IMPROVED CASH FLOW:
A HIDDEN SOURCE OF SELF-FINANCING

FIFTH THIRD BANK
The curious bank.

By Marybeth McManus, VP,
Commercial Treasury Management,
Fifth Third Bank

As credit markets remain tight, many businesses are looking to a more reliable source of financing — their own working capital. By implementing an effective cash management program, treasurers can manage their working capital more effectively, optimizing cash flow and uncovering a hidden source of capital. For businesses that have traditionally relied on bank credit to pay suppliers, developing a working capital management plan, then implementing proactive measures can improve the cash conversion cycle. Using treasury tools that improve efficiencies in disbursement and receivables processes will deliver better cash flow, increased liquidity, and a reduced dependence on short-term borrowing.

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UNDERSTANDING THE CONNECTION BETWEEN SALES AND RECEIVABLES

The first step in developing an effective strategy is reviewing receivables as they relate to sales. It is crucial for treasury to broaden its perspective of the business. The metrics used to calculate the cash conversion cycle, Days Sales Outstanding (DSO), Days Inventory Outstanding (DIO) and Days Payable Outstanding (DPO) are averages. For example, the input of Net Sales which is used to calculate the DSO may include revenue items which don't make their way into Accounts Receivable.

Take cash for example. An organization which generates a significant portion of its sales from cash, should consider an overall DSO calculation, but also a more refined DSO calculation that is based on sales resulting from their extension of credit. Or consider the payor mix – do different customers have different payment habits? Any organization in the healthcare field knows very well that the collection of receivables from Medicaid or Medicare has different timing than those from a self-pay receivable.

By gaining a clearer picture into their cash and float, the company is now better able to take steps to maximize both cash and credit components.

With an understanding of the mix of receivables as they relate to sales, treasury can then target efforts at migrating customers to payment types that will enable quicker access to funds. Treasury can work with a banking partner to optimize existing payment streams. Payment technologies, such as the Automated Check Clearing House (ACH), can help optimize the receivables mix by converting paper checks to electronic alternatives. In addition to streamlining and automating the payment process, electronic methods also offer improved fraud controls and risk management. Ultimately, the goal of shortening the receivables cycle can be achieved, which in turn will improve the cash conversion cycle and reduce reliance on short-term debt.

HOLDING ONTO YOUR CASH LONGER: DEVELOPING MORE EFFICIENCY IN A/P SYSTEMS

Frequently, businesses establish a line of credit or other type of short-term debt instrument to assist in paying suppliers while waiting for customers to complete their purchases. Taking a strategic approach to the management of Accounts Payable (A/P) can enable treasury to reduce the need for borrowing.

Similar to the review process recommended for receivables, treasury should take a close look at its disbursement processes as well. It is critical that supplier agreements be examined to ensure invoices are being sent, and most importantly that the invoices are being paid in accordance with negotiated terms. Such a review allows treasury to determine if some payments are being made too quickly. It also presents an opportunity for treasury staff to truly scrutinize the payables function, taking a candid look at why disbursements are handled in a particular way. Often times, this sort of examination reveals that processes are not always conducted with an eye toward gaining maximum efficiency, but instead are executed for convenience.

The next consideration for treasury is whether the company has a centralized payment function or if payments are being made throughout the organization. Centralizing the payment function allows for more control over the entire disbursement function. Not only does a centralized payment function allow treasury to control the flow and timing of disbursements, it also aids in mitigating risk and payment fraud as well as reducing the cost of payments.

In addition to reviewing the controls around proper disbursement functionality, treasury should also assess its mix of paper and electronic payments. Using electronic payments, such as commercial cards, offers significant advantages, allowing treasury to pay suppliers in the same time frame as paper checks, or potentially even faster, yet without having to tap working capital until later. Using a commercial card allows you to have a flexible conversation around the possibility of discounts. For example, the conversation could be that you will pay in 10 days with a 2% discount using the card or revert to full terms with no discounts. In either scenario, using the card improves your working capital.

This scenario opens the door for treasury to earn a discount on the purchase of goods or services, or the payment, thereby reducing the cost associated with payments, as well as holding on to funds for an additional one to three weeks. This in turn would allow time for payments from customers to reach the company's accounts, and potentially eliminate the need to tap into short-term debt.

> "The first step in developing an effective working capital management strategy is reviewing receivables as they relate to sales."

FIX IT, EVEN IF IT'S NOT BROKEN

There is a tendency in business to leave processes that appear to be working adequately alone because they are not broken. To achieve real process improvement and put working capital to best use for the company, treasury should look at all its functions to see what can be improved. Even if it is not broken, making enhancements to a function can deliver real benefits for the organization.

Treasury should always keep in mind the underlying relationship between the income statement and balance sheet to gain the clearest insight into what is driving dollars through the organization. Finance should avoid taking a narrow view, which fails to take into account operational and support aspects of the business. Through a thoughtful review of internal processes, treasury is better able to connect more deeply to the business, and consecutively uncover important funds that can help to move the business forward.

Taking a strategic approach to working capital management requires thoroughly understanding receivables and maximizing efficiency in payables. This will enable treasury to optimize cash flow and improve the availability of cash, making it more readily available to the organization to support the growth objectives of the business. In this way, treasury can solidify the importance of its contributions by delivering tremendous value to the organization.

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