Inspira-Journal of Commerce, Economics & Computer Science (JCECS)
ISSN : 2395-7069, Impact Factor: 4.964, Volume 06, No. 04, October-December, 2020, pp. 147-150

ADEQUATE AND INADEQUATE CASH MANAGEMENT SYSTEM

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ABSTRACT

Cash is the lifeblood of a business and a business needs to generate enough cash from its activities so that it can meet its expenses and have enough left over to repay investors and grow the business. Cash is the important current asset for the operation of business. It is main component of working capital working capital management. Cash management encompasses how a company manages its operations or business activities, financial investments, and financing activities. A company has to generate adequate cash flow from its business in order to survive, meaning it is able to cover its expenses, repay investors and expand the business. In addition to generating cash from its activities, a business also needs to manage its cash situation so that it holds the right amount of cash to meet its immediate and long-term needs. This paper highlights on all about cash management adequacy and inadequacy.

KEYWORDS: *Good Cash Management, Motives, Dimensions, Models.*

Introduction

Cash management means optimum utilization of cash to ensure maximum liquidity and maximum profitability. It refers to the proper collection, disbursement, and investment of cash. It is a vital business function; it is a function that manages the collection and utilization of cash. Cash management refers to a broad area of finance involving the collection, handling, and usage of cash. It involves assessing market liquidity, cash flow, and investments. It is more often used to specific services such as cash concentration, zero balance accounting, clearing house facilities. It also involves in financial instruments like money market funds, treasury bills, and certificate of deposits.

Good Cash Management means:

- Knowing when, where, and how your cash needs will occur,
- Knowing what the best sources are for meeting additional cash needs; and,
- Being prepared to meet these needs when they occur, by keeping good relationships with bankers and other creditors.

Objectives of Cash management

The objective of cash management is to have adequate control over the cash position, so as to avoid the risk insolvency and use the excessive cash in some profitable way. The cash is most significant and highly liquid asset the firm holds. It is significant as it is used to pay the firm's obligations and helps in the expansion of business operations. An optimum cash management system is one that not only prevents the insolvency, but also reduces the days in account receivables, increases the collection rates, chooses the suitable investment vehicle that improves the overall financial position of the firm.

- To satisfy day-to-day business requirements;
- To provide for scheduled major payments;
- To face unexpected cash drains;
- To seize potential opportunities for profitable long-term investment;
- To meet requirements of bank relationships;
- To build image of creditworthiness;
- To earn on cash balance;
- To build reservoir for net cash inflow till the availability of better use of funds by conscious planning
- To minimize the operating cost of cash management

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Motives for Holding Cash

- **Transaction Motive:** Transaction motive is used for holding cash and to meet routine cash requirements to finance transactions in the normal course of business. Example- salary, wages, interest, dividend, goods purchased etc.
- **Precautionary Motive:** Precautionary motive is used for holding cash and to meet unexpected contingencies, unexpected situation like floods, strikes etc.
- **Speculative Motive:** Speculative motive is used for holding cash for speculative purposes to avail the benefit of bargain purchases that may arise in the future.
- **Contingency Motive:** Contingency motive is used for holding cash takes into account the element of uncertainty associated with any form of business. The uncertainty can result in prolongation of the working capital operating cycle or even its disruption.

Benefits of Maintaining Adequate Cash

- Higher productivity and liquidity
- Firm can avail cash as well as trade, discounts.
- It helps to improves credit worthiness, goodwill.
- Firm can enjoy new business opportunities.
- It helps to overcome short term crises.
- It creates good confidence among the investors.
- It ensures timely procurement of raw material.

Dimensions of Cash Management

Cash management is important but it is very difficult to correct prediction of cash flows. To gain control on company's cash flows, a firm or finance manager should develop some strategies for cash management followings points:

Cash Planning and Forecasting

A cash budget is a summary statement presented in an orderly format containing forecasted figures of receipts and disbursements of cash over a given period of time. Cash budget like any other budget is concerned with future events, events which can be approximated or best guessed taking into considerations past results, present strengths and future trends. Cash budget is a tool for forecasting short term cash requirements of an enterprise. They provide a blueprint of the cash inflows and outflows that are expected to occur in the immediate future period. Cash budgets are generally prepared in the following format, for short periods say month by month.

Particulars	Amount
• Opening balance of cash	
• Cash inflow or receipts Cash sales Receipts from debtors Other revenue receipts Capital receipts (to be specified)	
• Cash outflow or payment Payment to creditor for goods Expenses or to creditor for services Other payments, which incurred periodically like debenture Interest, advance tax, dividend, sales tax etc. Capital expenditures Repayments of loans	
• Surplus or shortage = b – c = inflows less outflows	
• Closing balance of cash = a + b = Opening balance + surplus	

Cash Flow

A Cash flow statement provides information about the changes in cash and cash equivalents of a business by classifying cash flows into operating, investing and financial activities.

Ratio Analysis

Ratio analysis is a form of financial statement analysis that is used to obtain a quick indication of a firm's financial performance in several key areas.

Managing the Cash Flows

Cash flow management is the process of tracking how much money is coming into and going out. It refers to the process by which an organization maintains control over the inflow and outflow of funds. The fundamental goal of cash flow management is to ensure that the incoming flow of funds is always greater than the outgoing so that the business sits on a surplus. Cash flows include both cash inflows and cash outflows.

Managing Cash Inflows

It refers to collection of cash required for detailed study of each phase of the cash cycle. The aim of managing collection of cash is to reduce these time lags as far as possible. Efforts to reduce time-lags aims at speeding up cash collections. Methods used for accelerating cash inflows.

- Timely billing and cash discount
- Reducing time gap in deposit float

Managing Cash Outflows

It refers to the management of cash outflows is to slow down or delay the payments as much as possible. It aims to ensure the payments and obligations are discharged timely, delayed payments would tarnish the reputation of the company and affect the credit worthiness. So, reduction in outflows is effective remedy for the company. Measures used for reduction in cash outflows are:

- Centralized disbursement centre
- Payments on due dates
- Playing the float

Cash Management Models

Baumol Cash Management Model

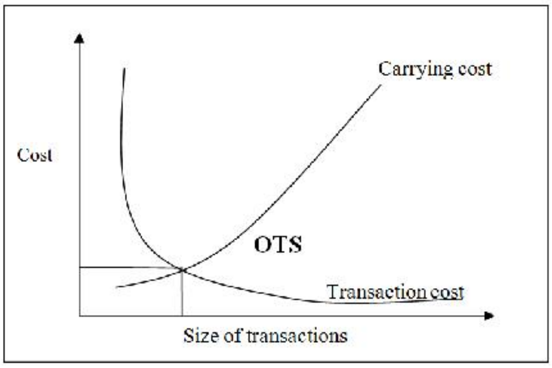
Baumol or Economic order quantity model was suggested by William j. Baumol in 1952. According to this model, Optimum level of cash is where the carrying costs and transactions are minimum.

Carrying Costs

This refers to the cost of holding cash, namely the interest foregone on marketable securities. They may also be termed as opportunity cost of keeping cash balance.

Costs

This refers to the cost involved in getting the marketable securities converted into cash. This happens when the firm fails short of cash and must sell securities resulting in clerical, brokerage, registration and other costs. There is an inverse relationship between two costs. When one increase, the other decrease. Hence the diagrammatically EOQ (Optimal transfer size) can be represented as:



The formula of obtaining optimal transfer size is

$$C = \sqrt{2} \times A \times F \div R$$

Here C = Optimum cash level

A = Annual or monthly cash disbursement

F = Fixed cost per transaction

R = Interest rate per month or annum on marketable securities

Assumption

- Inventory model of cash management is based on the following assumptions-
- The demand for cash, transaction costs for obtaining cash and holding period costs for a particular period are given and do not change during that period.
- There is a constant demand for cash during the period under consideration.
- Cash payments are predictable.
- Bankers do not impose any restrictions on firms in respect of maintenance of minimum amount of balance in the bank account.

Limitations of the optimum cash model

- Cash payments are assumed to be steady over the period specified. When the cash payment becomes uneven, it may be appropriate to reduce the period for which calculations are made so that expenditures during the period are relatively steady.
- Cash payments are seldom predictable. Hence the modal may not give 100% correct results.

Stochastic or Miller-Orr Cash Management Model

Baumol's model is based on the basic assumption that the size and timing of cash flows are known with certainty. The cash flows of a firm are neither uniform nor certain Miller-Orr model helps in determining the optimum cash balance level which minimizes the cost of management of cash. It deals with cash management problem under the assumption of stochastic or random cash flows by laying down control limits for cash balance. These limits consist of an upper limit (h), lower limit (o) and return point. No transaction between cash to marketable securities and marketable securities to cash is made during the period when the cash balance stays between the high and low limits. The lower limit is set by management. It can be set as zero if a business has sufficient investments in marketable securities or perfect creditworthiness and can raise additional short term debt at any time.

Assumptions

- The cash inflows and cash outflows are stochastic.
- The daily cash balance is normally distributed.
- There is a possibility to invest idle cash in marketable securities.
- There is a transaction fee when marketable securities are bought or sold.
- A business maintains the minimum acceptable cash balance, which is called the lower limit.

Conclusion

In today's world, cash management is necessary for living a good life with the atmosphere. Cash management reduces the wastage of money and helps for saving. Cash management, also known as treasury management, is the process that involves collecting and managing cash flows from the operating, investing, and financing activities of a company. In business, it is a key aspect of an organization's financial stability. Cash management is important for both companies and individuals, as it is a key component of financial stability. Cash is the only thing from which, we can satisfy our all the needs. It is only possible, when we manage our cash. Without cash management it is not possible. Sometime we can also say that our life is depends on only money. In today's world all things are measure in money. So, everyone make budget in mind before buying anything.

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