

## Management of Cash



Cash is an important component of current assets and is most essential for business operations. Cash is the basic input needed to keep the business running on a continuous basis. It is also the ultimate output expected to be realized by selling the service and product manufactured by the firm.

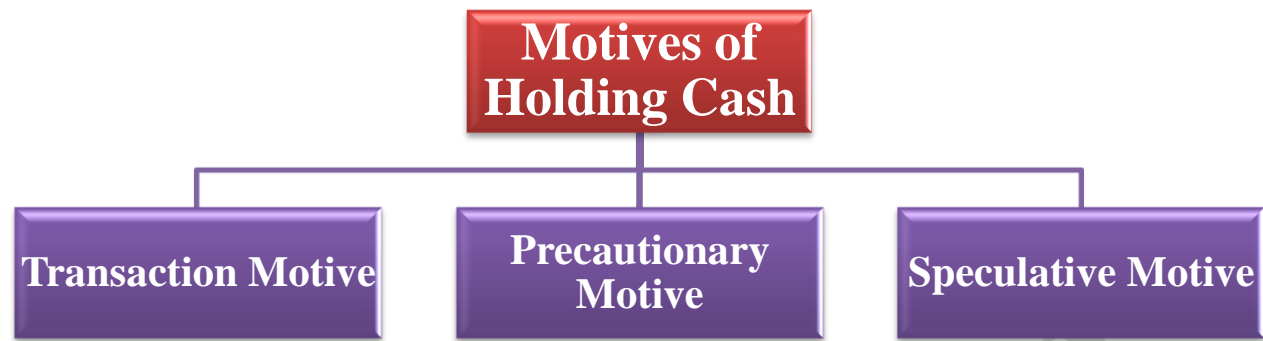
### Meaning

Cash management is the process of collecting and managing cash flows. Cash management can be important for both individuals and companies. In business, it is a key component of a company's financial stability. For individuals, cash is also essential for financial stability while also usually considered as part of a total wealth portfolio.

Cash management is a very important area and is very critical for survival of an organization. It entails management of cash for day today activities as well as maintaining cash for meeting the desired medium or long-term objectives of the organization. Objectives of cash management are to reduce the liquidity risks, make cash available for day today activities, minimize the cash, invest surplus cash in the best possible manner and maintain optimum cash balance in the system at all times.

### Motives of Holding Cash

Companies hold cash because the timing and amount of cash inflows do not match the timing and amount of cash outflows. Generally following are the objectives of holding cash:



### **1. Transaction Motive**

Money is required to settle customer's bills, pay salary and wages to workers, pay duties and taxes, etc. Some cash balance is to be maintained to complete these transactions. The amount to be maintained for the transaction motive depends on the cash inflows and outflows. Often, firms prepare a cash budget by incorporating the estimates of inflows and outflows to know whether the cash balance would be adequate to meet the transactions.

### **2. Precautionary Motive**

The transaction motive takes into account the routine cash needs of the firm. It is also based on the assumption that inflows are as per estimation. However, the future cash needs for transaction purposes are uncertain. The uncertainty arises on account of sudden increase in expenditure or delay in cash collection or inability to source the materials and other suppliers on credit basis. The firm has to protect itself from such contingencies by holding additional cash. This is called as precautionary motive of holding cash balance. Precautionary cash balance is also maintained to meet the non-routine needs. Generally, cash required for precautionary motive is held in the form of short-term securities with the objective to earn at least some positive return. The securities are sold and cash is realized as and when such emergency demand for cash arises.

### **3. Speculative Motive**

If the firm intends to exploit the opportunities that may arise in the future suddenly, it has to keep some cash balance. The term "speculative motive" to some extent is a misnomer since cash is not kept to conduct any speculation but merely to exploit opportunity. This is particularly relevant in commodity sector, where the prices of material fluctuate widely in different periods and the firm's business success depends on its ability to source the material at the right time. Some of the materials, whose prices show significant instability, are cotton, aluminum, steel, chemicals, etc. Surplus cash is also used for taking over of other firms. Firms that intend to take advantage on the above counts keep large cash balances with them, though the same are not required for transactions or as a precaution.

## **Problems of Cash Management**

Unfortunately, many businesses engage in poor cash management, and there are several reasons for the problem. Let us look at some of them:

### **1. Poor Understanding of the Cash Flow Cycle**

Business management should clearly understand the timing of cash inflows and outflows from the entity, such as when to pay for accounts payable and purchase inventory. During rapid growth, a company can end up running out of money because of over-purchasing inventory, yet not receiving payment for it.

### **2. Lack of Understanding of Profit versus Cash**

A company can generate profits on its income statement and be burning cash on the cash flow statement.

When a company generates revenue, it does not necessarily mean it already received cash payment for that revenue. So, a very fast-growing business that requires a lot of inventory may be generating lots of revenue but not receiving positive cash flows on it.

### **3. Lack of Cash Management Skills**

It is crucial for managers to acquire the necessary skills despite the understanding of the abovementioned issues. The skills involve the ability to optimize and manage the working capital. It can include discipline and putting the proper frameworks in place to ensure the receivables are collected on time and that payables are not paid more quickly than is needed.

### **4. Bad Capital Investments**

A company may allocate capital to projects that ultimately do not generate sufficient return on investment or sufficient cash flows to justify the investments. If such is the case, the investments will be a net drain on the cash flow statement, and eventually, on the company's cash balance.

### **5. Difficult to Make Settlements in Different Currencies**

In many organizations, it is tough to make the settlements or transactions in different currencies. There are many organizations that have their branches in different countries. But the problems

occur when they evaluate the dollars in Euros or in other currency. It is a lengthy process for making the conversion of one currency into others.

## **6. Inconvenience in Tracking the Business Expenses**

In a small and large organization, it is quite tough to track the expenses like payments, transactions, and other expenditures. These things make a great impact on your balance sheet. How much you spend, where you used the earning money and how much material you buy? Avoiding these things means a huge loss in business profits.

## **7. Regulatory changes**

Constantly changing laws, regulations and employment practices can make compliance a difficult to ensure. For example, if a department lacks oversight of cash, counter party risk and existing controls in a high risk jurisdiction, it might be a good idea to think about whether working in that segment will yield any significant value.

Fraud, negligence, and lawsuits can spring about when a business is not compliant and there are no internal controls to prevent such things.

Managing cash flow correctly means increasing the chances for a business to succeed. Without any doubt, a lot of business transactions are made in cash all over the world. Business organizations need to cope with major challenges in cash arrangements to strengthen their finances & keep making progress every day.