European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.6, No.37, 2014

On the Liquidity Management in Businesses: A Key to Survival and Growth

Ezeamama Martin (FCMA)
Department of Banking and Finance, Caritas University, Amorji – Nike, Enugu, Enugu State, Nigeria
E-Mail: ezeamama@yahoo.com.

Ugbor, Raphael Oluchukwu
Department of Accountancy, Institute Of Management and Technology, Enugu, Enugu State, Nigeria
E-Mail: raphngo2003@yahoo.com

Eze Everistus Obinwanne,
Department Of Mathmatics, Michael Okpara University of Agriculture Umudike, Umuahia, Abia State, Nigeria
E-Mail obinwann-eze@yahoo.com

ABSTRACT
The management of cash no doubts impacts positively on the survival and growth of firms. What is in doubt is the amount of cash to be held by a firm as enough cash to enable the firm stay "afloat". The objective of this paper is to examine the liquidity management in firms as a key to the survival and growth of businesses. Data from existing literature were collated and used for narrative purposes on liquidity planning and management problems. This paper recommends that good knowledge of cash flow forecasting and budgeting, two key components to financial stability and solvency are essential to growth in business.
Key words: liquidity Management, Cash flow, Survival and Growth, Forecasts, Behavioural Motivations.

1.0 INTRODUCTION:

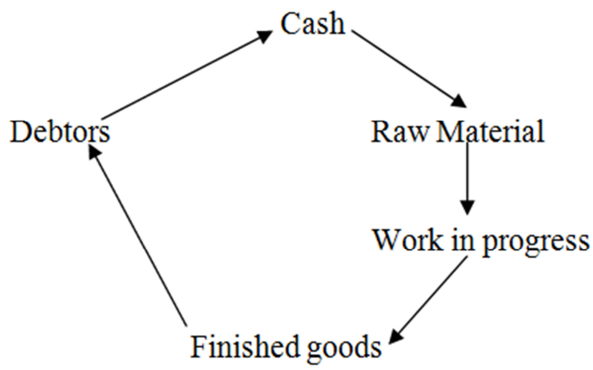
If your definition of cash flow is flawed, and you are not tracking your transactions, then you are growing your business right into liquidity crisis. Everyone wants cash on hand at the right times, and tighting your seat belt, surviving the ups and down of the world economy means keeping an eye on business (firm's) finances. When liquidity crisis strikes, credibility with vendors, banks and other creditors which takes time to build is destroyed quickly.

2.0 LITERATURE REVIEW

Investment in current assets affects the firm's profitability and liquidity.
The profitability-liquidity trade-off requires that the financial manager should develop sound techniques of managing current assets. Pandey (2005:5), a firm should estimate its needs for current assets and make sure that funds would be made available when needed.
Van-Horne (2005:429), assets other than money have two dimensions: -

a. The time necessary to convert the asset into money; and
b. The degree of certainty associated with the conversion ratio, or price realized for the asset.

Ezeamama (2010:71), recognized these varying degrees of assets while distinguishing the operating cycle of assets from the cash cycle. He depicted these cycle diagrammatically as below:



Although most assets have a degree of liquidity, we shall concentrate on the most liquid of the firm's assets (i.e. cash).

A good liquidity management policy determines a satisfactory level of liquidity balance, given the expected rate of cash inflow and outflow. The liquidity balance of an organization at any particular point in time can be viewed as a reservoir from which funds may be withdrawn not only to meet the day to day obligations, but to cope with emergencies as well. Decision on the amount of liquidity that will be just adequate to meet all obligations when they become due therefore became a problem. Depending on the rate of inflow and outflow of funds, cash reservoir contains either a surplus or deficit.

The demand for cash is as postulated by Keynes in Hanson (1975:378), normally attributed to three behavioral motivations: transactions, precautionary and speculative. The fourth motive, the finance motive was added by Keynes in a later article.

The transactions demand derives from the normal periodicity of payments for the purchase of goods and services. The precautionary demand for cash is derived from the uncertainty in the origin and timeliness of cash inflows and outflows. The speculative demand for cash balances derives from the desire to take advantage of expected changes in prices, for example, anticipation of lower prices for assets may be translated into increased cash balances that may enable the organization to purchase financial assets at their lowest possible prices and vice versa. The finance motive for holding cash relates to the amount of cash which has to be set aside in anticipation of a major expenditure, for example, an extraordinary capital budgeting item.

Since cash is a very scares resource and its supply is often inadequate to meet the demand for it, it is essential that inflows and outflows of cash be planned.

Time has changed since Keynes. Consequently, the rationales behind cash planning in the treasuries of many progressive tertiary institutions no longer follow his dichotomy very strictly. Nwadialor (1997:9) stated that cash planning in the treasuries of many progressive tertiary institutions is now through to involve two types of policies and procedures. First, those that provide cash to meet obligations resulting from normal requirements of the institution and second, those that provide cash to meet abnormal or irregular requirements of the operations of the institution.

The normal cash requirements are those that are predictable and occur as a result of normal operations, and include cash for such items of expenditure as salaries and wages, traveling expenses, supplies and materials, maintenance and repairs, etc.

Abnormal requirements pertain to those that cannot be anticipated under normal operational conditions such as emergency disbursements brought about by natural calamities and interruptions of the cash flow which reduce cash receipts without a corresponding reduction in the cash disbursements. This as Ugbor (2010:274) stated, “Calls for not only an efficient method of forecasting cash but a system that would be susceptible of sensitivity analysis and simulation”.

Cash management in an establishment is, by definition, a process of collecting; organizing, directing and investing cash in short term financial products, a key component of ensuring that a business is financially stability and solvency.

Until recently, large banks had the stronghold on the provision of treasury management products and services. Present day economic environment has made it possible for banks of all sizes and highly seasoned treasury management professionals, including third party technology providers to access industry standard and provide products and services tiered to the needs of clients.

To an uninformed, treasury management and cash management are sometimes used interchangeably. Treasury management is larger (and includes funding and investment activities).

Treasury Management includes management of institutions holdings, with the ultimate goal of maximizing the institution’s liquidity and mitigating its operational, financial and reputational risk. Treasury management includes a firm’s collections, disbursement, concentration, investment and funding activities.

As your business becomes more complex, you will have to adopt financial accounting. However, you have to keep focus on liquidity and cash management even though you track net income through financial accounting.

3.0 METHODOLOGY

This paper takes a literature survey pattern of various perspectives in order to give a narrative description of cash in terms of planning and management problems in firms. This paper is purely a review of literature type, emphasizing on planning and management problems of cash in firms.

4.0 RESULTS AND DISCUSSIONS

Cash, being the most liquid asset, is a very important commodity. Like the blood which gives life and strength to the human body, it gives life and strength to an organization either in the public or private sector of the economy. Although no organization can do without cash, to hold too much of it is an evidence of bad management. Cash is like manure which can help to grow many things if utilized but rots and then stinks if left in a pile. It is important, therefore that the use of cash like any other asset be planned and controlled to ensure an economic, efficient and effective utilization of all available resources of an organization.

4.1 Problems of liquidity management in firms:

- Difficulty in payment of maturing bills. If a firm or business is late in making bills payments or defaults on loans, it is a clear indication that the firm has liquidity problems. Late payment of bills makes it difficult to borrow in future and can even result in fees/charges.
- Illiquidity robs a firm off investment opportunities and can lead to increase in cost of production of the firm's goods and services thus resulting in higher products pricing.
- Other problems usually associated with poor liquidity management in businesses are
  - Loss of valued customers
  - Industrial unrest;
  - Loss of goodwill;
  - Denial of future credit facilities.

4.2 Resolution of liquidity management in firms:Cash Budgets:

Most organizations should prepare monthly cash budgets to keep track of their cash. In fact, cash budgets should be done six to twelve months in advance to project cash needs. The cash budget will capture the timing difference between the profit you see on the income statement and the cash that is actually coming into the firm and flowing out of the firm (Van-Horne 2005:392).

Cash budget is not to set targets for cash but to anticipate needs. If you prepare cash budgets six to twelve months in advance and you needs change, then change your cash budgets. Keep them up to date because the cost of running low cash in business is high.

Cash budgets can address 'what if' scenarios. You can use them to test different possible future scenarios. You can also attach a percentage of probability to the future scenario and test you assumptions. For example, you can change the speed of your collections or the timing of your inventory purchases and see how it affects you cash position.

Your goal as the owner and manager of your company is to squeeze all the cash out of your balance sheet. Not only do you want to get as much cash out of your company as you can, you want to keep it out in case of potential or actual crisis.

Two of your current assets accounts are usually big drains on your cash. They are inventory and accounts receivables. Inventory is the products you sell and accounts receivables are your credit accounts or those accounts that represents the credit you extended to customers. The balances in both accounts need to be converted to cash as soon as possible.

You can use financial ratios analysis to check out your position regarding inventory and accounts receivables. Inventory turnover ratio, can tell you if your inventory is obsolete or if you are selling of fast and are stocking out. Accounts receivable ratios, such as days' sales outstanding, can tell you how fast your credit customers are cleaning up their accounts among other things. Once you determine your inventory and accounts receivables, you can take the appropriate actions to adjust the situations and have more cash coming into your firm.

Another way to get more cash into your business regarding your credit customers and accounts receivables is using a 'lockbox system' to collect payments. If you have payments transferred to a lockbox, those payments get to your accounts faster, and your bank can then sweep funds into an interest bearing account.

Another short term strategy of squeezing money out of the balance sheet is to look at your account payables. Accounts payables are what you owe to your suppliers of goods and services or creditors. Pay your accounts payables on the day they fall due, not early. There is no reason to give your suppliers or creditors the use of your cash days before the bill is due, your business needs to have use of that cash. Stretch out the use of your funds.

5.0 CONCLUSION

The bottom line to good liquidity management is that, in crisis, typical issues in financial statements become irrelevant and all that is important is surviving from a cash point of view. In periods such as recession, business owners' or Chief Executive Officers' focus becomes, by necessity, very short term. Long term planning, issues and projection are not needed. Often, liquidity crisis install good management practices into business managers that carry over from that day forward.

A good knowledge of forecasting is important in business for informed decisions. The feedbacks are invaluable.

REFERENCES

Adegbile P. O. (1998), "An Evaluation of the Funding of Polytechnics: Sources, Effectiveness and Constraints."

An unpublished paper presented as a Workshop organized by COHEADs

Ezeamama, M. C. (2010), Fundamentals of Financial Management (A Practical Guide), Enugu: Ema Press Limited.

Hanson, J. L. (1975), A Textbook of Economics, (6th Edition), Great Britain: The Chaucer Press Limited.

Igbinosun, F.E. (2002), "In Search of Excellent Cash Management and control Strategies in Business Endeavour", Journal of the Institute of Chartered Accountants of Nigeria, vol. 3 No.4

Nwadialor, E. O. (1997), Management of Finances in polytechnics, "An unpublished Paper presented at a workshop in Kaduna orgamised by National Board for Technical Education (NBTE)

Okonkwo, I. C. (2004), The Budgetary Process and Educational Development in Nigeria. A paper presented at a workshop on "Financing Education in Nigeria" organized by the Education Tax Fund, at Alvan Ikoku College of Education, Owerri: November 22-23.

Pandey, I. M. (2005), Financial Management (9th Edition), New Delhi: Vikas Publishing House PVT Limited.

Ugbor, R. O. (2010), Essentials of Cost Accounting, Enugu: Professor's Press Limited.

Van-Horne, J. C. (2005), Financial Management Policy, (12th Edition), New Delhi Prentice – Hall of India Private Limited.

Wikipedia, the free Encyclopedia (2012), Cash and Liquidity Management: Retrieved from www.bizfinance.about.com November 26, 2012.