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Cash Management – A Recurrent Necessity for Business Growth

KEYWORDS: Cash, Cash Planning, Cash Inflow & Outflow, Cash management, Cash Management Cycle

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ABSTRACT *Cash is the important current asset for the operations of the business. It 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 or product manufactured by the company. Cash management involves managing cash efficiently, the proper usage of cash while assessing liquidity and the cash flow and investments. Cash planning protects the financial condition of the firm by developing a projected cash statement from a forecast of expected cash inflows and outflows for a given period. Cash management necessitates speeding cash inflows while slowing down cash outflows, but it may not be considered in isolation. A company's cash flow is coupled to its operations, investment activities (such as the purchase or the sale of capital equipment), and to its financing activities (such as raising debt or equity funding or repaying such funding). The cash that a firm produces from its operations is tied to its core business activities and provides the best opportunities for cash flow management. Cash plans are very crucial in developing the operating plans of the firm. Cash planning can be done on daily, weekly or monthly basis. The period and frequency of cash planning generally depends upon the size of the firm and philosophy of management. The Cash Management Cycle is followed in industry, which incorporates number of operations; the operations are generally concluded after the appropriate analysis on checking about the desired quality, price transactions of sales and purchases are taking place like wise.*

INTRODUCTION

Cash can be referred as medium of exchange, which is immediately exchangeable. Cash has to face the prime requirements of common acceptability and easy accessibility for immediate use in purchasing and payment of debt. Acceptability to a bank for deposit is a common test applied to cash items. It is channelizing available cash into expenditures that enhance productivity, directly or indirectly. In addition, Cash is ready money in the bank or in the business. It is not inventory, it is not accounts receivable (what you are owed), and it is not property.

Cash is the important current asset for the operations of the business. It 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 or product manufactured by the company. The company should keep sufficient cash, neither more nor less. Cash shortage will disturb the company's manufacturing operations while excessive cash will simply remain idle, without contributing anything towards the company's profitability. Thus, a major function of the financial manager is to maintain a sound cash position. All cash and cash equivalents must be disclosed as current asset's financial statements in Accordance with GAAP (Generally Accepted Accounting Principles). Effective Cash management must be incorporated accuracy, completeness, authorization, existence, disclosure, and reporting overall cash activities and the cash cycle within the organization. Management requires the control over cash so that future business planning, forecasts, and projects can be made, as well as for the production and issuance of the entity.

MEANING OF CASH & CASH FLOW

Cash is organized money in the bank or in the business. It is not inventory neither accounts receivable (what you are owed) nor is it property. These can potentially be transformed to cash, but can't be used to pay suppliers, rent, or employees. Profit expansion does not essentially indicate more cash in hand. Profit is the sum of money you expect to make over a given period of time, while cash is what you must have on hand to keep your business running. Over time, a company's profits are of little value if they are not accompanied by positive net cash flow. You can't spend profit; you can only spend cash. Cash is the money which a company can disturbs immediately without any restrictions. The term cash includes coins, currency and cheques held by the company, and balances in its bank accounts. Sometimes near-cash items, such as marketable securities or bank term deposits, are also included in cash. The basic characteristic of near-cash assets is that they can readily be converted into cash.

Cash flow refers to the association of cash inflow and outflow in a business. Scrutiny of the cash inflows and outflows is one of the most serious management errands for any business. The outflow of cash includes those cheques you write each month to pay salaries, suppliers, and creditors. The inflow includes the cash you receive from customers, lenders, and investors.

If the cash inflow exceeds the outflow, a company has a positive cash flow. A positive cash flow is an excellent sign of financial health, but is by no means the only one. If company has a cash outflow that exceeds the inflow, a company has a negative cash flow. Reasons for negative cash flow contain too much or outdated inventory and poor collections on accounts receivable. The initial point for good cash flow management is developing a cash flow projection. Smart business owners recognize how to develop both short-term (weekly, monthly) cash flow projections to help them manage daily cash, and long-term (annual,

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3-5 year) cash flow projections to help them develop the necessary capital strategy to meet their business needs. They also prepare and use historical cash flow statements to understand how they used money in the past.

MEANING OF CASH MANAGEMENT

Cash is the important current asset for the operations of the business. 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 or product manufactured by the firm. The firm should keep sufficient cash, neither more nor less. Cash shortage will disrupt the firm's manufacturing operations while excessive cash will simply remain idle, without contributing anything towards the firm's profitability. Thus, a major function of the financial manager is to maintain a sound cash position. Cash is the money which a firm can disburse immediately without any restriction.

The term cash includes coins, currency and cheques held by the firm, and balances in its bank accounts. Sometimes near-cash items, such as marketable securities or bank time's deposits, are also included in cash. The basic characteristic of near-cash assets is that they can readily be converted into cash. Generally, when a firm has excess cash, it invests it in marketable securities. This kind of investment contributes some profit to the firm. Cash management is a broad term that refers to the collection, concentration, and disbursement of cash. It encompasses a company's level of liquidity, its management of cash balance, and its short-term investment strategies. In some ways, managing cash flow is the most important job of business managers. For some time now, technology has been the key driving force behind every successful bank. In such an environment, the ability to recognize and capture market share depends entirely on the bank's competence to evolve technically and offer the customer a seamless process flow. The objective of a cash management system is to improve revenue, maximize profits, minimize costs and establish efficient management systems to assist and accelerate growth.

CASH MANAGEMENT IN INDIA

The Reserve Bank of India (RBI) has placed an emphasis on upgrading technological infrastructure. Electronic banking, cheque imaging, enterprise resource planning (ERP), real time gross settlement (RTGS) is just few of the new initiatives. The evolution of payment systems such as RTGS has posed some tough challenges for cash management providers. It is important that banks now look towards a shift to fees from float although all those cash management providers who have factored in float money in their product pricing might take a hit. But of course there are opportunities also attached like collection and disbursal of payments on-line across the banks. There are a number of regulatory and policy changes that have facilitated an efficient cash management system (CMS). Fox example, the Enactment of Information Technology Act gives legal recognition to electronic records and digital signatures. The establishment of the

Clearing Corporation of India in order to establish a safe institutional structure for the clearing and settlement of trades in foreign exchange (FX), money and debt markets has indeed helped the development of financial infrastructure in terms of clearing and settlement. Other innovations that have supported in streamlining the process are: Introduction of the Centralized Funds Management Service to facilitate better management of fund flows, Structured Financial Messaging Solution, a communication protocol for intra-bank and interbank messages. Today, treasurers need to ensure that they are equipped to make the best decisions. For this, it is imperative that the information they require to monitor risk and exposure is accurate, reliable and fast. A strong cash management solution can give corporate a business advantage and it is very important in executing the financial strategy of a company. The requirement of an efficient cash management solution in India is to execute payments, collect receivables and managing liquidity.

MOTIVES FOR HOLDING CASH

The firm's need to hold cash may be attributed to the following the motives:

- Transactions motive
- Precautionary motive
- Speculative motive
- Compensation Motive

They are explained in detail as –

Transaction Motive

The transaction motive requires a firm to hold cash to conducts its business in the ordinary course. The firm needs cash primarily to make payments for purchases, wages and salaries, other operating expenses, taxes, dividends etc. The need to hold cash would not arise if there were perfect synchronization between cash receipts and cash payments, i.e., enough cash is received when the payment has to be made. But cash receipts and payments are not perfectly synchronized. For those periods, when cash payments exceed cash receipts, the firm should maintain some cash balance to be able to make required payments. For transactions purpose, a firm may invest its cash in marketable securities. Usually, the firm will purchase securities whose maturity corresponds with some anticipated payments, such as dividends, or taxes in the future. Notice that the transactions motive mainly refers to holding cash to meet anticipated payments whose timing is not perfectly matched with cash receipts.

Precautionary motive

The precautionary motive i s the need to hold cash to meet contingencies in the future. It provides a cushion or buffer to withstand some unexpected emergency. The precautionary amount of cash depends upon the predictability of cash flows. If cash flow can be predicted with accuracy, less cash will be maintained for an emergency. The amount of precautionary cash is also influenced by the firm's ability to borrow at short notice when the need arises. Stronger the ability of the firm to borrow at short notice less would be the need for precautionary balance. The precautionary balance may be kept in cash and marketable securities. Marketable securities play an important role here. The amount of cash set aside for precautionary reasons is not expected to earn anything; therefore, the firm attempt to earn some profit on it. Such funds should be invested in high-liquid and low-risk marketable securities. Precautionary balance should, thus, held more in marketable securities and relatively less in cash.

Speculative motive

The speculative motive relates to the holding of cash for investing in profit-making opportunities as and when they arise. The opportunity to make profit may arise when the security prices change. The firm will hold cash, when it is expected that the interest rates will rise and security prices

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will fall. Securities can be purchased when the interest rate is expected to fall; the firm will benefit by the subsequent fall in interest rates and increase in security prices. The firm may also speculate on materials' prices. If it is expected that materials' prices will fall, the firm can postpone materials' purchasing and make purchases in future when price actually falls. Some firms may hold cash for speculative purposes. By and large, business firms do not engage in speculations. Thus, the primary motives to hold cash and marketable securities are: the transactions and the precautionary motives.

Compensation Motive
Such motives require holding cash balance in case the concern enters into some loan agreement with the bank. Bank provides a great variety of services to its customers. For some of such services it charges commission or fee. While for other an indirect compensation is demanded by it by asking its customers to keep a minimum bank balance sufficient to earn a return equal to cost of services provided by it. Such balances are termed as compensating balances.

CASH PLANNING
Cash flows are inseparable parts of the business operations of firms. A firm needs cash to invest in inventory, receivable and fixed assets and to make payment for operating expenses in order to maintain growth in sales and earnings. It is possible that firm may be taking adequate profits, but may suffer from the shortage of cash as its growing needs may be consuming cash very fast. The 'cash poor' position of the firm can be corrected if its cash needs are planned in advance. At times, a firm can have excess cash with it if its cash inflows exceed cash outflows. Such excess cash may remain idle. Again, such excess cash flows can be anticipated and properly invested if cash planning is resorted to. Cash planning is a technique to plan and control the use of cash. It helps to anticipate the future cash flows and needs of the firm and reduces the possibility of idle cash balances (which lowers firm's profitability) and cash deficits (which can cause the firm's failure).

Cash planning protects the financial condition of the firm by developing a projected cash statement from a forecast of expected cash inflows and outflows for a given period. The forecasts may be based on the present operations or the anticipated future operations. Cash plans are very crucial in developing the operating plans of the firm. Cash planning can be done on daily, weekly or monthly basis. The period and frequency of cash planning generally depends upon the size of the firm and philosophy of management.

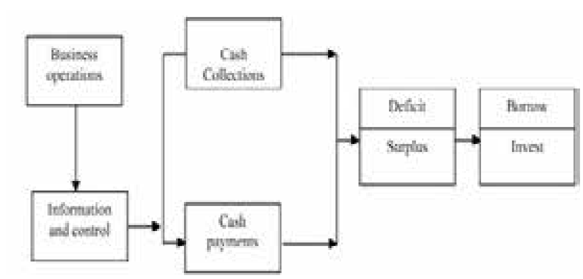
Large firms prepare daily and weekly forecasts. Medium-size firms usually prepare weekly and monthly forecasts. Small firms may not prepare formal cash forecasts because of the non-availability of information and small-scale operations. But, if the small firm prepares cash projections, it is done on monthly basis. As a firm grows and business operations become complex, cash planning becomes inevitable for its continuing success.

Cash planning has three main objectives:
(1) To ensure that expenditures are smoothly financed during the year, so as to minimize borrowing costs;
(2) To enable the initial budget policy targets, especially the surplus or deficit, to be met; and
(3) To contribute to the smooth implementation of both fiscal and monetary policy.

An effective cash planning and management system should:

- Recognize the time value and the opportunity cost of cash;
- Enable line ministries to plan expenditure effectively;
- Be forward-looking--anticipating macroeconomic developments while accommodating significant economic changes and minimizing the adverse effects on budget execution;
- Be responsive to the cash needs of line ministries;
- Be comprehensive, covering all inflows of cash resources; and
- Plan for the liquidation of both short- and long-term cash liabilities.

CASH MANAGEMENT CYCLE
Cash management is imperative because it is complex to forecast cash flows precisely, particularly the inflows and outflows of cash. In normal business process at times cash outflows may exceed cash inflows, because of payments for taxes, dividends, or seasonal inventory build-up. Similarly at times, cash inflows can be more than cash payments because there may be large cash sales and debtors may be realized in large sums promptly.



(Source: Financial Management – By I. M. PANDEY)

The Cash Management Cycle is followed in industry, which incorporates number of operations; the operations are generally concluded after the appropriate analysis on checking about the desired quality, price transactions of sales and purchases are taking place like wise. When the transactions take place, the cash collections and cash payments gets started and the results of it would be visible to the organization in sense of whether it is deficit or surplus. In case of deficit, the cash is borrowed from bank to surmount the result, and if it is surplus then normally, investment takes place for earning certain return on the otherwise idle cash.

Sales generate cash which has to be distributed. The Surplus cash has to be invested while deficit has to be borrowed. Cash management looks for achieving this cycle at a minimum cost. Simultaneously, it also seeks to attain liquidity and control. Cash management assumes more significance than other current assets because cash is the most important and the least productive asset that a company holds.

CONCLUSION
A business that is possibly trading beneficially with surmounted profit, can implausibly fail if cash is not available. The future for all businesses is vague due to constant tastes changes, interest rates go up or down, suppliers increase prices etc. and the economy itself endure uncertainty as the business cycle changes. Cash management necessitates speeding cash inflows while slowing down

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cash outflows, but it may not be considered in isolation. Cash is the lifeblood of a business and a business desires to generate adequate cash from its conduct so that it can meet its expenses and have enough left over to repay investors and grow the business. A company through certain manipulations can fabricate its earnings but its cash flow illustrates about the firms real health. A company has to generate an ample cash flow from its business in order to survive. Additionally, a business also needs to administer its cash circumstances in order that it holds the correct amount of cash to meet its urgent and long-term needs. Deprived cash management is probably the most frequent stumbling block for entrepreneurs. The basic concepts of cash flow will facilitate proper planning for the unforeseen eventualities that nearly every business faces.