Financial Planning

Cash Budgeting – Sources and Uses of Funds

Cash flow definition: cash flow in the sense we use it in the course is how much cash is available at any one point in time, usually monthly. to determine this one looks at cash needs or uses and compares it to cash sources or where it comes from. The other thing to understand is that when calculating cash needs, one has to determine how much they owe in taxes. to do this, one takes the gross income, subtracts expenses, interest and depreciation and then multiplies the balance by the tax rate. To determine how much cash is left, one adds back in depreciation since that is a non cash item.

When Michael Bregman decided to open Mmmuffins and later Micahel's Baguettes, he had in mind building a significant chain of restaurants, hopefully with both, if not with one. His long term financial planning was understandably 99% dream if not 100%. What form of growth he would take and how he might raise the money to do so was a future worry. At the point of opening Mmmuffins, he needed to focus on how much money was coming in the door and how much was going out, if not daily, at least weekly. While he might have had an idea of sales from comparable size stores selling a form of fast food and his supermarket experience his forecasts of traffic and weekly takes would have to be adjusted as he went along.

Michael in this case is not only the entrepreneur, chief cook and bottle washer, but also the financial manager. It's his job to forecast sources (inflows) and uses (outflows) of cash. He does this so he can: prepare in advance for shortfalls by raising enough money in the beginning (note his current cash on hand Exh. 3 Term deposit); measure how he is doing against some budget; and get some idea of potential earnings so he can plan for his expansion.

Sources of cash: inflow

Michael's sources of Cash are simple: Cash Customers and bank interest. (see exh. 3 pgs. 10-11). He also might take credit cards, but that lag is short enough to count it as if it were cash. In many other businesses, the financial manager must be concerned with goods sold but not yet paid for. This we term receivables. How quickly a company, on average, converts its receivables and what percentage have to be written off directly affect a company's cash position. We can look at the following chart to understand that better.

	Period			
	1st qtr	***2nd qtr***	***3rd qtr***	***4th qtr***
A. Receivables at start of period	10	16	21	24
B. Sales	100	110	120	120
C. Collections				
Current	90	99	108	108

Prior period	4	6	9	9
Total	94	105	117	117
D. Receivables End of period = A+B-C	16	21	24	27

Uses of cash: outflow

1. **Actual payments made on accounts payable**. While a bill might be received for goods or services rendered, there is a certain leeway that one has in the paying of that bill. In order for bills to be paid more promptly, the seller usually offers a discount, ie. "1 and 10" which means that a 1% deduction can be taken on the bill if paid within 10 days.
2. **Payroll expenses, administration and other currently due business expenses.** A utility bill, credit card bill or other bill that can be paid late in certain circumstances may fall within the accounts payable section.
3. **Real estate, income, and other municipal or governmental taxes, interest, dividend and other regular distribution type payments.**

Contingency:

Oftentimes, and preferably, a financial planner will allow for some cushion in the cash planning. This contingency might be a percentage based on estimated sales or expenses.

In Michael Bregman's case, he has used the operating results in Exhibit 2 to create a proforma or estimate of earnings for a potential Franchisee. If we were the franchisee of a Mmmuffins, we would need to go through the budget exercise making certain important assumptions such as:

1. how long will it take to get to stabilized sales
2. how much do we, the owners need to live on per week
3. how much interest will we owe monthly on our capital investment
4. how much waste and loss will we incur do to inefficiencies in the beginning