UNIT 4

The Business Guys

Chapter 13
Finance

FINANCE

Gavin Duffy
www.thebusinessguys.ie

Chapter 13 – Finance – Cash Flow Forecasts

2015 Q6 (C)

(i) Explain the reasons Amrod Ltd would prepare a cash flow forecast.
(ii) Calculate the figures represented by the letters **A**, **B** and **C** on the cash flow forecast. (**Show your workings in your answer book.**)
(iii) Explain how Amrod Ltd might deal with the financial problem identified in this cash flow forecast. (25 marks)
MS: 2 @ 5m (2+3); 3 figures @ 2+3(2+1)+2m; 8m (4(2+2)+4(2+2))

Cash Flow Forecast for Amrod Ltd for the 4th Quarter of 2015

	October €	November €	December €	Total €
Total Receipts	70,000	180,000	90,000	340,000
Total Payments	100,000	165,000	120,000	385,000
Net Cash	-30,000	15,000	B	-45,000
Opening Cash	20,000	A	5,000	C
Closing Cash	-10,000	5,000	-25,000	-25,000

Improves Financial Control
A cash flow forecast acts as a financial control mechanism that can be used to **measure actual cash flow against planned cash flow** encouraging Amrod Ltd to plan its finances **sensibly** and **live within its means** and not to **overtrade** (e.g. buy/sell too much on credit)
It helps avoid cash flow problems as costs are considered in advance, so they can ensure it has sufficient funds when the time comes.

Helps Avoid Deficits
It will help Amrod Ltd identify periods of time in the future when the business will have an **excess of expenditure over income** i.e. a **deficit**.
They can then take **corrective action**, **assessing** the **best methods** to deal with the cash shortfall.

Helps Highlight Times of Surplus
It will help Amrod Ltd identify periods of time in the future when the business will have a **surplus of income over expenditure**.
Amrod Ltd can then make **plans** to place these surplus funds on **deposit** with a **financial institution** or make **expansion decisions** e.g. plan investments.

Help Access Finance

It will help Amrod Ltd **gain access to finance** from financial institutions as the cash flow forecast is an **integral part of the business plan** given to banks and other potential investors.
A professional cash flow forecast supports **applications** for **loans** and **grants**.
Only 2 were needed but four given for illustrative purposes.

(ii) A = (€10,000) =2m
B = (€30,000)= 2m (90,000 -120,000)= 1m
C = €20,000 =2m

(iii) **Financial Problem:**
The deficits months are October and December.

Avail of a short-term source of finance:
Amrod Ltd could arrange a **bank overdraft facility** with its bank to finance problem months where the business is running a **deficit**. They can then access more money than is in their account, but the **rate of interest is usually high**.
Other short term sources could be considered such as **trade credit (delaying payment to creditors/ seeking an extension period of credit from creditors).**

Adjust receipts
Amrod Ltd could try to **increase receipts (revenue).**
They could try to create a **better promotion campaign, try lowering prices and selling more, or try to increase cash sales or reduce credit periods for debtors.**

Adjust payments
The business could **decrease its cash payments** by **sourcing cheaper suppliers, restructuring loan repayments** or **asking employees to take a wage decrease**. By moving €10,000 of payments from October to November, the company would break even at the end of October etc.

2013 Q5 (C)
(i) Outline **two** reasons why a household should prepare a cash flow forecast.
(ii) Illustrate how a household can overcome cash flow problems. (20 marks)

Same as above except linked to household not business

2009 Q6 (C) *"Cash Flow is the lifeblood of any business and its management is critical to business survival."*
In September 2008, Buttercup Garden Centre prepared the following Cash Flow Forecast.

Cash Flow Forecast of Buttercup Garden Centre				
	October	November	December	Total
	€	€	€	
Receipts				
Cash Sales	12,500	9,500	10,000	32,000
Credit Sales	2,000	1,500	3,500	7,000
Total Receipts	**14,500**	**11,000**	**13,500**	**39,000**
Payments				
Cash Purchases	1,000	2,500	4,000	7,500
Credit Purchases	5,000	2,000	1,000	8,000
Wages	6,000	6,000	7,500	19,500
Equipment	12,000	-	-	12,000
Total Payments	**24,000**	**10,500**	**12,500**	**47,000**
Net Cash	(9,500)	500	1,000	(8,000)
Opening Cash	3,000	(6,500)	(6,000)	3000
Closing Cash	(6,500)	(6,000)	(5,000)	(5,000)

(i) Explain the benefits to Buttercup Garden Centre of preparing a Cash Flow Forecast.
(ii) Based on the information provided above, outline how Buttercup Garden Centre could improve the Cash Flow position of its business. (20 marks)
MS: 2 @ 5 Marks (2+3) 2 @ 5 Marks (2+3)

(i) Same points as 2015 Q6 (C)

(ii) Purchase of Equipment – Capital Expenditure
Buttercup Garden Centre plans to purchase and pay for equipment out of Cash Flow in October 2008. Equipment is an item of capital expenditure and will most probably be used in the business over a period of a number of years. Buttercup should consider taking out a **medium term loan** to pay for the equipment – this would ease their Cash Flow position considerably, as repayments can be made **monthly** over a few years rather than **one payment**.

Arrange A Bank Overdraft

Buttercup Garden Centre will need to **negotiate a bank overdraft** with its local bank. If trade continues as per the month of December, and there are no changes in overheads or other unforeseen expenses it will take **at least another five months to clear the forecasted deficit of €5000.** An overdraft will allow them to access more cash than is in their current account.

Control of Overheads

Wages increase from €6000 to €7500 (a 25% increase €1,500 of €6,000) from October to December, yet sales fall in the same period. Buttercup Garden Centre needs to **review and control** the amount of money spent on **wages**.

2017 – Short – Q5

Study the cash flow forecast below and fill in the figures represented by the letters A, B, C, D and E.

Cash flow forecast for Intenso Ltd, for the 3rd quarter of 2017				
	July (€)	**August (€)**	**Sept (€)**	**Total (€)**
Total Receipts	20,000	**A= 25,000**	12,000	57,000
Total Payments	14,000	17,000	15,000	46,000
Net Cash	6,000	8,000	**B=(3,000)**	**C=11,000**
Opening Cash	5,000	11,000	19,000	**D=5,000**
Closing Cash	11,000	19,000	16,000	**E=16,000**

2018 – Short Q6

Q6 Study the table below and fill in the figures represented by the letters A, B, C, D and E

Sales (units)	Selling Price (per unit) (€)	Fixed Costs (€)	Variable Costs (€)	Total Costs (€)	Total Revenue (€)	Profit/loss (€)
0	**20**	360,000	0	360,000	0	**E =**
30,000	**20**	**A =**	240,000	600,000	**D =**	0
50,000	**20**	360,000	**B =**	**C =**	1,000,000	240,000

MS: 2+2+2+2+2

A = 360,000

B = 400,000
C = 760,000
D = 600,000
E = (360,000)

Chapter 13 – Finance – Sources of Finance

2014 Q6 (C) (i) Explain the term 'short-term finance'
(ii) Outline two sources of short-term finance Sarah may consider to meet her working capital needs. (20 marks)
MS: 4; 2 x 8 (4+3+1) - Name, explain, reference to Sarah's usage

(i) Short-term finance is finance available for a **period of up to one year**. It should be repaid within twelve months and **should be used for short term needs** (i.e. spent on things that will be used up within a year e.g. **stock**)

(ii) **Bank Overdraft**
This is a facility offered by a bank that allows current account holders to withdraw more money from their account than they actually have in it. Interest is charged on the outstanding balance on a daily basis and is generally expensive.
Sarah could use an overdraft facility to **purchase stock** or **pay the wages of part- time staff.**

Accrued Expenses
This source of finance **frees up money by delaying the payment of regular bills** such as **utilities**, **rent** or **insurance**.
This would free up cash for **Sarah** to **pay for supplies which in turn could be sold allowing these bills to be paid later.**

Trade Credit
Sarah may **buy stock for resale on a "buy now and pay later" basis**. The amount of credit available may be dependent on her **reputation** and **creditworthiness**.
There is **no direct charge** but cash discounts can be sacrificed if **Sarah** chooses to **buy raw materials and stock on credit**.

Other: Factoring Debts

Chapter 13 – Finance – Sources of Finance

2010 Q6 (C) (i) Discuss the factors that should be considered when choosing between different sources of finance.
(ii) Analyse **two** appropriate sources of finance for acquiring an additional delivery van at 'Marie's Pizzas'. (30 marks)
MS: 3 @ 5 marks (2+3); 8 marks (2+3+3) + 7 marks (2+3+2)

(i) 1. A business should try to obtain the **cheapest source of finance available**.
The **rate of interest** is of great importance.
All loans advertised by financial institutions should quote the **APR (Annual Percentage Rates)** and should be examined for **additional fees/ charges/ penalties** when making the choice.

2. Sources of finance must be matched with its purpose e.g. a long term business **expansion** plan should not be financed by a **bank overdraft**.
Assets which are going to last a long time are paid for with long term finance. **Day-to-day expenses** are financed or paid for with **short term finance**.

3. Issuing **new voting shares** (**Equity Capital through Ordinary Share Capital**) in a company could lead to a change of **power/control**. The use of loan capital (**Debt Capital through Long Term Loans**) will not affect voting control but financial institutions such as banks may **take control of fixed assets (collateral) if the loan can't be repaid in full.**

4. Lenders often **seek security/collateral before giving finance**. This restricts the freedom of the borrower regarding what it wishes to do with these particular assets. Sometimes the **borrower may not have enough assets to give as security, which can then limit the sources of finance available.** They may not want to offer some collateral as they would **risk losing it** if they can't pay back the loan.

(ii) **Medium Term Loan**
A medium term loan is obtained for a period of **one to five years**.
Interest must be paid back in **agreed installments** (with the principle) but it is **tax deductible.**
The bank may require **security (collateral) or personal guarantees** to ensure the loan is repaid.

Leasing
This involves **renting** rather than **purchasing** the asset. The business will **never get to own the asset**, it will only ever get the use of the asset. Payments **may be offset against tax. No security is required**, as if the business can no longer make payments, use of the asset is withdrawn. While it costs more than cash purchase it **helps a businesses cash flow**.

Hire Purchase
This is purchasing an asset in **installments**, when **ownership passes to the business with the final payment**. If no final payment is made, the business won't own the asset.
It is **expensive** and carries a high rate of interest and **no security is required**, but the **lender may repossess the asset if you default on repayments.**

2017 Q7 (C)

Discuss the factors a business should consider when choosing a source of finance. (20m)

Answered in 2010 Q6 (C) (i) on previous page

2018 Q4 – Short

Column 1 is a list of finance terms. **Column 2** is a list of possible explanations for these terms. *(One explanation does not refer to any of these finance terms.)* **MS: 3+2+2+2+1**

1.	Leasing	A.	A facility on a current account that allows you to access funds to an agreed limit above your actual balance.
2.	Hire Purchase	B.	A financial contribution given by an organisation for a specified purpose, provided certain conditions have been met.
3.	Overdraft	C.	Selling a trade debt to a third party at a discount.
4.	Grant	D.	Purchasing an asset by installments over time.
5.	Trade Credit	E.	Renting an asset but never owning it.
		F.	Receiving goods from suppliers and paying for them later.

1E; 2D; 3A; 4B; 5F