



Cash Management

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Cash

The term cash is used in two senses,

- **Narrow and**
- **Broad.**

In the narrow sense, it includes coins, currency and cheques in hand and balances in bank accounts.

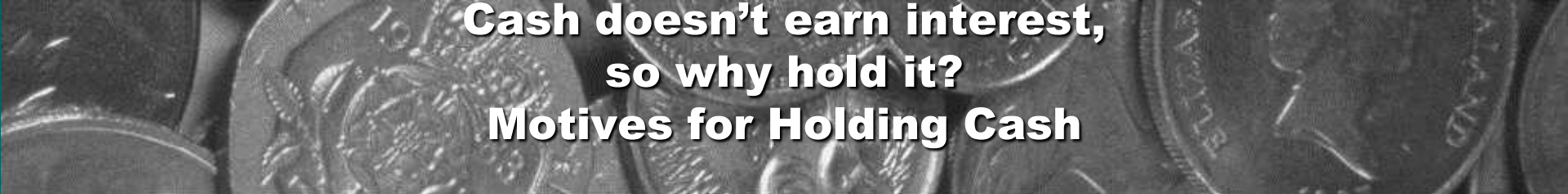
Second, in a broader sense, it also includes near cash assets such as marketable securities and short term deposits with banks.

For **cash management purposes, the term cash is used in this **broader sense** i.e., it covers cash, cash equivalents and those assets which are immediately convertible into cash.**



Cash management is concerned with the managing of:

- cash flows into and out of the firm,***
- cash flows within the firm, and***
- cash balances held by the firm at a point of time by financing deficit or investing surplus cash***



**Cash doesn't earn interest,
so why hold it?
Motives for Holding Cash**

- **The transactions motive**
- **The precautionary motive**
- **The speculative motive**

The Transactions motive :

This motive refers to the holding of cash in order to meet the day-to-day transactions which a firm carries on in the ordinary course of the business.

e.g.

**purchase of raw materials,
wages,
operating expenses,
taxes,
dividends etc.**

Therefore, in order to meet the day-to-day transactions, the requirement of cash is known as transaction motive. Although, a major part of transactions balances is held in cash, a part may also be held in the form of marketable securities whose maturity conforms to the timing of the anticipated payments, such as, payment of taxes, dividends etc.



The Precautionary Motive :

This motive for holding cash has to do with maintaining a cushion or buffer to meet unexpected contingencies. The unexpected cash needs at short notice may be the result of :

- (a) uncontrollable circumstances, such as, floods, strikes, droughts etc.;**
- (b) bills which may be presented for settlement earlier than expected;**
- (c) unexpected delay in collection of trade dues;**
- (d) cancellation of some order for goods due to inferior quality; and**
- (e) increase in the cost of material, labour etc.**

Precautionary balances are the cash balances which are held as reserve for random and unforeseen fluctuations in cash flows, i.e., this motive implies the need to hold cash to meet unpredictable obligations. The more predictable the cash flows, the less precautionary balances that are needed and vice-versa. Sometimes a portion of such cash balances may be held in marketable securities, i.e., near-money assets.

The Speculative Motive :

This motive refers to the holding of cash for taking advantages of expected changes in security price. In other words, when the rates of interest are expected to fall, cash may be invested in different securities so that the firm will benefit by any subsequent fall in interest rates and rise in security prices. On the other hand, when the rate of interest are expected to rise the firm should hold cash until the rise in interest rates ceases. The precautionary motive is defensive in nature while speculative notice represents a positive and aggressive approach.

The speculative motive helps to take advantages of :

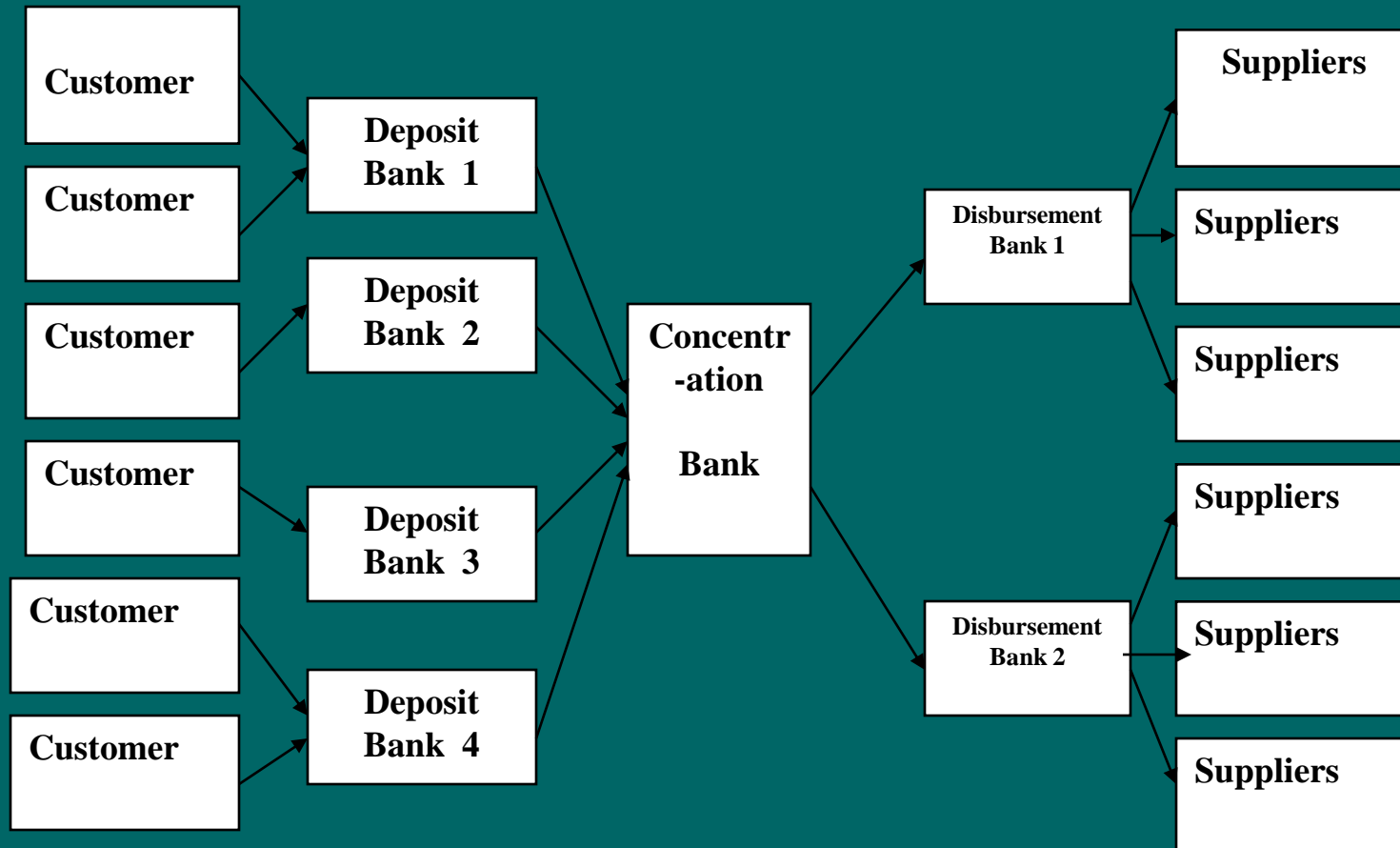
- (i) in opportunity to purchase raw material at a reduced price against immediate payment, i.e., benefit of cash discounts;**
- (ii) a change to speculate of interest rate movements by purchasing securities when rates of interest are expected to decline;**
- (iii) the purchase at favourable prices**

FUNCTIONS OF CASH MANAGEMENT

An executive who manage cash of an enterprise has to look after the functions like:

- (i) collection and up-keeping of cash and securities;**
- (ii) control of payments, i.e., providing requisite cash at the proper time and place to meet financial obligations;**
- (iii) maintenance of adequate supply of cash to meet projected cash requirements, cash budgets and day-to-day demands;**
- (iv) investment of surplus cash in suitable marketable securities to keep it fully utilised and working towards greater profits; and**
- (v) maintenance of sound banking relations. Some of the important aspects of cash management have been dealt with below.**

The Cash System



Management of Cash Flows

Besides, efficient utilisation of cash involves accelerating cash inflows and slowing disbursements. There are various methods of speeding cash collections and delaying payments. We shall now discuss each of these methods are:

- **Accelerating the cash inflows**
- **Slowing Cash Outflows**

Methods of Accelerating the cash inflows

- **Quick deposit of customer's cheques**
- **Prompt Payment by Customers**
- **Decentralised collections**
- **Lock Box System**

Methods of Slowing Cash Outflows

- **Delaying outward payment**
- **Making Payroll periods Less frequent**
- **Using float**
- **Inter-bank transfer**
- **Centralisation of Payments**