What is Liquidity Management?

Worksheet

Liquidity management involves ensuring you have enough cash available to pay bills and handle emergencies without selling assets at a loss — it's a critical balance between having money on hand and using capital efficiently.

Questions

1. A household has 30,000 savings and5,000/month expenses. Liquidity ratio?

A) 30,000 / 5,000 = 6 months
B) 5,000 / 30,000 = 0.17
C) 30,000 / 60,000 = 0.5
D) 6 months coverage

2. Which is most liquid?

A) Savings account
B) Real estate
C) Stock portfolio
D) Business inventory

3. Why not keep all cash in high-yield savings?

A) It's not safe
B) Inflation erodes purchasing power over time
C) Banks charge fees
D) Too many transactions

4. A business expects $100K revenue next quarter but payments arrive 60 days late. What's the risk?

A) None
B) Shortage of working capital to cover payroll/bills
C) Excess liquidity
D) Overdraft not needed

5. A freelancer earns $5,000/month but bills clients 30 days late. What cash management strategy helps?

6. A small business has 20,000 cash and monthly expenses of4,000. Is liquidity healthy?

7. Your savings account yields 0.5% but a CD yields 4%. Should you move all savings to the CD?

8. Define: What is liquidity management?

9. Define: Why is an emergency fund important?

10. Define: How many months of expenses should you keep liquid?

Answer Key

1. A) 30,000 / 5,000 = 6 months — Months of expenses = savings / monthly spend = 30,000 / 5,000 = 6 months.

2. A) Savings account — Savings account is cash — instant access. Real estate and inventory take time to sell.

3. B) Inflation erodes purchasing power over time — Inflation averages 2–3% yearly; high-yield savings (4–5%) barely keep pace. Investing excess beyond emergency reserves is wiser.

4. B) Shortage of working capital to cover payroll/bills — Without cash on hand, the business can't pay staff or suppliers during the 60-day waiting period.

5. Emergency buffer: Keep 3 months expenses ($12,000+) in savings Shortfall bridge: Take a line of credit to cover the 30-day gap Accelerate receipts: Offer 2% discount for immediate payment

6. Months covered = 20,000 /4,000 = 5 months This exceeds the 3–6 month rule → healthy Consider investing excess ($16,000 beyond 6 months) in low-risk instruments

7. Keep 3–6 months in liquid savings (emergency access) Invest only the surplus in the higher-yield CD Liquidity cost (0.5% vs 4%) is worth financial peace of mind

8. Balancing available cash with expenses to ensure financial stability and the ability to meet obligations.

9. It prevents forced asset sales or high-interest borrowing when unexpected expenses arise.

10. 3–6 months, depending on income stability and job security.