

## Chapter 20: Worksheet mark scheme (36 marks)

- 1** Give an equation for working capital. (1)

Working capital = current assets – current liabilities
- 2** Define working capital in terms of business operation. (2)

Working capital is the money tied up in the day-to-day running of the business at any one time.
- 3** Draw a diagram of the working capital cycle. (4)

See Figure 20.1 in Chapter 20 of the Coursebook.
- 4** Define ‘liquidity’. (2)

This is the ability of a firm to pay its short-term liabilities.
- 5** What is the difference between profit and cash flow? (2)

Profit is the total value of sales less all costs, whereas cash flow is the amount of cash coming in minus cash going out.
- 6** List **five** possible cash inflow categories. (5)

  - capital injection
  - customers paying cash
  - customers paying on credit terms (debtors)
  - sales of assets
  - loans received
- 7** List **five** possible cash outflow categories. (5)

  - payments to creditors
  - repayment of loans
  - purchase of assets
  - payment of wages or salaries
  - payment of rent
  - loan interest
- 8** What does ‘insolvent’ mean? (2)

The business cannot meet its short-term financial obligations.

- 9 Give **two** reasons why cash-flow forecasting may be inaccurate. (2)
- unit costs of supplies and utilities are not under the firm's control
  - the future is uncertain, so sales are uncertain
  - wrong assumptions may be made, e.g. about market trends or fashion expectations
  - inflation
  - debtors may not pay when the money is due
- 10 State **three** reasons why cash-flow planning is important. (3)
- Potential cash-flow problems can have solutions (e.g. loans) if worked out in advance.
  - Having a plan can alert the firm and its bankers if actual results are different. This allows corrective action to avoid a crisis.
  - Working out potential cash flows in advance may stop the firm from starting a project or business with potential cash-flow problems.
- 11 There are only two ways to improve cash flow: raise inflows and/or reduce outflows. Give **two** examples of each. (4)
- Raise inflows by:
- giving shorter credit terms to customers
  - borrowing e.g. short-term loan or overdraft
  - selling some assets
  - debt factoring.
- Lower outflows by:
- delaying payment of creditors
  - delaying buying capital equipment
  - cutting overhead spending that does not affect production or sales
  - leasing instead of purchasing.
- 12 State **four** reasons why new businesses often have cash-flow problems. (4)
- lack of planning
  - customer base is slow to build but overhead expenses happen from day one
  - new businesses may not be offered credit from their suppliers for purchases but they may have to offer credit in order to make sales
  - some customers do not pay money owed to new firms because they know new businesses often fail and so they may never have to pay
  - poor credit control/unwillingness to ask customers to pay
  - lack economies of scale and so business expenses may be relatively high