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In an uncertain economy fraught with unprecedented inflation, understanding and scrutinizing cash flow through forecasting is a must

As the global economy faces headwinds, companies that effectively position themselves for stability and resiliency will likely focus increasingly on how they forecast liquidity to deal with decades-high inflation, waning consumer demand, regular interest rate increases by the Federal Reserve, and unknown consequences from the ongoing geopolitical unrest across the globe. In isolation, each of these issues poses risks to companies. When combined, they create unprecedented uncertainty for management teams and refocus attention on the most vital asset they hold—cash.

Strong governance around short-term forecasting challenges functional leaders to understand how every operational decision has liquidity impact.

Tools such as direct cash flow forecasting and working capital analytics are designed to enhance management teams' understanding of its liquidity by:

- Providing insights on how operational drivers influence cash flow.
- Projecting the liquidity impact of various downside and upside scenarios.
- Calibrating capital allocations to drive near-term goals without compromising long-term strategy.

Direct cash flow forecasting is no longer reserved for distressed companies, nor should it be defined as a "treasury exercise." It should be embedded and integrated in the larger financial planning and analysis of the entire organization using operational stakeholder input to inform analysis. Sustainable, value-driven forecasting requires much more than a financial model. The model may be the analytical tool, but a strong governance framework activates that tool through stakeholder engagement, active dialogue, collaborative decision-making, and organizational alignment.

Cash flow forecasting is predicated on a foundational structure that promotes regular dialogue to drive insights from, and accountability within, operational and finance leadership teams.

Liquidity Management Governance Framework

Create 'tone' through executive sponsorship
The message tone prioritizes liquidity management for functional leaders and effective cash management.

Engage functional stakeholders
Functional leaders should be brought in early to assist with forecast design and to drive ownership and accountability.

Identify types of insights to be derived
Identifying an initial set of insights helps create a baseline forecasting tool, including data granularity and key assumptions.

Define an analysis cadence
Setting a regular cadence is essential for understanding and evaluating variances between forecast and actual cash flow.

Create action from insights
Creating a regular communication loop to understand the data and take action on insights can enhance liquidity discipline, increase working capital, and drive predictability.

If liquidity management is the underlying mandate driving leading-class cash management, then forecasting is the window into an integrated, operations-based view of cash flow. Companies that take this approach may not have the best model or the most comprehensive assumptions, but they should be able to provide organizational transparency into how each function influences and measures the effect of their behaviors on liquidity. Companies that prioritize governance as the foundation of reliable, insightful, and sustainable forecasting should consider adoption of the following pillars:

- **Executive sponsorship:** While forecasting is an organizational exercise, it requires finance leadership to communicate purpose, vision, and accountability across functional silos. Forecasting should challenge functional leaders to understand the impact of every operational decision on liquidity. Messaging should include a clear articulation of why liquidity matters and the benefits such an exercise can provide. A "cash culture" starts at the top to drive functional accountability.

- **Functional alignment:** Aligning the forecasting process requires functional leadership from sales, supply chain, indirect procurement, IT, disbursements and collections, capital markets, and payroll. This type of alignment connects liquidity consequence with operational decision-making. These types of siloes show up throughout organizations such as a sales organization that is incentivized by incremental volume while the collections team is often measured by customer collections. A robust functionally-aligned forecasting process enables these types of issues to become collaborative and efficient by driving dialogue that focuses on analyzing the entire Order-to-Cash continuum.

Defining a set of goals up front is not binding, but it does drive purpose and empowers functional leaders to streamline internal processes to achieve optimal liquidity.

- **Goals and aspirations:**
  The accountability of a sustainable, direct-cash forecasting process is embedded in what insights the organization wants today and what questions it may ask in the future.

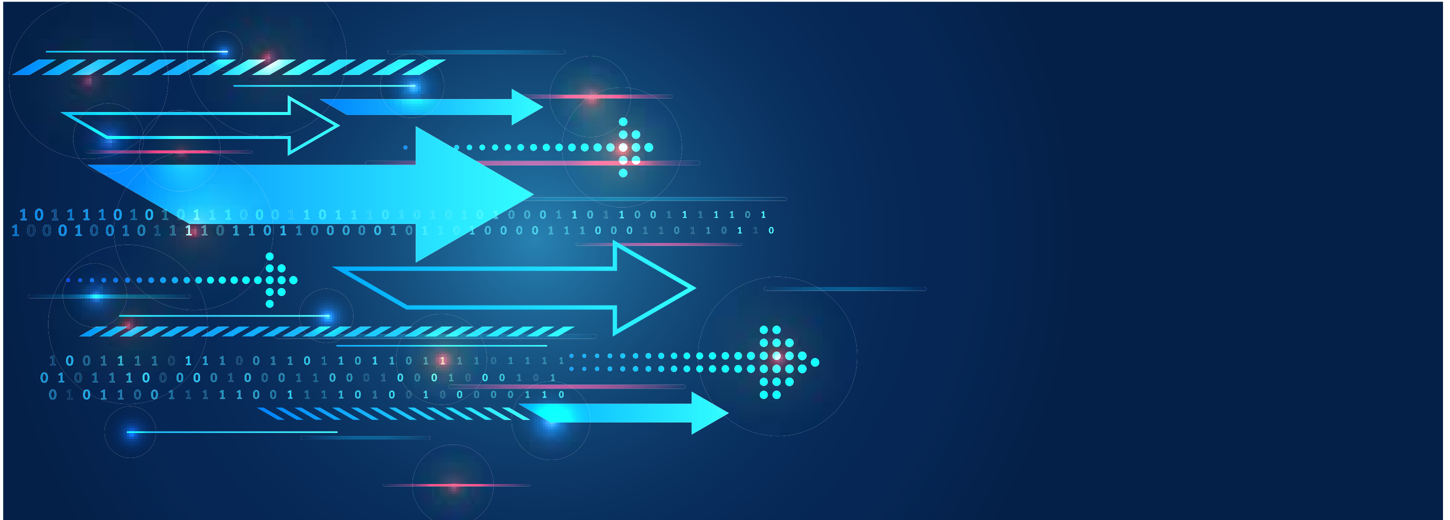
- **Cadence and input:**
  Sustainable and active liquidity management relies on a regular cadence of dialogue around a central forecasting tool. Such a cadence drives accountability but also creates a forum to understand end-to-end cash conversion issues. Accountability relies on ownership in the form of input. A primary benefit of any forecasting tool is the ability to empower functional leaders to obtain a clear understanding of how the forecasting model works, what data is being used, and what key assumptions drive cash conversion. This transparency and opportunity for input creates trust that the forecasting tool accurately reflects how each function understands the impact of its decisions on liquidity.

Organizations that drive cash forecasting strictly out of finance or treasury without obtaining functional buy-in may miss out on the true value of the exercise, which is understanding how to bridge gaps, identifying process issues negatively impacting liquidity, and implementing changes that enable better predictability.

- **Transparency and analysis:**
  A central part of cash flow analysis is understanding the "what" and "why" behind actual and projected weekly cash flow variances. Such analysis helps organizations understand whether consistent misses are due to incorrect assumptions or underlying process issues, and where improvements can be made.

  Example: If vendors with 30-day terms are consistently being paid in 20 days, the issue is not with the assumption, but rather with the process of paying invoices 10 days before they are due, (absent a factor such as early payment discounts). There is a wealth of opportunity in these small insights that uncover larger process issues that may be missed if the organization is only analyzing a large Days Payable Outstanding ("DPO") metric. Many organizations will view metric consistency as a measure of efficacy rather than striving for improvement – direct cash flow analysis provides a roadmap for where to look with drill-down visibility from the disbursement to payment category to vendor level (in this instance).

Scenario-building around liquidity increases confidence during uncertain economic climates and accelerates decision-making.



Companies that create a strong liquidity management foundation via executive sponsorship, functional leadership/ownership, and insights derived from forecasting tools are usually better positioned to understand the impact of various scenarios on liquidity. Scenario-building can be used to understand the upside and downside liquidity impact of consumer uncertainty in the face of inflation and geopolitical unrest, or it can be used to measure the potential impact of business model changes on liquidity. For example, a scenario of falling demand may start with a change to the sales forecast, but it requires additional functional inputs to understand how and when falling demand will impact liquidity.

Example: During the early months of the COVID-19 pandemic, some companies faced an unprecedented reduction in the demand environment. This reduction did not just change how much customers bought; it also began to affect how customers paid. Customers deferred orders and delayed payments beyond historical patterns. This type of change required functional input from:

- **Sales team:** Reduction to the sales forecast based on customer discussions
- **Direct procurement:** Reduction of orders placed with key suppliers reflecting weakening demand and a desire to avoid a costly inventory build
- **Indirect procurement**: Reduction to any indirect procurement reflecting lower-than-expected sales levels
- **Collections:** Customers starting to pay outstanding invoices slowly

The scenario described may seem simple, but anticipating the effect of demand shock is a dynamic process that should include end-to-end engagement with functional leadership—from sales to procurement to customer collections. Direct forecasting may be the tool employed, but comprehensive foundational governance provides the information the tool needs to develop the analysis required.

Drive enhanced liquidity management by investing in the foundation.

Organizations that seek leading class liquidity management through tools such as direct cash flow forecasting can start by investing in foundational governance that creates sustainable, comprehensive, and insightful use cases. Influencers of cash flow reside in functional operations. Regular dialogue among leaders from across the cash conversion spectrum can better inform how tools are built, what organizational needs those tools support, and how measurable actions will be agreed on from insights gained. Foundational governance is the backbone of effective liquidity management, and a leading practice is to design such a structure in conjunction with building a cash flow forecast.

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