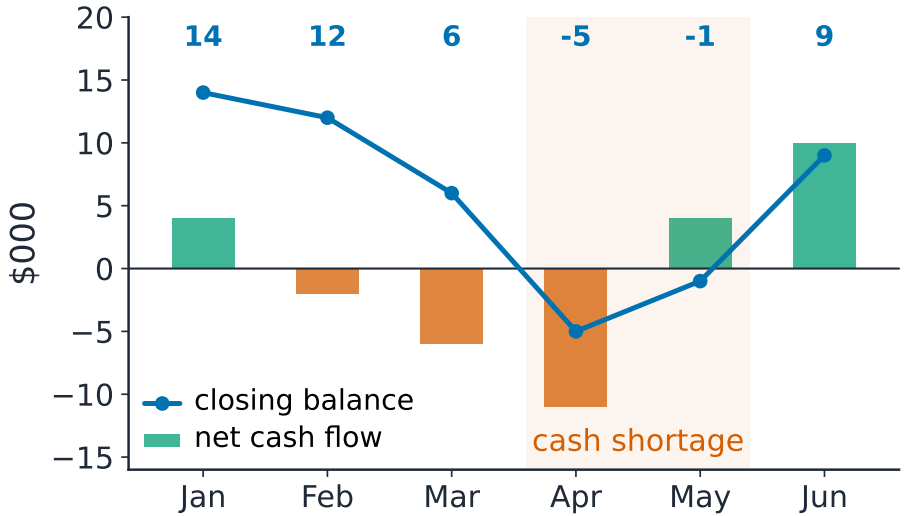
Exercise walk-through

3.4
Cash flow

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Figure: Cash flow



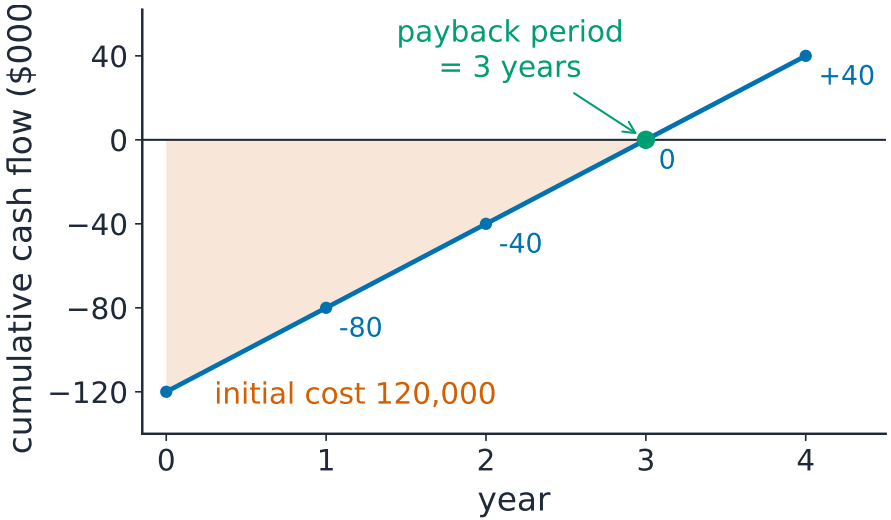
- A six-month cash-flow forecast: bars of net **cash flow** and a line of closing balance that falls below zero in April and May before recovering in June
- Match each part of the diagram to the text.

Investment appraisal

- **Investment appraisal** checks whether a capital project is worth its cost.
- The repair business plans a third workshop.
- It costs 120,000 and should bring in a net **cash flow** of 40,000 a year for four years.
- *The third workshop pays back its 120,000 cost after exactly three years*

$$\text{ARR} = \frac{(\text{total returns} - \text{capital cost}) \div \text{years of use}}{\text{capital cost}} \times 100 = \frac{(160{,}000 - 120{,}000) \div 4}{120{,}000} \times 100 =$$

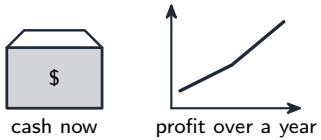
Figure: Investment appraisal



- Cumulative **cash flow** starting at minus 120,000 and rising by 40,000 a year, reaching zero at the end of year 3
- Match each part of the diagram to the text.

Exercises 2.1·2.2

2.1 Distinguish between cash and profit. [2]

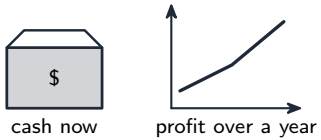


2.2 Define **working capital**. [2]

current assets − current liabilities

Exercises 2.1·2.2

2.1 Distinguish between cash and profit. [2]



2.1

cash: the money actually held by the business or in its bank account at a point in time; profit: revenue minus costs over a period, which may include sales on credit not yet paid

2.2 Define **working capital**. [2]

current assets − current liabilities

2.2

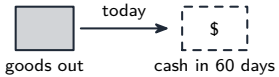
current assets minus current liabilities; the money available for day-to-day running of the business

Exercises 2.3·2.4

2.3 Complete the cash-flow forecast: find the net cash flow and the closing balance for each month. [4]

$	January	February	March
cash inflows	12 000	10 000	8 000
cash outflows	14 000	9 000	13 000
net cash flow			
opening balance	5 000		
closing balance			

2.4 Explain **one** reason why a profitable business may run short of cash. [2]



Exercises 2.3·2.4

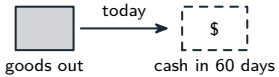
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opening balance	5 000		
closing balance			

2.3

net cash flow: January −2 000, February +1 000, March −5 000; closing balance: January 3 000, February 4 000, March **−1 000**

2.4 Explain **one** reason why a profitable business may run short of cash. [2]

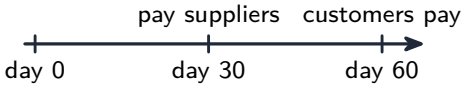


2.4

e.g. it sells on credit, so revenue is counted as profit before cash arrives / spends heavily on stock or equipment / overtrading; explained: outflows (wages, suppliers) must be paid before cash from customers comes in

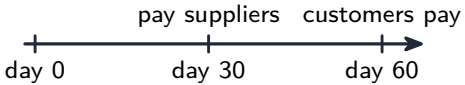
Exercise 2.5

2.5 A wholesaler gives customers 60 days' credit but must pay its suppliers within 30 days. Explain the effect on its working capital, and suggest **two** changes it could make. [4]



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2.5

cash goes out to suppliers 30 days before cash comes in from customers, so cash is tied up and the working capital cycle is long; changes, any two: shorten customer credit / offer discounts for early payment; negotiate longer credit from suppliers / use an overdraft or factoring

Exercise 3.1

3.1 Harbour Café is a seaside café. Its cash-flow forecast for the winter is shown ($). In December it plans to buy a new oven for $3,000. In winter there are few tourists.

Discuss how Harbour Café could deal with its forecast cash-flow problem. [10]

$	Oct	Nov	Dec	Jan
cash inflows	9 000	6 000	7 000	4 000
cash outflows	8 000	8 000	11 000	8 000
net cash flow	1 000	−2 000	−4 000	−4 000
opening balance	4 000	5 000	3 000	−1 000
closing balance	5 000	3 000	−1 000	−5 000

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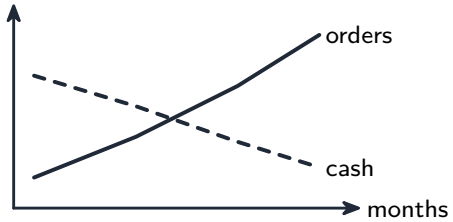
3.1

award up to [10]: the closing balance becomes negative in December (−1 000) and worse in January (−5 000); causes: seasonal fall in sales; the oven purchase; delay or lease the oven: removes the $3,000 outflow, but may limit menu or raise long-term costs; overdraft for the winter months: flexible and repaid in summer, but interest costs; cut outflows: fewer staff hours or a shorter opening time in winter, but may lose regular customers; raise inflows: winter promotions, events, takeaway service; negotiate later payment with suppliers; judgement, e.g. delay the oven and arrange a small overdraft, as the problem is seasonal and short-term

Exercise 3.2

3.2 A fast-growing online clothing firm reports record profit but cannot pay its suppliers on time.

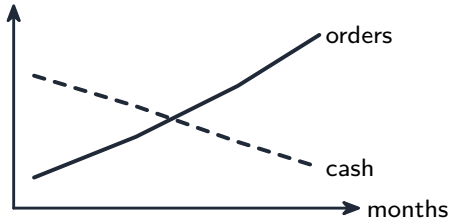
Explain how this firm may be **overtrading**, and how it could avoid failure. [6]



Exercise 3.2

3.2 A fast-growing online clothing firm reports record profit but cannot pay its suppliers on time.

Explain how this firm may be **overtrading**, and how it could avoid failure. [6]



3.2

overtrading: growing faster than its cash and working capital can support; it must buy more stock and pay more staff before customers pay; so cash runs out even though profit is high; suppliers may stop supplying, and the firm could fail; avoid failure: slow growth / raise long-term finance such as share capital / better stock control; explained in context