Finance Factsheet: Forecasting Cash Flow

A cash flow forecast shows how and when you expect money to go into and out of your business, usually over a period of six or 12 months, and plays an essential role in showing that your business is viable. This factsheet explains:

- How to prepare a cash flow forecast
- How to use the forecast to monitor your cash flow on an ongoing basis
- What management decisions the forecast will help you to make.

What a cash flow forecast consists of

A cash flow forecast has three main sections:

- **Receipts** - made up of cash sales, credit sales and other income (eg bank loan) -and including VAT
- **Payments** - made of categories determined by the nature of your business (eg credit purchases, wages, operating expenses, finance and taxes, capital expenditure such as office equipment)
- **Net cash flow/cash-in-hand** - total receipts minus total payments, which is calculated on a monthly basis.

At the end of each month, net cash flow is added to the opening balance to give the closing cash balance. This is the amount of cash your business has at that particular time.

Receipts	January	February	March	April	May	June
Cash sales	£3,000	£4,000	£4,500	£4,500	£5,000	£6,000
Credit sales	£5,000	£7,000	£7,500	£10,000	£10,000	£14,500
Other income	£10,000	£0	£0	£0	£0	£0
Total receipts	£18,000	£11 ,000	£12,000	£14,500	£15,000	£20,500
Payments						
Credit purchases	£1,500	£1,500	£2,000	£2,250	£2,500	£4,500
Wages	£4,000	£4,000	£4,000	£4,000	£6,000	£4,000
Operating expenses	£2,750	£3,000	£3,250	£3,500	£5,750	£9,000
Finance and tax payments	£0	£500	£500	£500	£500	£500
Capital expenditure	£1,250	£10,000	£0	£0	£1,500	£0
Total payments	£9,500	£19,000	£9,750	£10,250	£16,250	£18,000
Net cash flow	£8,500	(£8,000)	£2,250	£4,250	(£1 ,250)	£2,500
Opening cash balance	£0	£8,500	£500	£2,750	£7,000	£5,750
Closing cash balance	£8,500	£500	£2,750	£7,000	£5,750	£8,250

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A cash flow forecast

How to prepare a cash flow forecast

You need to think about the following before preparing a cash flow forecast:

- What your weekly or monthly sales will be (in the case of a start-up business, on the basis of your market research and business plan)
- What credit terms (usually 30 to 60 days) you are going to offer your customers
- The amount of capital you need to fund your day-to-day operations
- The cash cycle of your business -e.g. the gap between making payments to your suppliers and receiving payment from your customers -which determines the amount of working capital your business requires
- The four main types of costs for which your business makes payments -fixed costs (which you incur on a regular basis, regardless of the sales you make), variable costs (which vary according to sales), capital costs (which relate to the purchase of business assets, such as buildings or equipment), and government taxes (e.g. VAT, national insurance contributions and corporation tax).

The most common method for preparing a cash flow forecast is to use a spreadsheet (such as Excel or Lotus 1-2-3). Whether your forecast is for six or 12 months, once you have sorted out the above, go through the following steps:

1. Estimate your credit and cash sales (and put credit receipts in whatever month is appropriate on the basis of your credit terms).
2. Establish what other cash income (e.g. bank loan) you will receive and when.
3. Estimate the purchases you will need to make to achieve your sales forecast.
4. Estimate your regular monthly cash payments, such as salaries and operating and marketing costs.
5. Identify any likely capital costs.
6. Set out the forecast month by month.

Using the forecast

When you are starting up a business, a cash flow forecast will help you to decide:

- The size of the initial investment you need to start up your business
- What loans you may require and can afford
- What you will be able to pay yourself
- When you will be in a position to spend larger sums than usual on developing the business.

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Once your business is up and running, you need to compare your forecast cash flow with actual cash flow and produce what is called a 'variance analysis' for both receipts and payments. For each month this has four columns headed:

- Forecast
- Actual
- Variance (the difference between the two, with any actual figure that is worse than the predicted figure being shown in brackets)
- Notes (in which you give any obvious explanation of the variance).

Receipts	January	February	March	April	May
Cash sales	£3,000	£4,000	£4,500	£4,500	£5,000
Credit sales	£5,000	£7,000	£7,500	£10,000	£10,000
Other income	£10,000	£0	£0	£0	£0
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

A variance analysis may highlight the need to revise the cash flow forecast. An established business will probably need to do this every three to six months; a new business may need to do it every month.

* Based on Cobweb information: *How to forecast cash flow*

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