly to a company's cash management or accounting systems provides near-real-time information and enables more effective cash decisions. For example, a company in the healthcare industry uses electronic bank interfaces to download data on a daily basis from its several banks into its cash ledgers, where it is automatically reconciled. Before noon, the firm's treasury professionals have complete visibility into approximately 96% of their cash.

Establish the Right Cash Strategy

Once bank connectivity is established, companies have more flexibility in their banking strategies. Now is the time to:

- Rethink current approaches. For example, some companies find that keeping cash at the local level has disadvantages. It can place added burden on local accounting staff that might lack cash management expertise. Further, having pockets of cash in so many different physical locations is problematic in that it may not be withdrawn easily or wired quickly enough to meet payment obligations in other regions. As a result, many firms are reevaluating whether to maintain cash balances in bank accounts in far-flung locations, centralize it through cash pooling, or use a combination of both approaches.
- Concentrate cash. Many firms choose to centralize their cash management through physical or notional cash pooling. In this case, legal entities in other locations transfer cash to a centralized treasury function where the cash is managed in an internal account on their behalf. This enables treasury departments to have greater control over cash balances and the timing, approval, and release of payments – either to external parties or subsidiaries. By concentrating cash, companies can also earn higher returns on debit balances, negotiate better rates on financing, and reduce fees associated with cash transfers.

Stef-TFE Group

Industry: Logistics service providers

Summary

Based in Paris, Stef-TFE Group has three primary businesses – each with its own organization and corporate culture. Together, these businesses provide temperature-controlled warehousing and transportation for fish and other fresh and frozen food products for manufacturers, retailers, and food service professionals. The company and its partners operate nearly 200 sites across France, Italy, Spain, Portugal, and the United Kingdom.

Results with SAP® Software

- Real-time management of collections and dispute processes
- Reduction in days sales outstanding of three days
- Reduction in bad-debt write-off of 10%
- Improved cash flow

"With the new functionality in place, we have reduced days sales outstanding by three days, improved the average dispute resolution time, and trimmed bad-debt write-offs by 10%."

Bernard Jicquel, IT Project Manager, Stef-TFE Group

MOVING AHEAD
THE ROLE OF TECHNOLOGY

As companies struggle with the effects of the global economic slowdown, their ability to generate adequate liquidity to meet maturing obligations may be challenged. To manage successfully in this crisis, executives must gain:

- **Better control over commercial sources of cash to ensure healthy cash flow.** This means getting a handle on billing disputes and past-due accounts to ensure low DSO and minimize bad debt. You must resolve these exceptions quickly and efficiently. In the best of times, having a quarter of your commercial cash flows tied up in billing disputes is a problem. During an economic slowdown – with liquidity at a premium – the effect can be dangerous.
- **Stronger capabilities to accurately forecast cash.** This is often a difficult task, because it requires the ability to integrate data from across the enterprise systems that set cash requirements in motion.
- **Greater visibility into and control over cash on hand.** Executives must manage their cash more effectively to ensure they know exactly how much they have on hand, where cash balances are located, and how quickly that cash can be accessed. Visibility into external cash balances is an important part of the cash management equation.

An important first step to solving these challenges is standardizing on a unified technology platform that provides a consistent view of the end-to-end financial value chain, without the cost and pain of having to integrate multiple systems.

Standardized systems solve the data integration problem. By aggregating data from many systems and data sources into a single repository, companies can generate more accurate forecasts and resolve AR process exceptions more effectively. In addition, this approach helps organizations comply with financial reporting standards. For example, systems managing financial transactions must interface directly with general ledgers to maintain reporting integrity.

Cash is the lifeblood of any business. Integrated financial management technology provides the critical insights and workflows that enable companies to effectively manage their cash through the current crisis and to build a solid foundation for future vitality.

About the Authors

Chakib Bouhdary is chief value officer of SAP AG. He is the founder of SAP's value engineering framework. His mission is to make every SAP customer a best-run business. Over the past six years, he has built a world-class organization of professionals that is focused on creating value along the entire IT investment cycle for prospects and customers.

Jim D'Addario is director of solution marketing for the SAP® ERP Financials solution, responsible for extending SAP's leadership position in enterprise financial management software. Prior to joining the software industry, he worked for a major global investment bank.

SUPPORT FROM SAP
ASSOCIATED PROCESSES AND SOLUTIONS

SAP supports end-to-end, integrated processes with built-in industry best practices. Among these processes is **optimization of working capital.** This ensures the availability of adequate cash flow and liquidity to fund business operations. It combines rigorous forecasting and liquidity management with effective management of all sources and uses of cash such as receivables, collections, customer credit, payables, payments, and investments.

This process is supported by a variety of solutions, including the following:

- The **SAP® Credit Management application** enables faster and more accurate trade credit decisions both at the initial approval and in the continual monitoring of account relationships.
- The **SAP Dispute Management application** enables faster resolution of billing disputes by streamlining internal communications and collaboration and through more effective information management.
- The **SAP Collections Management application** helps your collections professionals be more effective in prioritizing and processing past-due accounts – enabling faster resolutions and reductions in days sales outstanding.
- The **SAP Treasury and Risk Management application** helps you make more effective decisions using timely information on current market conditions.
- The **SAP Cash and Liquidity Management application** enables you to forecast and manage liquidity more effectively by accessing sources and using data from multiple systems.
- The **SAP In-House Cash application** enables you to improve control over cash and liquidity. Gain greater efficiency by centrally managing cash and payments on behalf of your subsidiaries.

Executive Insights from the Chief Value Office

SAP is committed to delivering value to our customers. With decades of experience working with thousands of CXOs worldwide, across all industries and lines of business, we have captured insights based on the best practices of top performers and the latest market trends. We have developed actionable, value-based recommendations to help companies chart their journey into the future. We are pleased to share our point of view in the *SAP Executive Insights* series.

www.sap.com/contactsap

50 095 041 (09/05) Printed in USA.