Forecasting Profit and Loss and Cash Flow

When I am working with a SCORE business CEO and also teaching SCORE classes, I stress the importance of “knowing your business numbers”. This is vital for a new or existing business because this process helps you predict the cost of your products or services, the amount of sales revenue, and the profit you can anticipate. If your business is not already off the ground, financial forecasting will explain/determine how much you'll have to invest or borrow.

I started this discussion with one of three common techniques in last week’s column, the Break-Even Analysis. Now, I will discuss the other two.

**The Profit and Loss (P&L) Forecast:** This is really the next step after the Break-Even Analysis. This is where you refine the sales and expense estimates that you used for your break-even analysis, into a formal, month-by-month projection of your business's profit for one or two years of operation. It's basically a spreadsheet that details your expected expenses and revenue on a month-by-month basis. For example, you plug in estimates of monthly revenue and of expenses like phone service, depreciation, shipping, and other expenses. I happen to be a strong advocate of forecasting dollars for all line items but also including the percentage each one is of the Gross Sales/Revenue line which is always 100. It is a very good management tool as it allows for a very quick assessment of the relationship between your “forecast numbers” to your “actual results” when reviewing any P&L statement. Percentages keep one focused whereas fluctuation of dollar numbers can lead to misleading and confusing conclusions.

**Cash Flow Projection:** This forecast focuses on day-to-day operations and tries to help you predict whether you can survive those in-between times when you must pay bills but there is no revenue. For example, the cash flow for the first few months of a business is often negative. In order to survive, you may need to borrow money during that period. Cash flow projections are useful for every business, but they're particularly helpful if you have not yet opened.

To make your cash flow projection you'll have to prepare a spending plan, setting out items your business needs to buy, and expenses you will need to pay. You then feed these numbers, along with information from your profit and loss forecast, into a spreadsheet. You'll need to determine and add in details such as whether you will be making credit sales and how much time is granted—for example, you grant 90 days to pay a bill (Net 90) on your invoices. That helps determine when you can expect payments.
Forecasting your business numbers is very helpful. Start with your break-even analysis, continue to the profit and loss forecast, and finish the process with your cash flow projection. Your local SCORE Mentors can help you access templates to use for this analysis. You may also want to ask them about a business planning tool that helps you do these forecasts as a part of the business plan and then has the option to import data from your business QuickBooks to update and compare your plan to your actual results.

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