Cash management and its goals

Although good cash management cannot save a business whose products have no market, weak cash management can contribute to bankruptcy. This is because bankruptcy can result when a firm's liquid assets are insufficient to meet current obligations.[1] Insufficient revenue flows and practices that squander the cash flow exhaust the assets that can be quickly converted to cash to meet obligations, leaving the firm bankrupt.

Q 4-01. What are the outcomes of a cash management program?

A cash management program improves the match in the timing of cash inflows and cash outflows. This reduces operational risk by increasing the certainty that payments are made and receipts are deposited on time. The better matching of cash flows and the minimization of unaccounted or idle balances trims needless borrowing, opens the possibility for fund investment, and safeguards cash balances and investment assets. This reduces the cost of borrowing, minimizes transaction costs, and increases investment income.

Q 4-01.01. What are the main functions of cash management?

There are three functions of cash management: cash mobilization, properly timed disbursements, and an improved investment program.

Q 4-01.02. Why is cash management concerned with cash mobilization?

The cash mobilization function accelerates the deposit of collections. Having funds in-hand is preferable to having accounts receivable. A receivable, or item to be converted in the future, often is subject to transaction delay or depreciation of value. Once funds are due to the government, they should be converted to cash-in-hand immediately. If funds wait at a district office or in transit, they are little better than accounts receivable.

Q 4-01.03. Why is cash management concerned with disbursement timing?

Disbursements should be timed properly because they surrender cash resources. Some payments must be made on a specified or legal date. For such payments, there is no cash management decision. For other payments, discretion in timing is possible.

[1] Take, for example, the business failures of many railroads. Railroads, even when they are bankrupt, may be rich in assets, such as a large stock of capital in rights-of-way, rail cars, and facilities.

Government vendors, for example, face the same cash management needs as the government: they want to accelerate collections. One way to do this is to offer discount terms for quick payment for goods sold. A common proposal, for example, is to offer a 2% discount for payments made within 10 days and full payment due within 30 days otherwise.[2] A cash manager should evaluate the possible uses of his funds. Is there an opportunity to earn 2% return on his funds in ten days? If not, the best use of the funds (if he has them and there are no significant outflows to worry about) is to pay early, that is, on the tenth day.

Q 4-01.04. How does cash management support improved investment?

One can reduce idle cash balances by doing something worthwhile with the cash. A dollar held as idle cash and not used either to augment revenues or to decrease expenditures is a lost opportunity. Funds that are not needed to cover expected transactions can be used to buy back outstanding debt (and cease a flow of funds out of the treasury for interest payments) or can be invested (placed in a bank at interest) to generate a flow of funds in. Minimizing idle cash balances, however, requires accurate information about expected receipts and likely disbursements.

Principles guiding cash management

Q 4-02. What are the principles of cash management for a sovereign state?

- Funds should be readily accountable and available to meet financial obligations.
- Cash is a resource to be used on a just-in-time basis. Payments are made only at the appropriate time.
- By pooling funds into a single account, one exploits their fungibility and makes disbursements from a common source.
- With pooled funds, periodic or transient shortfalls in one program area can be covered by surpluses in others.
- Cash held by the government has a cost that is measured as the direct financing costs of debt issued, i.e., the government's cost of capital.
- Holding excess cash imposes a second cost in the economy when it drains reserves from the economy.
- Short-term timing gaps should be dealt with through short-term funding.
- A surplus of funds should exist only for short time periods.
- During periods of surplus funds, cash should be placed in collateralized deposits or in similarly secure investments to earn interest or used to reduce outstanding indebtedness.

[2] Alternatively, what is termed "2/10, net 30."

These principles should be of primary importance in designing a program. The availability of particular tools used to manage cash depends on the specifics of the environment and technological endowments of the state. The technology that may be deployed to manage the cash resources of a state is of secondary consideration. The focus should not be on the tools of cash management; it is easy to be distracted by sophisticated electronic funds transfers systems.