

Chapter 26

Cash flow forecasting

1. The importance of cash

: Cash is the most liquid of all business assets.

1.1 To pay supplier, overheads and employees

: Overheads - Money spent regularly on rent, insurance, electricity and other things that are needed to keep business operating.

: Suppliers have to be paid for the materials and components that have been purchased.

: Finally employees have to be paid every week and every month.

1.2 To prevent business failure

: If business runs out of cash, it may become insolvent, This means that the business cannot pay its debts.

2. The difference between cash and profit

Cash \neq Profit

2.1 Some goods are sold on credit. So, at the end of the period, some customers will still owe money. Therefore, profit is greater than cash.

2.2 Sometimes owners might put more cash into the business. This will increase the cash balance, but have no effect on the profit made.

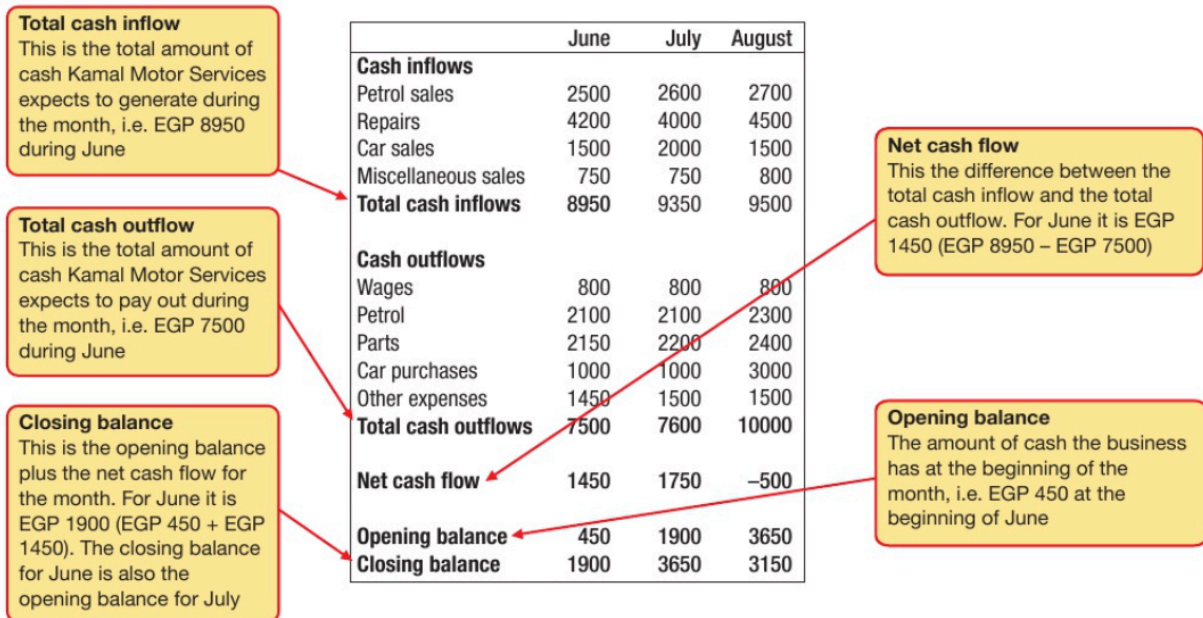
2.3 Purchases of fixed asset, such as equipment, will reduce cash balances, but have no effect on the profit a company makes. This is because the purchase of assets is not included for the purpose of calculating profit.

3. Cash inflows and outflows

- Cash inflow : flow of money into a business
- Cash outflow : flow of money out a business
- Net cash flow : The difference between cash inflows and cash outflows

4. Cash flow forecast:

: This is a financial document and shows the expected cash inflows and cash outflows over a future period. It also shows the closing cash balance at the end of each month.



▲ Figure 26.2 Cash flow forecast for Salah Motor Services



5. Why are cash flow forecasts important?

5.1 Identifying cash shortages

: A forecast can help to identify in advance when a business might need to borrow cash. The forecast clearly shows how much cash is left at the end of each month. This will help to identify when, or if, a bank overdraft will be needed.

5.2 Supporting application for funding

: When trying to raise finance, lenders often insist that businesses support their allocations with a cash flow forecast.

5.3 Help with planning the business

: Careful planning in business is important. It helps to clarify aims and improve performance.

5.4 Monitoring cash flow

: A business should compare the predicted figures in the cash flow forecast with those actually occur. It could then try to investigate the reasons why the figures were different.

