Cash Flow Forecast: What Happens When You Get It Wrong, How to Get It Right

Why is a cash flow forecast so important growing your small business? We gather insights about why you should have one, and best tactics for forecasting.

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It isn't enough to be profitable. To survive, your business should have the cash available when employees, landlords, vendors and other vital partners need to be paid. To do that, you must be able to effectively forecast and manage cash flow.

OPEN Forum spoke with small-business owners and managers about how and why to forecast and manage cash flow. Evan Singer is general manager of **SmartBiz**, a San Francisco-based online marketplace for government-backed SBA business loans; Michael E. Chadwick is a financial planner and principle of **Chadwick Financial Advisors** in Unionville, Connecticut; and Vernon Tirey is co-founder and CEO of **LeaseQ**, an online leasing marketplace based in Woburn, Massachusetts.

Why is it important to forecast and manage cash flow?

"The reason cash flow and forecasting are so important comes down to one word: surprises. In business, especially small business, there are always surprises."

Evan Singer: As we all know, cash is king for a small company. So they have to build an actual cash flow forecast to understand how they're going to grow their business over time.

Vernon Tirey: The reason cash flow and forecasting are so important comes down to one word: surprises. In business, especially small business, there are always surprises. An employee leaves and you have to replace them, someone pays late that you were expecting to pay on time, a deal doesn't come through that you were counting on—those kinds of surprises are happening every month. When you have a forecast and cash flow worked out, you know the impact of these surprises and can start developing strategies to deal with them. If you have to spend time scrambling to find out what the impact is, it wastes a lot of time.

Michael Chadwick: I would argue that without forecasting cash flow, you can't run the business effectively. If you don't have a solid cash flow model, you're running your business very dangerously.

What are common errors or shortfalls made in forecasting and managing cash flow?

Chadwick: First, they don't forecast at all. Second, the forecasts are far too optimistic. They are building a forecast where everything lines up in an ideal world. We all know the world doesn't work like that. So I'd build it somewhat pessimistically. Reality should come in more optimistically and they'll be fine.

Singer: The biggest error from a lending perspective is businesses will take fast and easy money that's expensive and has a high monthly payment versus spending just a little more time to get a loan with a much lower monthly payment. It goes back to what Michael and Vernon were saying earlier. It's best for businesses to put themselves in position to succeed. That's going to mean keeping cash outlay as small as possible and making sure cash inflows are as high as possible. If a business can get a loan with a lower monthly payment, like an SBA loan that has a longer term and lower interest, they should take advantage of that opportunity.

Tirey: As we say in Texas, you want to make sure the milk check is bigger than the feed bill. If you're buying a piece of equipment, you need to know what your monthly revenue is going to be from that equipment, and what your monthly expense is going to be. Don't spend cash on equipment you can lease or take out a loan for. If you look at it on a monthly basis, that can make a big difference in cash flow.

What are some best practices in forecasting and managing cash flow in small businesses?

Chadwick: Number one, have a cash flow management system. There's a law that says anything you pay attention to improves. Number two, make sure your modeling system is written down. Also, what you've projected and what reality is has to match up. I usually have my people report monthly. People who do this regularly make projections that are very accurate. People who only do it once in a while are not accurate. So do it, do it consistently and compare projections to results.

Singer: I like what Michael is saying. I'd add to it by saying that if small-business owners can pick out items that are hurting or helping cash flow, they can improve it. For instance, they might identify that they have high debt payments. If their monthly payments are high with the loans they have outstanding, they can refinance those into a lower monthly payment to save on cash flow. Or, if many customers are taking 120 days to pay, they can work with them to get that down to 30 days and can improve cash flow that way.