Chapter 4
CHAPTER - 4
MANAGEMENT OF CASH

Introduction:

Cash is one of the prime current assets of the business. Any business could not be considered without cash. It is needed at all times to keep the business going. Cash is most of the unproductive of all the assets. Any shortage of cash will hamper the operation of concern. Cash is a common denominator to which all current assets can be reduced because the other major liquid assets. Though the proportion of corporate assets held in the form of cash is very small often between 1 percent and 3 percent, its efficient management is crucial to the solvency of business because in a very important since cash is the focal point of fund flow in a business.

In view of its importance it is generally referred to as the “Life Blood of a business enterprises”. Cash is needed to acquire supplier, resources, equipment, payment of wages, taxes to Government & dividend to shareholders. Cash is the medium of exchange which allows management to carry out various activity of business from day to day.

In last we can say that:

Cash, the most liquid assets, is of vital importance to the daily operations of business firms. Cash is basic input needed for a business running on a continuous basis. It is also the ultimate output expected to be realised by selling the service or product manufactured by the firm. While the proportion of corporate assets held in the form of cash is very small often between one percent to three percent, its efficient management is crucial to the survival of the business.

Cash shortage will disrupt the firm’s manufacturing operations while excessive cash will simply remain idle without contributing anything towards the company’s profitability. In every sense, cash is the focal point of fund flows in a business.
4.0.1 Facts of Cash Management:

Cash Management is concerned with managing of

(i) Cash flows into and out of a firm

(ii) Cash flows within the firm

(iii) Cash balances held by the firm at a point of time by financing deficit or investing surplus cash.

It can be represented in a cash management cycle as given in Figure below:

Sales generate cash which has to be disbursed out. The surplus cash has to be invested while deficit has to be borrowed.

As cash is least productive and is used to pay firm’s obligation. The aim of cash management is to maintain adequate control over cash position to keep the firm sufficiently liquid and to use excess cash in some profitable way. It is also important as there is difficulty in predicting cash flows accurately.

4.0.2 Nature of Cash:

For some persons cash means only currency, for some mean cash in hand and at bank. Cash itself does not produce goods or service. It is a medium to acquire other assets. It is the other assets which are used in manufacturing goods or providing services. The idle cash can be deposited or invested to earn interest.
A firm has to maintain a minimum level or critical level of cash. If at a time it does not have sufficient cash with it, will have to borrow from market for reaching the required level. There remains a gap in cash inflow & outflow. A manager has try to synchronize the cash inflow & outflow. Perfect synchronization of receipt & payment of cash is only an ideal situation.

4.1 Motives for Holding Cash & Securities:

As cash & marketable securities does not required in producing goods or services, unlike the firms fixed assets. When firm hold cash in currency or in non-interest bearing account. They obtain no direct return on their investment. They serve as a pool & liquidity that provide cash quickly when needed. The cash can be need in two sense, in narrow sense it broadly cover currencies & broad view of cash includes near cash assets.

One question arises that, If Cash doesn’t carry return why it be held or why a firm need cash? John Maynard Keynes the following motives for holding the cash.

(a) Transaction Motive: It refers to the holding of cash to meet routine cash requirement to finance the transactions which a firm carries on its ordinary course of Business. A firm need cash to meet their transaction needs. The collection of cash from sales of goods & services & its disbursements. It is also to ensure that payment to be made in time when distribution of cash is more than its receipts. The requirement of cash balance to meet routine cash needs is known as transaction motive and such motive refers to the holding of cash to meet anticipated obligation whose timing is not perfectly synchronised with receipts. Hence we can say that, the transaction motive requires a firm to hold cash to conduct its business in the ordinary course. A firm needs cash primarily to meet payments for purchases, wages and salaries, other operating expenses, taxes, dividends, etc. The need to hold cash arises because their is no perfect synchronisation between cash payments and receipts (from sale of goods and services, sale of assets and additional financing). Hence, some cash balance is required as a buffer.
(b)  **Precautionary Motive** :

A firm is required to keep cash for meeting various contingencies because of uncertainties about cash outflows on account of purchase and other obligation. A firm may have to pay cash for purpose which cannot be predicted or anticipated. The cash for precautionary motive may be:

1. Flood or Strike
2. Slow Debtor Receivable
3. Increase in Cost of Resources
4. Low sales than Expection etc.

The cash balance held is reserve for such random and unforeseen fluctuation in cash flow are called as Precautionary Balance. Precautionary Balance are kept because cash inflows and outflows are anticipated but there may be variations in these estimates. It depends upon the predictability of cash inflows. The amount of precautionary motive is also influenced by the firms ability to borrow at short notice when the need arises. Precautionary balance can be held in marketable securities which have high liquidity and low risk values.

(c)  **Speculative Motive** :

Firm like to tap profit from fluctuation in Commodity prices, Security prices, Interest rates & Foreign exchange rates. A cash rich firm is better prepared to exploit such bearing because such opportunity donot come in regular basis. There opportunity cannot be scientifically predicted but only conjectures can be made about there occurence. Such opportunities can be availed if a firm has cash balance with it. Where precautionary motive is defensive in nature, speculative have positive and aggresive approach.

A speculative has following advantage:

1. In purchase of Raw Material at Low Prices.
2. Buying securities at low interest rates.
3. Purchase at Favourable prices.
(d) Compensating Motive:

Another motive to hold cash balances is to compensate banks for providing certain services and loans such as clearance of cheque, supply of credit information, transfer of funds and so on. For taking advantage of these, firms are required to maintain a minimum balance of cash at bank. This balance is not available to firms for transaction purposes, the banks themselves can use the amount to earn a return. Such balances are compensating balances. Compensative balance are also required by some loan agreement between bank and customer. During the period when supply of credit is restricted and interest rates are high bank requires a borrower to maintain a minimum balance in his account condition precedent to grant of loan.

Out of the four motive, transactions & compensating are important one. Business firm normally do not speculate and need not have speculative balance. The requirement of precautionary balance can be meet out of short term borrowings.

4.2 Managing Cash Flows:

In Order to minimize cash leaks, the financial manager should establish some sort of control system over incoming cash. Cash management will be successfully only if cash collection are accellerated and cash disbursement as far as possible are delated.

Managing cash involves atleast two special functions namely:

1. Way in which accelerating cash inflows.
2. Way through which slowing cash outflow.

Accelerating Cash Inflows:

1. Prompt Payment By Customer:

Collection from customer should be prompt in order to accelerating cash inflows. Customer must be promptly informed about the amount payable. Cash discount and some cash incentives must be allowed for customer so they can pay as earlier as possible.
2. Quick Conversion of Payment Into Cash:

It can be through improved cash collecting process. Once a customer has given cheque in favour of firm it can be collected as quickly as possible.

The gap due to (1)Postal Float (2)Bank float and (3)Deposit float can adverse cash inflows. An efficient cash management will be possible only if the time taken in deposit float is reduced and make the money available for them.

CASH FLOW TIMELINE FOR A GENERAL COLLECTION SYSTEM:

<table>
<thead>
<tr>
<th>Payer mails payment</th>
<th>Company receives payment</th>
<th>Company deposits payment</th>
<th>Fund available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mail delay</td>
<td>Processing delay</td>
<td>Availability delay</td>
<td></td>
</tr>
</tbody>
</table>

3. Collection From Different Location:

A big firm operation universally or big geographical area can use system of decentralise collection. Different collection centers are to be opened at different place instead of one at one place. The idea behind this is to reduce mailing time of customers dispatch of cheque and its receipt in the firm and reducing the time of collection of these cheques. After receipt of cheque they can immediately send to collection. Due to local cheque it does not take time. The amount collected can be transfer to central office at earliest.
COMPONENTS OF A COLLECTION SYSTEM FOR OVER-THE-COUNTER RECEIPTS:

4. Mailed Payments Collection:

It consists of collection centres, deposits are processed at collection centres. Cheques are encoded, deposits are prepared and data are transmitted to head in central system. However, it is a firm decision about the number of collection centres, if automation depends upon firm policy.

COMPONENTS OF A MAILED PAYMENTS COLLECTION SYSTEM
Collection Point Location: The optimal location of the collection points is a function of many factors, including:

1. The geographical locations of the payor's mail points and hence, mailing times between mail points and collection points.
2. Availability time at collection points for the payor's drawee banks, i.e., the banks on which the cheques are drawn.
4. Number of cheques processed.
5. Amount of cheques processed.
6. The firm's opportunity cost or interest rate.
7. Variable and fixed costs imposed by collection points in addition to administration costs of managing the collection system.

5. Lock Box System:

Under this system the firm select some collecting centers at different places. The places are selected on the basis of number of customer and the revenue expected to be received. The firm hires a post box in a Post Office and parties are asked to send cheque on PO Box number. The bank collected the post numbers & start the collection process, & collected amount is credited to firms account.

By transferring the clerical functions to bank. The firm may reduce its costs, improve internal control and reduce possibility and fraud.

However location of lock box is a big problem in view of cost minimisation.

To solve this problem firm has to:

1. Check mail & clearing time of each possible lock box.
2. The total amount of daily funds and number of cheques received by the firm from each part of the sales area.
3. The required rate of return.
4. The variable and fixed costs of each proposed lockbox site. To speed clearing times, lockboxes are usually located in cities.

With these data in hand, it is relatively simple to calculate the one best lock box for the firm is constrained to have only one. This optimal solution is the one lock box.

![Diagram](image)

**4.2.2 Slow Cash Outflows**

1. **Paying On last dates:**

The disbursements can be delayed on making payment on the last due date only. It helps in using money for short period. Payment must be made on last date. For example, if the due date of payment is 30th then pay it on 30th only.
2. Payment through Cheques:

A company can issue cheque at different points. You had to submit the cash at bank one day before the cheque present for payment (Dated Cheques). The company can economise larger resources by using this method.

CHEQUE DISBURSEMENT SYSTEM
3. Adjusting Payroll Funds:

Some economy can be exercised on payroll funds also. It can be done by reducing frequency of payment. If paid weekly then monthly, if paid cash then by cheque etc. Cheque instead of DD's are made through which payment can be disbursed for some time. On the basis of past experience finance manager can deposit the money in bank because it may be clear to him about the average time taken by employees in encashing their pay cheques.

4. Centralisation of Payments:

The payments should be centralised and payments should be made through cheques. The mailing time can be availed as benefits for concern.

5. Making Use of Float:

Float is the difference in the balance shown in company cash book and balance in pass book of bank. The company can use float if able to estimate it correctly but due payment made by cheque to the party & not presented to bank for payment. "Float used in this manner can be called as cheque kiting". 17

CASH FLOW TIMELINE FOR DISBURSEMENT: PAPER CHEQUES

Payer receives invoice Payer mails cheques Payee receives cheques Payer deposits cheques Payer account debited

Payment initiation float Mail float Processing float Presentation float

Disbursement Float Presentation float

Payment Float

4.3 Investment of Surplus Cash:

4.3.1 Optimal Cash Balance:

A firm has to maintain optimal cash balance for settling the dues in time. The test of liquidity of the firm is that it is able to meet various obligation in time, some safety stock is also be maintained. Cash balance can be maintained on the basis of past experience & future expectation for maintaining optimal cash balance transaction costs & risk of too small.

![Diagram showing Total Costs, Opportunity Cost, and Transaction Cost]

Surplus cash can be invested in liquid and risk free securities to earn some income. There are quite good number of doors where funds can be invested.

1. Treasury Bills:

It represents short term obligation of the government issued by Reserve Bank India which have maturities like 91days, 182days, and 364days. They are sold on a discount basis. The investor donot receive an actual interest payment. This bill are issued in bearer form. Name of the purchasee are not written in the bill hence they are easily transferable. Since there is a backing of central government they are risk free securities.

2. Certificate of Deposits:

These are marketable receipts for funds that have been deposited in bank for a fixed period of time. It may be in a registered from bearer form. The
denomination and maturity period are decided as per need of investor. Certificate Deposite carry an explicit rate of interest. The funds deposited earn a fixed rate of interest on maturity, the holder of the Certificate Deposite gets the principal amount along with interest there on.

Certificate Deposite are:

1. Fairly Liquid
2. Generally risk free
3. Offers higher rate of interest.

3. **Unit of the Unit 1964 Scheme:**

The UTI scheme 1964 is very popular for short term investment. The face value of per unit is Rs.10. The purchase and sale value of unit are not squarely based on the net assets. Value per unit as should be the case for a truely open ended scheme.

**Advantage of UTI:**

1. The dividend income from unit received by companies is qualifies from tax exemption upto 80%, under section 80 M of Income tax.
2. Unit appreciate over time in a family predictable manner as UTI makes a gradual upward revision in its selling and repurchase price.
3. There is an active secondary market for units, there will be no liquidity problem.

4. **Ready Forwards:**

This deals are made by the banks under which the banks sells & repurchase the same security at predetermined price. Difference in sales & purchase price of security is incompany. Ready forward are permitted on certain securities. Ready forwards are generally done in units, public sector bonds of government securities.

The return on ready forward deals are closely linked to money market
condition. The investor can hope to earn more if money market is tight during buy 
season and at closing of the year.

5. **Commercial Paper:**

It refers to short term unsecured promissory note sold by big concern to 
raise cash. They have a maturity period of usually 90 days or 180 days. It is sold on 
discount & reedem at par. The main attraction of commercial paper is that it offers 
an interest rate that is typically higher than that of marketability. Commercial Paper's 
provide a yeild advantage over other near cash assets of comparable maturity.

6. **Inter Corporate Deposites:**

There are short term of deposits which can be of three types maximum upto 
180day/6months are calculated as intercorporate deposite.

**Call Deposite:** With drawable by the leander on a day notice. In practise one has 
to wait for 3 days. The rate of interest is 14% on these deposite.

**3 Months Deposite:** More popular in practise these deposite are taken by bor­
rower to tide over a short term cash adequacy. The rate of interest on such deposite is 
influenced by bank over draft interest rate.

**6 Months Deposite:** Normally leading companies do not exceeds depositories be­
yond this time frame Rate of interest flies to 25% to 26%. Since Inter Corporate 
Deposites are unsecured loans the leading company must satisfy about credit wor­
thiness of the borrowing firm.

Section-370 of Companies Act 1956 stricts ICD’s:

* Company can’t lead more than 10% of its net worth.

* Total leanding should not exceeds 30% of capital without prior ap­

proval of central government.

7. **Bills Discounting:**

Bills aim out of trade transaction. In order to raise funds the seller may get bill discounted with his bank. The bank will change the discount and return the
balance amount to the drawer. A company may allow to deploy its surplus funds to discount the bills the way bank does while participating bills discount one should:

* Ensure that bills are trade bills.
* The bill backed by letter of credit rather than open bill as the former are more secure because of the guarantee provided by the buyers bank.

Some other deposits are:

* Badla Financing
* Units
* Call Market
* Repurchase agreement
* Investment on marketable securities.

However it depends upon situation that company choose which of above as per market situation and condition as per market situation and condition.
4.4 Cash Planning in Grasim Cement, Raipur:

Cash inflows form inseparable parts in the business operations. This unit invests cash in inventory, fixed assets and payment for operating expenses in order to maintain a continuous production cycle. Cash balance helps to anticipate future cash flows and reduces the possibility of idle cash balances (which can lower profitability) and cash deficits (which can cause the unit's failure).

The unit develops a projected cash statement from a forecast of expected cash inflows and outflows for a period of one month. It is very crucial in developing overall operating plans. Cash budget is prepared which serves as most significant device to plan for and control cash receipts and payments. Cash budget is a summary statement of the unit's expected cash inflows and outflows over a month. It gives information on the timing and magnitude of expected cash flows and cash balances over a month. This information helps the finance manager to determine the future cash needs, plan for financing of the needs and exercise control over cash and liquidity of the unit.

Cash budget is prepared once the production has been set for next month w.r.t clinker and cement. It is sent to Head Office till 25th of the month for the requirement of cash for next month. The expenses are divide week-wise. The fixed payments which during the whole year remain fixed and some expenses are to be compulsarily paid in the first week include salary and wages. The rest of fixed expenses are divided equally. The variable expenses paid during first week and vary with production are payment to CSEB, Entry tax and Royalty is paid according to fixed norms and Excise duty every fortnight. Thus, this unit has managed effectively to anticipate expenses on weekly basis. This has helped a lot in decreasing the amount of cash balance to be maintained.