CASH FLOW FORECAST = THE MOST IMPORTANT TOOL IN BUSINESS

When you are buying or operating a business the single most important tool you can have to manage your finances is a cash flow forecast (CFF). It should be used when conducting your due diligence to decide whether a business opportunity is right for you and it should be used while operating your business. The reasons behind each use are different but equally significant.

But what is a cash flow?

Cash flow is literally the flow of cash into and out of your business. Picture it as your business bank account and the money that gets deposited into this account and taken out of the account. A CFF is when you project 'cash in' and 'cash out' of your business in future (generally) months. Cash flows are generally laid out in an excel spreadsheet.

Cash flow is not profit – that's a different concept altogether.

Key components of a cash flow

There are 3 parts to a cash flow:

1 - Revenue

Your cash flow forecast needs to capture all sources of revenue into your business. You can make this section as detailed or as simple as you like.You may choose to capture all sources of revenue as one item or you may prefer to split it up. For example, if you operate a café you may want to be able to track revenue for food and drinks separately. You may wish to do a further breakdown of drinks into hot drinks, bottled drinks, alcohol, other. There is no right or wrong with this – you decide what you'd like to measure.

2 - Expenses

In this section you would capture 2 areas of costs: set up costs and operating costs. Set up costs are cost that you incur when you first enter a business such as fitout, equipment purchase, induction training, legal advice, the purchase price and so on. Operating costs are costs you incur to run the business ongoing such as rent, staff, insurance, coffee beans, food ingredients and so on.
You capture these costs in the period they fall due. For example BAS (Business Activity Statement: helps you report and pay your GST and other taxes to the Australian Tax Office) is paid quarterly so you enter it into the months of the year it falls due.
All expenses should be included no matter how big or small – lots of small expenses can add up.
One item many business owners forget to account for is the salary they will need to pay themselves to cover costs at home.

3 - Closing Cash Position

Once you have completed revenue and expenses for each period (month) you will get a closing cash position. Firstly you will have a figure that tells you how much of a deficit or surplus you have for that particular month and then you will have an accrual figure. For example if in February your revenue was $5000 and your expenses were $3000 then for the month of February you will have a surplus of $2000. However if you started your business in January and in January you has a deficit of $1000 then have accrued a surplus is $1000. The accrual figure should match what is physically in your bank account.

When to use a CFF

Earlier I mentioned there are 2 key uses for a CFF:

1 - When conducting due diligence to determine whether you should buy a business

A CFF during due diligence will give you these key figures:

- Your capital requirement, that is how much money you need to invest in the business until it generates sufficient revenue to cover all cost
- When breakeven is likely to occur, that is how long it will take for business revenue to cover business costs
- Pay back period, that it how long it will take you to pay yourself back the amount you needed to invest to commence the business

When purchasing a business you should have a CFF where you forecast 3 - 5 years and often for the initial term of your franchise agreement.

2 - When operating your business

When operating a business you should have a CFF for at least the next 12 months. Once you are operating your business you should revisit your cash flow each month and update projects for the prior month to actuals. This then makes your CFF a living tool to track your performance against plan, to make adjustments to future months and to make strategic or operational changes in your business based on what your cash flow is telling you. You can foresee tough times and good times. You can plan and act accordingly.

Your cash flow should be completed after you have completed a business plan. The reason for this is that the business plan outlines how you will run your business and this then determines revenue and costs. The CFF is where you then determine the financial impact of the business plan. Engage your Virtual CFO or accountant in this process.

Running a business is fun but it is also stressful. Good planning (strategic and financial) helps reduce stress by placing you in an informed position.

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