The Advanced Cash Flow Forecasting Guide:

Beyond the Basics

2017

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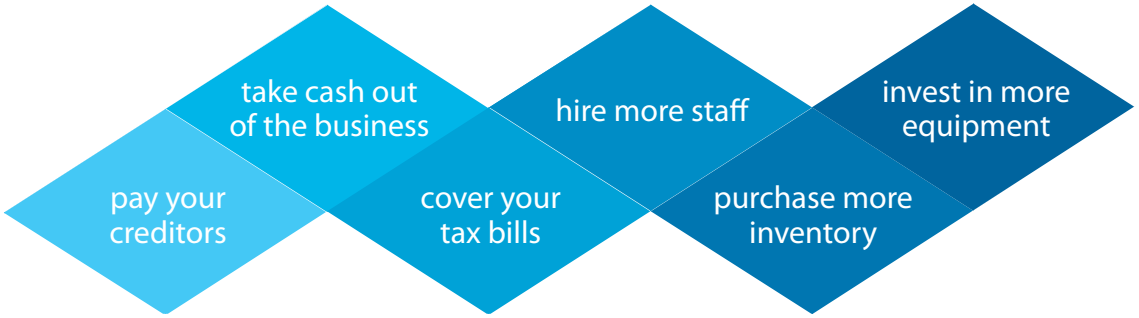
The benefits and importance of cash flow planning.

The well-worn phrase, ***"cash flow is the lifeblood of any business"*** is absolutely true.

The amount of cash you have on hand is also known as working capital, which is what enables you to do things such as:



This means that cash flow forecasting is an essential part of business management. By preparing a basic cash flow forecast you can make a rough prediction of how much working capital you'll have at any point in the future.

However, by going beyond the basics you can achieve more accurate predictions, allowing you to invest more aggressively or be confident that you are drawing the most you can without damaging your business.

82%

of businesses who fail cite cash flow as the reason (U.S. Bank Study)

1 in 5

small businesses in the US don't survive their fifth birthday (Xero)

What is the difference between having a budget and having a cash flow forecast?

Every business will need both a budget AND a cash flow forecast. ***They are not the same thing.***

A budget is your financial plan for where your business wants to go. For example, how much are you going to sell…? What's it going to cost? And what overheads are you likely to incur? It should also include finance costs such as interest.

A cash flow forecast is a plan of when the cash will flow into and out of the business. To grow your business or take money out of it, you must have funds available at the right time.

It's important to have both, because a budget may show that you're going to make profit, but customers can take time to pay and suppliers require payment, often before customers have paid you. It's vital to plot this all out in black and white, so that you can see where the 'peaks and troughs' are likely to occur and plan how you're going to manage them.

"Both budgeting and forecasting are vital for business success. One helps you remain profitable; the other helps your business always have the right amount of cash on hand."
- Sue Hirst, CFO On Call

Cash flow forecast in more detail.

Cash flow forecast in more detail.

While similar to a budget, the cash flow forecast looks at the situation from a cash perspective, rather than a profit and loss one. It also includes items such as tax, repayment of loans and dividends, which aren't included in the budget. By doing this forecast, you can see what your closing bank balance will be for each month and where you might have shortfalls or a surplus of cash.

Once you know the amount of the 'peaks and troughs' you can play around with the numbers to work out how to retain a positive bank balance, when you may need funds to cover a shortfall or when you will have a surplus of cash to invest in the business.

One of the challenges to maintaining a cash flow forecast is that you need to start with an accurate **opening balance**, which is something of a moving target because of the transactions that constantly occur in your business. (We go into more detail on this later).

'Once you know the amount of the 'peaks and troughs' you can play around with the numbers...'

Having fixed an opening balance, you then plot in monthly what income you expect to receive, based on when and how much customers pay, against what you expect to pay out, based on fixed monthly expenses and amounts owed to suppliers.

Using the past as a guide to the future.

Although it is sometimes inadvisable to use the past as a guide to the future, when forecasting cash flow, a look backwards can provide a lot of useful insight:

Historic trend.

This could be used as the basis of a future forecast. For example, a certain expense has increased 5% a month every month over the previous 12 months, so predict a 5% increase per month going forward.

Historic average.

Take an historic average of cash in and cash out of your business and use this as the basis of a future forecast. For example, use a 3 month, 6 month or 12 month average.

Forecast vs actuals.

Consider how accurate your forecast was in the past compared to what actually happened. For example, if you were always predicting getting more cash in than you did, you need to be more realistic with your predictions.

Prediction patterns.

Looking back at the previous 12 months, you could make a prediction on the pattern you see. For example, predict the same, or predict the same plus 10%.

By using any of the above you will start to create a system to inform your future cash flow.

Best Practice Cash Management.

The best way to keep on top of your cash position is to have a proactive credit control strategy. If you are on top of your Accounts Payable and Accounts Receivable you won't just have a smoother-running business, you can also use that information to create an extremely accurate view of your short-term cash flow. Best practice cash management includes these great tips:

Send invoices as soon as possible.

There's no merit in waiting. The sooner an invoice is with your customer, the sooner any agreed credit terms can start running. Make sure your invoice is accurate too - it is better to give too much detail than too little.

Don't be afraid to send invoice reminders.

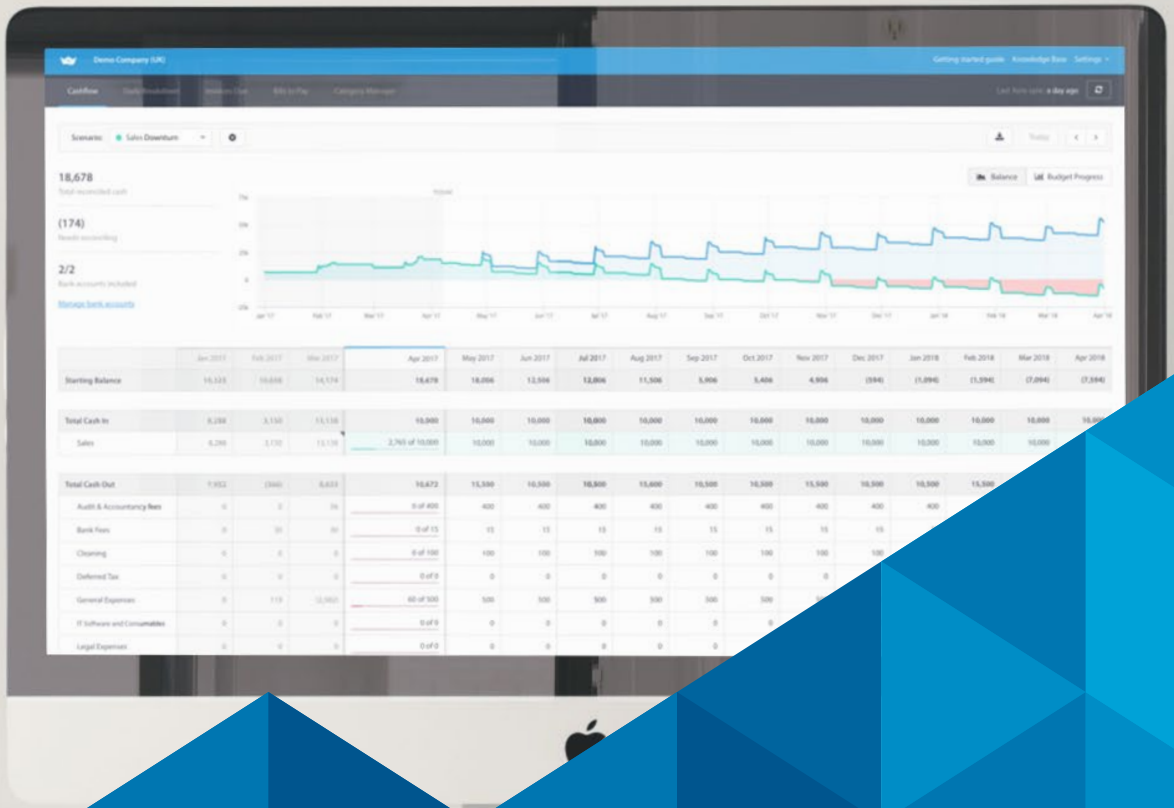
Send the first before it reaches the deadline. You can then deal with any claims that the invoice hasn't been received or approved. Subject lines starting with 'Remember!' work very well.

Automate as much as you can.

Take the pain out of chasing your customers personally by automating the invoicing process. The best way to avoid invoices being overdue is to collect payment by Direct Debit.

Go Cardless makes Automation a very accessible option for small business. If you do need to chase, you can use technology that links to your accounting software to do the chasing for you. We like **Chaser** for this purpose.

Scenario forecasting: planning for changes in your business.



An example of a scenario in Float

You may ask yourself, ***"What happens if my biggest invoice doesn't get paid?"*** or ***"What if my sales are going to decrease next month?".***

"What if" scenarios such as these are all part of running your business, which essentially involves dealing with change and the critical need to plan for these changes. You may want to change premises or supplier, launch a new product, or just see when you are going to run out of cash.

Some of your customers will try to delay paying you for as long as possible. You probably know who they are, so you should allow for this in your forecasting and not just use a uniform 30 days. Look at your average actual collection period and use this instead as your starting point.

As you grow, you will probably want to invest in your business with new people or equipment. Your sales may increase, but your overheads definitely will. You can use a cash flow forecast to model various scenarios and see how much margin for error there is in your sales forecast before the new overheads become onerous.

"To be slightly pessimistic is better than being overly optimistic."

By using a tool such as **Float**, you can add in the costs of new employees and any associated taxes and see the exact impact these extra costs will have month on month so you can plan accordingly.

You may need to increase sales or make efficiencies in other areas to allow for these changes. This information can be presented to the board or the senior management team, so timely decisions can be made and in advance of any potential cash flow problems.

A tool that pulls data directly from your accounting software, like **Float**, can save you time and provide you with the visual forecast you need to see what impacts these changes will have on your cash flow going forward.

The perils of the spreadsheet approach.

The urge to reach for your favourite spreadsheet application when doing anything involving calculations is a strong one and, let's face it, countless cash flow forecasts have been created in this way. ***However, watch out for these pitfalls:***

Choosing the wrong opening balance.

Using a spreadsheet brings with it several inherent risks. The first, and arguably most important, is that the calculation of the whole cash flow relies on the opening balance being correct. If you get that wrong, or more likely, it changes because something happens while you are working on your forecasts, the whole forecast is wrong.

Trying to match your spreadsheet with your accounting system.

Monthly, weekly or daily reconciliation means you will need to monitor and adjust your forecast against the actual performance, and manually enter the payments in and out of the account. That might not seem too complicated in theory, but you can spend hours in practice trying to work out why the balance on your spreadsheet doesn't match the balance in your accounting system.

And all of this assumes that the spreadsheet calculations are set up in the right way in the first place. Life is made a lot easier and your forecasts made more accurate by using a cash flow forecasting tool like **Float**, which syncs with your accounting software. This removes any need for manual entry of past actuals and upcoming invoices and bills, bringing you to an accurate and constantly updated starting point without you having to do anything.

Important inflationary and currency factors.

Getting into even more detail now, you need to consider external factors outside of your control and monitor them carefully. For example, a rise in commodity prices such as oil, metals and agricultural products causes a rise in component costs such as the price of raw materials that your business might be dependent on.

A fall in the exchange rate also typically leads to an increase in the prices of imported goods, such as essential raw materials, components and finished products.

Bigger companies typically pass on these cost increases to their customers via the supply chain. Lacking the negotiating and purchasing power that the bigger companies enjoy, smaller companies often find their margins being squeezed as they are unable to pass on the cost increases in the same way.

Wage increases as a result of low unemployment, or periods of high inflation, can all have an additional adverse effect on your cash flow. Taking steps to monitor and improve your cash flow management will help you deal with these changes.

Insights and reports a cash flow forecast can help with.

			Mar 2017	Apr 2017	May 2017	Jun 2017	Jul 2017	Aug 2017	Sep 2017	Oct 2017	Nov 2017	Dec 2017
		11,070	14,586	15,383	20,083	19,783	24,483	29,183	28,783	33,483	38,183	37,883
0	8,288	3,150	16,547	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000
				15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000	15,000
												10,300

The insights that can be derived from a detailed cash flow forecast are extensive. Here are just a few examples:

The impact and timing of large occasional payments.

Liabilities such as VAT, Corporation Tax and quarterly rent all have the potential to draw large amounts of liquidity from a business. By planning for these with a cash flow forecast, it can be decided in advance how they are going to be paid for.

The impact of bad debts.

Some of your customers may, unfortunately, not be able to pay you at all and this has been known to drag some suppliers under. If you have large exposure to one or more customers, model a scenario in which you are not paid. Can you survive it? What can you do to minimise your reliance on this money?

The impact of price rises.

If you are enjoying good levels of demand, you might want to consider putting your prices up. This will increase your sales revenue and you can see what effect this will have on your bank balance. (Remember too, that it may increase your tax liability so this also needs factoring into your forecast). Price rises from your suppliers will have the same effect in reverse so forecasting the impact will help you decide the extent to which these need to be passed on to your customers.

The affordability of loan agreements.

Growing your business might lead to you wanting to borrow money to accelerate your ability to take the next steps.
By creating a detailed cash flow forecast and factoring in the payment amounts, you will be able to satisfy yourself and your finance provider that the repayments are affordable and that the overall effect is a positive one.

Presenting your cash flow forecast to your stakeholders.

The Senior Management Team.

The senior management team is at the sharp end of running the business on a day-to-day basis, so they are concerned about information flow and planning for the next operational cycle, be it a month or a quarter.

Now, the detail is your ally. You need to be able to present with real clarity what the expectations for cash receivables are and what significant payments are going to be made. You will need to gather key information from different people and departments to make these predictions; whether it's about expected payment dates for invoices, suppliers changing their prices or payment terms, or any predicted marketing expenditure.

The forecast will be used to evaluate how realistic plans are for the coming period; be it investment for growth or the impact proposed drawings, dividends and bonuses will have on the business.

To a significant extent, the cash flow forecast becomes the senior management team's target for the next period and its members need to be informed and empowered to achieve it.

The Board.

The needs of your board will be different to those of the senior management team. The board is likely to be interested in the budget versus the actuals because this raises questions about the systems, processes and assumptions that led to the original forecast. The affordability and timing of big-ticket investments and withdrawals from the business might also need reviewing.

Your board presentation needs to be big on the key metrics and what they are telling you, and short on lots of detail which might mask what is really going on.

Export a collapsed view of your numbers into your report so that only the top-line figures can be seen and provide an executive summary. You can always add the detail into an appendix or return later with any additional information that is asked for.

How can Float help?

Case Study: **The Marketing Eye**

Float makes scenario planning a breeze for growing marketing agency.

We have helped many businesses by adopting the approaches detailed in this guide.

Here is one such example.

Neil Edwards
Managing Director,
The Marketing Eye

The Marketing Eye.

Float makes scenario planning a breeze for growing marketing agency.

Our client is a successful marketing agency that was ready for its next phase of growth. Demand for its services was increasing and it was recognised that the current role of the Managing Director needed to be split between the day-to-day management of the business and the continued exploitation of strategic growth opportunities. More investment was needed too in the technical delivery team.

Could the business afford another managing director, or service increasing business levels?

The impact on cash flow had to be understood, quickly.

By 2016 The Marketing Eye was ready to grow, but the company's structure was hindering its efforts. It was clear that Neil, who acted as managing director, was being pulled in too many directions and that his role needed to be split. With demand for services increasing, The Marketing Eye also had to appoint more people to the technical delivery team, or risk losing out on business.

How Float helped.

The Marketing Eye's owners had used Float for about 18 months to manage their operating cash flow, after their financial controller pointed out the advantages of using Float instead of clunky, never current spreadsheets.

"...I wince now at the amount of time we spent trying to update a spreadsheet before we could be comfortable with it."

Now, the owners could model a variety of cash flow scenarios around their new appointments and investment, including what the cash position would look like if everything went to plan, but also, what would happen if sales dipped.

Unlike in their old cash flow spreadsheets, the new scenarios created in Float could be compared with the existing baseline, so they could visually see if the risk of the new investment was worth it and how soon their working capital would come under pressure.

The business case was developed over a period of several weeks, and, because the starting point of the forecast was always based on real-time information from Xero, it didn't have to be updated every time it was re-visited.

The clear visualisation of the data enabled the owners to see where the pressure points would occur and where things didn't look quite right in their forecasts, allowing them to look again at the underlying data. The result was a realistic set of forecasts that all stakeholders were satisfied with.

Neil Edwards, Managing Director said:

"Before adopting Float, we used spreadsheets, and I wince now at the amount of time we spent trying to update a spreadsheet before we could be comfortable with it.

"We have always monitored cash flow because it is crucial to running our business. We had used Float for about 18 months, but this was the first significant investment we had considered and having the ability to model different scenarios relatively quickly was invaluable. This forced us to be honest with ourselves and not allow over-optimism to get in the way of our decision making.

"When conversations were opened with our bank, it was extremely helpful to be able to insert detailed cash flow forecasts into our management information pack".

What the future holds.

The growth programme will allow The Marketing Eye to realise its full potential by taking on more work, recruiting the best marketers and extending its reach into new markets.

Neil added: "We are energised and positive about the future, but no matter how things turn out, we will always keep a close eye on cash flow. Float allows us to keep on top of our cash situation and anticipate any problems that might be ahead of us. We can then take the necessary action in a measured way".

Conclusion.

The importance of maintaining a cash flow forecast, as well as a budget, is clear. Without it, you risk limiting your ability to grow or being surprised by a shortfall.

A good cash flow forecast involves looking at historical trends and building different scenarios, such as a large invoice not getting paid, or adding to your headcount. These potential situations happen all the time, and the impacts need to be managed.

The main challenges are getting your forecast right, using the right opening balance, reconciling your forecast on a regular basis, and easily being able to export the reports you need.

A tool like Float can take away the headache of doing this all manually, since it connects with your accounting software and updates automatically each day.

The benefit to your business of getting this right can be enormous, not only saving you time day to day, but also in allowing you to anticipate problems, and enabling you to grow in line with your ambitions.

Useful blogs:

Why a cash flow forecast is important to your advisors:

http://blog.floatapp.com/why-a-cash-flow-forecast-is-important-to-your-advisors/

Further information:

CFO on call - http://cfooncall.com.au/

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