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UNLOCK CASH: A GUIDE TO AI-POWERED CASH FLOW MANAGEMENT

Urgent Measures for CFOs: Harness the Power of AI to Accelerate Cash Flow and Optimize Working Capital in Anticipation of an Economic Hard Landing

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In just 18 short months, the financial world has been turned upside down.

In January 2022, the market was characterized by abundant cheap money. With the COVID-19 pandemic receding, the Secured Overnight Financing Rate (SOFR) stood at a mere 5 basis points (bps), banks were flush with deposits and actively seeking deals, and the cost of capital for most companies reached historic lows.

Fast forward to the present day, and the situation is starkly different. The SOFR has skyrocketed to 5%, with 72% of large domestic banks increasing loan rate spreads over their cost of funds. Commercial loans are exhibiting signs of tightening, putting pressure on CEOs and CFOs to carefully consider the impact of rising capital costs on their bottom line.

Considering these circumstances, it is crucial to address the potential erosion of the bottom line caused by escalating capital costs. It is imperative to prevent cash from becoming trapped within the organization, tighten the cash conversion cycle and optimize cash flow. While traditional key performance indicators (KPIs) such as the Cash Conversion Cycle and its components serve as a solid starting point, they may prove inadequate in isolation within the current environment.

To evaluate their existing cash management strategies in this uncertain landscape, CFOs should pose three critical questions centered around **Certainty, Speed, and Resilience:**

1. Will we possess adequate liquidity in the coming 12-18 months?
2. What should be the appropriate level of the Cash Conversion Cycle (CCC)?
3. Can we effectively identify, anticipate, and unlock trapped cash?

In today's uncertain economic landscape, preserving cash should be paramount for companies. As businesses confront a range of challenges, safeguarding liquidity is crucial to ensure survival and capitalizing on emerging opportunities. This article delves into the significance of cash flow efficiency and provides strategies for US companies to navigate through these uncertain times.

Anticipate tough economic conditions.

In the current economic landscape, economists are engaged in a debate between a soft landing and a hard landing. While the projections may be uncertain, CFOs should adopt a cautious approach and prepare for the possibility of a hard landing, even as they hope for a softer outcome.

Capital cost pressure will continue to squeeze the margins. The Federal Reserve is expected to maintain its policies aimed at reducing inflation, which includes keeping interest rates elevated. The significant changes observed in the Secured Overnight Financing Rate (SOFR) reflect the proactive measures taken by the Fed.

To counter the impact of low rates on their fixed-rate portfolios and account for ongoing inflationary pressures, large domestic banks have been increasing loan rate spreads. This trend was observed in April' 23, when 72% of these banks implemented such measures. As a result, many firms now face double-digit interest rates due to the combined effect of elevated indexes like SOFR and increased spreads.

Furthermore, firms are grappling with inflationary pressures stemming from higher costs of

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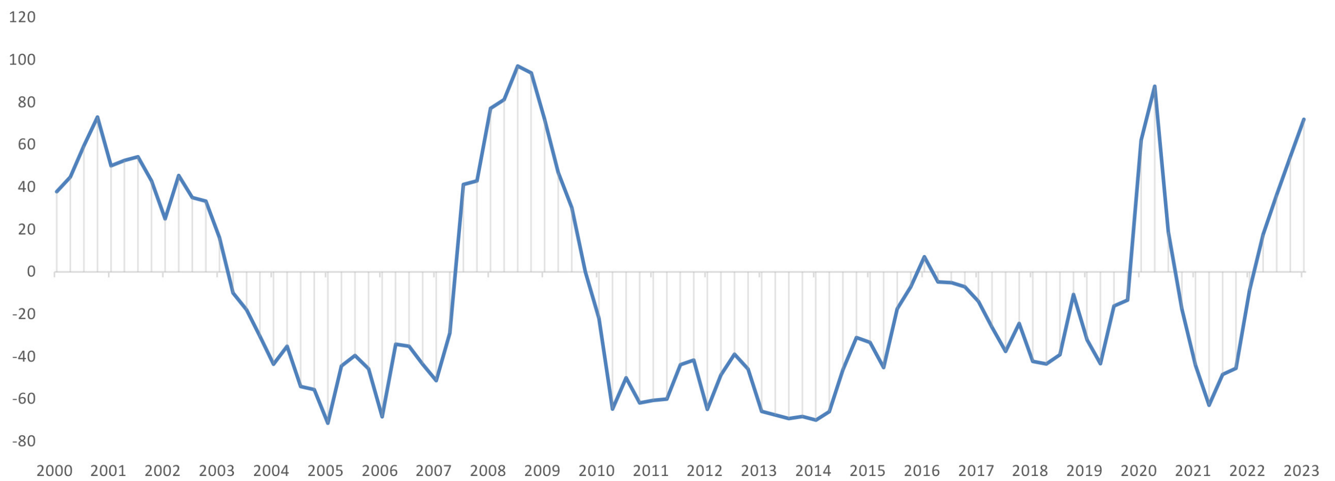
Net Percentage of Large Domestic Banks Increasing Spreads of Loan Rates over Banks' Cost of Funds to Large and Middle-Market Firms



Source: Federal Reserve Bank of St. Louis

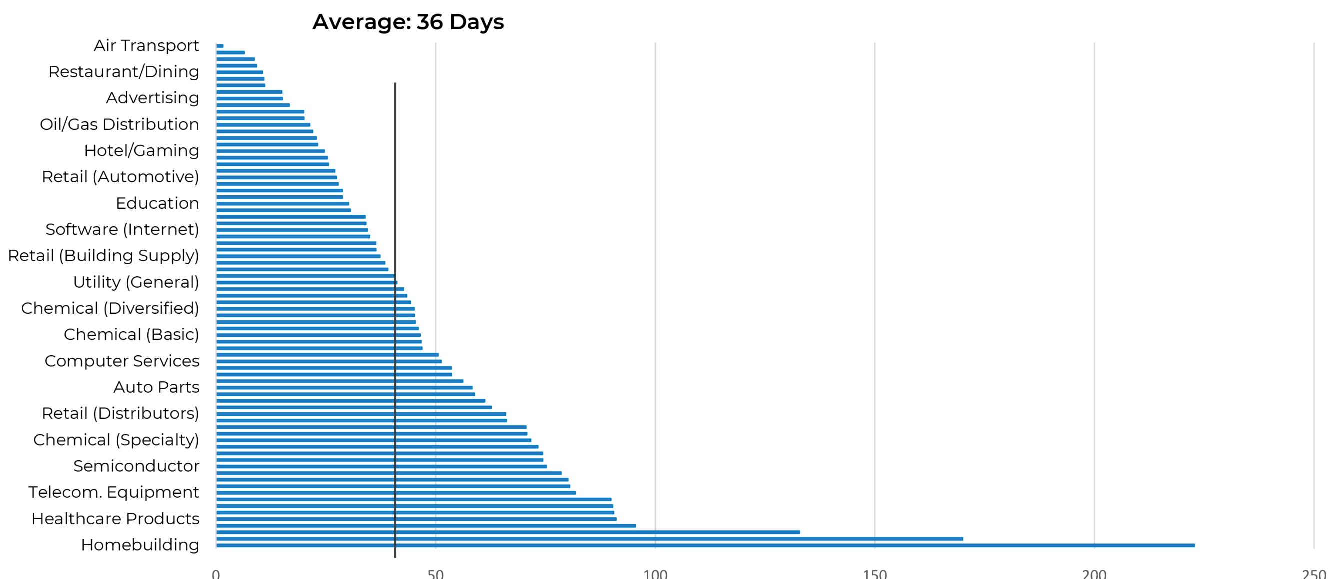
raw materials and wages throughout their supply chains. This situation poses an even greater challenge for small and mid-market companies. As economic conditions worsen, the cost pressure will further squeeze margins, demanding proactive measures from business CFOs.

Inefficient cash flows erode $100B of margins.

In 2022, US mid-market companies generated over $9 trillion in revenues, but unfortunately, approximately $1 trillion of cash was trapped in supply chain and inventory. These companies are burdened with over $100 billion in interest charges due to the significant increase in capital costs associated with this trapped cash.

To gauge cash flow efficiency, it is essential to consider the Cash Conversion Cycle (CCC). CCC

Cash Conversion Cycle (Days)



Source: https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datacurrent.html

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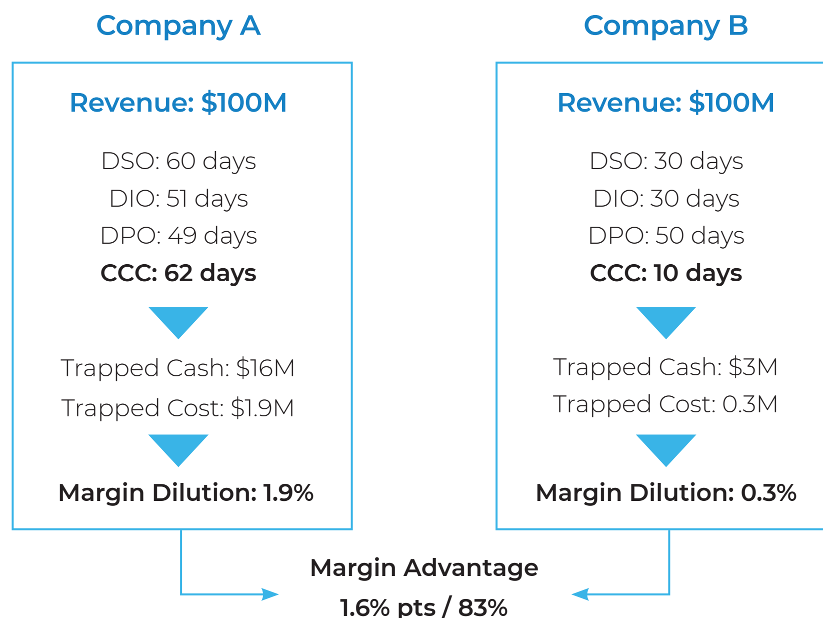
varies across industries, but the overall average for US companies is 36 days. CCC is calculated by combining the Days Sales Outstanding (DSO) and Days Inventory Outstanding (DIO), and then subtracting the Days Payables Outstanding (DPO).

To improve cash flow efficiency, companies must deploy strategies to improve each component of CCC. They should set goals to minimize account receivables (DSO) and inventory (DIO), while maximizing account payables (DPO).

The following figure illustrates the direct financial impact of deploying strategies to improve cash flow efficiency.

Let's consider two companies, A and B, with revenues of about $100M. The cash flow for company A is inefficient with the CCC at 62 days. In stark contrast, cash flow for company B is quite efficient with their CCC at 10 days.



As a result, **Company B enjoys a significant advantage, generating $13 million more cash, 160 bps better margin, and $1.6 million more net income!**

By focusing on enhancing cash flow efficiencies, companies can strengthen their financial resilience and improve their ability to navigate economic downturns, volatile markets, and unforeseen disruptions. Preserving cash also provides a cushion for investments in research and development, expansion initiatives, and strategic acquisitions, enabling businesses to maintain competitiveness and capitalize on emerging trends.

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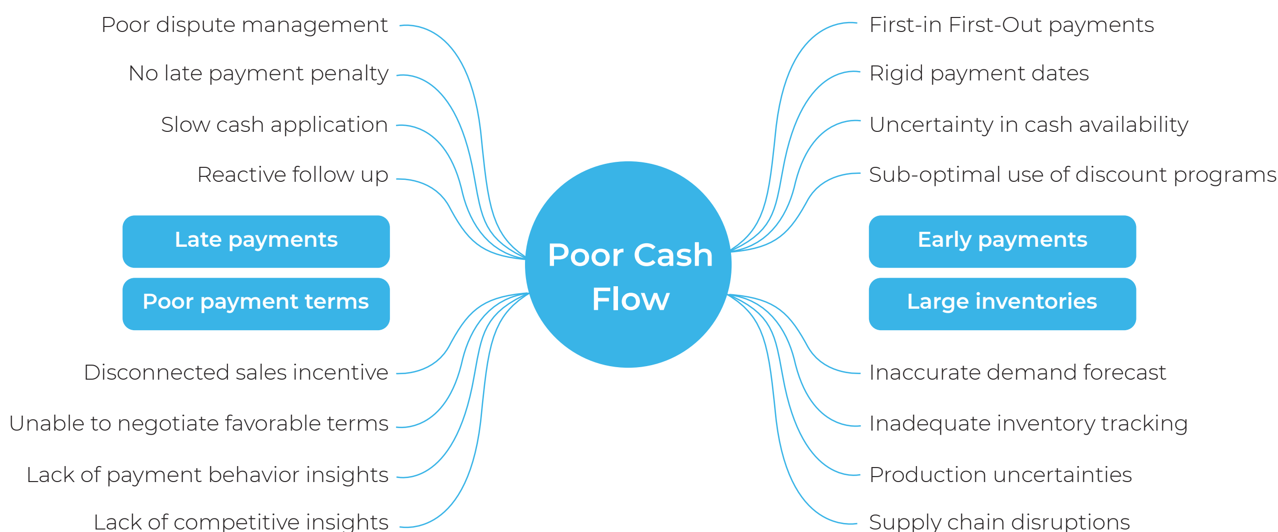

CFOs must evaluate root-causes of their end-to-end cash flow process, which includes assessing Account Receivables, Account Payables and Inventories.

Companies that struggle with large amounts of Accounts Receivables often face challenges in cash collections, cash application processes, customer dispute management, and sub-optimal payment terms. Sales incentives are often disconnected from collections performance and customized payment terms, further exacerbating the issue. On average, US companies have a Days Sales Outstanding of 42 days. However, when a large number of customer invoices (> 200/month) overwhelm manual tracking, it becomes even more difficult to manage outstanding invoices and address past-due challenges.

Many companies do not regularly optimize their Account Payables process. The average Days Payables Outstanding for US companies is 39 days. Companies typically adhere to a rigid weekly or bi-weekly payment cycle, paying suppliers on a first-in-first-out basis. As a result, companies often make early payments to avoid late payment penalties, leading to sub-optimal high bank balances.

Companies that take advantage of early payment discounts from suppliers often fail to evaluate the actual trade-off between their cost of capital and the discounts being offered. For instance, in a high interest rate environment, a 30-day/50 bps discount program may not be the most cost-effective one to opt for.

Supplier payment schedules are frequently disconnected from cash collections. CFOs maintain large cash buffers to accommodate payment schedules, incurring bank interest charges and subsequently, missing out on investment opportunities.

Average Days Inventory Outstanding for US companies is 33 days. Companies with large inventories struggle to predict orders, manage disruptions in production cycle times, and streamline supply chain deliveries. Additionally, they often lack robust inventory tracking processes.

Surprisingly, over 90% of US mid-market companies still manage Receivables and Payables using spreadsheets. With limited access to advanced analytics for predicting and prescribing optimal actions, these companies rely on slow, inflexible and reactive manual processes that come with hidden costs.

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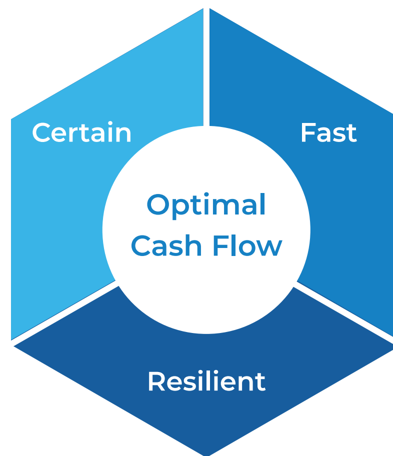
CFOs must create a cash flow process that enables cash **Certainty, Speed** and **Resilience** while minimizing costs.



Certainty in liquidity provides a strategic advantage for companies.

CFOs often secure credit lines and incur unused line fees to ensure cash availability when needed. However, there is an alternative approach to achieving cash certainty that involves predicting and proactively managing cash flow while minimizing cash buffers and unused credit line fees.

The main drivers of uncertainty are demand projections and cash collections. To build confidence in projections, companies should utilize predictive cash management systems that have the following features:

Step 1: Real-time visibility of sales order pipeline, fulfilment, invoice tracking and payment. This requires integrating the Customer Relationships Management (CRM) system with the Enterprise Resource Planning (ERP) system. Tracking associated cash flows and conversion cycles in parallel empowers finance teams to have a proactive view of potential process bottlenecks.

Step 2: Ever-ready Key Performance Indicators (KPIs) to visualize health of the cash flows at any time. These KPIs should include demand pipeline, order conversion, order fulfillment, receivables aging, collections effectiveness, disputes and returns. Easy and intuitive access to KPIs eliminates surprises and ensures an ability to react quickly.

Step 3: Accurately predict cash flows. CFOs should use the advancements in Artificial Intelligence (AI) techniques to build a more predictable system. An innovative cash flow management system would incorporate embedded AI that automatically learns business patterns, adapts to changing conditions, and generates accurate predictions. These AI systems can predict cash inflows and recommend supplier payment outflows that preserve cash and minimize costs.

A **Faster** cash flow cycle directly impacts the bottom line.

To speed up cash flow and minimize the cash conversion cycle, CFOs can take the following steps using AI-powered advanced analytics:

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Step 1: Proactively follow up on potential late payers. An AI-based system can predict customer payment delinquencies before they even occur. CFOs can deploy automated and customized escalation messages at scale, which can include a digital payment option to eliminate friction.

Step 2: Accelerate order fulfillment and inventory turns. An AI-powered system can accurately predict orders and optimize fulfillment schedules. Advanced analytics can then identify potential bottlenecks.

Step 3: Offer smart payment terms to customers. Benchmark and utilize AI to automatically create smart payment terms at the point of sale that ensure deal success and on-time payment behavior. CFOs should design a payment terms strategy that aligns with their cash flow goals. An AI engine for smart payments can be tuned to manage trade-offs between deal conversion, capital costs, and cash conversion cycle to optimize deal economics. Sales incentives must then be aligned with the chosen strategy.

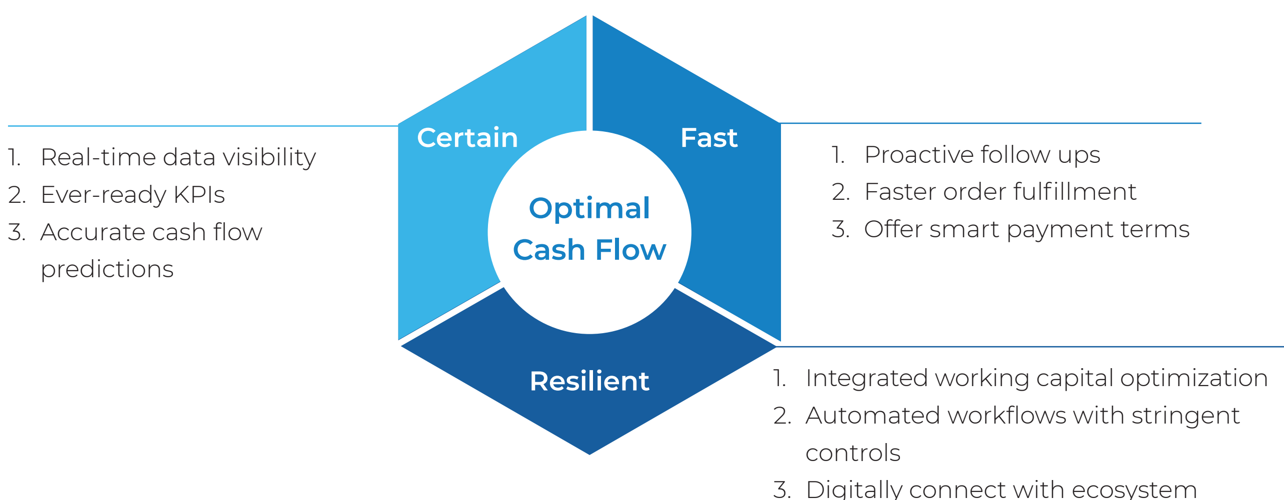
A **Resilient** cash flow ensures adaptability in changing business needs.

CFOs should strive for an integrated cash flow system that can respond quickly to changing business goals or environmental factors. Here are the steps to achieve this:

Step 1: Create an integrated working capital optimization system. Utilize human-in-the-loop AI systems to generate optimal supplier payment schedules that simultaneously consider cash availability, early payment discounts, late payment penalties, capital cost and payment methods. Such a system enables CFOs to create multiple supplier payment scenarios based on their short-term and long-term goals. With an integrated system, they can now manage their end-to-end cash flow with just a few clicks.

Step 2: Automate workflows with stringent control points. While automation accelerates actions, CFOs must establish strong internal control points. Design workflows to manage supplier payment authorization, dispute resolution, inventory re-orders, etc. Robust AI models can generate trend insights and exception alerts automatically, empowering CFOs in decision-making.

Step 3: Digitally connect with your ecosystem. During the COVID 19 pandemic, lack of visibility was one of the biggest failure points for many companies. Customers and suppliers were caught



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in a doldrum where they couldn't determine outstanding payments. Many banks and financial institutions conducted cash-burn analyses to help their clients with credit needs. However, it was tedious and not fast enough for those who couldn't survive without government support. CFOs should adopt a digital payment platform that enables frictionless flow of cash with complete visibility across their customers, suppliers, banks and financial institutions.

Measuring the right KPIs can ensure rapid improvements in cash flows.

Turbo-charging cash flow efficiency is a journey, not a destination. CFOs must design KPIs across these key strategic pillars – **Cash Certainty, Cash Speed**, and **Cash Resilience.**

They should design KPIs for each of these strategic pillars, set up a repeatable measurable process, and set internal performance goals considering peer benchmarks.

We have illustrated a few KPIs that can help CFOs on a path to cash flow efficiency.

Strategic Pillar	KPI	Goal	Strategic Levers
Cash Certainty	Cash Forecast Accuracy 1/4/13 weeks Forecast/Actual	Minimize +/-5%	Real-time data visibility Ever-ready KPIs Accurate cash flow predictions
Cash Speed	Cash Conversion Cycle DSO, DIO, DPO	Minimize < 30 days	Proactive follow ups Faster order fulfillment Offer smart payment terms
Cash Resilience	Working Capital Ratio	Optimize 1.5 – 2.0	Integrated working capital optimization Automated workflows with controls Digitally connect with ecosystem
Working Capital Cost	Cash Buffer/Working Capital Cash buffer = Minimum Cash Reserve	Minimize < 10%	Reduce credit lines and utilization

In conclusion, achieving cash efficiency is crucial for US companies to thrive in uncertain times. CFOs play a vital role in minimizing reliance on debt and implementing strategies that ensure **Certain, Fast,** and **Resilient** cash flows. While companies have the option to build their own cash flow systems, partnering with innovative companies can provide a quicker and more cost-effective solution. When evaluating such partnerships, companies should prioritize the following factors. Does the solution:

1) Enhance cashflow predictability and **Certainty.** AI-powered systems are powerful and deliver best accuracy.
2) **Speed-up** cash conversion cycle. Recommend proactive actions at an invoice level to optimize cash.
3) Improve **Resilience** and flexibility. Offer controls across end-to-end cash flow.
4) Deploy in hours. Pre-built connectors to accounting systems.
5) Enable frictionless cash and information flows between customers, suppliers, and banks. Securely connect with the ecosystem.

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The time is now!! CFOs must take action to unlock the value of efficient cash flows and secure a stronger financial future for their companies!

About the Authors

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Founded in 2021, SimpliCapital is an AI-based SaaS software company focused on empowering companies to improve their cash flows. Visit www.SimpliCapital.ai for more information.

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