**Topic 3.1 How to Improve Cash Flow: Activity (2)**



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| **Case Study: John Fazil** |
| John Fazil has run a restaurant for the past ten years. It took him a couple of years at the start to earn a profit but since then he has been able to earn a reasonable living from his business. This was until a year ago. The economy began to do badly, unemployment rose and his customers began to think twice about going out for a meal. Sales of ready prepared meals in supermarkets boomed whilst John Fazil saw his customer numbers decline.  John was reluctant to take any serious action. He hoped the economy would recover quickly and everything would get back to where it was before. However, his bank has just phoned to say that they are worried about his overdraft. A cheque that he wrote to a food supplier would have taken him over his overdraft limit. The bank has therefore bounced the cheque (i.e. it has refused to pay out the money on the cheque).  Bouncing cheques means that John has got to take action. He looked at his cash flow for last week. This was a fairly typical week for him. In the restaurant trade, the general rule is that the cost to the restaurant of food ingredients should be around one third of the prices charged to customers for an item on the menu. Drinks can be sold for between three and five times their cost price to the restaurant. Restaurants are typically staffed by permanent and temporary workers. The temporary workers tend to be low paid doing jobs such as waiting tables and cleaning dishes in the kitchen. John employs both permanent and temporary workers.  Looking at his cash flow position, John does not know whether he should try to increase his sales to bring in more cash or cut his costs to reduce his cash outflows. He has thought about changing the prices he charges. Would cutting prices attract more customers into the restaurant and increase the amount of cash coming into the business? Maybe he should increase his prices and pitch for high quality food; would this increase his cash inflow? Should he perhaps have one or two evenings a week where he offers lower prices, or perhaps have a ‘happy hour’ say between 6 and 7 in the evening when prices are lower? Should he cut his costs? What about making some of his permanent staff redundant or reduce the use of temporary staff? Could he save on food ingredients?  In the short term, John has decided that some of his suppliers will have to wait longer to be paid. John’s business is now in crisis and it demands radical action.  Table 1 Cash flow, last week   |  |  | | --- | --- | | Cash inflow | £ | | Food sold | 1,800 | | Drink sold | 700 | | Cash outflow |  | | Food ingredients | 800 | | Drink supplies | 200 | | Wages and other staff costs | 1,200 | | Rent | 400 | | Gas, electricity, telephone | 320 | | Other costs | 80 | |

**Questions:**

1. Using table 1, calculate the following figures for John Fazil’s restaurant for last week.
   1. Total cash inflows. (**1**)
   2. Total cash outflows. (**1**)
   3. Net cash flow. (**1**)
2. Explain why John Fazil’s business is facing a cash flow crisis. (**3**)
3. John has decided that he will make suppliers wait longer for their payments. Explain how this will imp0rove his cash flow position. (**3**)
4. John is angry about the amount of food that his head chef wastes. Do you think that cutting back on orders of food could improve cash flow without affecting the quality of meals in the restaurant? Justify your answer. (**6**)
5. Would making staff redundant be the best way for John to solve his cash flow problems? Justify your answer looking at other possible alternatives. (**8**)