

How Financial Forecasting Adds Value – Business Plus+ Newsletter

ESS BIZTOOLS' Business Plus+ newsletter is prepared on a monthly basis, for subscribers to badge with their own name and send to the SME clients and prospects.

One of the articles from our recent edition of Business Plus+, **"How Financial Forecasting Adds Value"**, is available for you to use ([see below](#)). You're most welcome to utilise this article for your firm.

How Financial Forecasting Adds Value

Running a business is not a rerun of history. It is all about going into uncharted waters and creating a business that supplies services that their customers want, creates worthwhile employment for the team and earns a reasonable return on investment for the owners.

The problem with all this is that not enough attention is given to "charting how that future will emerge."

If you are going to build a new house, you would normally engage an architect to prepare a sketch of the type of house that could be built on your land and, after you have examined this, you would indicate whether the sketch drawings reflect what you are hoping to achieve. You would then commission the architect to prepare the detailed plans, followed by appointing of a builder who will be entrusted with the task of creating the architect's impression.

This is basically the same as the Financial Forecasting process.



The business' Leadership Team sketches out their thoughts on what might happen over the next few years.

Where they would like to expand to?

Research and Development to develop a new product or process they would like to undertake?

Where will they produce the products or services that they are planning?

How will they finance the operations?

If they are planning to borrow money, have they thought about the security that the lender will require?

Alternatively, the Leadership Team may have nominated share capital raising – does the business meet eligibility requirements?

The unfortunate reality is that not every business does this and, in many cases, this is where the process ends – why?

When you decide to build a house, most of us would normally need to engage the services of an architect. The architect will interpret your sketch into a building that meets your specifications for the type of house you need, fits within your budget and conforms to all local government requirements.

This process breaks down primarily for two reasons when it comes to a business.

In the first case

The business does not realise that their accountant can offer these types of services, to act as the “Financial Storyteller” to interpret the vision that the Leadership Team have developed, then document that vision into a workable series of documents comprising:

- ✚ Budgets for each individual business unit within the business, with Key Performance Indicators (KPIs) for each business unit that enables comparison to previous years KPIs and to benchmark against other similar businesses
- ✚ Key driver subaccounts relating to the forecast position for:
 - Inventory of raw material
 - Labour manning requirements
 - Stock of completed products
 - Debtors
 - Creditors
 - Capital expenditure
 - Research and Development projects
 - Expansion activities
 - Marketing and endorsement programs
- ✚ Cash Flow Forecast for the business; highlighting any forecast cash flow problems in the future so that strategies could be implemented beforehand to try to overcome that problem
- ✚ Projected Balance Sheet; which examines what the business will look like in a number of years’ time.

The Projected Balance Sheet is a very important document because it is able to illustrate in a few pages what the results will be of decisions being made now in three, four or five years’ time.

This entire process would have been extremely valuable to the Leadership Team of that business, because it gives them the ability to formulate changes if necessary. It also gives them the assurance that, as long as they can implement the plans, they have a very good idea of what the end result will look like.

In the second case

Accountants have not successfully articulated to their clients that they are able to perform a virtual CFO role and be the “architect” to document the Leadership Team’s vision into a set of Financial Forecasts that can be utilised to guide the Leadership Team and the entire business team in their day-to-day operations, because the vision has already been documented.

This approach is a significant improvement to what most SMEs currently do and that is virtually operate their day-to-day activities, without the benefit of a written document that has been signed off by the Leadership Team and Board of Directors or the business owners.

The discipline of preparing Financial Forecasts ensures that future problems are unearthed and researched long before the problem actually emerges, so that a remedial solution is available or the funding process has been organised long before the funding problem actually emerges.

This whole process, known as “Predictive Accounting”, is all linked – undertaking only one part is unsatisfactory, because there could be a problem that would have been identified in another part. However if a shortcut has been adopted, the other part and its associated problem will not have been revealed.

If you are interested in the preparation of Financial Forecasts using the 3 in 1 process that is now required by Banks, please make an appointment for a discussion with the Accountant in our firm that you normally deal with.