# Solvency

**Cash flow** is the movement of money in and out of the business.

- cash flows **into** the business as receipts - eg from cash received from selling products or from loans
- cash flows **out** of the business as payments - eg to pay wages, supplies and interest on loans
- **net cash flow** is the difference between money in and money out

**Profit** and **cash flow** are two very different things. Cash flow is simply about money coming and going from the business. The challenge for managers is to make sure there is always enough cash to pay expenses when they are due, as running out of cash threatens the survival of the business.

## Insolvency

If a business runs out of cash and cannot pay its suppliers or workers it is **insolvent**. The owners must raise extra finance or cease trading. This is why planning ahead and drawing up a **cash flow forecast** is so important, as it identifies when the firm might need an overdraft.

# Calculating the cash flow

This is an example of a **cash flow forecast** for the next three months:

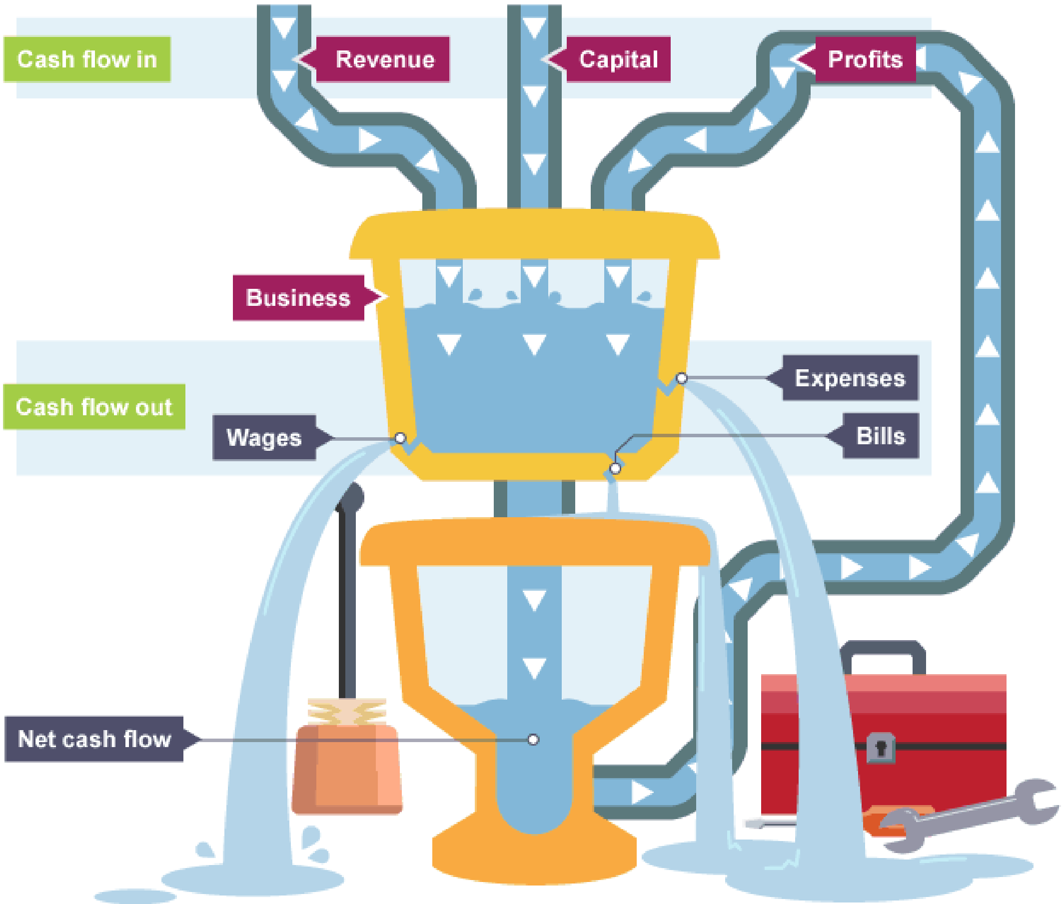
| Item | Jan | Feb | Mar |
|---|---|---|---|
| Opening bank balance | £2,000 | £1,000 | £-1,250 |
| Total receipts (money in) | £500 | £750 | £5,000 |
| Total spending (money out) | £1,500 | £3,000 | £2,000 |
| Closing bank balance | £1,000 | -£1,250 | £1,750 |

At the beginning of January, the business has £2,000 worth of cash. You can see that the total flow of cash into the business (receipts) for January is expected to be £500, and that the total outflow from the business (expenditure) is £1,500. There is a net outflow of £1,000 which means the projected bank balance at the beginning of February is only £1,000.

In February, there are expected payments of £3,000 and only £750 of expected income. This means that the business is short of £1,250 cash by the end of February and cannot pay its bills. An overdraft is needed to help the business survive until March when £5,000 worth of payments are expected.

A business can improve its cash flow by:

- **reducing cash outflows** - eg by delaying the payment of bills, securing better trade credit terms or factoring
- **increasing cash inflows** - eg by chasing debtors, selling assets or securing an overdraft



Task

Read through the following information and answer the test below

Cash is the amount of money a business holds. Which of the following describes 'cash'?

Notes

Notes and coins

Notes, coins and deposits in the bank

**2**

Which of the following is true about cash flow?

It is the same as profit

It is different from profit

It is the same as revenue

**3**

Where does the main cash inflow for most businesses come from?

Customers paying for products

Interest received on loans

Interest payments on a bank overdraft

**4**

What is net cash flow?

The difference between revenue and cost

The difference between money in and money out

The difference between assets and liabilities

**5**

Which of the following is an example of a cash inflow?

A new bank loan

Payment of a gas bill

Offering trade credit to a customer

## 6

If the opening balance is £5,000, total receipts are £4,000 and the closing balance is £3,000 then total payments are:

£4,000

£5,000

£6,000

## 7

Which of the following hinders cash flow?

Asking debtors for payment

Repaying an overdraft

Securing better trade credit terms from suppliers

## 8

What is a long term way to improve cash inflow?

Take out a loan

Take out an overdraft

Use a factoring service

## 9

How can cash outflows be improved?

Buy extra equipment

Lease out equipment

Use a factoring service

## 10

What does a postive cash flow mean?

- The business is making a loss
- The business is making either a profit or a loss
- The business is making a profit

Task 2

Using the cash flow worksheets calculate the cash flow for the two businesses