How to use cash flow forecasts

A cash flow forecast is one of the most useful financial tools in your small business arsenal. You already know that your business needs a positive cash flow to be a success but you might not know these hints and tips of how to use cash flow forecasts to improve your business.

Cash flow forecasts help you manage your small business

Understanding cash flow is the key to running a successful small business. Good cash flow management will help ensure your business runs smoothly and it gives you the insight to keep on top of your business' financial health.

What is a cash flow forecast?

A cash flow forecast is an estimate of the amount of money you expect to flow in and out of your business and includes all your projected income and expenses. A forecast usually covers the next 12 months, however it can also cover a short-term period such as a week or month.

☐ What can you use it for?

Cash flow forecasts can help predict upcoming cash surpluses or shortages to help you make the right decisions. It can help in tax preparation, planning new equipment purchases or identifying if you need to secure a small business loan.

You can also use it to see the effect of an upcoming business change or decision. If you're considering hiring a new employee for example, you'd add the additional salary and related costs into your forecast. The new figures in your cash flow forecast will tell you whether hiring that additional employee is likely to place your business in a stronger position and help you decide whether to hire them or not.

Including best, worst and most likely case scenarios allows you to see how your business will fare if you suddenly hit tough times or better than expected trading conditions. Knowing how this effects your cash position allows you to make informed and educated decisions, and you'll be more confident of running your business.

☐ Is your business meeting expectations?

You can use your cash flow forecast to check if your business is meeting your expectations. Comparing your actual income and expenses with your forecasts can identify areas where your business is over or under performing.

Reviewing your actual performance against your forecasts alerts you to any variance so you can investigate and find out why there is a difference.

If your sales are higher or lower than forecast for example, you'd want to find out why. Are your forecasts too high or too low? Has a competitor changed strategy or has a new competitor entered your market? Do you have a customer service or quality control issue?

Using forecasts in this way allows you to actively manage your business. It empowers you to ask the right questions, and ultimately make the right decisions.

How to prepare a cash flow forecast

Cash flow forecasts are easy to prepare:

☐ Estimate your likely sales

The first step is to estimate your likely sales for each week or month. Use your previous sales history from the last couple of years to get a good idea of the level of weekly or monthly sales you can expect. It's unlikely that your sales will be constant so include seasonal patterns and one-off events such as trade shows, in your projections.

If you're only just starting a business, you'll need to estimate your forecasts based on information from customer surveys, suppliers, industry experts such as your NAB Small Business Banker, and the performance of similar businesses.

Don't forget to factor in your future plans, and current market conditions and trends. If you're planning a new marketing drive or launching an exciting new product you'll need to put these increased sales expectations into your sales forecasts. Similarly if a new competitor has just entered the market you might want to drop your forecast figures a little to allow for the fact they may gain some of your market share.

☐ Estimate your payment timing

The next step is to estimate when you expect to receive payment for your sales. If you operate a cash sales business forecasting is relatively easy since payment occurs at the time of sale. If you sell on credit you'll need to factor the likely delay in payment into your cash flow forecasts. If your terms are 30 days you can then expect to receive payment between one to two months after the sale has been made.

Now that you know how much income you expect, and when you expect it, all that is left is to put these figures into the correct columns in your cash flow forecast.

☐ Estimate your likely costs

Your costs are likely to be made up of fixed and variable costs. Fixed costs are those you will have to pay regardless of your level of sales and include costs like rent and salaries. Variable costs vary – usually according to sales.
For example, you wouldn't have to pay delivery fees for stock if you weren't ordering any in.

Use your forecast sales levels to work out the amount of stock or raw materials you'll need to buy in to meet your sales figures.

Identify other bills you'll need to pay and when you'll need to pay them. It's a good idea to go through your historical payment records to make sure you don't forget to include annual or erratic expenses like accounting fees or business taxes.

Once you have identified the payments you need to make and when you need to make them, add these to your cash flow forecast.

☐ Use your forecasts

Now that you have your weekly or monthly income and expenses in your cash flow forecast its ready to use. Simply add in an opening bank account balance, and add the revenue less the expenses for each weekly or monthly period to find out your likely cash position.

The usefulness of your forecasts will depend on how accurate and up to date they are. It's important to update them against your actual business performance on a weekly or monthly basis. This will ensure that your information is accurate and allow you to adjust future forecast figures as soon as it becomes clear that they're likely to differ from your initial expectations.

**For more information,
visit nab.com.au/smallbusiness**

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