Management of Cash
Part I

Introduction

- "**life blood of a business enterprise.**"

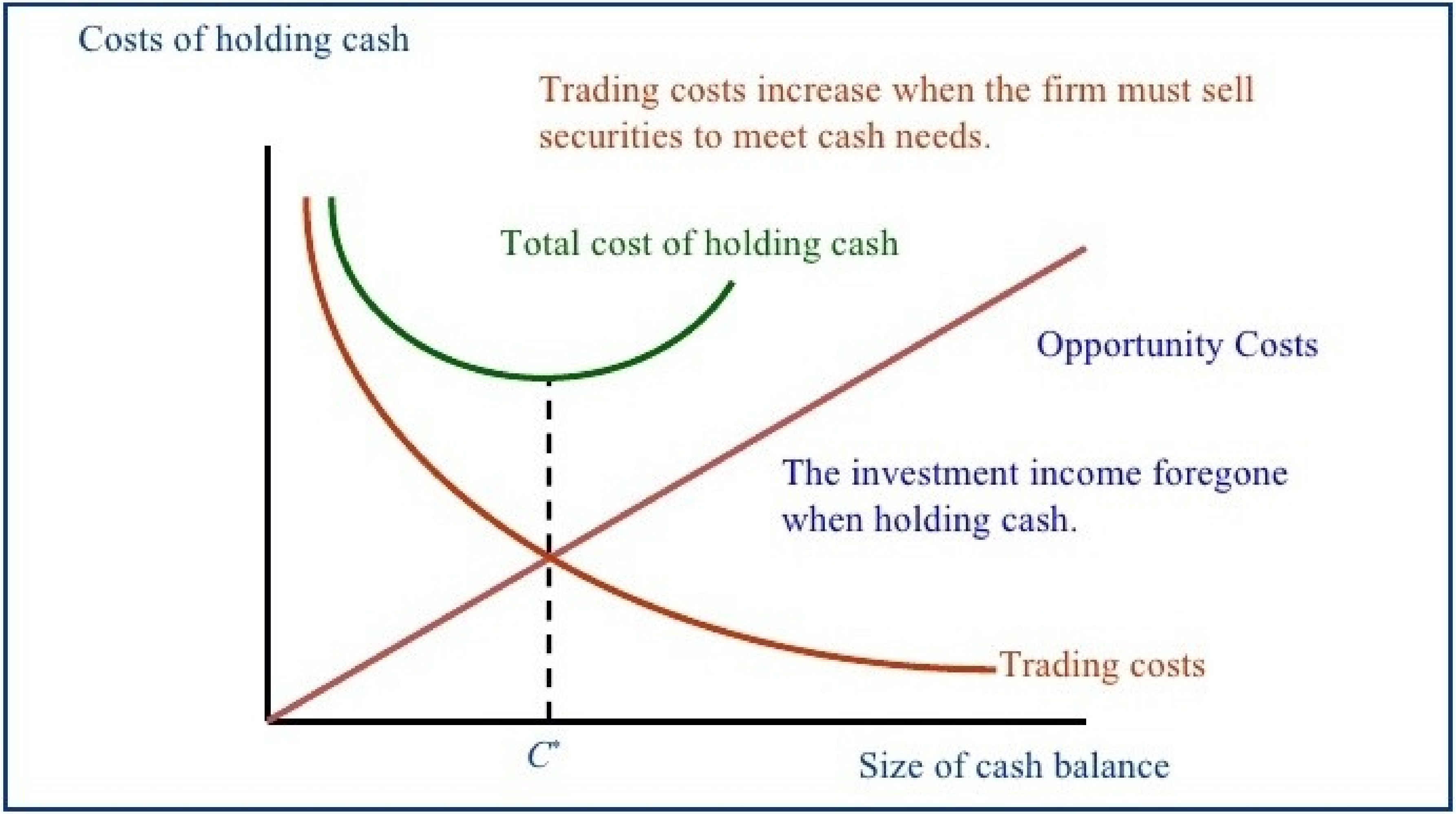
- **Transaction Motive** The collection of cash (from sale of goods and services, sale of assets, and additional financing) is not perfectly synchronised with the disbursement of cash (for purchase of goods and services, acquisition of capital assets, and meeting other obligations).

- **Precautionary Motive** There may be some uncertainty about the magnitude and timing of cash inflows from sale of goods and services, sale of assets, and issuance of securities. Likewise, there may be uncertainty about cash outflows on account of purchases and other obligations.

- **Speculative Motive** Firms would like to tap profit making opportunities arising from fluctuations in commodity prices, security prices, interest rates, and foreign exchange rates.

Need for managing cash

- It is a resource which has following costs:
  - An opportunity cost
  - Trading cost
- Hence, cash management demands
- (i) to have an efficient cash forecasting and reporting systems,
- (ii) To achieve optimal conservation and utilisation of funds.


Costs of holding cash
Trading costs increase when the firm must sell securities to meet cash needs.
Total cost of holding cash
Opportunity Costs
The investment income foregone when holding cash.
Trading costs
C*
Size of cash balance

Cash Budgeting

- Cash budgeting is a short-term cash forecasting tool.

- It is based on expected cash receipts and cash expenditure for a given time period.

- It is generally prepared for 3 months to 6 months. However, it can be prepared on weekly, daily and monthly basis (depending upon the nature and requirement of the firms).

An Illustration
(From Prasanna Chandra book pp. 581)

- ABC Company manufactures plastic bags. Its estimated sales for the period January 2020 through June 2020 are as follows: Rs.100,000 per month from January through March and Rs.120,000 per month from April through June. The sales for November and December of the previous year have been Rs.100,000 each. Cash and credit sales are expected to be 20 percent and 80 percent respectively. The receivables from credit sales are expected to be collected as follows: 50 percent of receivables, on an average, one month from the date of sale and the balance 50 percent, on an average, two months from the date of sale. No bad debt losses are expected to occur. Other anticipated receipts are: (i) Rs.5,000 from the sale of a machine in March, and (ii) Rs.2,000 interest on securities in June.

- ABC Company plans to purchase materials worth Rs.40,000 in January and February and materials worth Rs.48,000 each month from March through June. The payments for these purchases are made approximately a month after the purchase. The purchases for December of the previous year have been Rs.40,000 for which payment will be made in January 2020. Miscellaneous cash purchases of Rs.2,000 per month are planned from January through June. Wage payments are expected to be Rs.15,000 per month; general administrative and selling expenses are expected to be Rs.10,000 per month. Dividend payment of Rs.20,000 and tax payment of Rs.20,000 are scheduled in June 2020. A machine worth Rs.50,000 is proposed to be purchased on cash in March 2020. Prepare Cash Budget.

Solution

Expected Receipts							
s.n.	Particulars	January	February	March	April	May	June
1	Cash sales	20,000	20,000	20,000	24,000	24,000	24,000
2	Collection of accounts receivable (50 percent in one month)	40000	40000	40000	40000	48000	48000
3	Collection of accounts receivable (50 percent in two months)	40000	40000	40000	40000	40000	48000
4	Receipt from sale of equipment			5,000			
5	Interest						2,000
6	**Total cash receipts**	**100,000**	**100,000**	**105,000**	**104,000**	**112,000**	**122,000**

Expected Payments							
S.n.		January	February	March	April	May	June
1	Payment of accounts payable	40,000	40,000	40,000	48,000	48,000	48,000
2	Miscellaneous Cash purchases	2,000	2,000	2,000	2,000	2,000	2,000
3	Wages	15,000	15,000	15,000	15,000	15,000	15,000
4	Manufacturing expenses	20,000	20,000	20,000	20,000	20,000	20,000
5	General administrative and selling expenses	10,000	10,000	10,000	10,000	10,000	10,000
6	Dividend	—	—	—	—	—	20,000
7	Tax	—	—	—	—	—	20,000
8	Capital expenditure	—	—	50,000	—	—	—
9	**Total payments**	**87,000**	**87,000**	**137,000**	**95,000**	**95,000**	**135,000**

- Assuming that the cash balance on 1st January 2020 is Rs.22,000 and the minimum cash balance required by the firm is Rs.20,000, we can now prepare a summary statement.

Summary cash budget

	particulars	January	February	March	April	May	June
1	Total Receipts	100,000	100,000	105,000	104,000	112,000	122,000
2	Total Payments	87,000	87,000	137,000	95,000	95,000	135,000
3	**Net expected cash flow (1-2)**	**13,000**	**13,000**	**-32,000**	**9,000**	**17,000**	**-13,000**
4	Opening cash balance	22000	35,000	48,000	16,000	25,000	42,000
5	closing cash balance (3+4)	35,000	48,000	16,000	25,000	42,000	29,000

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5	closing cash balance (3+4)	35,000	48,000	16,000	25,000	42,000	29,000
6	Minimum cash balance	20,000	20,000	20,000	20,000	20,000	20,000
7	**Surplus or deficit in relation to minimum cash balance required**	**15,000**	**28,000**	**-4,000**	**5,000**	**22,000**	**9,000**

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7	**Surplus or deficit in relation to minimum cash balance required**	**15,000**	**28,000**	**-4,000**	**5,000**	**22,000**	**9,000**
8	Short-term borrowing			**4000**			
9	Repayment				**4000**		
10	Adjusted closing balance (5+8-9)	35000	48000	**20000**	21000	42000	29000

For any query
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