Executive Insights

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Emerging Trends in Financial Management and Senior Executive Leadership

Overview

Financial management in the modern era has once again dramatically shifted in style, scope and regulation. There has been an immediate and pervasive regulatory response to financial scandals like those of Enron Corporation and WorldCom where tens of thousands of employees lost life savings and investors lost billions. There are countless commissions, committees and organizations to sort out the criminal activity from the flaws in the system that allows corporations like Enron to hide debt and losses. As a result, the face of financial management has significantly changed forever. While much can be written on the impact of these scandals and resulting regulation the following focuses on emerging trends in strategic alliances, cash management and compliance with the Sarbanes-Oxley Act.

Strategic Alliances

Mergers, acquisitions and joint ventures are methods that have been utilized by numerous companies to expand, achieve diversification, market entry, obtain new technology or strategically increase market segments. These "marriages," however, present many challenges and companies need to carefully consider the significant amount of time, monetary investment and legal concerns that these entail. Strategic alliances have become increasingly popular as a viable alternative. The strategic alliance format provides a mechanism that accomplishes similar benefits of the more permanent business combinations with considerable flexibility. It is vital to clearly define important issues in written form outlining how shared revenue is to be dispersed; a system of responsibility and accounting; financial benchmarks that are to be met; length of the arrangement and renewal periods if any; dissolution of the alliance and settlement of amounts owed. If structured improperly, the benefits of the alliance will be lost along with significant costs for unforeseen litigation. In the final analysis the business combination that suits the company best will certainly win out, however, consider "dating" for awhile before you propose "marriage."

Cash Management

In traditional scenarios cash management is a function of three main components: days of inventory, days of payables and days of receivables. The relationship between these components is known as the "cash gap" or shortage. Cash gaps can be reduced in three ways: a) stretch out payment terms for inventory; b) shorten the collection period from customers; and c) increase inventory turnover. In rapid growth industries, like technology where both revenue and the cash gap are increasing, outflows can quickly outpace inflows, putting the company into serious financial risk. Stepping up the sales rate does not always translate into decreasing the cash gap. Companies tend to solve liquidity issues with borrowings, usually from a financial institution where rates fluctuate, conditioned upon restrictive covenants and collateralized with inventory and receivables. In these circumstances improving the cash gap has a direct impact on pretax profits with the reduction of interest and borrowing costs. If we have learned anything from Enron and WorldCom, crisis cash management is a leading indicator of impropriety. There are many continually fluctuating variables making the cash consequences more difficult to predict. Effective cash management is essential to profitable growth.

Sarbanes-Oxley

Most observers would agree that the Sarbanes-Oxley Act (SOA) is the single most important piece of legislation affecting corporate governance, financial disclosure and the practice of public accounting since the U.S. securities laws of the early 1930s. While most people are aware that both the CEO and CFO of the company must certify company financial statements, there are many other issues of SOA that go beyond finance. For example, a pending commission requirement would force companies to disclose a rapidly increasing menu of material events in just two days requiring the involvement of employees in operations. The act also has surprises in unexpected areas; such as, compensation, executive relocation, and overseas operations. Further, contrary to popular belief, private companies aren't entirely immune to the provisions of SOA. It also covers such disparate corporate functions as information technology, human resources, compensation, and environmental compliance, because these areas and a host of others affect company financials. Regardless of your function, whether it be a public or private company, SOA will have a dramatic impact on how your business is managed. It is imperative that all business managers understand the impact of their decisions and management style—big brother is watching.