Four out of Five Companies Can't Forecast Cash Flow

Hackett Group study shows only 22% of companies are able to forecast mid-term cash flow.

Tuesday, July 28, 2009

By . IW Staff

The uncertainty of being unable to accurately forecast mid-term cash flow creates a potentially dangerous scenario when combined with shrinking levels of cash on hand in most industries, plummeting revenues, reduced margins, and limited availability of credit and cash from other external sources.

A new study from the Hackett Group found that only 22% of companies say they can forecast mid-term (2-3 months out) operating cash flow to within 5% accuracy. Previous Hackett research also showed that only one in three companies can forecast earnings to within 5% accuracy, and less than half can make the same claim about sales forecasting.

"It's disturbing to think that most companies are virtually flying blind in this critical area," said Hackett Chief Research Officer Michel Janssen. "This problem is by no means a new one. But it's been exacerbated by the current economic climate, where it's more critical than ever for companies to be able to understand and predict their cash flow from operations."

Top performers do significantly better than their peers. A total of 74% are able to forecast mid-term cash within 5% accuracy. These top performers also complete their forecasts in less than half the time it takes typical companies, and require fewer staff to complete the process.

Several major findings from the study looked at how companies must improve organizational collaboration and alignment and the underlying technologies that support cash forecasting. Specifically, about 70% of all companies surveyed rely almost exclusively on standalone spreadsheets as their primary cash forecasting tool, with few turning to best-of-breed applications or ERP-related systems.

The best companies also have cross-functional teams with significant operational involvement, which is critical given the number of groups outside of finance that have a role in the forecasting process. Top performers drive greater effectiveness by achieving much higher levels of intimacy with customers and suppliers, developing a better understanding of their customers’ financial positions, and conducting more frequent credit reviews. They also have more structured, interactive customer and supplier dispute processes in place.

A related Hackett survey also found that while forecast accuracy is measured by most companies, 80% don't set accuracy targets and 85% don't have any form of incentives in place to promote improved forecasting accuracy.
The study identified several other best practice areas where top performing companies focus to improve their ability to forecast cash flow. Performance management is one area where the best companies excel. Top performers are much more likely to rely on an array of analytical techniques to turn cash forecasting information into business insight. They look at operational leading indicators and macroeconomic assumptions 40 percent more often than typical companies, are 62% more likely to rely on best/worst case assumptions, and turn to what-if analyses 79% more frequently.

Top performers also provide more detail to their analysis, and are about 50% more likely to offer a range of numbers, footnotes and scenario analysis as part of their forecast.

"The bottom line is simple -- you can miss the mark on sales or earnings forecasts occasionally and survive. But you can only run out of cash once. This study clearly details the practices and procedures that companies can use to avoid a calamity and get a handle on this key area. Companies would be well advised to consider whether they’re leaders or laggards here, and how they can make changes to improve cash forecasting accuracy," explained REL President Mark Tennant.

©2008 IndustryWeek. All Rights Reserved.

This copy is for your personal, non-commercial use only. To order distribution-ready copies or to electronically reproduce this material on your site, contact the IndustryWeek Reprints Department at 1-888-858-8851, or by e-mail at jkirk@penton.com. A complimentary subscription to IndustryWeek magazine is available to those who qualify. Fill out our online form at http://www.submag.com/sub/iy?pk=W0105. Distribution and use of this material are governed by copyright law. Copyright© 1998-2008 Penton Media, Inc. All rights reserved.