CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

CHAPTER OVERVIEW:

I. INTERNATIONAL CASH MANAGEMENT

II. ACCOUNTS RECEIVABLE MANAGEMENT

III. INVENTORY MANAGEMENT

IV. SHORT-TERM FINANCING

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

I. INTERNATION CASH MANAGEMENT

A. Seven Key Areas:

1. Organization
2. Collection/Fund Disbursement
3. Interaffiliate Payments Netting
4. Excess-Funds Investment
5. Optimal Global Cash Balances
6. Cash Planning/Budgeting
7. Bank Relations

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

B. Goals of an International Cash Manager

1. Quick/efficient cash control
2. Optimal conservation/usage

C. Organization: Centralize

1. Advantages:
   a. Efficient liquidity levels
   b. Enhanced profitability
   c. Quicker headquarter action

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

1. Advantages (con')
   d. Decision making enhanced
   e. Better volume currency quotes
   f. Greater cash management expertise
   g. Less political risk

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

D. Collection/Disbursement of Funds

1. Key Element: Accelerate collections
2. Acceleration Methods:
   a. Cable remittances
   b. Mobilization centers
   c. Lock boxes
   d. Electronic fund transfers

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

3. Methods to Expedite Cash Payments
   a. Cable remittances
   b. Establish accounts in client's bank
   c. Negotiate with banks
      - obtain value dating

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

E. Payments Netting

1. **Definition:**

   offset payments of affiliate receivables/payables so that net amounts only are transferred.

2. **Create Netting Center**

   a. a subsidiary set up in a location with minimal exchange controls

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

2. Netting Centers (con't)
   - b. Coordinate interaffiliate payment flows
   - c. Center's value is a direct function of transfer volume.

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

F. Excess Funds Investment

1. Major task:
   a. determine minimum cash balances
   b. short-term investment of excess balances
2. Requirements:
   a. Forecast of cash needs
   b. Knowledge of minimum cash position

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

3. Investment Selection Criteria:
   a. Government regulations
   b. Market structure
   c. Foreign tax laws

G. Optimal Global Cash Balances

1. Establish centrally managed cash pool
2. Require affiliates to hold minimum

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

3. Benefits of Optimal Cash Balances
   - a. Less borrowing nceded
   - b. More excess fund investment
   - c. Reduced internal expense
   - d. Reduced currency exposure

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

I. Bank Relations

A. Good Relations Will Avoid

1. Lost interest income
2. Overpriced services
3. Redundant services

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

2. Common Bank Relations Problems
   a. Too many banks
   b. High costs
      such as compensating balances
   c. Inadequate reporting
   d. Excessive clearing delays

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

II. ACCOUNTS RECEIVABLE MANAGEMENT

A. Trade Credit

extended in anticipation of profit by

1. expanded sales volume
2. retaining existing customers

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

B. Credit Terms Should Consider

1. Sales force
2. Adjusting bonuses for cost of credit sales.

III. INVENTORY MANAGEMENT

A. Problems:

Seem to be more difficult due to

1. Long,variable transits
2. Lengthy customs procedures

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

B. Production Location/Inventory Control

1. Overseas location
   may lead to higher inventory carrying costs due to
   a. larger amounts of work-in-process
   b. more finished goods

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

C. Advance Inventory Purchases

1. Usually where there are no forward hedges available
2. Another hedging method: advance inventory purchases of imported items, i.e. inventory stockpiling.

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

d. Reason for Stockpiling:
greater risk of delay

e. Solution to higher carrying costs:
Adjust affiliate's profit margins
to reflect added costs.

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

IV. SHORT-TERM FINANCING

A. Strategy

1. Identify: key factors
2. Formulate/evaluate: objectives
3. Describe: available options
4. Develop a methodology: to calculate/compare costs

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

B. Key Factors

1. Deviations from Int'l Fisher Effect?
   a. If yes
      trade-off required between
      cost and exchange risk
   b. If no
      costs are same everywhere

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

2. Exchange Risk
   a. Offset foreign assets with foreign liabilities
   b. Borrow where no exposure increases exchange risk
3. Firm's Risk Aversion

   direct relation to price incurred to reduce exposure

CURRENT ASSET MANAGEMENT AND SHORT-TERM FINANCING

4. Does Interest Rate Parity Hold?
   a. Yes. Currency is irrelevant.
   b. No. Cover costs may differ
      -added risk may mean the forward premium/discount does not offset interest rate differentials.

5. Political Risk: If high,

a. MNCs should

1.) maximize local financing.

2.) Faced with confiscation or currency controls, fewer assets at risk

C. Short-Term Financing Objectives

1. Four Possible Objectives:
   a. Minimize expected cost.
   b. Minimize risk without regard to cost.
   c. Trade off expected cost and systematic risk.
   d. Trade off expect cost and total risk.

D. Short-Term Financing Options

1. Three Possibilities
   a. Intercompany loans
   b. Local currency loans
   c. Euro market

2. Local Currency Financing: Bank Loans
   a. Short-term in nature
      role of cleanup clause
   b. Forms
      1.) Term loans
      2.) Line of credit
      3.) Overdrafts
      4.) Revolving Credit
      5.) Discounting

3. Calculating Interest Costs

a. Effective interest rate (EIR): most efficient measure of cost

b. Basic formula:

$$EIR = \frac{\text{Annual Interest Paid}}{\text{Funds Received}}$$

4. Commercial Paper
   a. Definition:
      short-term unsecured promissory note generally sold by large MNCs on a discount basis.
   b. Standard maturities
   c. Bank fees charged for:
      1.) Backup line of credit
      2.) Credit rating service

5. Euronotes and Euro-Commercial Paper

a. Euronotes

unsecured short-term debt securities denominated in US$ and issued by corporations and governments.

b. Euro-commercial paper(CP)

euronotes not bank underwritten

c. U.S. vs. Euro-CPs

1.) Average maturity longer (2x) for Euro-CPs

2.) Secondary market for Euro; not U.S. CPs.

3.) Smaller fraction of Euro use credit rating services to rate.