“Meeting the liquidity challenge”

The attention to liquidity and working capital management has been accentuated by the ongoing impact of the global credit crisis.

As a result, one of the biggest challenges that U.S. businesses face is maintaining positive cash flow and liquidity in today’s recessionary, capital-constrained environment. While maintaining liquidity and cash are important, it is crucial to have a full understanding of your financial picture to incorporate strategic working-capital solutions.

By employing specific cash-management strategies focused on optimizing cash flow, maximizing liquidity, mitigating risk and managing credit more efficiently, a business can maximize its availability of working capital, even in these tough times.

Although technology is a tool that can be utilized to improve overall efficiency and cut costs, it is not a replacement for a back-to-basics approach to cash management, which is the foundation for an effective working-capital strategy.

OPTIMIZING CASH FLOW

The first step in developing an effective working-capital strategy is to optimize cash flow, as the two go hand in hand. According to a 2007 study by the Association of Financial Professionals, more than two thirds of the respondents considered cash forecasting to be the greatest challenge to optimizing cash and short-term equivalent investments.

Cash forecasting remains a challenge for treasurers at all levels, and the number of treasury operations that continue to use spread-sheet-based programs as their main forecasting tool remains largely undiminished.

There are two major barriers to effective cash forecasting. First, cash forecasting involves input from nay different individuals, causing the models to become unmanageable. Second, basic spreadsheets are not a strong tool for monitoring data input and subsequent amendments to that data. Being able to access timely and accurate information is essential to effective forecasting. Banks and vendors continue to develop online tools to improve cash-flow forecasting, which is an evolving process.

Another challenge may arise when trying to forecast cash flows that are coming out of multiple-use accounts. Having clearly defined accounts structures helps to overcome this obstacle. This will enable companies to segregate transactions based on defined criteria and more efficiently match payments to forecasted transactions.

Banks also have an important role in supporting cash forecasting. Although the critical data is typically held by the company within its ERP systems, banks provide transparency with respect to a company's payments and receivables data thorough their expertise and investment in technology. They provide complete disclosure of your company's finances, which, in turn, allows you to make sound decisions with a complete financial picture.

Banks also play a role in consolidating data and presenting it to the corporate treasurer in a way that is consistent, timely and of value. Working with your banking partner to implement cash forecasting can help you optimize cash flow.

MAXIMIZING LIQUIDITY

Liquidity solutions also present opportunities for businesses to maximize cash flow. While there may not be an end-all solution to the liquidity challenges that businesses are currently facing, there are ways in which these challenges can be overcome or, at the very least, effectively managed.

The collapse of the auction-rate securities market forced treasurers to seek out conservative, low-risk investment vehicles. When that market forced seized up after the collapse of Lehman Brothers, and dealer support did not materialize, losses were incurred, or funds were set aside to cover those expected losses. This created a need for businesses to seek alternative liquidity solutions.

The future is unknown, yet non-U.S. cash growth is projected to grow at a greater rate than U.S. cash. Thus, if U.S. corporate treasurers are planning on holding cash going forward, they should consider holding more non-U.S. cash.

The AFP liquidity surveys conduct over the last several years reveal some significant findings. First, companies with more than $1 billion in annual revenue are decreasing investments in all short-term instruments other than money market mutual funds and Eurodollar deposits. Otherwise, their short-term investment policies are restricting the overall access to other instruments.

On the other hand, companies with annual revenues less than $1 billion have already moved their funds into safer investments. These companies took a more diversified approach to short-term investments. The expectation is that the short-term investment funds will continue to be invested in money market mutual funds and banks deposits.

In a time of turbulence, it is a return to the tried-and-true basics of cash management that is fundamental to success. Effective investment management requires balancing the fundamental principles of liquidity, return safety and security. By implementing processes and procedures tailored to specific needs, banks can help businesses weather this storm.

MITIGATING RISK

In the global credit crisis, there are heightened concerns around risk and security for businesses. Treasury must ensure that there are adequate controls and processes to address not only fraud, but financial and accounting risk, given the heightened regulatory oversight around financial management. Moreover, companies need to rely more and more on business partners globally, without increasing risk.

It is imperative for businesses to incorporate specific tactics to help mitigate risk. These include utilizing internal controls, such as account protection and daily reconciliation, and using technology, including the electronification of payments, Web-based reporting and two-factor authentication. The imposition of these controls, couples with additional reporting requirements, drives automation and standardization of treasury processes. The next logical steps in optimizing the efficiency of working capital and improving transparency are the integration of trade with liquidity and risk management, and then to create standardization for increased efficiency, visibility and control.

MANAGING CREDIT

Managing credit efficiently is a cornerstone of a company’s working-capital strategy. If companies are electing to use credit as a part of their financial strategy during this time, then it is crucial to maintain a strong balance sheet, which can help improve a business’ access to credit. Balance-sheet analysis will be a key component in a bank’s evaluation of the sustainability of a business.

Operating cash has to sit somewhere, and deposits are highly valued by banks right now. Because banks are under tight scrutiny and need to shore up their financial reserves, they value the deposits they receive from corporations in the form of operating capital or dollars that are waiting to fund other projects. Companies that need to borrow capital should explore with their lender how their deposits factor into the negotiation. For companies with excellent credit, deposits could tip the scale in their favor for obtaining capital. Their money market deposits may be the key to the operating capital that they need.

In addition, employing the previously mentioned cash-flow forecasting tools will strengthen their credit position and the ability to secure working-capital loans. Lenders view a well-tailored, efficiently administered cash management process as being indicative of a stable, capably managed organization with lower risk levels.

CONCLUSION

There may not be one single solution to the liquidity challenges in the U.S. and globally; however, it is important to be cognizant of the fact that by working with banking partners to implement the tried-and-true basics of cash management, cash forecasting and working capital solutions, liquidity is attainable.