CHAPTER 7

CASH PLANNING AND FORECASTING

CASH IS KING! The life blood of any business is its ability to collect cash and pay bills as well as pay its employees, particularly its owners. Far too often small businesses are profitable, but they do not have enough operating capital to meet their current needs. Consequently, they may be forced to sell out to a stronger competitor, sell a portion of the company to investors at an undesirable price or close the doors, and put the company out of business. None of these alternatives are typically what the owners intended when starting the business.

The ability to forecast cash resources and uses is an art and is by no means a well defined science. None of us have a crystal ball and any cash forecast which is prepared by the management of a company or an outside consultant can be no more than a guess as to when the customers will pay and when your business will pay its obligations. Hopefully, the more effort that is put into cash forecasting the better will be the educated guess and the more accurate the resultant picture of the future operations of your business.

Starting the Analysis

One of the most significant factors to be considered in your cash flow forecast is the volume of sales which will be generated in the next several months and for the rest of the period for which you intend to forecast. Your sales forecast must be as fine tuned as possible. It is typically unrealistic to assume that there is a million dollar market for your product in your area and you will be able to capture a specified percent of it. A sales forecast needs to be based upon specific facts. These might include your sales history or the history of similar businesses you have owned or operated or the competition. In your area of industry, what has been the experience of similar operations?

Some of the questions which should be addressed would include what other factions can I control such as adding new product lines, deleting unprofitable operations, adding a new salesperson, or terminating one that is not producing to quota? In preparing a forecast, you must also take into consideration items such as the seasonality of your business, the relative state of the economy, and the period over which you forecast.

Obviously your ability to forecast sales for the next month is better than it is to forecast three to five years from now. The amount of detail which must be included in the cash forecast is really a matter of preference. It can be based on per-unit sales extended out by the sales price of each type of unit or an average sales volume per day, week or month of your type of business in its current environment.

Cash Collections

Once you have determined a reasonable level of sales and you are comfortable with the forecast you have made, you must address questions such as: what percentage of my sales are received in cash, and what portion are credit sales for which I will have to carry accounts receivable? For those that are receivable based, how soon is the cash collected? Do I have to wait for customers to pay me or do third parties such as Visa or Mastercard take the customers account and convert it to cash for me with an appropriate discount?

If you are relying on customer payments for collection of receivables you must determine what portion of the receivables will be collected in thirty days, sixty days, ninety days, and thereafter, and what portion, if any, may never be collected. To assume that 100% of your sales will ultimately be converted to cash is probably unrealistic especially considering the economic environment and the tight cash situations that may face some of your customers.

Other sources of cash may be available in addition to sales. Do you expect to bring in a partner or other investors, or can you borrow money from a bank? When will you receive the cash and how much will you get? Part of your cash flow analysis may be to determine how much investment money or borrowings will be required to operate your business.

Once you are comfortable with the cash receipt side of your business, and the timing of the collections of funds from your sales and other sources, it is necessary to consider the expenses and other cash needs of your business operation.

Disbursements

Certainly if your business entails sales of inventory you will have to purchase the merchandise from others or purchase the component parts and pay employees to assemble it. This may require a significant outlay of cash before the first dollar of sales is generated and received. You should consider how often and in what amount your employees must be paid and when their payroll taxes must be deposited.

Additionally, you need to know the credit trade terms your vendors are willing to advance to you. Do you have to pay for inventory items on a COD basis or can you pay for them thirty or forty-five days after receipt?

What expenses must be paid to allow you to convert purchased merchandise to salable inventory? If your production cycle requires utilities to run machines, supplies such as dispensable chemicals and/or packing materials that must be purchased prior to the sale of the inventory, you should factor in the timing of the payment.

In addition to the cost of manufacturing, you should consider whether your productive capacity will allow you to generate enough inventory to support the level of sales which you are predicting. If the volume of sales you forecast is above and beyond your ability to produce today, what changes in your operating environment must be made to meet the production levels. Will you need additional employees, if so, how much will they cost? Do you have to acquire additional machinery for your shop operations? What is the cost of the machinery and when will you have to pay for it?

Once you have determined the cost of operating your production or service facilities, you need to consider what other expenses you must pay to keep the doors of your business open. You typically will have to pay rent for your office or manufacturing facility. You must consider how much the monthly payment is and when it has to be paid. Ask yourself if there will be other cash requirements such as a deposit on first and last month’s rent. If you are opening a new business, you must consider how much cash is required to make your facility ready for your specific needs and purposes. Will you have to buy or rent furniture? Will you need to make tenant improvements or pay deposits for utilities and other services?

You also need to consider many of the overhead items and costs to open a new business that will hopefully be one time expenses. This may be attorney’s fees for drafting partnership agreements or incorporating your business, the cost to obtain business licenses, authorization from the taxing authorities, setting up an accounting system, stationery costs, and costs of signs or logos.

It may seem like the list of costs and expenses to be incurred is endless. It may even discourage you from moving forward with your business endeavor. However, it is imperative to make the list as detailed as possible to ensure that you have sufficient funds to make your operation ready for business prior to running out of cash. The more detailed the list and the more information you can provide, the less chance there is of unpleasant surprises as you move down the stream to opening your business.

In addition to determining the amount and volume of expenses and cash outlays you will have to make, it is critical to determine the timing of such payments.

As we have discussed in other chapters, there may be a variety of financing alternatives which are available to you. Most of the start-up costs which you incur can be delayed or deferred until you can generate the cash from your operation to help pay them. This needs to be carefully analyzed and factored into your cash flow analysis. However, a good rule of thumb is to assume that you are going to have to pay your expenses sooner than you think and that you will collect your cash slower than you anticipate. If you work with this attitude, any surprises should be favorable ones.

Cash flow projections can be very slow, time consuming, and tedious to undertake. It is often very tempting to hire someone else to prepare the projections for you. There are a variety of individuals who can help you do this, but the critical factor is that they only **help**. You as the owner and operator of the business are the only one truly qualified to develop your cash flow projections. You know what it takes to open and operate your business. Certainly a trained professional can offer guidance and ask pointed questions to be sure you are considering all of the necessary and sometimes hidden costs of operating a business. However, the more effort you put into developing the cash flow projections the more accurate they will tend to be. This exercise may also help you to pin-point areas of potential cash savings which you had not otherwise considered.

We have included a worksheet following this chapter which may assist you in developing a cash flow analysis. Bear in mind however, this worksheet does not include all the items that should be considered in preparing **your** cash flow analysis but should help raise many of the questions which you need to ask yourself before deciding how much cash will be required to establish and operate your business and what period of time must elapse before you can expect to pay back the lender or return profits to your investors.

PROJECTED STATEMENT OF CASH FLOW
(for one year)

	Projected Quarter Ending			
	1st	2nd	3rd	4th
Net income				
Add (deduct) items not requiring cash:				
Depreciation				
Net Cash Provided				
Increase (decrease) in cash from:				
Accounts receivable				
Inventory				
Property and equipment				
Accounts payable				
Accrued income taxes				
Capital stock				
Increase (decrease) in cash				
Net change in cash				
Cash beginning of period				
Cash end of period				