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CASH MANAGEMENT FOR PRIVATELY-HELD COMPANIES

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Cash, it is the most important asset for any company. Business owners and managers do not need to be reminded how critical cash is to everything that the business does. Despite its importance, many companies have a difficult time managing cash, particularly small, privately-held companies. So why do these companies have difficulties with cash management? More importantly, how can these companies identify and implement sustainable solutions to improve how they manage cash?

THE BASICS OF CASH MANAGEMENT

When it comes to managing cash, information is key. Accurately predicting cash inflows and outflows is impossible without good data on actual cash flows. Good financial reporting is important for tracking pricing and margins as well as for managing expenditures. This is a significant area where companies, especially smaller privately-held companies, tend to struggle for a number of reasons.

Companies tend to operate on a loose set of business processes that are not documented or clearly defined. Basic business processes generate the core data that eventually ends up in management reports or forecast models. When there is too much flexibility or a lack of control in how these processes are performed, the same tasks end up being performed in different ways generating inconsistent data.

In a more loosely organized environment, data management is usually not consistent. When similar types of transactions are classified in different ways in the same system or there are no guidelines for how transactions are classified, data becomes inconsistent leading to inaccurate reporting.

Basic financial reports are not structured to provide management with the right information. Classifications of revenue, direct expense (costs directly associated with generating revenue like raw material costs), and fixed expenses are usually not aligned with business activities. When revenue is broken out, but direct expense is lumped together it makes breaking down gross margins by division or product or service offering a difficult exercise.

Improving the accuracy and consistency of data generated by business processes is the foundation of effective cash management. Regardless of the tools and strategy in place, inaccurate and inconsistent data will lead to cash management issues every time.

Getting the business to generate good core data is only part of the equation. To effectively manage cash, an effective management strategy needs to be in place. This is sometimes difficult for small businesses because of where management needs to focus its resources in order to maintain daily business operations.

Effective strategy starts with being able to take a holistic view of the business, step back, and ask the question *"What do I need to see in order to effectively manage cash for this business?"* The answer depends on the business itself.

A simple example is a business that manufactures three distinctly different products. In this situation, good cash management strategy would dictate setting up data management, reporting, and forecasting capabilities to track revenue and direct costs for each of those products. This simple strategy creates an environment for margins to be accurately tracked allowing pricing (cash inflows) and direct costs (variable cash outflows) to be managed. Fixed expenses (overhead) would be grouped together and tracked separately.

With a good strategy in place and clarity on what metrics need to be reported on and tracked, the business can implement good cash management processes and the tools necessary to support those processes.

In the presence of good data and effective strategy, the processes and tools that will enable management to track and manage cash can be determined. It is a common misconception that these processes and tools must be complicated and costly to implement in order to be effective. This is not the case.

When it comes to complexity, the complexity of cash management processes and tools should be dictated by the complexity of the business itself. Complex business models will require more complex cash management strategy which leads to more complex and robust processes and tools. An increased level of complexity surrounding cash management for less complex business models will only lead to decreased effectiveness.

Regarding cost, implementation costs will be reduced with good data and effective strategy matched to the business. A small, privately-held company can undoubtedly devise and implement the strategy, processes, and tools to effectively manage its cash and do so at a reasonable cost and in a short amount of time with minimal business interruption.

IDENTIFYING AND IMPLEMENTING SUSTAINABLE CASH MANAGEMENT SOLUTIONS

So a business has an understanding of the basics of good cash management, now what does it do to implement cash management solutions and what can it do to make those solutions sustainable?

When it comes to implementation, the business should take a bottom up approach. Consider the following scenarios.

Improving data-generating processes and reporting accuracy builds the foundation for a cash management strategy which is subsequently the foundation for effective cash management processes and tools. Trying to implement processes and tools before accurate data or effective strategy have been addressed will not produce desirable results because a suitable foundation has not been created. Good data is the foundation for the effectiveness of any system or tool and good strategy is the foundation for how that system or tool is used.

Trying to develop a strategy before improving data-generating processes can lead to the creation of a strategy that cannot be supported by the business. It is difficult to design an effective strategy on how data is going to be used without knowing what that data looks like.

Good cash management is achieved over time so there is no problem with taking it one step at a time and being thorough. Any improvements made to data accuracy, strategy, and tools will be beneficial to the business in areas other than cash management.

Accelerating timeframes for implementation, interchanging steps, and not being thorough will not yield a better solution in less time, it will only result in more work on the back end when the solutions do not produce the intended results.

With any solution, sustainability is also important. Sustainability in this case refers to the ability of a solution to grow and change with the business and continue to be used despite changes in organizational structure or personnel. When considering the sustainability of a solution there are a couple of important considerations.

The sensitivity of the solution to fluctuations in the business needs to be examined. For instance, think of a company that has three service offerings. A solution that is less likely to be sustainable would require each service offering to be handled differently with a multitude of variations and exceptions between each to achieve the same output.

A cash management example of this would be having to generate different reports and perform unique calculations for each service offering to calculate direct expenses. Not only is this cumbersome in the present, as the business grows the solution is at risk of becoming even more cumbersome, which means the likelihood of it continuing to produce accurate results decreases.

In this example, if other service offerings are added, there is no standard or precedent to determine how the new offering or offerings will be addressed by the solution which risks adding further complexity.

A more sustainable solution in this case would be one that standardizes how each service offering is handled as much as possible. Using the cash management example, this would mean having direct expense calculations that are as similar as possible across the board. This reduces the chance of future complexity which could render the solution ineffective.

The dependency of the solution being performed by a certain employee or narrowly defined function also needs to be taken into consideration. This is very important in smaller, privately-held companies that typically do not employ large accounting, finance, planning, and analysis departments. What this means is that any qualified employee within the larger group that is responsible for managing cash and/or generating data for cash management activities can follow the processes associated with the solution.

For example, a solution is designed around the capabilities and skillset of a single employee and that employee moves to a different position or leaves the company. In this case, the solution designed for that employee would become ineffective. Another employee could be hired in the vacant position that had a very similar skillset and method of thinking, but adding those requirements makes finding a suitable replacement that much more difficult.

The better solution would be built around a process where the process itself is the integral part and not the employee. This ensures that despite changes in personnel, the process can continue to be performed in a similar manner allowing the solution to continue to generate consistent results.

As always, complexity also plays a role. The less complicated a process is, the easier it is for different employees to learn and follow it improving consistency and sustainability.

CONCLUSION

Good cash management is achievable for privately-held companies without the need for complicated and costly processes, systems, and tools. Understanding the basics and implementing thoughtful and sustainable solutions tailored to the business and its needs allows virtually any company to achieve excellence in cash management, which when achieved represents a significant competitive advantage for any company in any market.

ABOUT THE AUTHORS

Maurice Nassar is the Managing Partner for Emergent Partners. He has served in a variety of positions for companies both large and small in management and as a business consultant. Formerly the Chief Financial Officer for a privately-held, international company, he was responsible for building the processes and infrastructure which led to exceptional growth. Throughout his career he has developed the business model and methodologies that Emergent Partners uses to help businesses improve their operations and succeed in their respective markets.

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