Companies Must Think Strategically about Cash Management

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The recent downturn in corporate fortunes is giving rise to liquidity problems across a wide range of companies. Although management teams are having to address these problems to ensure the survival of their businesses, they do so at their peril if they pay insufficient attention to the longer term consequences of focusing exclusively on cash. By managing through cash, managers can balance the need to think strategically about the future of the business while still retaining cash management as a central objective.

Stock markets have come down with a bump. During the halcyon days of the 1990s the link between share prices and underlying financial performance was stretched to breaking point. So much so that in certain sectors (particularly internet businesses) there was talk of a 'paradigm shift' which seemed to imply that the relationship between enterprise value and performance was irrelevant. Indeed, it was almost a badge of honour, and indicative of a commendable confidence on the part of management to invest in the future, for companies to spend extravagantly even when revenue was negligible.

In the more sober economic environment that now prevails, traditional measures of value have reasserted themselves. It is a reflection of how far removed from reality the markets had become that they have fallen so far in recent months. By historic standards, they are not undervalued even now. This is because they are once more looking at cash generation as the key measure of fitness to survive and are punishing companies that fail to earn a sufficient cash return.

Managing for cash

How are managers to respond to this situation? The obvious answer is for them to concentrate on cash, if necessary to the exclusion of almost any other consideration. In this way, the argument goes, many of their problems, even the seemingly intractable ones, stand a good chance of being solved. Investors and bankers are keen to support them in this endeavour. The terms of a refinancing following a cash crisis are likely to be very restrictive. Banks will be watching closely and off-plan performance is likely to lead to early covenant breaches. In this environment, cash can easily become the be all and end all.

As a result, CEOs and CFOs are currently rolling up their sleeves and putting themselves through crash courses in how to manage for cash. They are learning to draw up accurate short term daily rolling cash forecasts, to develop responsive mechanisms for prioritising financial commitments, and to manage unforeseen events through the use of contingency plans. They are axing capital investment, laying off the workforce and offloading assets and investments that they feel they can live without. This behaviour is exemplified by the current crop of share buy-backs, where managers in such industries as pharmaceuticals are distributing surplus cash to shareholders rather than re-investing it in the business.

However, this approach has its dangers. While it may appease bankers and analysts, it is likely to be a short term solution. The act of focusing on the generation of cash today can lead to the starvation of the mechanism that will generate cash tomorrow. If any investment that has no immediate benefit is cut, the essential process of business renewal and the creation of future value grinds to a halt.

Managing through cash

No management team can successfully run a business for ever by focusing only on the short term cash position. At some point, it must think strategically about the future. The question is how to do this without losing sight of cash. Successful managers adopt a formula that can be described as managing through, rather than for, cash. While managing for cash makes day to day cash control the key objective of the company, managing through cash makes the long term success of the company the key objective but in a way that is consistent with the need to manage the cash consequences. Cash therefore ceases to be solely a short term tactical concern and takes on a strategic significance.

Managing through cash involves a number of things. It involves understanding the precise linkage between revenue and cash and continuing to prioritise how surplus cash can be used to drive out greater savings later. For example, rather than repay bank loans, cash might better be used to retrain existing staff to work more flexibly or pay for capital expenditure with an early payback.

It is essential that the management team can rebuild their credibility by making promises that they are able to keep. This points to the need to prepare robust cash projections and, when faced with off-plan performance, management must be prepared to implement potentially unattractive contingency plans, such as asset disposals or the deferment of capital expenditure plans, to ensure that they can repay bank debt when they have promised.

At the same time, managing through cash is also concerned with creating appropriate incentives. Thus, it may be better to reward staff to meet cash rather than profit targets, for example by linking the remuneration of the sales team to cash collections rather than the achievement of sales.

Communication is also a critical element of managing through cash. Analysts and shareholders are not the only stakeholders who need to be kept on message. Financial creditors, key customers, suppliers and regulators are all critically important and they need to be given information regularly in a language they can understand.

Lastly, managing through cash involves positioning the company for a further refinancing, this time on terms that the management team can dictate. This will only be possible when banks are willing to do business with the company voluntarily. This in turn will only happen when stability has been won.

Attention to cash lies at the centre of any successful restructuring, both tactically and, later in the process, strategically. Management teams that recognise this will be rewarded by the support of their banks and of the capital markets. Following the demise of the paradigm shift, enterprise value is once more being based on such traditional measures as discounted cash flow. Without sustainable cash flow, there is no enterprise value. This is what is at the heart of managing through cash.