

The AI Edge in Cash Flow: Unleashing Business Growth

AI revolutionizes business liquidity by unlocking trapped cash in working capital, significantly boosting cash-on-hand.



By Rakesh Sahay, Feb. 2024

Efficient Cash Management Can Transform Your Business

With the economy continuing to be strong, the effect of high interest rates can hamper growth for small and medium-sized businesses. However, businesses have a significant amount of untapped growth capital. Our research has found that a staggering 75% of U.S. companies are hampered by inefficient cash flow, leading to a phenomenon we term as "**Trapped Cash Opportunity**." In this article, we'll explore effective strategies to identify and unlock this potential, significantly increasing cash-on-hand and the ability to invest in growth.

Billions Tied in Trapped Cash Opportunity (TCO)

Trapped Cash Opportunity (TCO) represents funds inefficiently tied up in customer past dues and premature supplier payments. Understanding and calculating TCO is crucial for identifying where your business might be missing out on valuable liquidity. Companies with inefficient cash flow can have TCO as much as 100%-200% of their cash-on-hand at any point in time.

$$\text{TCO} = \frac{\text{Past Due Amount} \times \text{Avg. Past Due Days}}{\text{Number of Days in Period}} + \frac{\text{Early Payment Amount} \times \text{Avg. Early Payment Days}}{\text{Number of Days in Period}}$$

TCO can be calculated for any period for which past due invoices and premature paid bills are available. To illustrate, we show an example TCO calculation for a company whose data has been modified for privacy reasons.

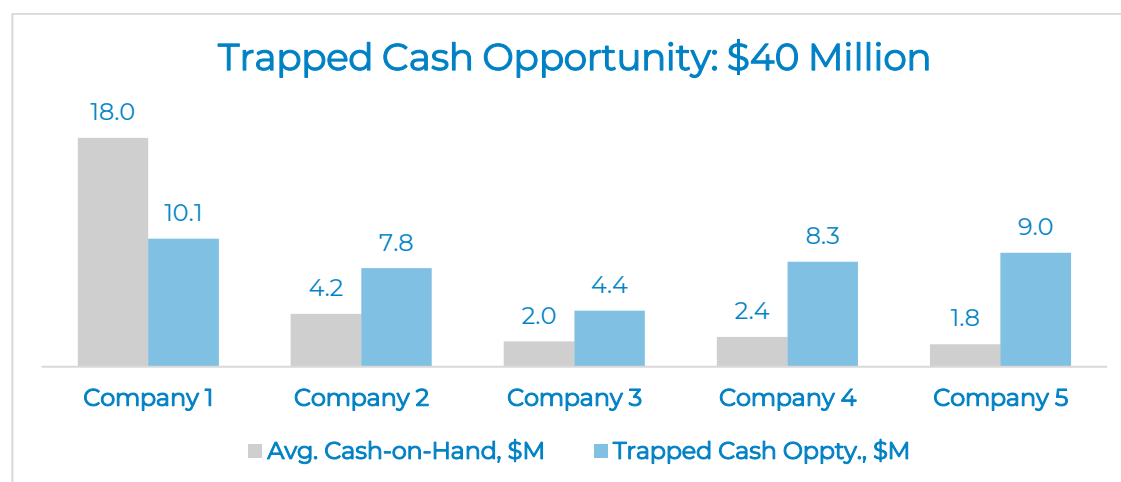
Table 1. Example TCO Calculations

Receivables		Payables	
Average Annual Past Dues (days)	30	Average Annual Early Pays (days)	7
Total Past Due Amount (\$M) ¹	72	Total Early Payment Amount (\$M) ²	46
Trapped Cash Opportunity (TCO) ³	5.9	Trapped Cash Opportunity (TCO) ³	0.9
Total TCO (\$M)	6.8		
TCO% (vs. average cash-on-hand)⁴	289%		

Note:

- 1) Total amount of invoices past due throughout the year.
- 2) Total amount of bills paid early throughout the year.
- 3) Number of days: 365
- 4) $TCO\% = TCO / \text{Average Cash-on-hand}$

To further demonstrate the impact of TCO, we showcase a deeper study of five manufacturing companies. This analysis reveals a potential to unlock significantly more cash than their average cash-on-hand, equating to about \$40 million or 5% of their total revenue.



Drivers of TCO: Best Performers are 2-3X more Operationally Efficient.

1. **2X leverage in On-Time collections:** Firms with the least amount of TCO boasted the best collections performance, with 85% of collections made on time while the worst performer made 31% on-time collections. A 2X leverage.
2. **3X leverage in Past Due collections:** Once an invoice becomes past due, the most efficient company collected within 28 days, in contrast, the worst performer did the same in 93 days.
3. **Nearly Zero Premature Supplier Payments:** The best performers rarely paid suppliers early, while the least efficient paid early 71% of the time, locking up 25% of their average cash-on-hand.

Cash Flow Performance

	Collections		Payments	
	On-time	Avg. Late Days	Premature	Avg. Early Days
Company 1	85%	28	71%	8
Company 2	41%	31	7%	5
Company 3	31%	48	4%	24
Company 4	50%	36	59%	4
Company 5	76%	93	7%	16

Strategies to Release Trapped Cash Opportunity (TCO)

The Role of CFOs

CFOs must focus on speeding up invoice collections and optimizing supplier payment outflows without degrading customer and supplier relationships. However, in many mid-market companies, CFOs are stretched thin, mainly focusing on day-to-day tasks. The problem is further exacerbated by the lack of skilled professionals in the current tight labor market.

The savings from an efficient cash flow can more than offset investments in technology. CFOs can set clear targets to reduce Trapped Cash Opportunity (TCO). Even a 20% TCO release for the 5 companies above could mean an \$8 million additional average cash-on-hand and a \$1 million saving in yearly interest charges.

AI Powered Automated Cash Management Systems

A practical solution lies in implementing automated cash management systems. It is important to choose systems that provide real-time visibility, actionable insights through a powerful analytics engine, and customer-friendly strategies to manage cash. These systems should be easy to deploy, integrate seamlessly with existing ERP or accounting systems, and address key operational inefficiencies by:

1. **Minimizing Days Sales Outstanding (DSO):** This can be achieved through utilizing AI to predict late payers, automate collections reminders and follow-ups, and provide real-time visibility into past dues and client behaviors.
2. **Maximizing Days Payables Outstanding (DPO):** By automating payment schedules, considering supplier discounts, late payment penalties, and cash forecasts, companies can optimize their payables and effectively slow down cash outflow.
3. **Accurately Projecting Cash:** Utilizing AI and integrated AR/AP automations, CFOs can now accurately predict cash availability and maximize investments in growth and value creation. With less uncertainty, they can reduce cash-buffers and invest surplus cash.

CFOs Must Choose the Right Partners

In today's fast-paced and technologically advanced business landscape, CFOs face the challenge of sifting through a myriad of options to find the most effective financial tools and partners. It is crucial to focus on a select few key features that can truly transform cash management:

1. **A comprehensive end-to-end cash management system**, encompassing modules for Accounts Receivable (AR), Accounts Payable (AP), and Cash Forecasting, ensuring a holistic cash management approach.

2. **AI-powered analytics** capabilities that deliver real-time insights, enabling prompt and informed decision-making.
3. **Easy to deploy platform**, equipped with pre-built APIs to facilitate seamless integrations, enhancing operational efficiency.
4. **An intuitive and user-friendly interface**, designed to save time and reduce effort, thereby improving overall user experience.
5. **Knowledgeable partner** who understands cash management, ensuring that the solutions offered are tailored to meet specific business needs.

In conclusion, the transformative power of efficient cash management is undeniable in today's economic landscape, particularly for small and medium-sized businesses. The concept of **Trapped Cash Opportunity (TCO)** underscores the significant potential that lies in optimizing cash flow.

Embracing AI-powered automated cash management systems emerges as a pivotal solution, offering real-time insights and actionable strategies to minimize Days Sales Outstanding (DSO) and maximize Days Payables Outstanding (DPO). CFOs play a crucial role in steering their organizations towards financial efficiency and should prioritize selecting the right technology partners and tools. Such proactive and strategic approaches to cash management not only bolster immediate financial health but also pave the way for enduring growth and stability, proving that mastering cash flow is not just a fiscal responsibility but a cornerstone for future business success.

About the Author:

Rakesh Sahay, Co-Founder and Chief Operating Officer of SimpliCapital, offers more than twenty years of experience in financial services. Throughout his career, he has been instrumental in creating innovative products and services for major corporations including GE, FedEx, and Citizens Bank.

About SimpliCapital:

SimpliCapital revolutionizes cash management with its AI-powered system, enabling businesses to increase their cash by over 20% at a reduced cost. The platform provides real-time insights into key processes like invoice-to-cash and procure-to-pay, along with predictive analytics for optimizing cash flow. The AI engine not only forecasts cash availability but also suggests strategies for efficient cash inflow and outflow management, streamlining financial operations for businesses of all sizes.

Interested in learning more? Contact us at hello@simplicapital.ai.