

Financial forecasting



Introduction

Financial forecasting is a crucial tool for start-ups, and growing businesses providing a roadmap for future growth and financial health. It helps founders and investors understand potential revenue streams, expenses, and funding needs.

Why is having a forecast important?

Having a financial forecast is an essential part of your business's plan. In particular:

- **Funding:** Without a forecast you won't know how much funding you'll need, and are unlikely to convince lenders or investors to partner with you
- **Budgeting:** forecasts enable you to manage your costs effectively and prioritise your spend
- **Strategic Planning:** having a forecast will inform your broader business decisions about growth opportunities and potential challenges.

Key components of a financial forecast

Revenue Projections

Estimate of future sales based on market analysis, existing orders, and historical data. Include best, worst, and most likely scenarios to cover various possibilities.

Expense Budget

List all expected expenses, categorised into fixed (rent, salaries) and variable (materials, marketing) costs. Consider initial start-up costs and ongoing operational expenses.

Cash Flow Forecast

A monthly plan that shows how cash is expected to flow in and out of your business. Important for identifying potential cash shortfalls and planning for contingencies.

Profit and Loss Statement

An estimate of income and expenses over a specific period, showing net profit or loss. Helps in understanding the operational effectiveness of the business.

Break-Even Analysis

Determines the point at which the business will be profitable. Essential for understanding the viability and sustainability of the business model.

How to Build Your Forecast

Start with Sales Forecasting

Begin by estimating how much you expect to sell over a certain period. This will be based on market research, industry benchmarks, and any pre-existing orders or contracts.

Estimate Direct Costs

Calculate the costs directly associated with producing your product or service, such as materials and labour. These costs usually vary with the level of production.

Project Operating Expenses

Outline all the operational expenses required to run your business, from rent and utilities to marketing and salaries. This should include both fixed and variable costs.

Incorporate Asset Purchases

Include anticipated capital expenditures like equipment and software that will affect your cash flow.

Develop Cash Flow Projections

Using the above estimates, project your monthly cash inflows and outflows to understand your working capital needs and identify any funding gaps.

Calculate Break-Even Point

Determine how much revenue your start-up needs to generate to cover all expenses. This analysis is critical for assessing when your start-up might start generating profit.

Consider Different Scenarios

Develop multiple scenarios (optimistic, pessimistic, realistic) to understand how changes in market conditions or business operations could impact your financial health.

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Best Practices for Financial Forecasting

Regular Updates

Revisit and update your forecasts regularly as new financial data becomes available and as market conditions change.

Conservative Estimates

Be realistic about projections, especially concerning revenue. It's better to under-promise and over-deliver.

Don't forget tax

Corporation Tax, National Insurance and Income Tax could be your single largest costs, and yet they're commonly forgotten in forecasts. Remember to add them!

Professional Advice

Consider consulting with financial experts or accountants who can provide insights and help refine your forecasts.

Conclusion

Financial forecasting is not just about predicting future results but about preparing your business to meet those challenges and opportunities effectively. With careful planning and regular review, forecasts can guide your business towards sustained growth and success.

Parry & Parry regularly helps clients map out their route to financial success. Contact us at hello@parryandparry.co.uk if you'd like to discuss how we can support you.

