Chapter 22 Cash flow forecasting and working capital

Key terms

1. Cash flow: the cash inflows and outflows over a period of time.
2. Cash inflows: are the sums of money received by a business during a period of time.
3. Cash outflows: are the sums of money paid out by a business during a period of time.
4. Cash flow cycle: shows the stages between paying out cash for labour, materials etc. and receiving cash from the sale of goods.
5. Profit: the surplus after total costs have been subtracted from sales revenue.
6. Cash flow forecast: an estimate of future cash flows and outflows of a business, usually on a month-by-month basis. This then shows the expected cash balance at the end of each month.
7. Opening cash balance: the amount of cash held by the business at the start of the month.
8. Net cash flow: the difference between cash inflows and cash outflows each month.
9. Closing cash balance: the amount of cash held by the business at the end of month, this becomes next month's opening cash balance.
10. Working capital: the capital available to a business in the short term to pay for day-to-day expenses.

1. Why cash is important to a business

Cash: immediate available for spending on goods and services i.e. cash inflow and outflow

2. **Why cash is important to a business**:

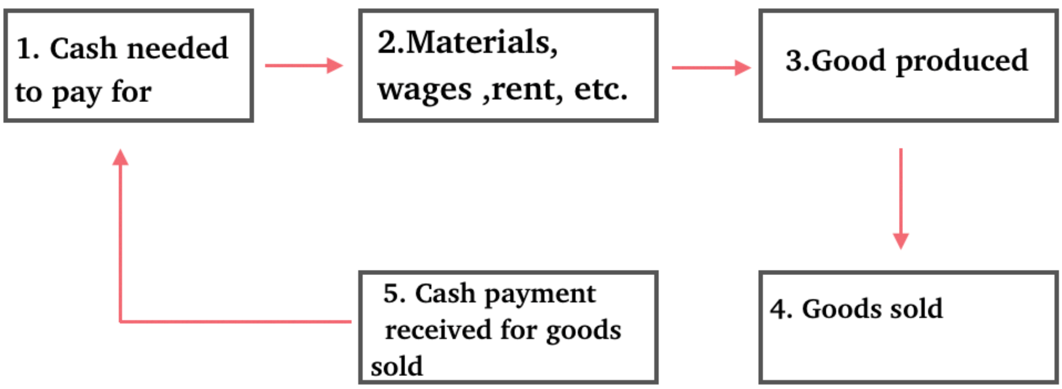
If a business has too little cash, it will face problems...

- Unable to pay for worker/ supplier/government
- Stop production : no money for buying materials
- Lack of liquidity

Cash inflows: are the sums of money received by a business during a period of time such as sale of product on cash and payment made by debtors.

Cash outflows: are the sums of money paid out by a business during a period of time such as purchasing materials on cash and paying wage.

Cash flow cycle: shows the stages between paying out cash for labour, materials etc. and receiving cash from the sale of goods.



3. Cash flow forecasts:

- **Cash flow forecast**: an estimate of future cash flows and outflows of a business, usually on a month-by-month basis. This then shows the expected cash balance at the end of each month.
- **Net cash flow =** Cash inflow - cash outflow
- **Closing bank balance =** Opening bank balance + Net cash flow

	January
Cash inflow	45,000
Cash outflow	20,000
Net cash flow (Cash inflow - cash outflow)	25,000
Opening bank balance	10,000
Closing bank balance (Opening bank balance + Net cash flow)	35,000

Uses of cash flow forecast:

- Planning to start up a business
- Informing the bank manager to get loans
- Managing existing an business
- Managing cash flow

4. How short-term cash flow problem overcome:

Methods	Limitations
1.Borrowing money from banks.	• It needs to pay interest on loan. • It causes money outflow from repayment in the future.
2.Delay paying off supplier	• The business may get a lower discount. • Suppliers reject supply goods.
3.Asking trade receivable of customers to repay earlier	• Customers may buy products from rival firms.
4.Delaying or cancelling the purchase of capital equipment	• It may reduce efficiency in the production.

4. **Working capital**: capital available for short term to pay day-to-day expenses. It refers to the amount of money available to run a business.

Working capital = Current assets - Current liabilities