

How To Correctly Project Cash Flow (and Why This Matters)

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If you're a small business or start up and you've yet to master the art of cash flow projection, then you're not alone. Many small and medium enterprises (SMEs) struggle with planning and managing cash flow. But what does projecting cash flow truly mean? And why does it matter?

What is Cash Flow Projection?

Projected cash flow is the amount of money you expect to flow in and out of your business on a monthly or quarterly basis. In simple math terms, cash flow projection means predicted cash in (sales or accounts receivable) minus predicted cash out (expenses or accounts payable).

Why Projected Cash Flow Matters

According to one 2021 study, 30% of businesses fail because they run out of money. The same study found 60% of small business owners don't feel confident about managing their finances. Could there be a link between the two?

Accurately projecting cash flow is a key component to delivering longer term growth projections for your business. It empowers you to make informed, strategic decisions and avoid a cash flow crisis of your own making. In other words, understanding your cash flow lets you know if now is the time to add expenses—like a new hire or piece of technology—or look for saving opportunities.

The Method: How to Correctly Project Cash Flow

STEP ONE: Pull Together All the Documents You'll Need

Bring together all your financial documents containing details of cash flowing in and out of your business at any given time. Below is a non-exhaustive list:

- Balance sheet, calculating your business's running value by subtracting total liabilities from total assets
- Profit and loss or income statement showing net profit, revenue and expenses
- Cash flow statement showing how much cash you have available
- Payroll wage and tax report—summarizing salaries and payroll tax paid
- Payroll benefits and deductions report—deductions and additions to wages including year-end reporting

STEP TWO: Determine Your Opening Balance

Before you can begin calculating your projected cash flow for the month or quarter ahead, you need to determine the opening balance going into this period. The first column on your spreadsheet should be dedicated to this. Essentially, this Opening Balance is how much you have in the bank, going into the month ahead.

STEP THREE: Calculate Your 'Cash-In'/Sales and Receivables

This is your estimated incoming funds for the month ahead, based on sales, revenue, grants, loans and investment returns, and any other cash coming into the business.

STEP FOUR: Calculate Your 'Cash-Out'/Expenses and Payables

Be sure to include every possible category that applies to your business for optimal accuracy. Consider, for example, materials, rent, tax, utilities, insurance, payroll and any seasonal payments or larger unusual payments (e.g. purchasing a company car.)

STEP FIVE: Calculate Cash Flow

Simply subtract Cash-Out from Cash-In.

STEP SIX: Add the Cash Flow to Your Opening Balance

Adding the Cash Flow to the month's Opening Balance will give you your Closing Balance. For instance, in a given month you could have received \$5,000 and paid out \$6,000, leaving you with -\$1,000. In this situation, if your Opening Balance was \$8,000, this would leave you with \$7,000 to carry forward to the next month.

STEP SEVEN: Bring It All Together

Bringing together all these elements will give you your Projected Cash Flow for the month. At the end of every month, you must adjust your projections to reflect the *actual* Cash-In and Cash-Out of that month. This final Cash Balance will then form the "Opening Balance" for the following month. If you have projected cash flow several months in advance (as many businesses do) don't forget to adjust all later months based on an individual month's actual data also.

	Start	January	February
Money Received			
Cash Sales	0	5,000	7,000
Payments Received Account	0	0	20,000
New Loans	10,000	0	0
New Investment	10,000	0	0
Total Received	10,000	0	0
	30,000	5,000	27,000
Money Spent			
Rent, Utilities	2,000	2,000	2,000
Payroll & Taxes	3,000	3,000	3,000
Purchase Inventory	7,000	0	0
Other Bills 0 1,000 1,200 Purchase Assets 10,000 0 0			
Total Spent	6,200		
	22,000	6,000	
Cash Flow	8,000	-1,000	20,800
Cash Balance	8,000	7,000	27,800

What Time Period Should Your Projection Cover?

The example above focuses on monthly cash projections, but sometimes quarterly projections may make sense. For example, if your business is more established or it deals with longer term projects and services.

Keep Your Cash Flow Projections Realistic

Do everything you can to make your predictions as realistic as possible. For example, what were your sales figures last January? Do customers usually settle invoices straight away, or wait until the last minute? Your projections should reflect all these things. Many businesses also add an "Other Expenses" category to create a buffer for unexpected expenses.

How Accurate Are Your Cash Flow Projections?

As you get into the flow, keep a critical eye how your projections are landing. How accurate are they? You may start to notice seasonal patterns, or categories you are consistently over- or under-estimating. The more you keep analyzing and adjusting your approach, the more value your Cash Flow Projections will add to your business.

Make Cash Flow Projections Work For You

Cash flow projections are pointless unless you put them to work. You should consult them whenever you have an important financial decision to make. If you see a potential deficit on the horizon, this is your time to start seeking new sales or cutting costs. At times when your cashflow is higher than expected, you can consider making meaningful business investments, such as new premises or equipment.

Still Have Questions About Cash Flow Projections?

Our expert team at Abacus are happy to talk you through the finer points of projecting cash flow and give you any extra support you need. Get in touch today for a confidential consultation.