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BALANCES OF CASH AND THE FIRM VALUE

***Abstract**: Firms hold cash for a variety of different reasons. Generally, cash balances held in a firm can be called considered, precautionary, speculative, transaction, and intentional. The first reason is the result of management anxieties. Managers fear the negative part of the risk and hold cash to hedge against it. Second, cash balances are held to use chances that are created by the positive part of the risk equation. Next, cash balances are the result of the operating needs of the firm. In this article, we analyse the relation between these types of cash balances and risk. This article also contains propositions for marking levels of precautionary cash balances and speculative cash balances. Current models for determining cash management assign no minimum cash level, or their minimum cash level is based on the manager's intuition. The model presented in this paper avoids intuition and is based on calculation. Application of this proposition should help managers to make better decisions to maximize the value of their firms.*

***Key words**: demand for cash, cash balances, risk, uncertainty, real options, option value of money, short-term financial management, working capital management*

JEL: G 32, G 11, M 11, D 81, O 16, P 33, P 34

1 Introduction

Corporate cash management depends on demands for cash in a firm. The aim of cash management is such that limiting cash levels in the firm maximizes the owner´s wealth. Cash levels must be maintained so as to optimize the balance between costs of holding cash and the costs of insufficient cash. The type and the size of these costs are partly specific to the firm's financial strategy.

In addition, cash management influences firm's value, because its cash investment levels entail the rise of alternative costs, which are affected by net working capital levels. Both the rise and fall of net working capital levels require the balancing of future free cash flows, and in turn, result in firm's valuation changes.