

Knockout.Economics by Kru P'Eve & Kru P'Da

# IGCSE -Business studies

## Cash flow forecasting and working capital 🔍

- Executive summary IGCSE Business studies
- Series of exam questions each chapter
- Exam Strategies and exclusive tips to achieve A\* from Knockout.Economics
- Exclusive Key Terms for IGCSE Business studies exam



# Overviews

1. Why cash is important to a business
2. What is meant by cash-flow
3. Cash-flow forecasts
4. How short-term cash flow problem overcome
5. The importance of working capital



# 1. Why cash is important to a business

**Cash**: a liquid asset. It is immediately available for spending on goods and services

## *Why cash is important to a business ?*

**If a business does not have enough cash, it will cause lots of problems.**

- It is unable to pay wages to workers, raw material to suppliers, and tax to government.
- Production process may be stopped. Workers reject working because they can not get wages.
- The business may unable to repay debt and finally it has to sell its assets to pay debt.

## 2. What is meant by cash-flow?

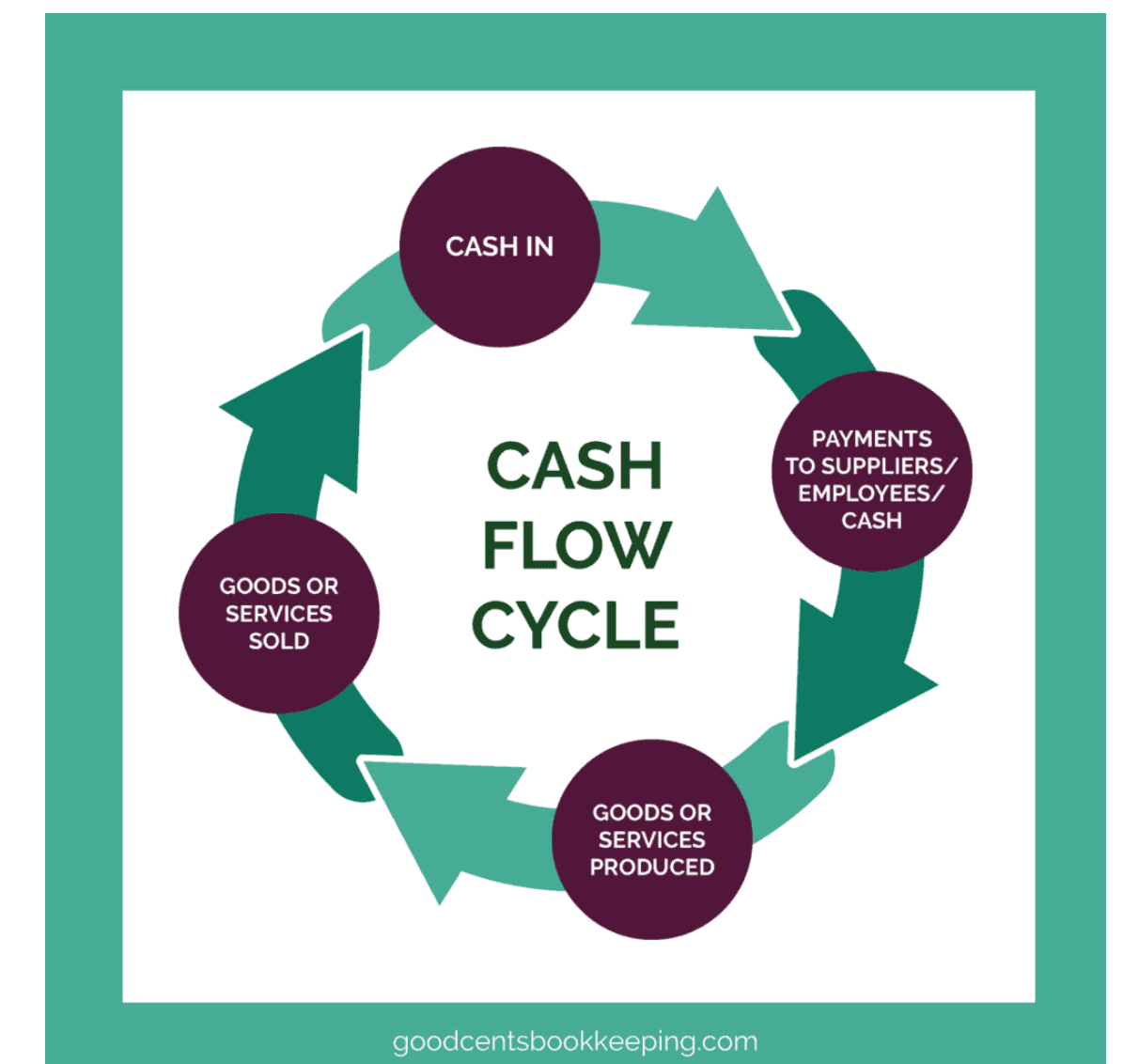
**Cash**: a liquid asset. It is immediately available for spending on goods and services

**Cash flows**: the cash inflows and outflows over a period of time

**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.



## 2. What is meant by cash-flow?

Transaction	Cash inflow	Cash outflow
Paying wages to workers		
The bills paid by debtors		
Sale of products to customers on credit		
Interest paid on loan		
Sale of products to customers - no credit given		
Issue shares to shareholders		

# 3. Cash-flow forecasts

- **Cash flow forecast:** an estimate of future cash inflows and outflows of a business, usually on a month-by-month basis. This shows the expected cash balance at the end of each month.

$$\text{Net cash flow} = \text{Cash inflow} - \text{Cash outflow}$$

$$\text{Closing bank balance} = \text{Opening bank balance} + \text{Net cash flow}$$

	January	February	March
Cash inflow	45,000	13,000	28,000
Cash outflow	20,000	25,000	15,000
<b>Net cash flow</b> (Cash inflow - cash outflow)			
Opening bank balance	10,000		
<b>Closing bank balance</b> (Opening bank balance + Net cash flow)			

# 3. Cash-flow forecasts

- **Uses of cash flow forecast**

- Planning to start up a business; to estimate how much cash will be needed
- Informing the bank manager to get loans
- Managing an existing business; to forecast cash flow and to plan in advance to raise fund
- Managing cash flow; to arrange cash to repay creditors and banks



## 4. How short-term cash flow problem overcome

Methods	Limitations
1. <b>Borrowing money from banks.</b>	<ul style="list-style-type: none"><li>• It needs to pay interest on loan.</li><li>• It needs to repay the loans causing money outflow in the future.</li></ul>
2. <b>Delay paying off supplier</b>	<ul style="list-style-type: none"><li>• The business may not get a discount.</li><li>• Suppliers may reject supply raw materials.</li></ul>
3. <b>Asking trade receivable of customers to pay quicker</b>	<ul style="list-style-type: none"><li>• Customers may buy products from rival firms.</li></ul>
4. <b>Delaying or cancelling the purchase of machines</b>	<ul style="list-style-type: none"><li>• It may reduce efficiency in the production.</li></ul>

# 5. The importance of working capital

**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.

$$\text{Working capital} = \text{Current assets} - \text{Current liabilities}$$

## **Different forms of working capital:**

- ▶ Cash
- ▶ The firm's debtors
- ▶ The value of inventories



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# IGCSE -Business studies

## Exercise: Cash flow forecasting and working capital 🔍

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## Exercise

ABC produces table by using batch production. The business has to hold a lot of raw material used for producing table. ABC also pays bonuses to motivate its 5 full-time employees. The business has cash-flow forecast which reflects financial problems in the coming months. The information of this cash-flow forecast is found in Table below.

	May	June	July
Cash inflow	1,200	800	28,000
Cash outflow	1,700	1,500	15,000
<b>Net cash flow</b>	(500)	(700)	<b>Y</b>
Opening bank balance	100	<b>X</b>	(1,100)
<b>Closing bank balance</b>	(400)	(1,100)	<b>Z</b>

(a) Calculate the values of **X Y and Z**. [3]

**X:** .....

**Y:** .....

**Z:** .....

# Exercise

ABC produces table by using batch production. The business has to hold a lot of raw material used for producing table. ABC also pays bonuses to motivate its 5 full-time employees. The business has cash-flow forecast which reflects financial problems in the coming months. The information of this cash-flow forecast is found in Table below.

	May	June	July
Cash inflow	1,200	800	28,000
Cash outflow	1,700	1,500	15,000
<b>Net cash flow</b>	(500)	(700)	<b>Y = 13,000</b>
Opening bank balance	100	<b>X = (400)</b>	(1,100)
<b>Closing bank balance</b>	(400)	(1,100)	<b>Z = 11,900</b>

(b) Explain **two** ways ABC could overcome its cash-flow problems. [4]

Way1: .....

Explanation:.....

Way2: .....

Explanation: .....

## Exercise

ABC produces table by using batch production. The business has to hold a lot of raw material used for producing table. ABC also pays bonuses to motivate its 5 full-time employees. The business has cash-flow forecast which reflects financial problems in the coming months. The information of this cash-flow forecast is found in Table below.

**(b)** Explain **two** ways ABC could overcome its cash-flow problems.

- ▶ **Delay payment of bills to suppliers** => to keep cash in the business for closing balance (\$1100) in June
- ▶ **Asking customers to pay earlier** => to receive cash inflow sooner and reduce a negative closing balance in May.
- ▶ **Overdraft** => to enable the business to have a negative net cash flow in May at \$500
- ▶ **Bank loan** => to increase cash inflow
- ▶ **Delay/cancel purchases of capital equipment**
- ▶ **Find cheaper suppliers**

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