The importance of cashflow forecasting

While a strong cash flow is rightly perceived to be a positive attribute of a business, it appears that some businesses do not place as much importance on cash flow as they really could.

Traditional accounting reports focus on the profit and loss and balance sheet, which are very important to gauge the ongoing profitability and current financial position of the business; however, in themselves they do not identify the sources and application of cashflow in the business.

A cashflow includes the cashflows from operations, being receipts from customers, payments to suppliers and employees along with tax payments, investing activities which include purchases and sales of fixed assets, financing activities which include, loan repayment and drawdowns, advances from and to shareholders and dividends. Knowing the application of cash for business owners can be eye opening.

A profitable business can have cashflow challenges for a number of reasons, including timing of receipts from customers, payment to suppliers, build-up of stock, impact of seasonal trading, timing of purchase of fixed assets, loan repayments above what the business can carry and excessive drawings.

In particular, when a business is fast growing, developing new products or entering new markets, additional cash will be needed for upscaling operations before future cash will be received from customers. This cash can be funded through loan drawdowns, shareholders advances or issue of share capital.

As part of planning new ventures, businesses must first predict the ongoing income and expenditure and assets and liabilities. This is done through a budgeted profit and loss and balance sheet. Next they need to determine the timing when funds will be generated and applied from and to various activities; these assumptions drive which month the balance sheet is affected and flow on to a cashflow forecast. A budgeted profit and loss, balance sheet and cashflow forecast should be presented by month over a minimum one-year period.

A cashflow forecast assists in identifying potential shortfalls in cash at particular months in the future. This allows management to manage cashflow through purchase decisions, ie running lower stock, working with suppliers, getting bank support, ie a short-term overdraft or restructuring term debt, deferring purchasing fixed assets, deferring dividends or drawings.

Planning ahead through the use of a cashflow forecast supports management in making informed decisions with the benefit of time to discuss options with their board and if needed their bank. It also allows time to develop a plan B rather than the unexpected and usually costly position of arriving at a cash shortfall without warning.

There are many advantages to working closely with your business banker. Regularly sharing management reporting, including cashflow forecasting, means a no-surprise approach and allows appropriate time to set up overdraft facilities or long-term debt drawdowns. Banks may be able to negotiate better rates for businesses with excellent reporting, therefore reducing cost of funding and increasing available cash. Likewise, by only drawing down debt when required, businesses can save on interest costs.

So how do you prepare a cashflow forecast? There are many tools available in the market: the most commonly used is excel. A cashflow forecast model prepared in excel can be very robust, include assumptions and scenario analysis and forecast cashflows for an extended term.

This kind of forecast model will require someone with experience to create it to ensure it works correctly and is tailored specially for your business. Excel can also be used for smaller, less-complex models. These models only scratch the surface, but can suffice for established businesses with lower cash dependency or can be the first place to begin for businesses new to cash flow forecasting.

Other off the shelf tools include Futrli, float and PwC Cashflow coach. These apps connect with your accounting software Xero and report on real time data. PwC Cashflow coach uses predictive technology to assume future cash in and outflows based on past transactions for a 12 week period. Futrli provides past cashflow reporting and future cashflow forecasting for up to 10 years. It uses both financial and non-financial data to produce graphs and charts for your reporting pack. Float has the ability to scenario plan and compare to current cashflow forecast. The time spent by your finance/accounting team preparing a cashflow forecast is worth its weight in gold (or cash).

Cashflow forecast supports businesses in various stages of their lifecycle and is a powerful tool in support of making informed decisions in driving future sustainable growth and profit to increase the overall value of the business. Finding the right tool to help your business forecast future cashflow is as important as finding your trusted business advisor.

The comments in this article of a general nature and should not be relied on for specific cases. Taxpayers should seek specific advice.

TAXATION AND THE LAW

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BUSINESS TIME

"Fail Forward"


Tony Begbie

Last week I attended Unfiltered Live https://unfilteredlive.co.nz "Fail Forward" in Auckland, with 1000 other people (including various business owners from the Waikato). We had all invested our time there, to hear from twenty plus (Kiwi & Global) Entrepreneurs, Business & Sports achievers, about what they'd experienced & learnt from failure on their success journeys.

The overarching themes were, failures are an essential part of greater business success & failure is a far greater teacher, than achievement. Each attendee, like myself, would have resonated with different individual speakers & come away with different personal learning points. However the true measure of the ongoing impact, is what do we actually go away with & take action on implementing, in our personal & business lives.

The importance about making time in your (often over full) business schedule to attend events, workshops & courses like this is:

- As per Stephen Covey's seven habits of highly successful people, the last is critical; make time to sharpen the saw.
- You take yourself operationally & mentally away for a period, from the day to day business as usual environment.
- You get exposed to the experiences, ideas, strategies & inspiration of others in different businesses & sectors.
- You get to associate & network with other business leaders focused on improving their personal & business performance.
- You often get time to travel to & from with your spouse, business partners and/or business friends.

As we deal with the winter month's weather, changing economic conditions, & moving into the second quarter of 2019/20 financial year, I challenge you all to review what have you, or what are you planning to do this year, to invest in further developing yourself & your business. There are many options available (locally & nationally); Waikato Chamber of Commerce, Soda Inc, Export Institute, EMA, Institute of Directors, the Icehouse, Property Council, Wintec & University of Waikato.