

## 3.7B: Cash Flow: Activity



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### 3.7 CASH FLOW: ACTIVITY B

Read the case study below and answer the questions that follow.

#### FASHION SHOP FORECASTS LOOK GOOD



"I have stood outside some of the fashion shops for hours counting the number of people coming out with their carrier bags and I am convinced my sales forecasts are OK," announced Divya Singh to her business partner Courtney Allen.

They were both putting the finishing touches to their business plan for an exclusive 'top brands only' fashion store in the city. Divya's primary research was not the only evidence they had used in arriving at the sales forecasts and the cash-inflow forecasts. Some desk

research on the internet had also revealed the rapid growth of high-income consumer numbers spending increased amounts on expensive clothing.

Cash-outflow forecasts had been based on estimates of electricity and telephone usage. Courtney had found what she thought was a suitable shop, so they knew how much the rent would be. They would pay themselves a salary of \$2 000 a month each initially. Other labour costs were less certain. Should they employ full-time salaried staff or part-time hourly waged employees? The costs of buying the clothes were also uncertain. There would be no problem if they sold all of the suits and dresses they had bought in – but how likely was that? And what would happen to cash-flow forecasts if stock was left unsold and huge price reductions had to be advertised? Both Divya and Courtney realised why they had to construct a cash flow forecast for their business plan. The almost complete forecast is shown in table 1 below.

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<b>Table 1: Fashion Shop's Cash Flow Forecast</b>					
All figures in \$000		April	May	June	July
<b>Cash inflows</b>					
Owners' capital injection		28	0	0	0
Cash sales		6	8	12	9
Payments by debtors		0	2	2	3
<b>Total cash in</b>		<b>34</b>	<b>10</b>	<b>14</b>	<b>12</b>
<b>Cash outflows</b>					
Lease		18	0	0	0
Rent		2	2	2	2
Clothes purchases		6	4	3	4
Labour		3	3	4	3
Other costs		6.5	2	2.5	1.5
<b>Total cash out</b>		<b>35.5</b>	<b>11</b>	<b>11.5</b>	<b>Y</b>
<b>Net cash flow</b>	<b>Net monthly cash flow</b>	<b>X</b>	<b>(1)</b>	<b>2.5</b>	<b>Z</b>
Opening balance		0	(1.5)	(2.5)	0
Closing balance		(1.5)	(2.5)	0	1.5

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**QUESTIONS: 26 MARKS, 45 MINUTES**

1. Complete the cash flow forecast by calculating values for X, Y and Z. **[3 marks]**
2. Analyse two problems that Divya and Courtney might have experienced when drawing up their cash flow forecast. **[6 marks]**
3. The first three months' actual trading was poor and cash sales were 20% below forecast. Construct a new cash flow forecast for July assuming 20% lower cash sales, 20% lower clothes purchases, an opening cash balance of (\$2000); all other factors remain unchanged. **[7 marks]**
4. To what extent would drawing up a cash flow forecast increase the chances of this business being successful? **[10 marks]**