

Exercise walk-through

5.2

Cash-flow forecasting and working capital

IGCSE Business Studies

The external sources of finance

hire purchase

buy now and pay in **monthly parts**; the asset is owned only at the end

microfinance

small loans for **tiny businesses in poorer areas**, where banks will not lend

crowdfunding

many people each give a small amount, usually online

debentures

long-term loans paying fixed interest, repaid on a set date

grants

money from government that does **not have to be repaid**, usually with conditions

share issue

raises large sums and **dilutes ownership** – available only to a company

To overcome a cash-flow problem a business can arrange an **overdraft**, **delay paying suppliers**, or **ask customers to pay sooner** – all short-term, and all with a cost.

Cash flow

- start up – **start-up capital** to buy equipment and stock before it earns anything,
- grow – money for **expansion** , such as new shops or machines,
- run day to day – **working capital** to pay wages and suppliers while waiting for customers to pay,
- survive a **cash-flow** problem, when more money is going out than is coming in.

Exam tips

- **Cash is not profit**: a profitable business can still run out of cash if customers pay late. Watch the closing balance on a cash-flow forecast.
- Separate **internal** sources (retained profit, sale of assets, owners' savings) from **external** ones (bank loan, overdraft, shares, leasing, trade credit).
- Key formulas: net cash flow = inflows – outflows; closing balance = opening balance + net cash flow; working capital = current assets – current liabilities.
- Profitability ratios (gross margin, profit margin, ROCE) – higher is better.
Liquidity: the current ratio (healthy ≈ 1.5 –2) and the stricter acid test (which leaves out inventory).
- Only limited **companies** can raise money by issuing **shares**; a sole trader or partnership cannot.

Exercises 2.1-2.3

2.1 Define the term *net cash flow*.

[2]

2.2 A month opens with \$5,000. Inflows are \$18,000 and outflows are \$20,000. Calculate the closing balance.

[2]

2.3 State one reason a profitable business might run out of cash.

[1]

Exercises 2.1-2.3

2.1 Define the term *net cash flow*.

[2]

2.1

- **net cash flow** is inflows minus outflows over a period (K)

2.2 A month opens with \$5,000. Inflows are \$18,000 and outflows are \$20,000. Calculate the closing balance.

[2]

2.2

- net cash flow = $\$18\,000 - \$20\,000 = -\$2\,000$
- closing = $\$5\,000 + (-\$2\,000) = \mathbf{\$3\,000}$ (K)

2.3 State one reason a profitable business might run out of cash.

[1]

2.3

- any **one** of: customers have not paid yet / too much stock bought / too much spent on assets at once (K)

Exercises 3.1·3.2

3.1 Identify two ways a business could solve a cash-flow problem. [2]

3.2 Explain two benefits to a business of producing a cash-flow forecast. [6]

Exercises 3.1-3.2

3.1 Identify two ways a business could solve a cash-flow problem. [2]

3.1

- any **two** of: overdraft / delay paying suppliers / customers pay sooner / sell spare assets / cut spending (K, K)
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3.2 Explain two benefits to a business of producing a cash-flow forecast. [6]

3.2

- for **each** of two benefits: K + An, max 3 each
- e.g. **spot a shortage early**: arrange finance in time → avoid running out of cash
- e.g. **plan and control**: shows when money is tight → delay spending

Exercise 3.3

3.3 A business has forecast a cash shortage next month. Do you think arranging an overdraft is the best way to solve it? Justify your answer. [6]

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3.3

- **for an overdraft:** fast and flexible for a short gap
- **against:** high interest; a large or long shortage needs chasing debtors or cutting stock
- **judgement (Ev):** an overdraft is good for a short, small shortage – it depends on size and length