THE BOSTON CONSULTING GROUP

Cash Advantage

Moving from Fast to Sustainable Impact

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Moving from Fast to Sustainable Impact

In the current crisis, cash is a priority for most companies. Statements such as "Cash protection is key" and "Cash is king" are heard every day. When demand is falling and financial markets are tight, a company's ability to generate and protect cash can determine its survival.

Cash is not only the agent that extinguishes unexpected fires but also a crucial resource for value creation and strategic maneuverability. Neglecting it can leave companies at the mercy of their competition and the economy. In contrast, strong cash management enhances strategic positioning in good times and helps prepare for bad times. Being on solid footing from a cash perspective makes it possible for a company to undertake mergers and acquisitions or to emerge from a crisis stronger than its competitors.

The trick is to find a sustainable means of generating and protecting cash. The Boston Consulting Group has found that many companies try to instill good cash discipline but that these initiatives lack sustainability—and that any improvements vanish once the company's focus shifts. Cash awareness must be embedded in the corporate DNA. This does not mean turning an organization upside down, but rather adding practical levers to existing structures, thereby enabling employees to develop a "think cash" mentality and to integrate that mentality into their everyday work life.

Ensuring full transparency of cash sources and uses is essential. So, too, is anticipating different cash scenarios. Perhaps most important is to make cash management a central function in the organization, with assigned accountabilities accompanied by practical guidelines and a comprehensive incentive system. Of course, cash is only one resource among many, so interdependencies between cash levers and other resources should be recognized and actively managed.

Is Cash King in Bad Times Only?

Cash generation is important for every company, but maintaining reasonable cash buffers can be difficult. BCG analyzed 351 companies from 14 different industries for the period from 1999 through 2008 to find how many generated cash sustainably. We analyzed each company's operating cash-flow margin from 1999 through 2008 in comparison with the industry mean.[1] Over a five-year period, 42 percent of companies had outperformed their industry average, versus only one-fifth over a period of ten years. (See Exhibit 1.) At the industry level, more than one-third of companies in the travel and tourism industry and in transportation and logistics had above-average performance over a ten-year period, compared with less than 10 percent in the chemicals industry and automotive and supply. Sustaining above-average performance is a challenge for every company.

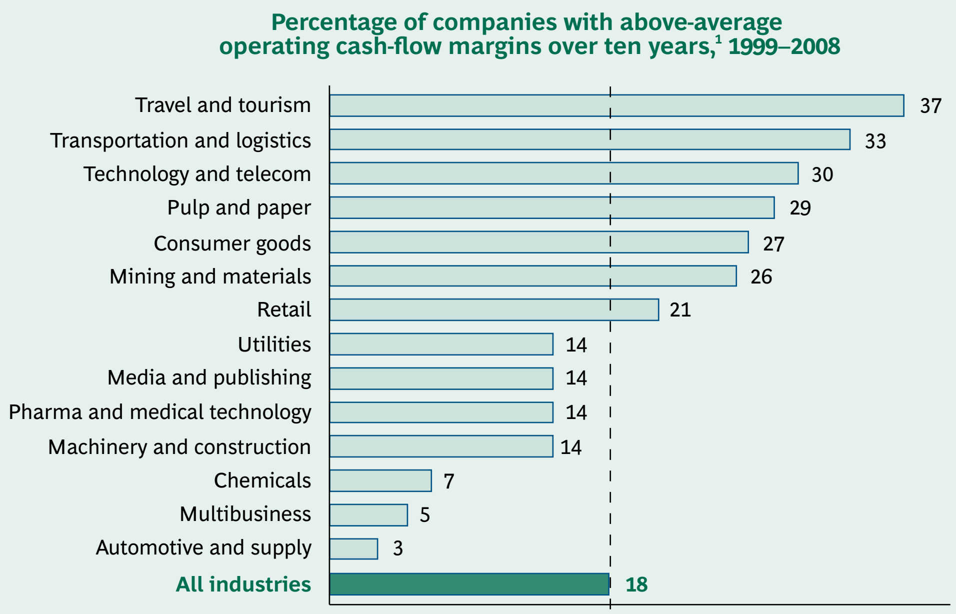
A key driver is working capital—the cash needed to finance the operating business. Reducing working capital releases cash, while increasing it creates a greater reliance on cash. Companies can actively manage their cash-conversion cycle, which is the length of time that working capital must be financed. Saving or generating cash is accomplished by keeping cash conversion steady or—even better—by decreasing it over time through careful management of inventories, receivables, and payables.[2]

One-third of the companies in our sample improved or at least maintained cash conversion over a four-year period. Only seven companies, however—all of which paid constant attention to their working-capital

1. The operating cash-flow margin equals cash flow from operations before investments (including funds from operations, funds from or for working capital, and extraordinary items), divided by sales.

2. See *Winning in a Downturn: Managing Working Capital,* BCG Focus, August 2009.

Exhibit 1. Beating the Norm: Ten-Year Cash Flow Margins by Industry



Sources: Thomson Reuters; BCG analysis.
Note: The sample consists of 351 companies with complete data for the period 1999 through 2008.
[1]The operating cash-flow margin equals cash flow from operations before investments (including funds from operations, funds from or for working capital, and extraordinary items), divided by sales.

base, ensuring steady cash generation—maintained or improved cash conversion over an eight-year period, and none managed nine years or more. (See Exhibit 2.)

Cash is a strong line of defense in times of economic shocks and diminishing sales. But focusing on cash control in critical situations only is not enough. Undisciplined spending in strong times can create weak foundations that cause a vulnerability to downturns, making the company dependent on the vagaries of the financial markets. A strong cash surplus enhances any company's strategic position and increases its ability to outperform market competitors.

Cash Excellence: The Nine Elements of Competitive Advantage

The challenge for any company is to understand cash sources—as well as their interconnections—throughout the company, making the whole organization cash oriented. Our experience with clients in all industries leads us to propose nine elements of effective cash management. The first three elements guide policy, and the remaining six are operational in nature. Note that our approach does not require revamping the entire organization; active cash management can be grafted onto the current structure and processes.

Cash Transparency: The Power of Speed and Pragmatism

Cash reporting is usually a significant part of regular company reporting. However, companies tend to generate an overambitious and unfocused collection of metrics and reports, with inconsistent accountability structures—and without the detail and transparency needed for actively steering cash generation. Success comes from balancing details against speed and pragmatism, and redirecting the focus toward measurable and usable figures.

Metrics should focus on the main drivers that influence cash. Consistency can be created by standardizing formats and predefining reporting structures. Companies should focus on ensuring transparency rather than rebuilding the whole reporting structure. A comprehensive definition of cash applied uniformly across all operating divisions is crucial. A leading European aviation company was hampered in its efforts to finance products for its customers by inconsistencies in its reporting structure and definitions of cash. Lacking the time for a comprehensive IT restructuring (because declining sales demanded a fast solution), the company adopted a system of reports based on simple but comprehensive templates that focused on key cash drivers. This allowed management and the sales staff to plan and report on cash within short intervals. The necessary adjustments to IT were made over a longer period.

Cash Governance: Empower the Experts

In most organizations, cash targets are set centrally and cash is anchored as a planning function within the finance department. Yet cash awareness has to permeate the whole organization, with personnel empowered not only in planning but also in enforcing cash control.

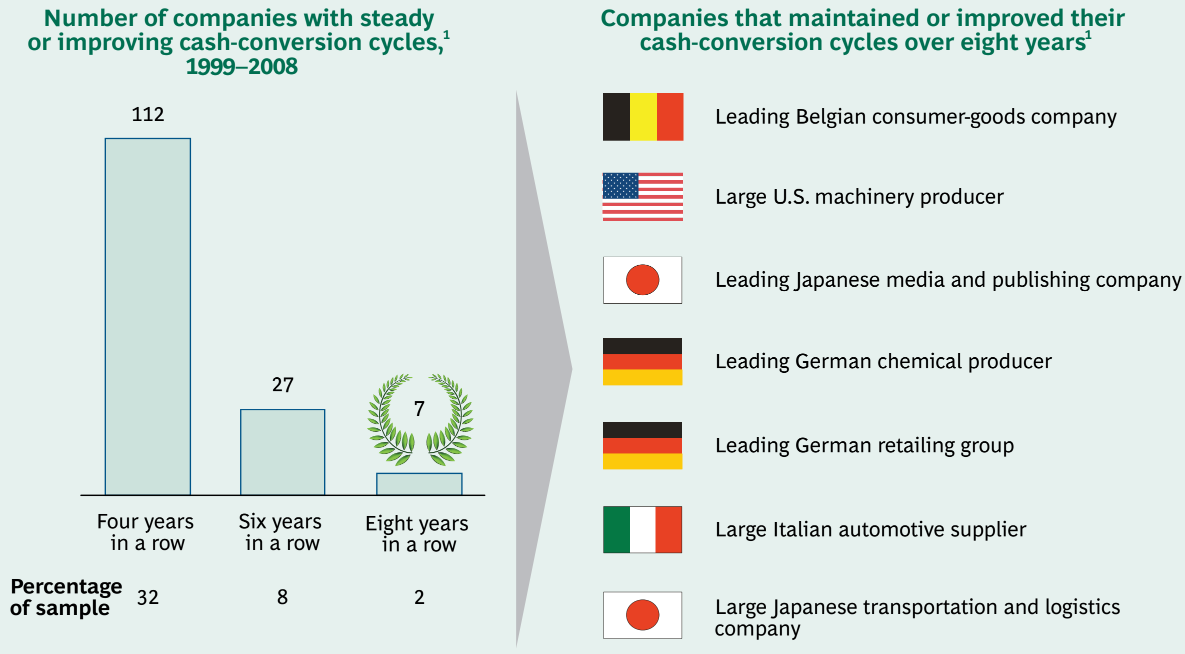
Treasury has a vital role. In good cash-governance structures, treasury not only reports cash levels but also traces and controls them. It performs central cash pooling, sets limits, and aligns cash planning with capital spending plans. The extent of centralization should be aligned with the overall role of the function, with treasury handling the more central functions and other competencies resting with the operating divisions. Treasury can be either an integrated part of the finance department, a separate department alongside accounting, controlling, and finance, or a staff function serving senior management.

A leading global manufacturing company was acquired by a private-equity owner that, typically for such investors, introduced a more cash-oriented approach. Treasury was integrated into the centralized CFO function, which allowed a more comprehensive cash orientation. This restructuring enabled a 40 percent reduction in working capital, releasing a vast amount of cash and creating a more capital market–oriented structure, opening new external financing opportunities.

Cash Competence: Make Everybody an Expert

After assigning cash control a central role, the next step is to make everybody in the company a true cash

Exhibit 2. The Challenge of Improving the Cash Conversion Cycle over Time



Sources: Thomson Reuters; BCG analysis.
Note: The sample consists of 351 companies with complete data for the period 1999 through 2008.
[1]The cash conversion cycle equals days inventories outstanding (DIO) plus days sales outstanding (DSO) less days payables outstanding (DPO); DIO = inventories/sales x 365; DSO = accounts receivable/sales x 365; DPO = accounts payable/sales x 365.

expert. Too often, cash orientation becomes lost at lower levels in the reporting hierarchy—but clear accountability is essential at every level, making a pyramidal, top-down cash-control structure desirable.

Such structures can take time to build, but they do not require a major reorganization. A large industrial conglomerate achieved a comprehensive, sustainable cash focus by creating three new key roles: a senior cash expert, a cash task force, and cash topic experts. The target was to reduce working capital by more than 30 percent and costs by 15 percent. The project, which was coordinated by a central program office, enhanced the company's cash understanding and orientation significantly.

The senior cash expert works as both an enabler and a catalyst, serving as the point person on cash control, with full knowledge of all cash sources and their future evolution. This role is centralized and has unlimited access to information, along with strong decision authority over the realization of cash targets. The senior cash expert identifies liquidity gaps and cash leakages, knows all possible countermeasures, supports cash planning and controlling, and sets standards.

The cash task force, which reports to the senior cash expert, comprises a mix of operations and finance experts. It identifies new cash sources, supports the improvement of existing ones, and trains cash topic experts. In normal times, the task force supports the ongoing establishment of a cash orientation. In critical situations, it can act as a fire brigade and deploy quick fixes.

Cash topic experts are in charge of cash control at the operating level, constantly reviewing sources of cash and reporting to the senior cash expert. They anchor the cash orientation throughout the organization in the business units and individual departments by acting as multipliers of the cash perspective and training other managers and cash project teams.

Cash Projections: Directional Relevance Beats Irrelevant Precision

Planning—preparing for future challenges and managing resources—is a core function in every organization. Cash planning in particular is not a science but rather an ongoing, iterative process that involves many parts of the organization. Experience shows that pragmatic approaches based on rapid analysis often work better than complex statistical models. In addition, scenario analysis should be a part of every good planning process, although too often it is used only superficially or even omitted altogether. Scenario planning enables a proactive approach. Wise managers have alternatives on hand and can quickly adjust to different scenarios as they unfold.

In many companies, cash planning is treated as a balance sheet residual rather than as an integral part of strategic planning to enable proactive cash control. Knowing the general direction of cash, rather than analyzing its various components in too much detail, allows experts to anticipate the evolution of cash balances and puts them "in the driver's seat." In general, cash targets for the next three to five years should be reviewed each quarter and adjusted where necessary.

In the recent crisis, many companies did their planning on the basis of old revenue forecasts and with no scenario analysis. This precluded the escape route taken by a leading aviation company that saw high default risks and established an early warning system connected to its cash-planning process. Through the use of scenario analysis, the company evaluated various financial options for its business and adjusted its operating strategies in accordance with economic developments and the corresponding impact on its customer structure.

Full Cash Control: Improving What You Have Is Better Than Wishful Thinking

Data gathering can be difficult, and data interpretation is even more challenging. What's more, mere data analysis can quickly lead to a loss of perspective. Good cash control needs solid execution at the operating level. Instead of reinventing the whole reporting structure, our experience shows that it is more effective to start with known cash levers—the direct influences on cash—and then, building on that experience, to expand the control system step by step.

Incorporating bottom-up data in high-level cash control can be a big hurdle. Many companies fail to consolidate and aggregate all their operating data appropriately and do not incorporate all business entities, making the information useless for strategic decision-making. Identifying timely available data—particularly with regard to the short-term cash situation—is a prerequisite for effective control.

Cash experts must be able to identify and address cash leakages, in addition to learning the characteristics of each cash driver. Direct cash-flow forecasts developed by operating divisions should be used instead of high-level indirect calculations, in order to increase overall transparency and accurate reckoning of the current cash situation. Sensitivity analysis of the drivers of cash flow can help create a clear understanding of their impact and the time frames involved.

Cash Guidelines: Pragmatic Formalism and Formal Pragmatism

For individual employees, guidelines are the key to cash awareness—the guardrails in a cash-oriented organization. They clarify for both frontline employees and management how to behave in a cash-oriented way. Good formal guidelines should be pragmatic and consistent and should cover all cash-relevant areas. They need to strike a balance between two contrasting risks: being too general and impractical versus being too complex and resource intensive.

A similar balance is needed in the organization structure. Poorly defined responsibilities lead to long and faulty decision-making processes and hinder the enforcement of rules, while excessive bureaucracy is equally ineffective. Decisions must be made at the appropriate hierarchical levels. Good cash guidelines control sources and uses of cash according to strategic and operating considerations from a cross-divisional perspective. As with mission statements, guidelines should last long enough to be incorporated into the organization's DNA, building the basis for sustainable cash generation.

Good guidelines consist of clear responsibilities, adequate cash thresholds, and comprehensive documentation. The senior cash expert, with the help of cash topic experts in the operating units, should identify relevant cash gates.[3] Cash gates should be part of a pooling structure in which the central administration monitors and consolidates the short-term generation and utilization of cash by the various organizational units, thereby avoiding, for example, expensive short-term loans.

Of course, control mechanisms are necessary to verify adherence to cash guidelines. A leading manufacturing company developed best practices in guidelines for tightly controlled and adequate cash positions, enabling the whole organization to react more quickly to economic changes and to avoid leakages. As a result, the company was always in a position to free cash for ready access and to navigate a major crisis.

Incentives: Simplicity Is Its Own Reward

While guidelines provide a broad framework, a good incentive structure encourages employees to approach cash management in a way that best serves the interests of the company. Well-aligned incentive systems are always more effective than rules and hierarchical pressure. Unfortunately, many incentive structures miss the mark by being complex and confusing—and by failing to address the drivers that an employee can influence. It must be clear how cash targets are derived and how employees can influence them. Without simple, transparent, and comprehensive incentives, a companywide cash focus is very difficult to accomplish.

Managers' rewards must be based on cash flow targets—and if blue-collar workers can influence cash flow, then their incentives, too, should be linked to cash. A leading industrial company found that it was experiencing cash problems because its sales force typically booked numerous contracts at the end of the reporting year by accepting unfavorable payment conditions in order to close the deal. Setting bonuses according to when customer payments were received had the immediate effect of smoothing sales and improving cash conversion.

Synergies: Business Insight Beats One-Size-Fits-All Measures

Most standard cash-related operating measures are widely known, creating the temptation to apply standard initiatives in the hope that they will fit the organization. But such initiatives will not have the same impact in every industry or for every supplier and client structure—nor will they be equally effective in every state of the economy. For example, a standard short-term "fix" is to squeeze payment terms. Yet when a leading manufacturer—aware that its suppliers had their own cash-flow problems and that

3. Cash gates are control points in the organization that significantly influence cash generation.

aggressive payment terms rarely brought long-term benefits—decided instead to give its suppliers more transparency and to align its stock-ordering procedures more closely with its production schedule, it was rewarded with shorter storage times, lower required levels of safety stocks, and more flexible ordering. This led to a sustainable 50 percent reduction of supply stocks at no out-of-pocket cost.

Cash control is built not on standardized systems but on business insight. Each company has its own individual cash sources. These are weighted differently across industries and markets and can change over time. Identifying them requires digging under the surface. Senior cash experts or the cash task force should analyze company initiatives—which may require only a bit of readjusting to be fully effective—with an eye toward cash synergies.

From Cash Control to Cash Advantage: Winning in a Downturn—and Winning in an Upturn

The recent liquidity squeeze on many companies underlined the role of cash as a resource for survival. Temporary liquidity shortages can generally be overcome—although access to external cash sources may be very expensive—but an enduring liquidity squeeze can lead to daily difficulties in paying bills and an inability to replace plant and equipment or make strategic investments, thereby weakening a company's financial foundations. A number of bankruptcies since 2007 have demonstrated the importance of adequate cash balances as a buffer in tight economic environments. And these bankruptcies were not confined to financial services companies. German retailer Arcandor sold most of its assets and leased them back at very high financing rates in order to release cash in the short term—but it had no longer-term strategy to increase its cash surplus. When the economy declined, the company had no cash buffers left.

Liquidity shortages can also occur in times of growth. A company might need to finance strong growth to exploit a first-mover advantage, or it might simply be overspending owing to a lack of central control over all its investment projects. In either case, the resulting cash drain can weaken the company's competitive position.

Successful companies identify quick levers to regain cash control. A major manufacturing company pulled quick levers for net working capital by analyzing its payment and invoicing processes—including comparing its own payment terms with those of its competitors—to exploit opportunities to optimize its payment practices. It found that payments to suppliers were often made before they were due—and that renegotiating batch order sizes enabled smaller and more evenly spaced payments (instead of large lump-sum payments). Another quick lever was to reduce receivables by requiring higher prepayments from customers and seeking earlier payments in full by structuring reminder and escalation processes and creating appropriate incentives for its salespeople.

A liquidity crisis makes it easier to enforce existing measures and to establish a new understanding of the importance of cash. Initiatives to secure sustainable sources of cash generation over the long term require planning and proactivity and must be aligned with corporate strategy and portfolio management. The senior cash expert and all subordinates must be given the resources necessary to coordinate a company-wide focus on cash conservation and generation.

Cash Advantage: Orchestrating the Elements

BCG has developed a framework that integrates the nine elements of effective cash management to help enable sustainable cash control for cash advantage. Managers must recognize that cash generation is always the result of an interconnected system of cash sources and requirements, so it is important to understand the logic and interrelations behind cash effects. Inherent interdependencies can influence strategic decisions, affect other operating areas, and endanger or negate solid sources of cash. Every business unit and employee must act in concert to avoid underperformance, hiccups, and yo-yo effects.

The great variety of available cash levers can succeed only if they are used in an integrated approach. Each lever is characterized by the resources it consumes and its time to impact. The magnitude and side effects of specific measures are not always fully known, nor are the size and urgency of cash needs entirely predictable. All levers must therefore be ranked by their cost-benefit ratio and time to impact, taking into account economic conditions, the company's strategic ambitions, and, finally, the "pain factor" of implementation in light of the organization's existing culture, traditions, and methods of working.

BCG's comprehensive and integrated cash-management approach comprises three pillars: cash governance and awareness to create a corporate cash DNA, cash visibility to plan and monitor cash, and active cash management for appropriate action. (See Exhibit 3.) Cash governance and awareness form the basis of cash control, bringing the organization to a strategic understanding and mastery of cash. This enables the organization to integrate a cash focus into its various operating mechanisms and to embed a pervasive cash orientation into its corporate culture. Cash visibility involves comprehensive, business-oriented reports, appropriate cash scenarios, and pragmatic management of operating cash, all adjusted to the current organization structure. Finally, active management balances all cash levers according to the company's current competitive situation and ensures a sustainable impact.

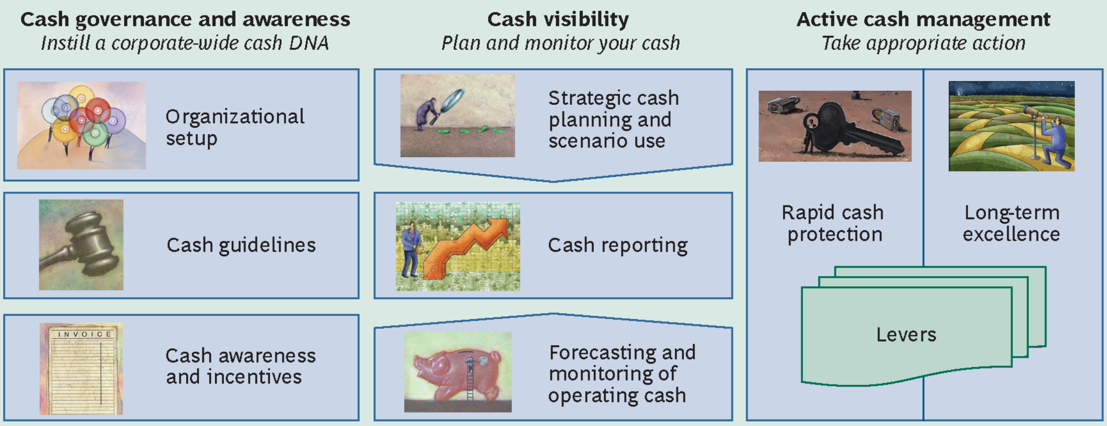
The Time to Begin Is Now

Every management team should examine the extent to which an integrated cash-management system is already in place. Implementing a fully integrated cash-management framework should not require rebuilding the existing organization but rather involves executing a step-by-step process for sustainable impact. At the start, key success factors arise from evaluating the status quo and the company's ability to develop a true cash focus. A reasonable rollout plan must take available resources and capabilities into account. Key personnel must commit to a process that may take considerable time for full implementation.

Analyzing your current cash situation and understanding your position relative to that of your competitors is the starting point on the path to full cash advantage. A quick comparison with peers in your industry can reveal preliminary opportunities to improve your cash position. Further analysis should address lower levels of the organization, concentrating on the areas with the greatest potential for releasing cash. A thorough analysis of current and future cash needs under the strategic plan is equally essential. Building scenarios and stress-testing cash positions are mandatory. At the bottom line, the organization should map its cash sources and drains. The company's current cash orientation should be assessed by qualitative appraisals of its cash culture and control as well as its incentive structures. Pragmatic quick checks—perhaps by the cash task force—are advisable.

Exhibit 3. BCG's Integrated Cash-Management Framework

The appropriate focus depends on a company's specific situation



Source: BCG analysis.

Implementing integrated cash management on all organizational levels is a significant challenge. Holistic implementation is necessary in all departments to avoid uncontrolled cash leaks. Because not every department will require the same effort, a central function—ideally the senior cash expert—should develop a prioritized training plan that focuses on the main cash levers and defines strategic and divisional cash targets. These targets must be validated at the operating level and integrated in iterative cash planning. The organization should also identify cash topic experts at the division and subdivision levels and assess the necessary training effort. The cash task force assembled by the senior expert enables topic experts and project teams in the various departments and business areas to fill their new roles, and supports the development and implementation of required measures.

Cash awareness, cash visibility, and active cash management must go hand in hand. The rollout plan must address imminent needs while keeping comprehensive, longer-term integration in mind. After a successful implementation, a cash orientation must become an integral part of the company's culture, fostering an ongoing process of striving for steady improvement. Integrated cash management will enable every company to fully enjoy the benefits of a solid cash position and readiness for future challenges.

Managers may ask when to start the process. The rewards of implementing an integrated cash-management approach are always attractive—and in light of the cash needs stemming from the current crisis, there is no better time to begin than right now.

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