

# CASH MANAGEMENT

SWARNAM S

# CASH MANAGEMENT

- Effective management of inflow and outflow of cash plays a crucial role in the overall performance of a firm
- Shortage of cash will disrupt the firm's manufacturing process
- While excess cash will remain idle without any contribution towards profit
- Thus, effective management of cash leads to proper balance between liquidity and profitability

# MOTIVES FOR HOLDING CASH

- Transaction Motive – Day to day operations. The cash needed to make purchases, pay expenses, taxes, dividend etc.. Cash need arises due to the fact that there is no synchronization
- Precautionary Motive – Unexpected Cash needs.  
Example: delay in receivables, increase in price of raw material
- Speculative Motive – Profitable opportunities

# OBJECTIVES OF CASH MANAGEMENT

- To meet cash payments:
  - It prevents insolvency
  - Relationship with bank is not strained
  - Good Relations with creditors
  - Trade discount may be availed if payment is made within due date.
  - Strong Credit rating
- To maintain minimum cash balance (reserve)

# TECHNIQUES OF CASH MANAGEMENT

- CASH PLANNING
- ACCELERATING CASH INFLOWS
- CONTROLLING CASH OUTFLOWS
- INVESTING SURPLUS CASH

# 1. Cash Planning

- Cash planning is a technique to plan and control of cash
- Forecasting of expected cash inflow and cash outflow for a given period of time
- Cash planning is done daily, weekly, monthly or quarterly basis
- Period of cash planning depends on the size of the firm
- Large firms prepare daily and weekly forecasts
- Medium firms prepare weekly and monthly forecast

# Cash Budget

- Cash budget is an important tool for the flow of cash
- It is a statement showing cash inflows and outflows
- It pinpoints surplus or deficit from one period to another
- The surplus or deficit helps to determine the future cash needs
- Cash budget helps to determine the future needs of the company

## 2. Accelerating Cash Collections

- Prompt Payment of Customers:
  - The customer must be informed about the amount payable
  - The time by which it should be payable
  - Use of Mechanical devices
  - Allow them a cash discount
- Early Conversion of Payments into Cash
  - Mailing Time; Lethargy and bank float (collection time)

# Contd..

- Decentralized Collection: Establishing collection centers at different areas instead of collecting receipts at one place.
  - The collection centers in turn all the surplus fund to the Bank Account of the firm
  - Advantages: **Mailing time is reduced**
- Lock-Box System : This system is quite popular in USA.  
Under this system a firm rents a post office box and authorises its bank to pick up remittances in the box

# 3. Controlling Cash Outflows

- Paying on last date
- Centralized Payments : It increases transit time
- Paying the float : Time gap between issue of cheque and its actual presentment, The Party to whom the cheque issued will not present immediately
- Investment of Surplus funds: Excess of firm's normal cash requirements

# 4. INVESTING SURPLUS CASH

- Marketability: convertibility without any loss of value and time
- Maturity : fewer the maturity, greater the risk
- Risk of Default : free from risk and surplus funds can be invested only for short period

# CASH MANAGEMENT MODELS

- BAUMOL'S MODEL
- MILLER-ORR MODEL
- STONE MODEL