**Working Capital Management**
**Prof. Dr. Anil K. Sharma**
**Department of Management Studies**
**Indian Institute of Technology-Roorkee**

**Lecture-46**
**Cash Management**

Welcome students, so now we are in the process of learning about the management of cash, the third important current asset and in the last part of discussion in the previous class we just initiated the discussion on the management of this particular current asset, there will be learned about the cash flow into an out of the firm, how important it is. Cash flow within the firm and cash balance is held by the firm at point of time.

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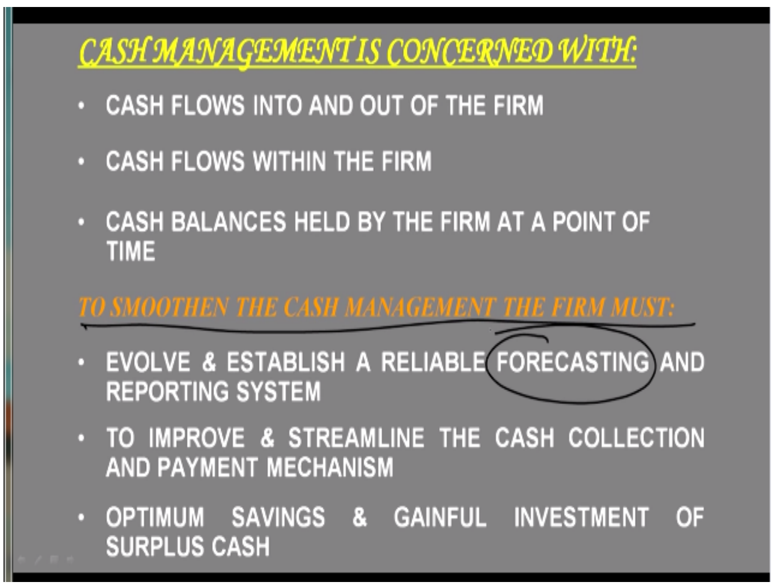


Now to smoothen the cash management, the firm must, means I have written here that smoothen the cash management the firm must what firm must do that is the, the firm must do something. And what the firm should do evolve and establish a reliable forecasting and reporting system, smooth management of cash, smoothen the management of cash evolve and establish a reliable forecasting and reporting system, when you talk about the forecasting or their reporting system this particular thing forecasting, how you can forecast the requirement of cash or the availability of the cash.

We have to know in advance, well in advance that what is going to be the cash position over a period of time. I told you in the say previous class that we can use the concept of cash budgets, cash budgets maybe you can prepare the say depending upon the time horizon or the depending upon the precision we want in our cash forecasting. We will have to look at the time horizon.

Normally we prepare the monthly cash budgets, some firm prepare fortnightly cash budgets and the firm who are really efficient and who have the resources, who can afford to prepare, they prepare the weekly cash budgets. So, the minimum time horizon the shortest time horizon is the weekly cash budgets, the firms must prepare the weekly cash budgets regularly, frequently. So, that they know in advance that what is going to happen in the next 5 or 6 days, how much cash we are going to receive from the different quarters.

And how much cash we are going to pay to the different claimants from there we have purchased on credit and what is going to the net position of the cash at the end of the week, when you prepare the weekly budgets you prepare automatically you calculate the daily cash balances or at least if not daily cash balances if the week and the balance is also going to be known to as, you can make out that in their particular week if you are falling short of case.

Then we can arrange cash by borrowing it from different sources either from the bank if we have the CC limit or we can take the short term loan or we can sell the marketable securities if we have the surplus marketable securities we can sell them. Because selling of the marketable security and converting them into cash that also requires sometime, this not that easy that okay, you say is a saleable is a sort term asset, very short term asset event, still we have to find out a customer.

We have to complete a process and then only the security can be converted into cash. So at least a day or 2 minimum it is required to convert the securities into the cash. So we should be knowing in advance that what is going to happen with regard to the cash in the next 1 week and do we need to arrange cash as we are going to have the sort we are means having a situation of the wear we are short of cash or we are going to have surplus of cash.

Because if we are going to have surplus of cash even then it should be carefully managing it as I told you that keeping more than the required amount of cash is not good for any firm, any businesses. So, if we are say that we are going to have surplus cash at the end of the week. So it means we should look for that where we can investor or at the end of the week that surplus cash can be invested wear.

Because even today we have the say called deposits for 24 hours we can deposit the surplus cash, you can earn something out of it or maybe we can make investment in the inter-corporate deposits. If you do not need the cash, surplus cash for 1 more week or 15 days or 1 month, we can invest into the some other firms who needs it. So for costing is most important and for costing is possible with the help of cash budget.

So, if you prepare the efficient and useful cash budgets then we are going to be very cleared about the cash position in the next 1 week or maybe the 15 days or maximum a month. More than a month we should not prepare the cash budgets because it is a short term current asset. So, maximum time horizon could be 1 month and minimum should be 1 week and if we are knowing in advance the surplus or shortage of the cash.

In case of the shortage we will be arranging the cash and in case of the surplus we will be looking for forward for the even knew whose invest the cash. So, automatically you can say that your cash management will be smoothen and it will be very effected and we will not have any liquidity problem, any payment becoming due to the made and we do not have the cash for that, that situation will never arise.

And if we are going to have surplus of the cash then is going to be a useful of wear to know it in advance and look for the avenues where their surplus cash will be invested and minimum or the maximum return will be earned. Similarly to improve and streamline the cash collection and the payment mechanism. Cash collection and payment mechanisms are very very important.

Many companies who are not serious in managing their cash or their say cash resources, they are failing to streamline the cash collection and the payment mechanisms, say when they have to collect the cash say these days to some extent we are using the online payments, online transfers and payments under sheets. But in many cases we are making the payment and receiving the payment through cheques.

Now the peer has peers responsibility is that we has to make sure that cheque reaches in the receiver's office or the selling company receives the cheque from the paying companies was that cheque is reached in the selling companies office, the responsibility of the peer is over. Now seller has to immediately send that cheque to the bank and bank has to collect it as early as possible. There are the miss you can call say that there are the gaps, time gaps, delays.

That we receive the cheque is lying in the drawer of the cashier and he will send their cheque to the bank maybe after 2 days, 3 days, 4 days, he is not bother about. He feels that we have received the cheque, we have received the payment but that is not the payment we have not receive the cash, we have not receive the say the amount, the amount you have received a document or maybe one instrument.

If that instrument has to be send to the bank, so sending to the bank should not be delayed we should be able to immediately receive the cheques and send them to the bank. So, quickly if we are able to do that then certainly I think we are going to further improve the cash collection and as per as the payment is concern firms normally what they do, they try to miss delay the payments not by not sending the cheques, they will send the cheques immediately.

And as it when this becomes due and they also know it that their responsibility of making the payment is over and that on the due date maybe due date is same you can say that is $14^{th}$ of march or $15^{th}$ of march. So by $14^{th}$ or latest by see evening of the $14^{th}$ if it is a $14^{th}$ and if it is 15 then the by the latest by that evening of $15^{th}$ march then cheque must be reaching in the receiver's office or the selling companies office and then the paying companies job is over.

Now for example if the selling company whoever received the cheque they are also very active and immediately they send their cheque to the bank. Now that has to be seen that on which branch that cheque has to be on which branch of the paying company that their cheque has been drop. For example you are making the payment to a company say we have a company they are 2 companies located, one is at in Delhi and another company is in say you can call it as Agra, one is in Delhi another is in Agra.

So, it means a company who has made the payment to a company in Agra, they have send the cheque the company is received the cheque and but that cheque is drawn on the Guwahati office of the company who is located in Delhi. And that is the pre-agreement between both buyer and seller that will make you the payment you will receive the cheque on the due date but all the payments will be drawn in favour of or maybe at other office at Guwahati.

So, it means what will happen then the cheque will be received by the firm who is located in Agra from the firm in Delhi. So, cheque is coming from the Delhi but that is drawn against the branch of the Delhi company based in Delhi their branch in Guwahati office or in the Guwahati. So, that cheque when will be deposited by the company in Agra in their own bank that cheque will be sent by the bank to Guwahati office and from there the concurrence of the cheque has to be obtained and then only the payment can be transferred.

So, if this kind of the situation is there then the paying companies very smart there on the one side issuing the cheque also, but that is big debited from the paying companies office after next 15 days. So, it means they have say smartly managed collection immediately they are receiving and collecting the cheques but in case of the payment they are only making sure that the cheque reaches the receiver's office.

But as per as the payment transfer is concerned that will take another 10 to 15 days period of time. So, that is known as basically in the technical terms we call it as float when you say that it is float. So, what do we mean by float, we have the collection float, we have the disbursement float and then we have to think about the other things.

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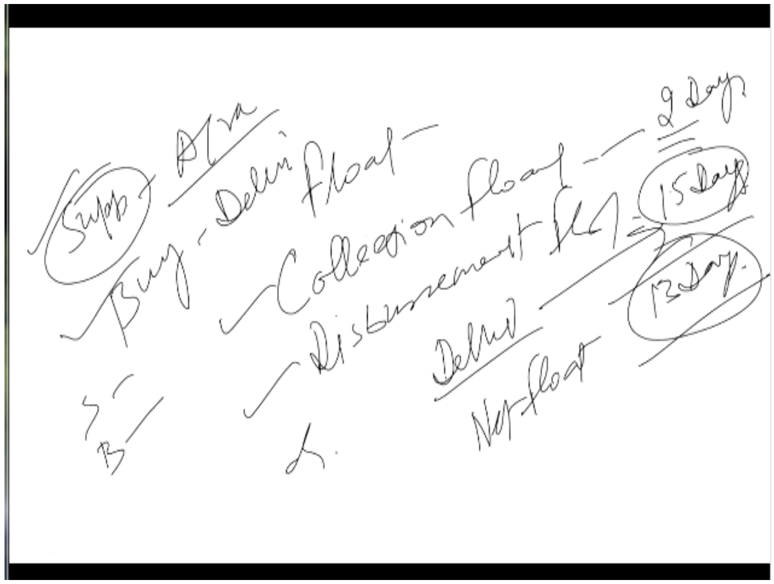


So, we call it as what we call it as it is float, float means correction float, this is the collection float, this is the disbursement float. So, 2 floats are there collection float I am talking about for example when we receive the cheque we immediately sent to the bank and that within 2 days the cheque is collected means immediately when it is receive today it is sent to the our bank in Delhi we are located in Delhi.

We received a cheque immediately it goes to the bank within an hour and within 2 days the cheque is collected by the bank on the behalf of this company. So, it means within 2 days the payment comes to the companies account and in case of the disbursement as I am saying that a company who is located in Delhi and if they are making the payment to a company in Agra and that is against the company's Delhi's companies office in Guwahati.

So, it will take how many 15 days for finally say making the payment actually making the payment to the company in Agra. So, the company who is in Delhi their account will be debited after 15 days, so it means they have manage the disbursement float and disbursement float is 15 days collection float for their own payments is 2 days. So, there is something called as net float, this is called as net float which is here that is how much 13 days.

So, float management is very very important in case of the cash management, but you see this all is not possible 15 days and writing the cheques against the Guwahati branch that is also not possible in the normal course. In that case this only happens that when the buyer is or maybe the supplier who is located in Agra and they are supplying buyer or the buyer is in Delhi, they are in Delhi and the supplier is in Agra.

So, when the buyer is very strong company it is in a very strong position and supplier is also not in that very strong position, supplier is depending for his supplies or making his supplies to the company whose buying it as I was talking to you that for example we talk about the Maruti, Suzuki or Suzuki India limited, they are buying almost all inputs from the different and sellers small firms, they are not manufacturing the glass, they are not manufacturing the steel.

They are not manufacturing the rubber, they are not manufacturing the tires and in some cases the suppliers are big companies, in some cases suppliers are small companies. But the small companies they are supplying to Suzuki motors for number of reasons, number one is they are supplying to a highly secured and credit by the customer and entire production of that unit is being what regularly by the Suzuki motors.

So they have not to look for any other customers is a long term buying and selling contract between the supplier as well as between the Suzuki motors limited. So suppliers entrusts that I have got such a wonderful customer that my payment is secured and if I am giving the credit I am able to load that credit with interest factor also my payment is also secured and I do not need to look for any other market anywhere around.

So no problem if there are certain conditions which are not normal, if I have to set some exceptions abnormal conditions also from my buyer or from my customer I will go by there. So, that is only possible that Suzuki motor may get say this agreement from the supplier in Agra that we will make you the payment on the due date. But their cheque will be drawn in favour of our branch in Guwahati, so you have to accept that.

So, in this case supplier may agree that no problem you give the cheque we will wait for another 15 days and finally the supplier also knows that my payment is secured and he is having multiple other benefits from say having relationships with this company. So, it means even I have to wait for another 10, 15 days for getting my cheque collected no problem I accept that because I am enjoying so many other advantages by dealing with Suzuki motors or any other such graded by the buyer.

So, it is not normally possible, for example if supplier and buyer they are offer the same wavelength or maybe the same financial strength is not only the one parties requirement that they have to depend upon the other, both are both can reciprocate with each other. So, in that case the buyer cannot dictate the terms on supplier and supplier could say that if you would not buy it on my terms, I will not receive any cheque which you are writing in favour of Guwahati office.

We will be giving you this much credit period we have to receive the cheque, you have to make us a payment on the due date and the cheque should be in say return against a branch or account in our city only we cannot accept any payment which is say in favour of the Guwahati office or any other office that is not possible. So, it means depending upon the economic strengths of both the sides creditworthiness of both the sides.

If both can reciprocate with each other then nobody will accept that any kind of the abnormal terms. But if the supplier is weak and the buyer is very very strong in the market very very creditworthy , in that case they can have this kind of the terms and the supplier has to agree because supplier has he is having the multifarious advantages by dealing with this kind of the bigger and the repeated buyers.

So, it means this is the concept of float which is a collection float in how many days you collect your own payments and disbursement float in how many days your payment is made actually your payment is made to your suppliers and the difference between the collection float and the disbursement float is the net float. So, net float should be maximum, we should try to maximize and that float.

So, that by keeping a minimum balance of the cash in our bank account as cash we can do maximum business. Because if we know that this payment is more going to be finally debited from our account in next 15 days. So, issuing a cheque of any today does not make any sense means if it is there we have made the payment, we have send the cheque but only cheque is sent and payment will be debited after 15 days.

So, it means we can keep on writing the same amount of cheques to the other suppliers also for the next 14 days because we know that the cheque we issue today that will be presented to our bank after 15 days. So, do not need to worry about we can keep on writing the cheques knowing it how many time, how many days are taken by the receiving from to get the cheques collected.

So, it means they can increase the transaction they can do by keeping the minimum balance in the cash because nobody want to keep in maximum balance of cash in the bank account because it is a current account and it does not any amount of interest right. This is the second thing is, so to improve the and streamline the cash collection and the payment mechanism. So, cash collection means the collection float and the payment means the disbursement float.

So, collection float should be minimum payments disbursement of the payment float should be maximum. So that the net float is maximized. Then is the optimum savings and gainful investment of surplus cash. I was telling you in the previous class that if you look at the balance sheet of the public sector company you will find that huge amount of cash, large amount of the cash is lying as cash in that balance sheet which actually that not required.

But they do not know how cost your expensive this asset is and it should be effectively managed knowing it that how much cash is required buyers actually, how much is available with us and if there is any surplus cash available there should be taken to the market and invested in the market. For example you have say you talk about the BHEL, BHEL has the 5 or 6 plants in the country.

And at every plant location it is considered as a independent unit and they are having their say plant labour balance sheets, profits and loss accounts and other kind of the statements and they are keeping cash at every plant location at the plant level. So, why not they do that total their all balances cash balances as well as you cannot store inventory or at the Delhi office or at the corporate office.

And then it will be used by the say Haridwar branch or Bhopal plant but at least cash, cash is such a thing that these digits can be transferred online. So, they should keep total cash at one place means beyond a level that cash should be at one place normally the unit should make that their cash daily cash requirements at their plant level. And if there is any surplus amount left there should be immediately transfer to the central office to the corporate office.

And from the corporate office by knowing their requirements of the plants, if some surplus cash is available that should be invested in the market. But nobodies worried about that and nobody wants to make a proper investment of their cash. Because there their pay-ins increase their and they are going to gain anything extra out of it, if they have the surplus cash they have to calculate first of all how much extra cash is there with us or going to with their with us where to invest have to look for the investment avenues.

And then when the cash is required they have to convert the marketable securities into the cash, so who will take all these cashes. Whereas this kind of the culture is not there in the privately held companies. They know that this asset has a cost. So they go for the very clear cut for costing system budgetary, process, cash budgets, weekly cash budgets, they estimate in advance that how much cash is required, how much is going to be available.

And if any surplus cash is there, you should be invested in the market. So, it means we should learn while managing the cash properly we should be knowing it that the optimum savings are important. And we should go for saving of the cash and gainfully investing it or gainfully investing the surplus cash in the market. So, these 3 things, these 3 points can help us to say smoothen the cash management, process apart from the other things.

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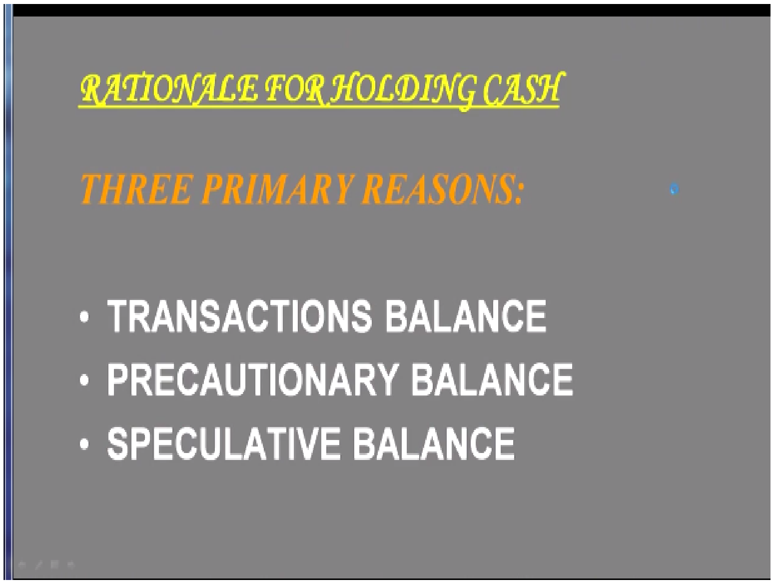


Now rationale for holding the cash, see you must have say seen elsewhere as well as we have already discussed the inventory management. And when you talk about the management of the cash we compare it sometimes with the management of inventory. Cash is as good as inventory of the raw material or the finish goods, there we are storing the inventory or the goods here we are storing the cash.

So, like inventory say holding cash also has the similar motives or maybe little one maybe different, for the other 2 are same say for example to have the transaction balance or transaction motive to make day to date payments and to ensure that firm is having sufficient liquidity for say transaction purpose, daily transaction purpose, weekly transaction purpose we have to keep the cash, so we are keeping.

So, we should only that much of the cash which is required and desired for fulfilling the transactional requirement not more than that and even not less than that. Precautionary balance okay after transaction you can increase that minimum is our this transaction level and we have to keep little more than that as a precautionary balance. Because if sometime our needs fluctuate sometime more or sometime less then we should keep not exactly as per our requirement but little more than that to deal with some any kind of the emergency.

So that any payment which is of not anticipated if becomes due to the made or sometime it may be possible that some of the firm who has supplied to us their credit period is ending 15 days but somehow if they make us a request that please make us the payment because we need the cash today. So, sometime it is for our own precautionary purpose and sometime to help our suppliers also, we have to keep the surplus cash.

So that the payment can be made as and when it is due and then the speculative purpose keeping more than the required amount of cash sometime is done with these speculative purpose also. Speculative purpose means that you can invest that cash in the opportunities if some of the opportunities arise, opportunities are like there for example we are say agriculture based product manufacturing company and our raw material is agriculture based.

So when the raw material is purchase by these companies, for example you talk about ITC, ITC's most of the products are agriculture based they are manufacturing flour, they are manufacturing even secretes they are manufacturing. So many other things consumer products and many of their products are based upon the agriculture imports or a agriculture material. So, when there is a harvest season when the crop comes you will have to buy at the time and store it.

Normally there are the prices which are pre-decided or the market decides but sometime they feel that some raw material is available in the market at the damn cheap prices. So, if we have surplus cash and we invest it into, so tomorrow means when will require the raw material for converting that into the finish product. We will get it at means we will be requiring it certainly, so if it is available at half the price find to buy it.

So, for that speculative purposes we can do it like this or sometime what happens that we have made or we have say got the supplies from some of the suppliers. And normally thus credit period which is the suppliers has allowed to the company maybe any company busy limited that is say normally it is 30 days. But just after 15 days the supplying company needs cash, so they give you offer to the buying company that normally our credit period to use 30 days which is going to end up a after another 20 days.

Because only 10 days are over and after another 20 days you will be making the payment to us but if you make the payment to us today we will give you 2% cash discount. So, it is a very good opportunity, company should enjoy it, if they are surplus cash why not to grab that opportunity and enjoy 2% discount and make the payment immediately. So, all these speculative purposes help the firm to gainfully invest the cash or to keep the cash for such type of the purposes where the cash is not required within the firm.

But it can be very efficiently used to deal with the speculative purposes and to earn some unexpected or extra incomes on this surplus cash.

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Now some other important aspects we will be talking about before moving to some cash management models. So, we will wear building their foundation about the cash management, so we will be trying to know about some important other important concepts. And these concepts are 3, one is the cash purchase profit, second is cash flow and the cash stock and third one is the cash flow presentation.

First one is cash verses profit, you see there is difference between the cash and profit, when you prepare what is the difference between the cash and profit, say when you prepare the profit and loss account, profit comes to us from where it comes from the profit and loss account, if I make this statement in the T-form.

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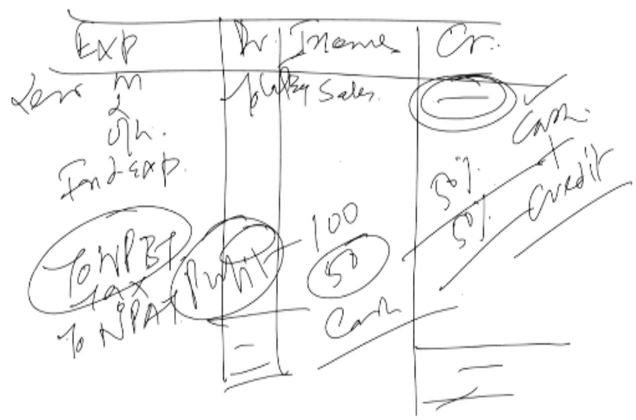


So, here we talk about we are taking here as the all expenses here we are taking all incomes and then we call it this is the credit side, this is the debit side. And if this side is bigger than this side, so what is there we have the difference here is to net profit before tax and then is the tax part here and then it is to net profit after tax or sometime we call it as NOPAT net operating profit after tax right.

So, here when you are calculating the net profit before tax or the net profit after tax, so this is only profit. We are saying this is not the cash, this is only profit because why I am saying that this is not in cash certainly it can be in cash. But certainly it is not I am say in all the cases is it not required to be in cash because when you are taking the source of this profit is what here the upper part of income statement and here it is from the sales by sales.

And when you write the figure of sales here less you have the manufacturing expensive like material, then is the labour, then the overheads and then is the indirect expenses right. So when you are talking about the sales in the income statement or in the profit and loss account we never mention that these sales are only cash, we say it is the total sales, total sales can be cash sales+credit sales, cash+credit sales is total sales.

So, it means when the sales are having the cash as well as the credit element similarly the profit is also having cash and the credit element, part of the for example the this ratio is 50-50, 50% of the sales are on cash and 50% of the sales are on credit this ratio is 50-50. It means out of this profit say it is for 100 rupees only 50 rupees profit is in cash. So because 50 rupees profit is on the credit we have not received that profit yet, so it is on the credit.

So, when you are talking about the cash verses profit understanding the cash management we must be clear about that cash is real and the profit is nominal. So out of the profit total profit how much is the cash profit that should be very clearly known to us. Because when we are going to prepare the cash budgets, we are going to differentiate normally what happens.

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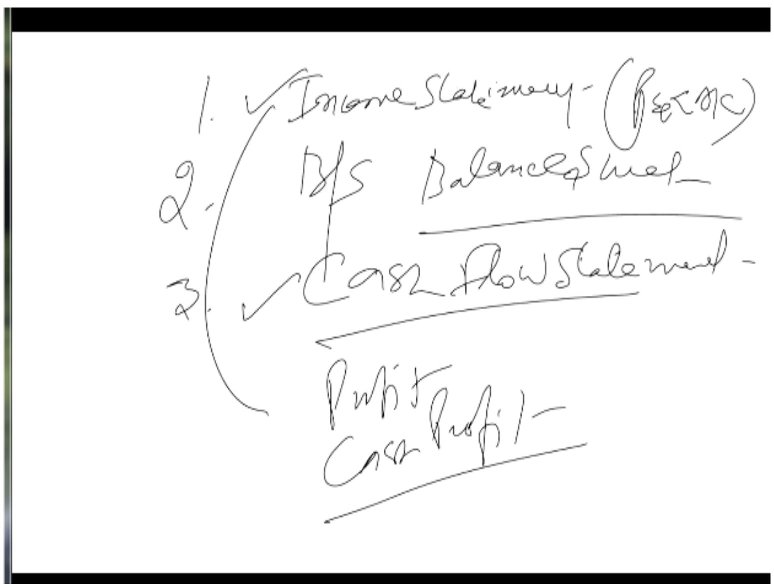


These days when you prepare the income sorry financial statements earlier we were preparing 2 financial statements. First one was the income statement and which is called as P and LA account also profit and loss account. And second was the balance sheet, we call it as balance sheet, so these were the only 2 statements. But now we have introduce the third statement also that has become the statutory statement or compulsory statement which is called as cash flow statement.

Cash flow statement which also has to be prepared along with these 2, so now the 3 statements are to be prepared by all the companies, income statement that is the profit and loss account, balance sheet and the cash flow statement, these 3 statements are required to be prepared for all the companies why now we are having the income statement also and the cash flow statement also, income statement is telling us what is the extent of profit.

And cash flow statement is telling us what is the extent of cash profits, this is the difference. So, we should be knowing that out of the total profits how much profits are the cash profits and if we are going to have some cash profit how to invest that profit in the market and how to deal with that profit efficiently because if we are going to have some say surplus profit that is cash. So, we have to find out the revenues where this cash can be invested.

And if we are going to have the profit but say largely the larger trunk of the profit say 80% of the profit is nominal profit because of the 80% of the sales being the credit sales, we know that now the cash profit is only 20%. So understand first that in your firm how much cash is going to be available and related with the profits but the profits first you calculate the profit figure and then prepare the cash flow statement. So you will get to know how much is now the cash available and then you start thinking of the management of the cash.

So, this is the one important point which has to be born in mine that cash is the earlier profit where is the profit is if it is only profit then it is a nominal profit. So, we will have to very clear, out of the total profit how much profit is in cash, how much profit is non cash or it is the nominal profit, this is one important point. Then they are the 2 other points cash flow and cash stock and the cash flow presentation with they are also very important and interesting points and we will discuss this points in the next class, thank you very much.