# The underestimated sexiness of cash

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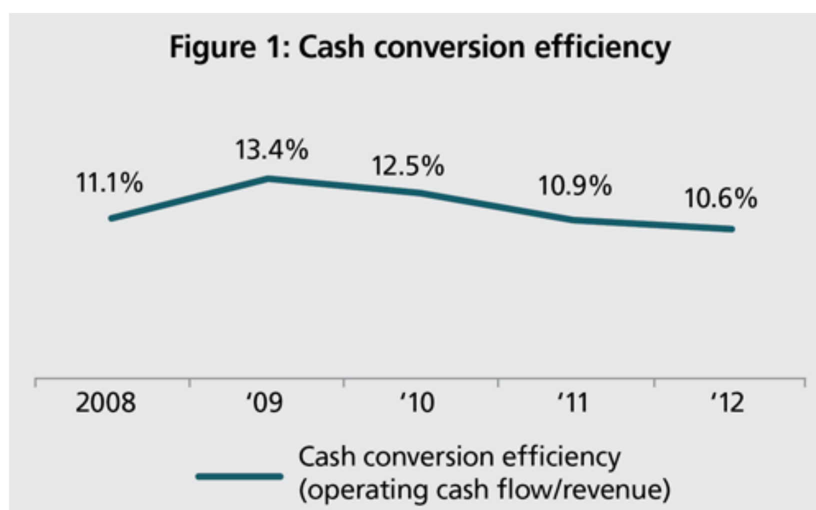
There is an emerging wisdom today that considers improving cash flow to be a key driver of shareholder value optimisation. It may not be as fashionable, or even as sexy, as a relentless focus on earnings per share but overlooking, or at least failing to prioritise, cash flow optimisation is short-changing shareholders.

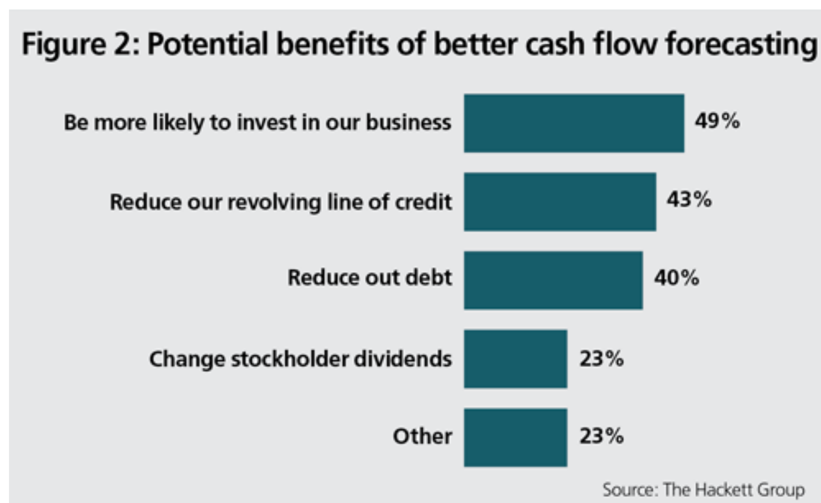
Shrewd financial directors today recognise that itï¿½s now imperative to understand future cash flows and requirements better than ever before because borrowing from the bank or sourcing investment is not as easy as it used to be.

In the main, however, sales and earnings initiatives take precedence over cash flow optimisation. Additionally, current levels of economic uncertainty have led to cash being hoarded rather than committed, resulting in a further general deterioration in cash efficiency. However, for shareholders returns on a companyï¿½s cash are low and itï¿½s easy to argue they would be better served by returning cash to shareholders so that it can be invested in a diversified portfolio rather than having it sit in company accounts.

High levels of working capital at best give you a return of one, but more likely a negative return. In this context, focus on cash flow and optimising capital consumption and working capital should be a key driver for management to optimise shareholder value.

Yet the majority, we find, do not anchor themselves to a ï¿½cash cultureï¿½ or, if they do, their intentions are often not effectively converted into management practice below the board level. Studies undertaken by REL of more than 800 of the largest companies in Europe prove that the cash mantra is not being fully practised.



Cash conversion efficiency (operating cash flow against revenue) deteriorated three years in a row (*Figure 1*), indicating companies are taking longer to convert sales into cash. Moreover, only 12 percent of companies within the survey managed to improve working capital continuously over a three year period.

As a result Free Cash Flow (FCF) reduced by 18 percent year-over-year on average, while debt continued to increase ï¿½ US$147 billion (or 6 percent) year-on-year and 11 percent over a three-year period for companies within the survey.

So why exactly is management not looking to cash flow optimisation to maximise shareholder value? The agency problem certainly comes into play, as does limited shareholder intervention. But in very human terms it is just sexier to manage a growing and profitable business than it is to manage a cash machine, hence the myopia of demonstrating one type of value over another.

A combination of sustained marketplace volatility and expansion of post-recessionary growth initiatives also continues to challenge companiesï¿½ ability to manage cash. The Hackett Groupï¿½s 2013 Operating Cash Flow Forecasting Study (*Figure 2*) revealed that only about 20 percent of companies can forecast mid-term (two-to-three month) cash requirements within 5 percent of actual figures ï¿½ and forecasting accuracy has actually declined since the 2009 version of the study.

One valuable source of insight for making improvements is the studyï¿½s "top performers" ï¿½ companies that can forecast cash flow accurately and share several other common characteristics, including a focus on employing sound working capital processes that reduce cash flow uncertainty.

As these top performers show, practising ï¿½cash is kingï¿½ can be extremely sexy, particularly in the current uncertain climate. Potential benefits of good cash management and accurate cash flow forecasting are numerous ï¿½ including better returns through more accurate investment of idle cash, the ability to hedge foreign exchange exposure, and opportunities to optimise supplier discount programs.

**A sign of good health**

When growing or even maintaining revenues is difficult and unpredictable, protecting margins through cost cutting is painful and slow, particularly in Europe, then maintaining strong cash flows and optimal working capital management becomes a key indicator of business health and efficiency.

And in those companies where itï¿½s really and truly taking place, a focus on cash is rewarded by shareholders. One of our recent clients, facing pressure on both top line revenue and margins, made a concerted effort to improve cash management through working capital optimisation, and analysts reacted positively.

"The reinforced focus on cash flow management matters more to us than earnings per se,ï¿½ said one, and ï¿½the company management intends to focus on free cash flow generation, sometimes at the expense of profitability, which we believe is a positive for the stock," said another.

Company efficiency, performance and perceived shareholder value are all winners when cash flow is brought into focus and managers should be more active in promoting this culture in their organisations. Momentum is building: the emergence of indicators such as Cash Flow Return on Investment as a key driver of performance, for example, proves this and values cash flow more prominently.

Yet many initiatives we see to convert companiesï¿½ earning mentality into a cash flow culture still falter because change management ï¿½ a particularly important consideration when undertaking such a seismic shift in an organisation ï¿½ has been underestimated.

Most operational stakeholders across business functions understand revenue and profit, but still fail to comprehend the cash impact. However, the time and energy spent educating the organisation will be a good investment, one that yields above average returns for both the company and the individual.

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http://www.cfoworld.co.uk/in-depth/financial-planning/3459321/the-underestimated-sexiness-of-cash/