ABS Lecture series: Financial Objectives and Cash-flow

Cash- flow crisis Watch UK

Neville Smith was very worried. He had seen turnover in his Surveillance business, rise by 50 percent cent between 2017 and 2018, with a similar increase in gross profit. However, after operating costs had been deducted, a loss of £16,300 in 2017 had only been turned into an operating profit of £7,330 in 2018, a return on sales of less than 3 percent.

Neville and his son Sam, a partner in the firm, knew that their gross profit margin on CCTV cameras was in line with industry norm, and in any case there after sales service was exceptional, yet they were not seeing the financial gains. After a meeting with the bank manager, they were required to produce a series of budgets and incorporate them into a cash-flow forecast.

Figure 1

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2017 | 2018 | 2019 |
| Turnover | £240,000 (actual) | £360,000 (actual) | £480,000 (budget) |

Their order book was expanding and they felt a 33 per cent increase in sales revenue was possible. The budgeted sales figures for the first 6 months are shown in the cash-flow forecast (figure 3).

Figure 2

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2017 | 2018 | 2019 |
| Labour costs | £57,000 (actual) | £70,000 (actual) | £73,000 (budget) |

The firm employed two engineers and one part time administrator. The engineers were paid a salary package, irrespective of the number of systems fitted or the time taken to fit them, packages which had increased substantially in 2018. Each engineer had use of a company van which they took home each night. The budgeted labour costs for the first 6 months are shown in the cash-flow forecast.

CASH-FLOW FORECAST

Figure 3

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| 2019 Income | Jan £ | Feb £ | Mar £ | Apr £ | May £ | June £ |
| Sales\* | 20,500 | 26,000 | 42,000 | 42,000 | 53,000 | 53,000 |
| **Expenditure** |  |  |  |  |  |  |
| Labour | 6,000 | 6,000 | 6,000 | 6,000 | 6,000 | 6,000 |
| Premises | 4,000 | 4,000 | 4,000 | 4,000 | 4,000 | 4,000 |
| Advertising | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 |
| Motoring | 1,900 | 1,900 | 1,900 | 1,900 | 1,900 | 1,900 |
| Admin | 1,400 | 1,400 | 1,400 | 1,400 | 1,400 | 1,400 |
| Finance | 500 | 500 | 500 | 500 | 500 | 500 |
| Sundries | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 | 1,000 |
| Materials | 11,000 | 14,000 | 22,000 | 22,000 | 28,000 | 28,000 |
| Drawings | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 | 2,000 |
| Total Exp. | 29,800 | 32,800 | 40,800 | 40,800 | **A** | 46,800 |
| Net cash-flow | (9,300) | (6,800) | 1,200 | 1,200 | **B** | 6,200 |
| Closing Balance | **(9,300)** | **(16,100)** | **(14,900)** | **(13,700)** | **C** | **(1,300)** |
|  |  |  |  |  |  |  |

\*The estimates for future sales indicated a similar level to those budgeted for in May and June, except for December were expected to fall.

**Question 1 (7 marks)**

Give two reasons to explain why the budgeted sales for 2019 (Figure 1) may not be achieved.

**Question 2 (2 marks)**

Calculate the missing figures at point A,B and C in the cash-flow forecast (Figure 3).

**Question 3 (4 marks)**

Explain two limitations of cash-flow forecasting for Watch UK.

**Question 4 (8 marks)**

Banks offer business various forms of finance.

To what extent might an overdraft be considered better than a loan to address Watch UK’s cash-flow problems?

(Question modelled on Edexcel Business Studies paper 2010)