The power of cash flow forecasts

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At some point in its lifetime, every small business suffers from cash flow problems. The trick is to think ahead and figure out when these problems are going to arise so you don't have to unexpectedly postpone a purchase or hurriedly seek out additional finance. This is where cash flow forecasts come in.

To effectively manage your cash flow, all you have to essentially do is use your sales and expenses figures to calculate your cash flow figures before they happen. Then you can plan to limit the impact of a cash drought before it arrives so you can still pay your staff, the bank and your suppliers.

The importance of cash flow forecasts

Cash flow forecasts are used to predict your business's future financial position for the period ahead, from three months to a year in advance. Your forecast allows you to see what money you expect to be paid into the business and the amount you'll need to pay out. It's a useful tool to help you manage your business more effectively.

If you owned a typical downtown retail store with high sales over Thanksgiving and Christmas, and then a traditional slump after the New Year Sales, your cash flow forecasts would show high income in December and much lower income over the following two months. Your forecasts would also show stock purchased on a 60-day term ahead of the festive Christmas rush in November and December would need to be paid at the end of January and February.

If you racked up record Christmas sales, there might be a strong temptation to splash out and buy that big-ticket item you've been hankering after – but can you really afford it? A quick look at your cash flow forecast will probably tell you that you need to park the thought of a new SUV or fishing boat and reduce your drawings by downgrading your request to Santa for an iPad. Otherwise, you'll have no money left to pay for the stock you sold in December.

If you're more pragmatic and less inclined to impulse spending, your forecast will also be able to tell you if you'll generate enough profit to cover the costs of new refurbishments or opening a new store.

Say your forecast sales figures for March and April will be down on previous years, as a result of continued low national economic growth, the global financial turmoil or the arrival of a new competitor in the market. You might need to arrange short-term finance to tide you over or find ways to increase sales to cover your monthly overheads and operating costs.

In summary, your cash flow forecast gives you a future view into your business finances. It helps you identify cash flow problems before they materialize and allows you to make informed business decisions.

How to create a cash flow forecast

You can use your computerized accounting package, a spreadsheet program such as Excel, or download a cash flow forecast template from the Internet to calculate your cash flow forecast. Most accounting packages will be able to pull up many of the figures you need to put into your forecast directly from your accounts, saving time and effort.

Step one
Enter your opening bank balance, which reflects the amount of cash you have on hand.

Step two
Identify the money coming into your business over the next 12 months (most forecasts cover the year ahead). This could be credit sales you've already made, any forward orders you've received and projections of future sales based on past performance or market research.

Step three
Record the expenses you'll need to pay each month. This will include your overheads or fixed costs, your variable or operating costs, any one-off purchases and annual payments, plus any money you're likely to draw from the business.

Step four

Add your income to your opening bank balance and subtract your expenses. This is your closing bank balance each month – repeat for the year and you'll have an appreciation of your business's likely cash position for the year ahead.

If your forecast bank balance at the end of each month is positive, you have sufficient cash flowing into your business to meet your expenses. If your bank balance is negative, you'll need to source additional finance to keep your business running, and look at ways to increase sales, reduce costs, or both.

The hardest part of creating a cash flow forecast is working out accurate income and expense figures for the months ahead. Obviously, the more accurate these figures are, the more accurate your forecasts will be (and the business decisions you base on them).

For your forecasts to continue to be of use, you need to update them based on your actual business performance each month. Replace your forecast figures with the actual figures for the month and make adjustments to the next few months' forecast figures if it appears, based on reality, that your projections were either overly optimistic or pessimistic.

Putting your forecasts to use

Apart from giving you a fairly good indication of your likely cash position at any point in time in the year ahead and alerting you to potential cash flow problems (which enables you to act in advance, rather than react), your cash flow forecasts can be used to model your future plans.

Let's say you plan to open a new store. You can put the additional expenses into your forecasts to see if you can afford the upfront expenses, and then add in the additional revenue you expect to receive to see the overall effect on your business.

You can run three versions of this forecast: a worst-case, best-case and middle-of-the-road scenario to see how this will affect your business finances. These forecasts will help you decide whether to open the new branch or not. If you're uncertain you'll achieve your best-case sales and your middle-of-the-road figures don't look that promising, you might decide to wait a year before you open the store or elect to open a virtual shop front and sell online instead.

Alternatively, you might discover it's better to use any surplus cash to pay off interest-bearing loans. Once you have your forecasts set up, use them to model "what if" questions about your business to help you make the best decisions for your business.

We hope this guide has been useful to you.

If you require more detailed or more tailored advice and support, call us today at **(08) 9380 3555** and book a **FREE no obligation meeting**. We can catch up for a coffee and discuss your individual needs.

You can access further tools, guides and calculators at

http://omnisgroup.com.au/free-resources-and-tools/