The Importance of Financial Forecasting

Why do some of us spend more time planning a vacation then we do planning the financial path of our company's. Would you leave your house on trip without first planning a route to take you to your destination?. Would you bake a cake or pie without a recipe? Do you ever start off a run or a bike ride without a distance or time decided on before you begin ?

Then why do company's start in business, or begin a year without a financial roadmap ? It is critical to know and plan for a level of revenue that will cover expenses and give you the owners the profitability they want. A Forecasted Income Statement can do this. Your profitability, your money, should not be a wish. The goal of any business is to make more money then you spend. This should not be luck, it should be part of a financial plan. Stop ending the year with less profit then you want or expect. Stop working so hard for nothing. Stop profit erosion while it is happening. Forecast your income.

If you are tired out getting collection calls from vendors or tired of worrying about meeting payroll each week, or not having the cash in hand to pay yourself, though the income statement says you are doing great; then you will understand the importance of a Forecasted Cash Flow Statement. Cash flow problems damage the workers and the owners psyche, a company's reputation, and most critically a company's ability to stay in business and make money. We grind our workers and ourselves into the ground, because we do not have a plan to pay our bills. Nothing is more frustrating then working harder and getting farther behind; and cash flow problems create this feeling of helplessness. Forecasted cash flow projections will help you identify cash flow issues before they occur.

Having a Forecasted Income Statements and Forecasted Cash Flow Projection will help you manage your money and successfully resolve any financial problems your business faces. Do not be the last to know you have a problem. Without a forecast, problems will hit you unexpectedly and cause chaos, anxiety and fear. None of us work well under these stresses. If you realize you are off course at the end of a month or year then it is too late make changes. None of us have the power to go back in time and change what may have been.

The benefits of forecasting will allow you to make moves to adjust your business when things are not going according to plan. If revenues are falling behind projections, or expenses are higher then forecasted or clients are paying slower then projected, or vendors are clamoring for payment sooner, with a road map, with a forecast you can make adjustments that will allow your business to stay in business, and meet all of its obligations and still make a profit.

Many of us have resisted forecasting with the excuse that past performance does not insure future success. Keep in mind that your customers will be working just as hard as you to keep their business at certain levels and thus you can make an educated guess, as to the levels of services or products your customers will need in the coming year. A forecast for sales or revenues has parts of past performance, and educated guess. Accept that none of us can read the future and thus forecasts are not perfect. But nevertheless they need to be predicted to the best of our ability.

Expenses follow the same path of thought that is used for revenue projections. Use the past years numbers, add new expenses you are planning to make, such as new employees, or equipment; and you have written your forecasted expenses.

Match the revenue numbers with the expense numbers and see the forecasted profit that you have left. Does it meet your expectation ? Is it enough return on your investment to justify the risk ? Are you making enough money to pay back loans you have taken to support the business ? With a forecasted income statement you can plan on making enough money to sustain your business and make more money for yourself or your staff. If you run into times where your actual business is not matching forecasts, you can see where the under or over achievement is taking place and make adjustments to keep your company viable. It is critical a business stay on a sustainable path before problems gets to big to resolve and the company flounders.

Once you have completed your forecast of projected income statement you can create a cash flow projection. This is the report that will match up the period of time it takes to collect money versus when you have to pay it out. Many if not every business has faced cash flow issues. Some of us have had great looking profitability and no cash. Cash is king and we must have it or our businesses die. Looking at how our level of revenues and expenses and the time element of how each occurs is reflected in the cash flow projection.

These Forecasted Income Statement and forecasted Cash Flow Statement should be compared to actual numbers at least once per month during the year. Some individual numbers in the Income Statement and the Cash Flow projections may have to review on a weekly or daily basis. This feedback loop is essential to checking how accurate our forecasts are. It is essential to make changes based on our actual performance. If we are underperforming because our revenues are behind forecast then we will need to reduce our expenses, or face a net loss from our business operations. If we are receiving our money slower then we projected then at some point we may run out of money. But if we see this information in near real time we can manage the situation and the money. The time to ask for help from a client or a vendor is before you are in a critical situation.

It is critical as management that we provide the environment and information for our people and our company's to succeed. Forecasting and actual financial performance should be shared with people in our organization who participate in or have an effect on these forecasts and actual performance. You do not want to divulge all financial numbers down to the net profit but you can provide key number values to stakeholders those who affect the outcome so they can work toward meeting or improving those numbers over which they have control. Visibility of the key numbers you share with team members will help you as an owner of manager control or manage the numbers better.

Determine which people can affect the numbers and which ones should be given certain numbers on a regular basis so they drive their performance to meet or exceed the forecast of those numbers. Examples of this could be to give the people responsible for

business development a goal per month and show them numbers weekly of how they stand month to date, or your projects managers billings month to date; or if your superintendents are responsible for controlling overtime then a weekly (some people prefer daily) report of man hours completed that period would allow them to make decisions about overtime before it "just happens". The same is true with updated job costing information to superintendents, foremen and project managers. If you want to make money on a project then you need a profit goal as a roadmap and map and you need to regularly check your performance versus forecast to make sure at the end you hit your profit goal.

Give people the few key performance indicating numbers that they can control and they will control them for the company. This type of control and management will help you achieve the profitability you want.

RECAP-The Importance of Financial Forecasting:

PROBLEM:

- No financial forecasting
- No forecast/roadmap for the company or its members to follow
- Poor profitability

WHAT THE PROBLEM AFFECTS

- Revenues not enough to support level of expenses
- Expenses exceed revenues
- Cash Flow problems occur
- Damages company reputation and moral
- Profitability is eroded or wiped out

HOW OWNERS OR MANAGERS CONTRIBUTE TO THE PROBLEM

- Don't make forecasts
- Tolerate lack of information or roadmap to follow
- Accept poor or less then expected profitability

SOLUTIONS THAT COULD SOLVE THE PROBLEM

- Develop financial forecasts
- Review financial forecasts versus actual numbers regularly
- Adjust financial forecasts as numbers deviate too much

IMPLEMENTATION PLAN

- Have numbers available weekly that require weekly attention like cash flow
- Present key numbers to stakeholders that effect numbers on a weekly basis
- Have regular meetings with stakeholders to review the numbers
- Set up financial statement reports to show actual versus forecast
- Have regular monthly meetings to review financial statements after month end

FEEDBACK LOOP

- At monthly meetings evaluate your actual to forecast "How are we doing ?
- Make adjustments wherever necessary to stay on target to meet or exceed our profitability goals. Changes are okay and are critical if numbers are off significantly from forecast, then changes will keep the roadmap reality based.

Related Content: See Financial Forecasting Spreadsheets Under "Forms"

Action Items to improve financial forecasting in the company:

Item: **By when**: **Team Help**

1)____

2)____

3)____

4)____

5)____

6)____

7)____

8)____

9)____

10)____