INTERNATIONAL CASH MANAGEMENT

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CASH MANAGEMENT

- The managing of cash flows is an extremely important task for a financial manager.

- Cash flow management is the process of monitoring, analyzing and adjusting the organization's cash.

INTERNATONAL CASH MANAGEMENT

- is the set of activities determining the levels of cash balances held throughout the MNE (cash management) and the facilitation of its movement cross-border (settlements and processing)

CASH FLOW ANALYSIS:
SUBSIDIARY PERSPECTIVE

- The management of working capital has a direct influence on amount and timing of cash flow.
  - inventory management
  - accounts receivables management
  - cash management
  - liquidity management

SUBSIDIARY EXPENSES

- International purchases of raw materials or supplies are more likely to be difficult to manage because of exchange rate fluctuations, quotas, etc.
- If the sales volume is highly volatile, larger cash balances may need to be maintained in order to cover unexpected inventory demands.

SUBSIDIARY REVENUE

- International sales are more likely to be volatile because of exchange rate fluctuations, business cycles, etc.
- Looser credit standards may increase sales (accounts receivable), through often at the expense of slower cash inflows.

SUBSIDIARY DIVIDEND PAYMENTS

- Forecasting cash flows will be easier if the dividend payments and fees (royalties and overhead charges) to be sent to the parent are known in advance and denominated in the subsidiary's currency.

SUBSIDIARY LIQUIDITY MANAGEMENT

- After accounting for all cash outflows and inflows, the subsidiary must either invest its excess cash or borrow to cover its cash deficiencies.
- If the subsidiary has access to the lines of credit and overdraft facilities, it may maintain adequate liquidity without substantial cash balances.

CENTRALIZED CASH MANAGEMENT

- The centralized cash management division of an MNC cannot always accurately forecast the events that parent-subsidiary or intersubsidiary cash flows.

TECHNIQUES TO OPTIMIZE CASH FLOWS

ACCELERATING CASH INFLOWS

- The more quickly the cash inflows are received, the more quickly they can invested or used for other purposes.
- Common methods include the establishment of lockboxes around the world (to reduce mail float) and preauthorized payments (direct charging of a customer's bank account) .

TECHNIQUES TO OPTIMIZE CASH FLOWS

MINIMIZING CURRENCY CONVERSION COST

- Netting reduces administrative and transaction costs through the accounting of all transactions that occur over a period to determine one net payment.
- A bilateral netting system involves transaction between two units, multilateral netting system usually involves more complex interchanges.

TECHNIQUES TO OPTIMIZE CASH FLOWS

MANAGING BLOCKED FUNDS

- A government may require that funds remain within the country, in order to create jobs and reduce unemployment.
- The MNC should then reinvest the excess funds in the host country, adjust the transfer pricing policy (such that higher fees have to be paid to the parent) , borrow locally rather than from the parent, etc.

TECHNIQUES TO OPTIMIZE CASH FLOWS

MANAGING INTERSUBSIDIARY CASH TRANFERS

- A subsidiary with excess funds can provide financing by paying for its supplies earlier than is necessary. This technique is called <u>leading</u>.
- Alternately, a subsidiary in need of funds can be allowed to lag its payments. This technique is called <u>lagging</u>.

COMPLICATIONS IN OPTIMIZING CASH FLOWS

- COMPANY-RELATED CHARACTERISTICS

  - When a subsidiary delays its payments to the other subsidiaries, the other subsidiaris maybe forced to borrow until the payment arrive.

- GOVERNMENT RESTRICTIONS

  - Some governments may prohibit the use of a netting system, or periodically prevent cash from leaving the country.

COMPLICATIONS IN OPTIMIZING CASH FLOWS

- CHARACTERICTICS OF BANKING SYSTEM

  - The abilities of banks to facilitate cash transfer for MNCs may vary among countries.

  - The banking system in different countries usually differ too.

INVESTING EXCESS CASH

- Excess cash funds can be invested in domestic or foreign short-term securities, such as Eurocurrency deposits, bills, and commercial papers.
- Sometimes, foreign short-term securities have higher interest rates. However, firms must also account for the possible exchange rate movements.

INVESTING EXCESS CASH

- CENTRALIZED CASH MANAGEMENT

- Centralized cash management allows for more efficient usage of funds and possibly higher returns.

- When multiple currencies are involved, a separate pool may be formed for each currency. The investment securities may also be denominated in the currencies that will be needed in the future.

INVESTING EXCESS CASH

- DETERMINING THE EFFECTIVE YIELD

  - The effective rate for foreign investments

$$r = (1 + i)(1 + e) - 1$$

where i = the quoted interest rate on the investment

e = the % Δ in the spot rate

INVESTING EXCESS CASH

- IMPLICATIONS OF INTEREST RATE PARITY

  - A foreign currency with a high interest rate will normally exhibit a forward discount that reflects the differential bet. its interest and the investor's home interest rate.

- USE OF THE FORWARD RATE AS A FORECAST

  - The effective yield will be higher if the spot rate at maturity is more than the forward rate at the time the investment is undertaken, and vise versa.

INVESTING EXCESS CASH

- USE OF EXCHANGE RATE FORECAST

  - A foreign currency with a high interest rate will normally exhibit a forward discount that reflects the differential bet. its interest and the investor's home interest rate.

- DIVERSIFYIING CASH ACROSS CURRENCIES

  - If an MNC is not sure of exchange rates will change over time, it may prefer to diversify its cash among securities that are denominated in different currencies.

INVESTING EXCESS CASH

- USE OF DYNAMIC HEDGING TO MANAGE CASH

- Dynamic hedging refers to the strategy of hedging when the currencies held are expected to depreciate, and not hedging when they are expected to appreciate.

CONCLUSION

Each subsidiary of an MNC can assess its cash flows by estimating expected cash inflows and outflows to forecast its balance in each currency. This will indicate whether it will have excess cash to invest or a cash deficiency. The MNC's parent may prefer to use a centralized perspective, which consolidates the cash flow positions of all subsidiaries. In this way, funds can be transferred among subsidiaries to accommodate cash defi ciencies at particular subsidiaries

THANK YOU