



# 19BAE711-WORKING CAPITAL MANAGEMENT

## Factors Affecting Cash Needs

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Understanding the factors that influence a company's cash needs is essential for effective cash management. These factors can be broadly categorized into internal and external elements.

### *Internal Factors*

1. **Business Operations:**
  - **Operating Cycle:** The length of time between purchasing inventory and collecting receivables. A longer operating cycle typically increases cash needs.
  - **Sales Volume:** Higher sales can increase cash needs for inventory purchases and production costs.
  - **Credit Policy:** Liberal credit terms can delay cash inflows, increasing the need for cash.
2. **Investment Activities:**
  - **Capital Expenditures:** Investments in fixed assets like property, plant, and equipment require substantial cash outlays.
  - **Expansion Plans:** Growth initiatives, including mergers and acquisitions, necessitate significant cash reserves.
3. **Financial Activities:**
  - **Debt Obligations:** Scheduled debt repayments and interest payments impact cash needs.
  - **Dividend Payments:** Regular dividend payments to shareholders require available cash.
4. **Seasonality:**
  - **Seasonal Business Cycles:** Businesses with seasonal fluctuations (e.g., retail during holidays) need to plan for periods of high cash demand.

### *External Factors*

1. **Economic Conditions:**
  - **Economic Cycles:** During economic downturns, cash flow may be reduced, increasing cash needs for ongoing operations.
  - **Inflation:** Rising prices can increase costs, necessitating more cash.
2. **Market Conditions:**
  - **Competition:** High competition may lead to lower sales and higher marketing expenses, affecting cash needs.
  - **Supplier Terms:** Changes in supplier payment terms can impact cash outflows.
3. **Regulatory Environment:**
  - **Tax Policies:** Changes in tax laws or rates can affect the amount of cash needed for tax payments.
  - **Compliance Requirements:** New regulations may necessitate additional cash for compliance-related expenditures.

# Cash Budget

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A cash budget is a financial plan that estimates cash inflows and outflows over a specific period. It is a critical tool for managing liquidity and ensuring that a company can meet its financial obligations.

## Components

- Cash Inflows:**
  - Operating Receipts:** Cash received from sales, accounts receivable collections, and other operating activities.
  - Non-Operating Receipts:** Cash from investments, asset sales, and other non-operating activities.
  - Financing Receipts:** Cash from loans, issuing bonds, or equity financing.
- Cash Outflows:**
  - Operating Payments:** Cash paid for inventory, salaries, utilities, rent, and other operating expenses.
  - Non-Operating Payments:** Cash paid for investment activities, such as purchasing fixed assets.
  - Financing Payments:** Cash paid for debt repayments, interest, dividends, and other financing activities.

## Preparation Steps

- Forecast Sales:** Estimate future sales based on historical data, market conditions, and business trends.
- Estimate Cash Receipts:** Project the timing and amount of cash inflows from sales and other sources.
- Estimate Cash Payments:** Project the timing and amount of cash outflows for operating, investing, and financing activities.
- Determine Net Cash Flow:** Calculate the difference between total cash inflows and outflows for each period.
- Adjust for Beginning Cash Balance:** Add the beginning cash balance to the net cash flow to determine the ending cash balance.
- Identify Surplus or Deficit:** Determine periods of cash surplus or deficit and plan accordingly.

## Benefits

- Improved Liquidity Management:** Helps ensure that sufficient cash is available to meet short-term obligations.
- Informed Decision-Making:** Provides insights into cash flow patterns, enabling better financial planning.
- Cost Control:** Identifies potential cash shortages, prompting cost-cutting measures or adjustments in spending.
- Risk Management:** Helps anticipate and mitigate financial risks related to cash flow fluctuations.

## Control Aspects

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Effective cash management requires robust control mechanisms to safeguard cash assets and ensure financial stability.

### *Internal Controls*

1. **Segregation of Duties:** Divide responsibilities among different employees to prevent fraud and errors.
2. **Authorization Controls:** Implement procedures requiring management approval for significant cash transactions.
3. **Access Controls:** Limit access to cash and financial records to authorized personnel only.
4. **Reconciliation:** Regularly reconcile bank statements with company records to identify discrepancies and ensure accuracy.
5. **Cash Handling Procedures:** Establish clear procedures for cash handling, including deposits, withdrawals, and petty cash management.
6. **Cash Flow Monitoring:** Continuously monitor cash flows to detect and address issues promptly.

### *External Controls*

1. **Bank Services:**
  - **Lockbox Services:** Use lockbox services to accelerate cash collections and reduce the risk of theft.
  - **Positive Pay:** Utilize positive pay services to prevent check fraud by verifying checks presented for payment.
2. **Audits:**
  - **Internal Audits:** Conduct regular internal audits to review cash management practices and ensure compliance with policies.
  - **External Audits:** Engage external auditors to provide an independent assessment of cash management controls and practices.
3. **Compliance:** Ensure adherence to regulatory requirements and industry best practices for cash management.

## **Conclusion**

Effective cash management is essential for maintaining a company's financial health. By understanding the factors affecting cash needs, preparing a comprehensive cash budget, and implementing robust control mechanisms, companies can ensure liquidity, minimize risks, and optimize their financial performance.