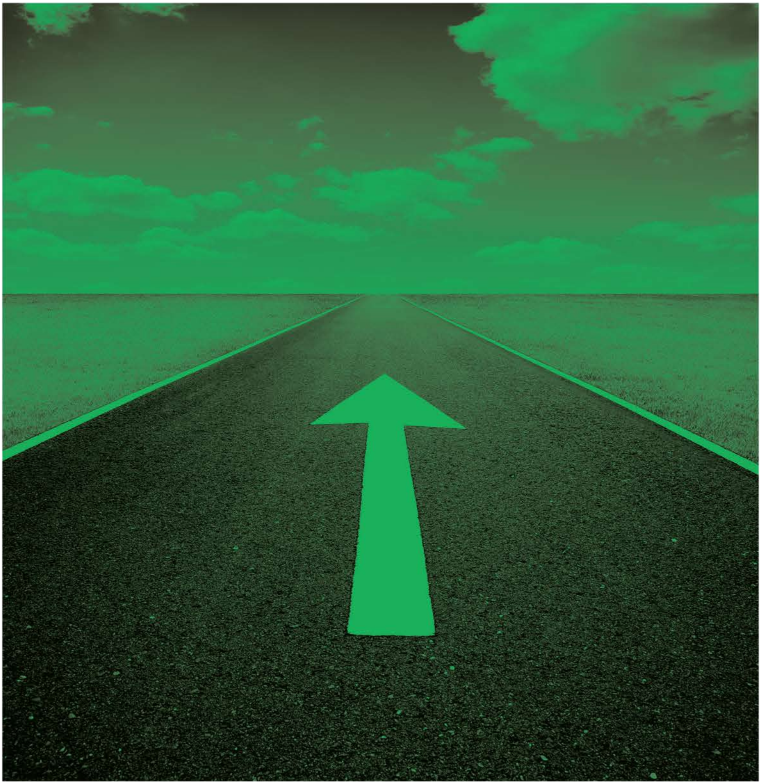
THE AUTHORITY GUIDE TO FINANCIAL FORECASTING FOR SMEs



Pain-free financials for finance and planning

SIMON THOMPSON

“

Getting to a final, finished version of your forecast can be like getting kittens in a box. You’re bound to cycle through it many times and a clear, comprehensive process is key. (At least start by knowing how many kittens you’ve got…)

”

Why do we forecast?

Start with the end in mind…

It has to be said that if you're concerned with working out the best way to do something, it helps to be clear about why you're doing it in the first place; to understand what your objectives are.

We forecast in business for a mix of two reasons.

1. To *understand*. It's from a desire to understand the potential financial outcome of our business, based on the various different assumptions we may make. In essence to run the numbers; to see if the plan 'stacks'; to quantify our goals. We do it for *us*.
2. To *communicate*. We do it to communicate our financials to someone else – usually a lender or investor because we want some money from them. We do it for *them*.

In an ideal world the first precedes the second. We would always want to understand our own numbers; to know that they stack, even if we weren't after money. But in fact it's often the other way round. What causes a forecast to be built is usually an impending finance application: most often we build a forecast because we have to.

All the advice in this book is focused on these two objectives: what factors contribute to our *understanding* or our ability to *communicate* what the recipient wants to know? How well it does these two things is the only measure of a good forecasting process.

The eight essential benchmarks of all good forecasts

Financial forecasts come in all shapes and sizes. Like most jobs, all are achieved through a combination of knowledge, skills and experience, and some kind of a tool for the job.

I can tell you from experience that good forecasts will tend to share a clear set of common qualities and benchmarks. However you finally go about this task, the more of these you can achieve, the easier your life is going to be, the better the result and the more likely you are to meet your real objectives.

What's more, the odd thing about these benchmarks is that they are barely more expensive to include than to omit, and the ones that take a little more time in the short run will generally save time in the long run. They are mostly the application of common sense, and the trick is *be aware* of them. Tools and techniques to achieve them are readily available if you know what you're looking for.

Keep these benchmarks in mind when you go about your forecast!

The conventional accounting structure: profit and loss, cash flow *and* balance sheet

We've already covered this, but it bears repeating. Double-entry bookkeeping, on which these concepts are based, has been around since the 15th century. We still use it for a simple reason: it works! It is the foundation of professional business finance and it's no different because your business is small or a start-up. You need to understand it, not reinvent or ignore it.

Try not to see it as a burden. The structure of profit and loss, cash flow and balance sheet is a clever, elegant and productive way of dealing with business numbers. It's your friend, not your enemy. Make sure your forecast structure adopts it and take the time to understand how it works. It is valuable – some would say *indispensable* – business knowledge.

A good forecast always comprises profit and loss, cash flow and balance sheet.

Self-editable (*own* your numbers!)

We've all seen *Dragon's Den*. We know what happens when people don't understand their own numbers. It's never pretty! You need to be fully in control of the numbers in your forecast. (If only because they're usually subject to a surprising amount of revision before they're published. Sometimes it's like getting kittens in a box!) The only way to properly own them is to input and edit them *yourself*.

If you're outsourcing your forecast to an accountant you need to make sure that you get a model that *you* can understand and edit. Avoid the temptation to let an advisor enter numbers and just give you the finished result. Make sure you're part of that input process.

A good forecast is easy to own and edit.

Flexible

Things change in business. You think you know how it all works and then something unexpected happens, or you simply change your mind. Your forecast has to be adaptable: flexible enough to respond to changes in circumstances or expectations. This is a functional, practical consideration. Can you easily add records to your forecast? Can you edit the way you calculate certain numbers? Can you easily change the start date when time has slipped?

When either outsourcing the forecast or buying software to do it, make sure it offers this flexibility. Off-the-shelf solutions can be surprisingly restrictive about what they'll easily let you do.

A good forecast is flexible and can easily respond to changing circumstances.

Properly 'tailored'

Your forecast tells the financial side of the story you set out in your business plan. Within a conventional accounting structure it should be set up to specifically reflect your business. When you look at your forecast do you recognise the business which you are trying to manage and discuss? Or have you shoehorned it into some vague and generic business model?

A good forecast sets out a specific, recognisable business. (Yours!)

The right level of detail

There is no hard and fast rule about the level of detail required in any forecast. It depends on what you're trying to understand and what you're trying to communicate. Too much and too little detail are the twin enemies of understanding and communication. If it helps, put it in; if it doesn't contribute to either, leave it out.

A good forecast has the right level of detail. (Not too much; not too little!)

Clear, recent opening balances

Your forecast is a picture of a financial journey, and you can't describe a journey unless you know where you're starting from.

Your current financial position (and to a lesser extent at least a summary of *how* you got there) is fundamental to the integrity of your forecast. Anyone interested in your forecast, especially someone who is considering lending or investing money, is bound to ask, 'Where are you now?'

This information should be up to date, and materially correct – not months old because you haven't done your books for ages, or incorrect or incomplete because you haven't done them properly!

A good forecast shows clear, recent and materially correct opening balances.

Modelled revenue and direct costs, with clear assumptions

Sales revenue is *always* the product of activity: it doesn't come from nowhere. It is always the result of 'so many people doing so many things at an average price of…' or some variation on that theme.

A forecast which projects revenue in purely monetary terms, without addressing the extent or plausibility of this activity (How many new customers? How much will they spend?...) is rarely adequate, in terms of either your own understanding or what you need to communicate. There are some circumstances in which you can get away with it, but in general you need to understand and model what *drives* your revenue, and state your assumptions clearly.

The same is true of the financial relationships which drive your direct costs or 'cost of sales'. These are inevitably defined by their relationship to sales according to some assumption, and this needs to be modelled.

> *A good forecast models revenue and direct costs and shows assumptions clearly.*

Clear, transparent, user-friendly reports

We've already said, numerous times, that one of the main reasons you are likely to be building a forecast is to communicate your numbers to someone else, so obviously producing reports is an important issue.

There are two sides to this. One is the amount of grief this gives you at a practical level. (Creating coherent, legible documents from extensive spreadsheets can be unbelievably time-consuming!) The other is the quality and effectiveness of what you produce – from the *reader's* perspective.

You need to be able to produce reports which are both readable and legible. By readable I mean well laid out, logically paginated and clearly labelled, and by legible I mean the right amount of information on a single page at a font size that can be read easily both on screen and when printed. And they need to be in an appropriate format (almost always a PDF file and not a raw spreadsheet file), so that they can be electronically published and distributed. They need to look professional and make a strong impression that reflects well on you and your business.

> *A good forecast produces user-friendly reports that are clear, elegant and professional, and makes life easy for everyone.*

Conclusion

When you think about your core objectives in forecasting – to *understand* and to *communicate*, these benchmarks are just common sense. They are obviously things which make a positive contribution to these objectives. It is equally obvious that if you compromise them, you will compromise your objectives.

They are not rules. Instead, think of them as setting the bar. Use them as tests for any process or tool you may be considering or already using. You may not always achieve all of them, but the closer you get, the better your result will be.

Build a better, faster forecast.

In this Authority Guide, forecasting guru Simon Thompson shows you how to build financial forecasts quickly, effectively and cheaply through his unique, proven and easy-to-follow 10-step process. By learning how to create effective forecasts you will master the ability to understand the potential financial outcomes for your business and be able to communicate financial information in order to successfully raise investment or loans.

"At last! A simple distillation of the essential issues that face small and medium businesses when they need to provide financials for raising finance. We know how much businesses struggle with this task and this book breaks it all down and offers real help and guidance. A concise read that will really pay dividends!"

Philip Tellwright, Access to Finance Specialist, Business West

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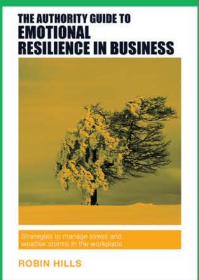

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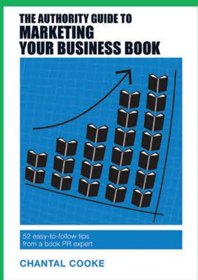

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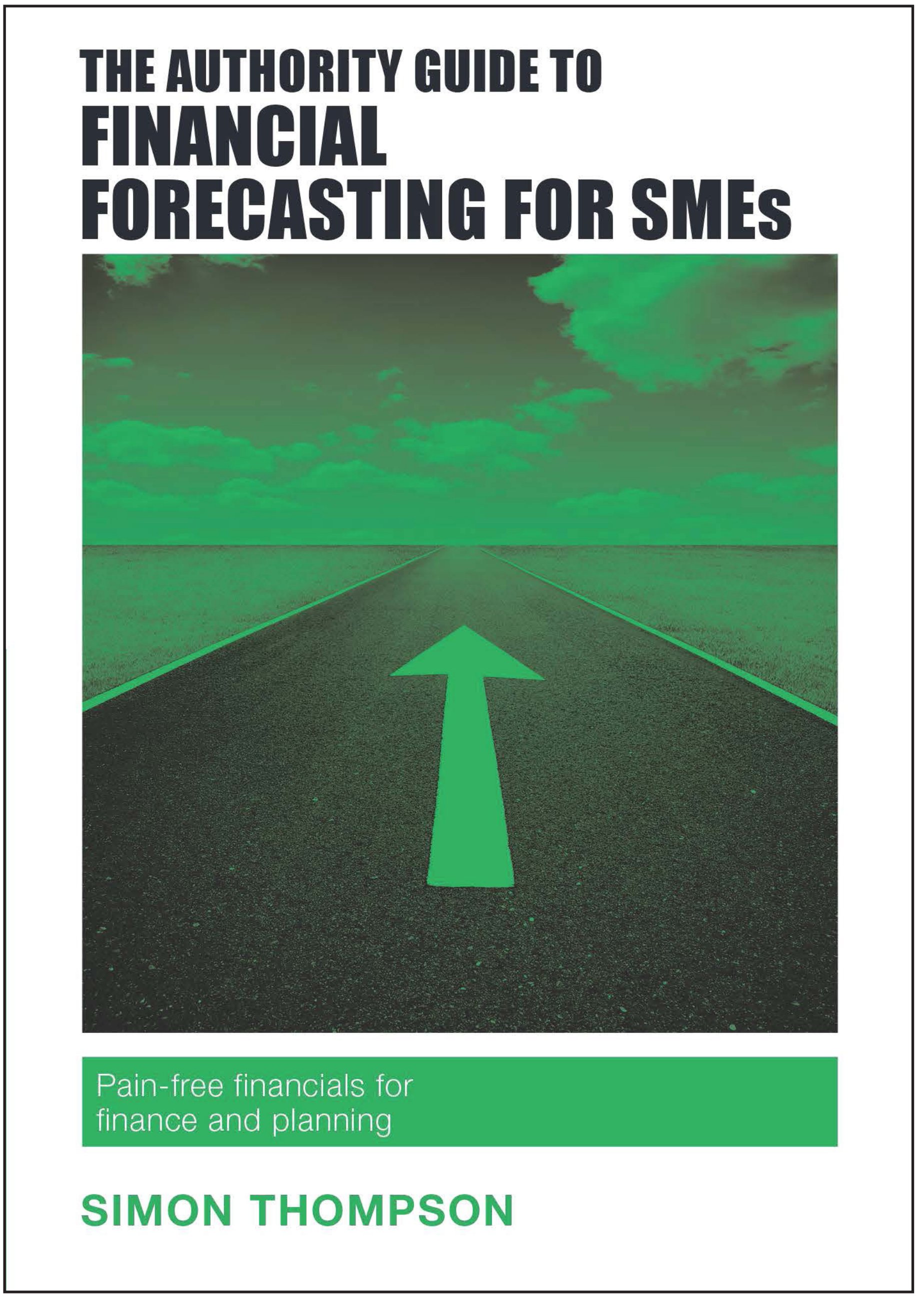

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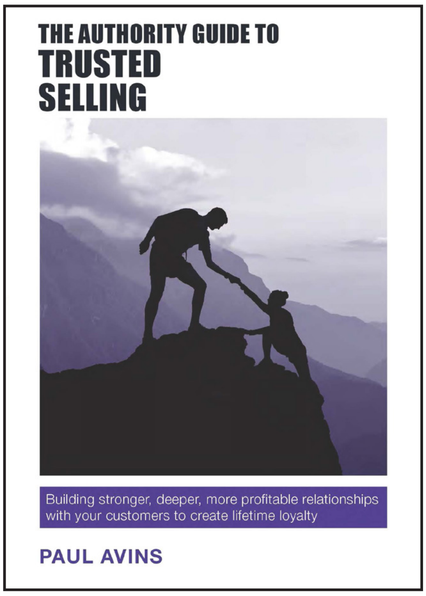

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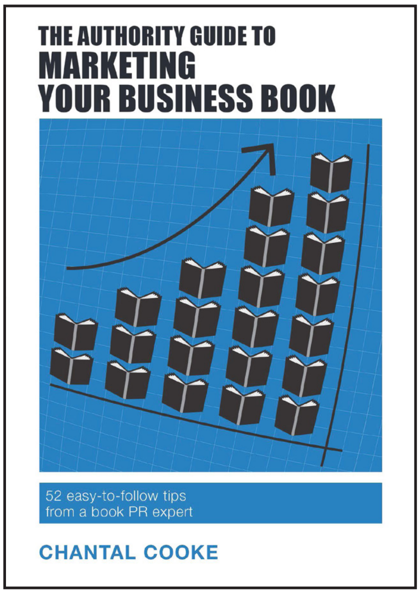

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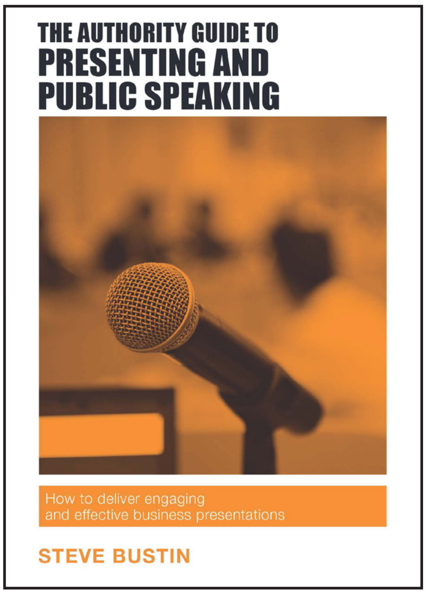

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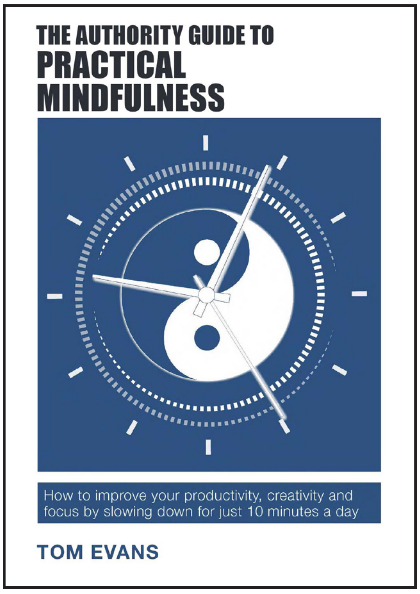

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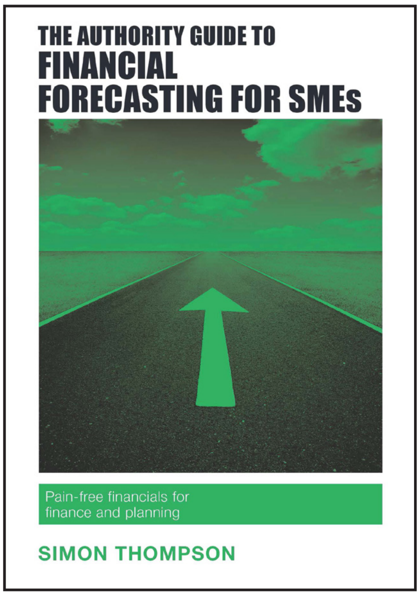

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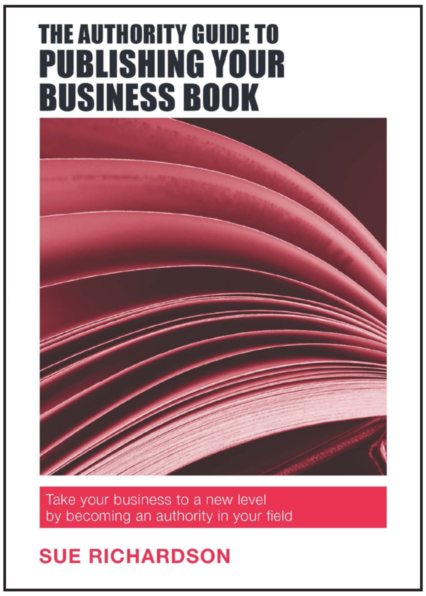

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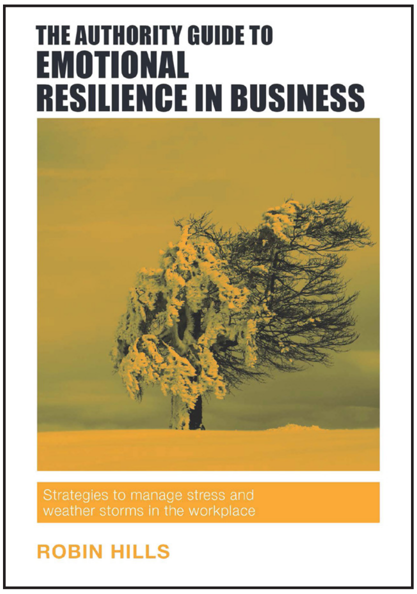

The emotional resilience of those involved in a business will contribute significantly to the organisation's success. This Authority Guide from leading emotional intelligence expert, Robin Hills, will help you change the way you think about yourself and the way you approach potentially difficult situations. You will be able to develop your own personal resilience and understand how to develop resilience within the hearts and minds of your team and your organisation.

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