Topic 6 – Cash Budgeting

N5 Business Management

Learning Intentions / Success Criteria

Learning Intentions	**Success Criteria**
Cash budgeting	By end of this topic you will be able to: • describe how businesses generate cash • describe what businesses spend cash on • describe why businesses must have enough cash • explain why cash flow problems may occur • justify how cash flow problems can be resolved • produce a cash budget • interpret a cash budget and identifying any cash flow problems • justify suitable solutions to cash flow problems.

Cash Budgeting

- Cash is an important resource for any business because without it bills would not get paid and staff would not get paid.
- Cash is needed on a day-to-day basis to operate.
- Cash flow (the amount of cash in a business) has to be carefully monitored.
- Businesses that do not have a healthy cash flow can face problems.

Cash Budgets

- To help manage cash and ensure control over future cash flow, a cash budget can be prepared.
- This is a forecast of the money expected to be received **(receipts)** and the money expected to be paid out **(payments)** over a period of time.

Common terms that appear in a cash budget:

- Opening balance
- Total receipts
- Cash available
- Total payments
- Closing balance.

Terms that appear in a Cash Budget

Term	Definition
Opening balance	The amount of cash available at the start of the month.
Total receipts	The total cash received during the month.
Cash available	The amount of cash available to spend. Calculated by: opening balance + total receipts
Total payments	The total amount of cash spent during the month.
Closing balance	The amount of cash available at the end of the month. Calculated by: cash available – total payments

Cash budget for Rob's Joinery for October-December

The cash available at the start of the period

Money expected to come in

Opening balance + receipts

Money expected to go out

Cash available less total payments

	£ October	£ November	£ December
Opening balance	100	190	185
Receipts			
Sales	200	120	110
Total receipts	200	120	110
Cash available	300	310	295
Payments			
Purchases	50	60	70
Advertising	30	30	20
Wages	20	25	30
Rent	10	10	10
Total payments	110	125	130
Closing balance	190	185	165

Interpretation of Cash Budget

Sales (decreasing)

- Demand is going down.
- Competitor is cheaper.
- Customer unhappy with quality of product.

Solutions

- Carry out market research.
- Advertise and carry out promotions.

Purchases (increased)

- Concern especially when sales are forecasted to go down.
- Suppliers may be increasing their prices.

Solutions

- New supplier to be found or a discount negotiated.
- Use JIT approach.

Benefits of Preparing a Cash Budget

- To show if the business will have a surplus (more cash expected to come in than will go out) or deficit (more cash expected to go out than will come in) of cash.
- It can show if additional finance is required, e.g. overdraft or loan.
- It can help control expenses by highlighting periods when expenses could be high.
- It can help in making decisions.

Reasons for Poor Cash Flow

- Too much money tied up in stock or buying stock that is not selling as fast as the business would like.
- Interest rates are too high to allow the business to borrow from the bank.
- The owners of the business take too much in drawings.
- Customers taking (or being allowed) too much time to pay their invoices.
- Allowing customers to have a high credit limit.
- Purchasing things such as vehicles, machinery, or premises when you can't afford it.
- Having high borrowings with high rates of interest.
- Suppliers not allowing credit or only having a very short credit period.
- Not selling enough to bring money into the business.
- A sudden and unexpected increase in expenses.

Methods to Improve Cash Flow

- Offering discounts to customers if they pay quickly.
- Offering discounts to customers if they pay up front in cash.
- Selling any unused assets the business doesn't need.
- Trying to reduce loans by investing more money in the business.
- Selling some assets such as buildings or machinery and then leasing them back.
- Asking suppliers for longer to pay.
- Arranging an overdraft or loan from the bank.
- Try to cut costs by reducing waste in the business.
- Advertising to encourage more customers to buy the product(s).