



## Section 3.7

### Activity 3.7.1

Research task.

### Activity 3.7.2

1. Reasons why Australian businesses might be operating with negative cash flow despite being profitable include:
  - Slow customer payments
  - Lack of access to credit.
2. Australian businesses might be affected in the following ways:
  - a. If credit and other forms of finance become 'more scarce' it could lead to cash flow problems
  - b. If customers delay payment then this will lead to cash flow problems.

### Activity 3.7.3

- One more cash payment received could be the sale of an asset
- One more cash payment paid could be administration.



## Activity 3.7.4

Revised cash flow from Keon:

	All figures in \$000	Jan.	Feb.	Mar.	Apr.
<b>Cash inflows</b>					
	Owner's capital injection	6	0	0	0
	Cash sales	3	4	6	7
	Payments by debtors	0	2	2	3
	Total cash in	9	6	8	10
<b>Cash outflows</b>					
	Lease	8	0	0	0
	Rent	1	1	1	1
	Materials	0.5	1	3	2.5
	Labour	1	2	3	3
	Other costs	0.5	1	0.5	2.5
	Total cash out	11	5	7.5	9
<b>Opening balance</b>		0	(2)	(1)	(0.5)
<b>Net cash flow</b>	Net monthly cash flow	(2)	1	0.5	1.0
<b>Closing balance</b>		(2)	(1)	(0.5)	0.5



## Activity 3.7.5

1. Completed cash flow forecast:

- $X = -1.5$ ;  $Y = 10.5$ ;  $Z = 1.5$ .

2. Problems for Suyuri and Koreda in drawing up the cash flow forecast might be forecasting:

- Cash and credit sales
- Debtor payments.

3. New cash flow forecast:

	All figures in \$000	April	May	June	July
<b>Cash inflows</b>					
	Owner's capital injection	28	0	0	0
	Cash sales	4.8	6.4	9.6	7.2
	Payments by debtors	0	2	2	3
	Total cash in	32.8	8.4	11.6	10.2
<b>Cash outflows</b>					
	Lease	18	0	0	0
	Rent	2	2	2	2
	Clothes purchases	4.8	3.2	2.4	3.2
	Labour	3	3	4	3
	Other costs	6.5	2	2.5	1.5
	Total cash out	34.3	10.2	10.9	9.7
<b>Opening balance</b>		0	(1.5)	(3.3)	(2.6)
<b>Net cash flow</b>	Net monthly cash flow	-1.5	(1.8)	0.7	0.5
<b>Closing balance</b>		(1.5)	(3.3)	(2.6)	(2.1)



4. Cash-flow forecasts might increase the chances of business success by providing managers with knowledge of how to manage cash flow effectively through giving them forecasted information on:

- Value of cash inflows and outflows
- Timings of cash inflows and outflows
- Times when extra finance needs to be arranged with lenders and other sources
- Plans that need to be made to cut outflows and increase inflows.

The problems with cash-flow forecasts is the difficulty of predicting:

- Sales
- Debtor payments
- Costs
- Changes in the business environment.

## Activity 3.7.6

The cash flow of a taxi company might be affected by the following events:

- An increase in oil prices may increase the costs and cash outflow on diesel and petrol
- As unemployment rises more people may become taxi drivers and this forces revenues down and fares fall
- As train fares fall more people might take the train and this reduces the demand for taxi journeys, which reduces their revenues.

## Activity 3.7.7

1. Two reasons why it might be difficult to forecast net cash flows for a gold mining business might be:

- The fluctuating gold price affects cash inflows
- Difficulty in forecasting operating costs of a mine.

2. Two reasons why the annual net cash of a gold mine will not be the same as annual profit might be:

- Profit does not account for the initial cash outflow and cash flow does
- Profits are made when goods are sold to the buyer and cash inflows occur when goods are paid for.

3. By cutting back on capital expenditure cash flow might improve because less:

- Cash flows out of the business initially
- Cash is needed to maintain capital (maintenance)
- Cash is needed to finance interest payments.

The disadvantages of cutting back on capital expenditure might be:



- The capacity to produce gold falls, which reduces cash inflows
- Lower quality capital might incur higher maintenance costs and cash outflows.

### Activity 3.7.8

1. 'Working capital' is the day-to-day finance needed by a firm to carry out its operations. It is calculated as current assets - current liabilities.
2. Mr Gupta might find it difficult to control its working capital because the recession:
  - Reduces cash inflows from sales
  - Creditors want to be paid more quickly
  - Debtors take longer to pay.
3. Mr Gupta could try to improve cash flow by:
  - Increasing sales revenue. The problem with this approach is increasing sales in a recession
  - Cutting labour costs. The problem with this is the effect it might have on motivation
  - Paying creditors more slowly. The problem with this is the relationship with suppliers
  - Reducing the debtor period. The problem with this is trying to get customers to pay more quickly in a recession.



## Exam practice question

- Liquidity is the ability of a firm to pay its short-term debts.
- Cash-flow forecast for Coffee Call:

	All figures in \$000	Jan	Feb	Mar	Apr	May	Jun
<b>Cash inflows</b>							
	Cash sales	20	20	20	40	40	40
	Loan inflow		20				
	Total cash in	20	40	20	40	40	40
<b>Cash outflows</b>							
	Materials	10	10	10	20	20	20
	Electricity and gas		2				
	Staff wages	2	2	2	3	3	3
	Drawings			10			
	Marketing	0.5	0.5	0.5	0.5	0.5	0.5
	Fitting tables			20			
	Total cash out	12.5	14.5	42.5	23.5	23.5	23.5
<b>Opening balance</b>		7	14.5	40	17.5	34	40.5
<b>Net cash flow</b>	Net monthly cash flow	7.5	25.5	(22.5)	16.5	16.5	16.5
<b>Closing balance</b>		14.5	40	17.5	34	40.5	57

- The advantages of Coffee Call using the venture capitalist might be:

- Access to finance to fund expansion
- No repayment
- No interest cost
- Expertise to help the business.

The disadvantages might be:

- Some loss of control over decision making
- Profit is split with venture capitalist
- Some ownership is given up.



## Key concept questions

The importance of change in managing cash flow might be how an organisation manages a change in strategy in terms of:

- Financing new investment
- Financing a change strategy
- Cash inflows resulting from change in strategy
- Cash outflows resulting from change in strategy

The importance of ethics in the management of cash flow might be:

- Sourcing finance from ethical places
- Managing cash inflows to fairly impact on different stakeholders
- Managing cash outflows to fairly impact on different stakeholders.