

A guide to financial forecasting for SMBs



Your guide to financial forecasting

Running an SMB can be all-consuming, keeping owners and managers firmly in the present. But by looking beyond today's challenges, you can carve out a path to future success.

The key to understanding your business's future lies in financial forecasts. They are a roadmap for success, setting out where decision-makers wish to take the business and the milestones that must be reached along the way.

Not all SMB owners or managers are financial gurus. This ebook is therefore an easy-to-understand, step-by-step guide to help you develop and use reliable financial forecasts for your small business.



Chapter 1:

Defining financial success

An SMB may define 'financial success' in several ways. For some, this means more wealth, while for others it simply means less debt.

As an SMB owner, financial success could just mean keeping your head above water. A recent [productivity report by Bankwest](#) found that around 32% of small businesses and 43% of medium-sized businesses were concerned about managing cash flow.

The *Atradius Payment Practices Barometer Australia 2016* further highlights the issue, with around one-quarter of suppliers surveyed stating that maintaining adequate cash flow was the greatest threat to business profitability last year.



However you define it, financial success will always be tied to your business's foundations – that is, revenue and expenses. If cash flow turns negative, an SMB's outlook can quickly turn negative. If operating costs grow unsustainably, an SMB's prospects for growth may be short-lived.

Control your foundation and you'll be better placed to control your future.

A photograph of a man and a woman sitting at a table, looking down at a document. The man is on the left, wearing a blue denim shirt, and the woman is on the right, wearing a grey top. They are both focused on the document. The background is blurred, showing what appears to be a cafe or office setting. A yellow line graphic starts from the top left, curves around the text, and then forms a bracket-like shape around the word 'Control' and the phrase 'your foundation'.

Control

your foundation

Chapter 2:

Why your SMB needs financial forecasting

You may be familiar with the issue of having 'too much month at the end of the money'. The solution? Intervene earlier. Financial forecasting lets you anticipate financial challenges, including rising costs, well before they stymie business growth.

Think about it this way. Most SMBs only consider their financial performance at the end of every financial year. But what if you could evaluate your financial position, using past trends to predict and analyse future performance, and put in place proactive measures to head off any challenges?

This is the power of financial forecasting. It allows SMBs to take advantage of opportunities as they arise and not look back on what might have been.

Luke Brown, a Chartered Management Accountant at Busy Beans Accounting, says the main benefit of financial forecasting is allowing SMBs to understand how to improve in the future.

"Financial forecasting is important because many small businesses want to grow but don't have a structured plan to guide them,"

– Luke Brown,
Chartered Management Accountant,
Busy Beans Accounting

Luke explains that "the key to [financial forecasting's] success is that it bridges the gap in small steps that are both manageable and measurable".

"Financial forecasting is important because many small businesses want to grow but don't have a structured plan to guide them," he says. "This leads to short-term decision-making that is not aligned to a long-term strategy."

In essence, the financial forecast acts as a roadmap for future growth, setting out the long-term business ambitions into short-term actions or targets based on past and expected financial performance.



Chapter 3:

A step-by-step guide to creating a financial forecast

This chapter will provide some suggestions on how you can create reliable financial forecasts. However, it may be worthwhile to consult with an experienced accountant as part of the process.



6 simple steps:



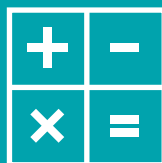
> Step one: **Get organised**

Gather all your past and current financial information, including financial reports like your income and cash flow statements, balance sheet, and profit and loss statement.



> Step two: **Budget for your fixed expenses**

Create a projected expense budget for all your fixed costs, including rent, utilities, salaries, and advertising and marketing expenses.



> Step three: **Forecast sales**

Using past sales, estimate monthly sales for the next year. Work out the average revenue expected from each sale to calculate the total. Allocate resources, adjust expenses to cover the cost of goods sold (COGS) or devise your sales strategies.



> Step four: **Consider variable costs**

Consider fluctuations in costs relating to sales – for example, increased sales lead to increased production and supply costs. Using your sales forecast, reconcile your expense projections to account for sales fluctuations.



> Step five: **Forecast cash flow**

A cash flow forecast measures cash flowing in and out of a business, and shows how profit and expenses are affected by cash surpluses or shortages. This helps you spot issues affecting whether you can pay your debts on time, or determine whether you can hire extra staff to keep up with projected demand.



> Step six: **Monitor financial performance**

Regularly compare financial forecasts with real-world performance using data and information from financial reports. Use these to guide future projections.

Using the rough guide above, consider your likely revenue and spending for the next six to 12 months. How does the forecast hold up? Are you likely to dip into the red? Are there seasonal or economic factors you need to consider? Take note of any influencing factors and reassess your forecast on a monthly or quarterly basis.

A note on assumptions



Business-as-usual scenario:

This conservative view assumes that things will happen as planned or within an expected range, and is usually the scenario most aligned to past performance.



Best-case scenario:

This scenario shows the effects of your achieved short-term targets or goals. Creating an optimistic forecast encourages you to think big about your future ambitions.



Worst-case scenario:

This scenario provides a glimpse into your business operations should things go wrong, forcing you to think about contingency plans so you're not blindsided if it happens.

Chapter 4:

Choosing your tools

SMB owners and managers can use plenty of tools to measure current financial performance and predict what it'll look like in the future. More experienced financial managers and those a little savvier at Microsoft Excel will benefit the most from using spreadsheets, which offer infinite customisations at a relatively low cost.

Alternatively, cloud-based accounting software automates a number of complex processes and calculations for those who are less experienced. For example, tools such as Xero, QuickBooks Online, MYOB Essentials and Reckon One allow for easy monitoring of sales and expense figures, and typically feature solutions to build robust financial forecasts.

There are pros and cons to each approach. Consider the nature of your SMB and your level of financial expertise before selecting a solution.



Software vs spreadsheets:

The **pros** and **cons**



Accounting software **pros**

- ✓ Tracks income and expenses to easily determine future profitability over a given period
- ✓ Typically features add-on solutions to build detailed financial forecasts
- ✓ Secures data with automated backups

Accounting software **cons**

- ✗ Generates reports that are either too simplistic or too advanced, depending on the software and the user
- ✗ Requires monthly subscription fee and possible costs for technical support, upgrades and add-on features
- ✗ May need future software or equipment upgrades to support the latest versions



Excel spreadsheet **pros**

- ✓ Allows for infinite customisations to suit your business's projected profit, revenue or expenses
- ✓ Handles complicated variables and assumptions
- ✓ Available as a single purchase with subscription options

Excel spreadsheet **cons**

- ✗ Relies on manual data entry
- ✗ Involves risk of human error
- ✗ Calls for spreadsheet planning, manipulation and presentation skills

Chapter 5:

Overcoming obstacles

In business, the path to success is rarely a straight line. When creating or reviewing financial forecasts, SMB owners and managers may encounter a range of challenges. This could be predicted shortfalls in cash flow or unexpected changes to the economy, regulations or consumer demand.

The key is to remain nimble and responsive, reforecasting to adapt to the change or risk.



Reforecasting helps you answer the following questions:

- How is the business currently performing against the plan?
- How will the change affect the plan?
- How should the plan be adapted as a result?

Ask

yourself



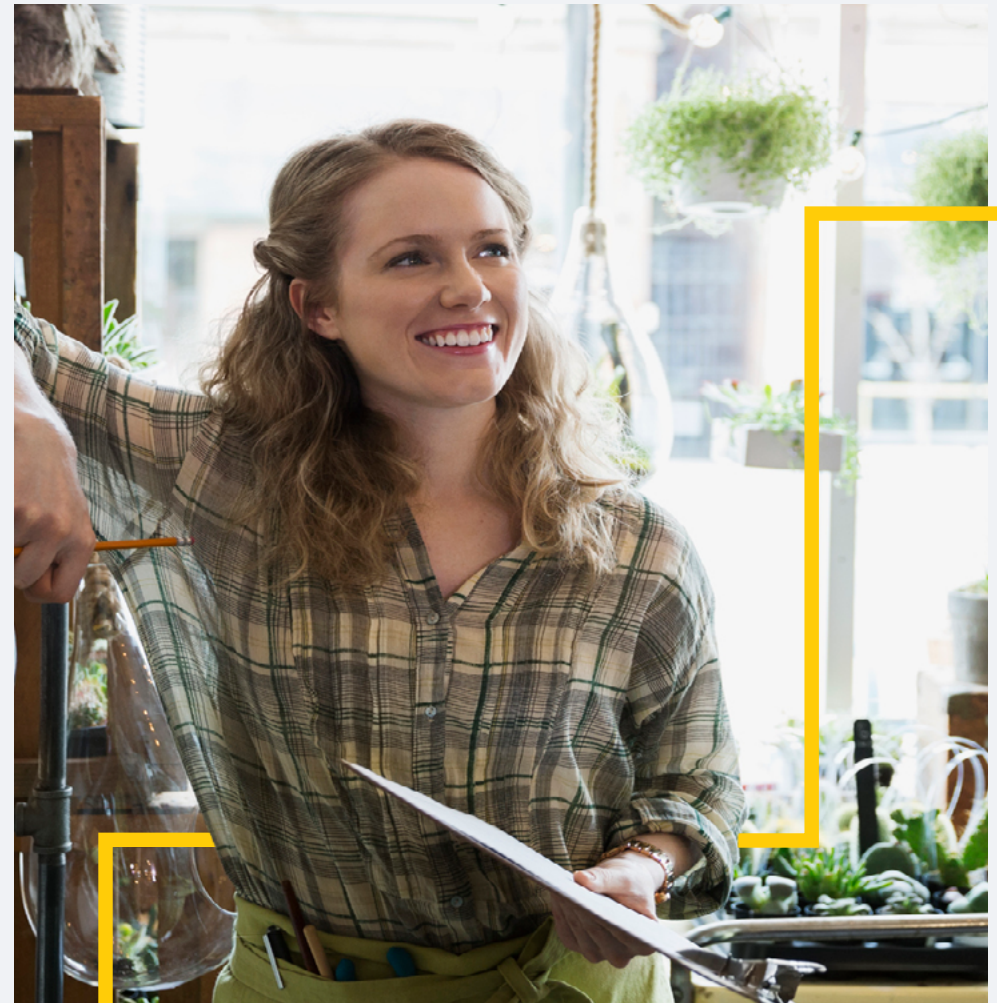
Chapter 6:

Monitoring your current financial performance

Forecasting your financial performance is clearly an important practice for determining future success. But don't get too bogged down looking forward or you might miss out on how you're performing right now.

Keep an eye on financial reports that shine a light on your current performance and use these to guide your future projections. Specifically, monitor key financial statements, such as your income and cash flow statements, as well as your balance sheet. Set up an accounting system that allows you to easily produce these reports at regular intervals.

It may also be valuable to expand your reporting arrangements to include metrics such as current ratio (whether current assets cover current liabilities) and gross profit margin (the proportion of money left over from revenue after accounting for COGS).



Turning financial forecasts into financial success

Financial forecasts are a crucial tool for SMBs. A reliable financial forecast offers a yardstick for success, giving you a roadmap to drive your company toward a brighter financial future.

Today, effective financial forecasting doesn't require financial wizardry. SMB owners can access tools that automate forecasting and reporting functions. This means you can focus on the insights from the reports, rather than how to produce them.

A key point is that financial forecasting is not a set-and-forget function. It's a dynamic process that delivers the most promising results when using the most up-to-date information. So make sure you continually monitor and update projections as business and economic conditions evolve.

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