

Business Plan Financial Projections: How To Create Accurate Targets



Small businesses and startups have a lot riding on their ability to create effective and accurate financial projections as part of their business plan.

Solid financials are a strong enticement for investors, after all, and can help new businesses chart a course that will take them beyond the legendendarily difficult first year and into a productive and profitable future.

But the need for business owners to look ahead in order to secure funding, increase profits, and make intelligent financial decisions doesn't end when startups become full-fledged businesses—and business plan financial projections aren't just for startups.

Existing businesses can also put them to good use by harvesting insights from their existing financial statements and creating sales projections and other financial forecasts that guide and improve their ongoing business planning.

What Are Business Plan Financial Projections?

Successful companies plan ahead, looking as best they can into the near and distant future to chart a course to growth, innovation, and competitive strength.

Financial projections, both as part of an initial business plan and as part of ongoing business planning, use a company's financial statements to help business owners forecast their upcoming expenses and revenue in a strategically useful way.

Most businesses use two types of financial projections:

- **Short-term projections** are broken down by month and generally cover the coming 12 months. They provide a guide companies can use to monitor and adjust their financial activity to set and hit targets for the financial year. In the first year, short-term projections will be entirely estimated, but in subsequent years, historical data can be used to help fine-tune them for greater accuracy and strategic utility.
- **Long-term projections** are focused on the coming three to five years and are generally used to secure investment (both initial and ongoing), provide a strategic roadmap for the company's growth, or both.

For startups, creating financial projections is part of their initial business plan. Providing financial forecasts banks and potential investors can use to determine the financial viability of a business is key to obtaining financing and investments needed to get the business off the ground.

For existing businesses—for whom an initial business plan has evolved into business planning—financial projections are useful in attracting investors who want to see clear estimates for upcoming revenue, expenses, and potential growth.

They're also helpful in securing loans and lines of credit from financial institutions for the same reason. And even if you're not trying to get funding or investments, financial projections provide a useful framework for building budgets focused on growth and competitive advantage.

So whether you're a small business owner, an aspiring tycoon starting a new business, or part of the financial team at a well-established corporation, what matters most is viewing financial projections as a living, breathing reference tool that can help you plan and budget for growth in a realistic way while still setting aspirational goals for your business.

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Financial Projections: Core Components

Whether you're preparing them as part of your business plan or to enhance your business planning, you'll need the same financial statements to prepare financial projections: an income statement, a cash-flow statement, and a balance sheet.

- **Income statements**, sometimes called *profit and loss statements*, provide detailed information on your company's revenue and expenses for a given period (e.g., a quarter, year, or multi-year period).
- **Cash flow statements** provide a comprehensive view of cash flowing into and out of a business. They record all cash flow from operations, investment, and financing activities.
- **Balance sheets** are used to showcase a company's assets, liabilities, and owner's equity for a specific period.

How to Create Financial Projections

The process of creating financial projections is the same whether you're drafting a business plan or creating forecasts for an existing business.

The primary difference is whether you'll draw on your own research and expertise (a new business or startup business) or use historical data (existing businesses).

Keep in mind that while you'll create the necessary documents separately, you'll most likely finish them by consulting each of them as needed. For example, your sales forecast might change once you prepare your cash-flow statement.

The best approach is to view each document as both its own piece of the financial projection puzzle *and* a reference for the others; this will help ensure you can assemble comprehensive and clear financial projections.

1. Start with a Sales Projection

A sales forecast is the first step in creating your income statement. You can start with a one, three, or five-year projection, but keep in mind that, without historical financial data, accuracy may decrease over time.

It's best to start with monthly income statements until you reach your *projected break-even*, which is the point at which revenue exceeds total operating expenses and you show a profit. Once you hit the break-even, you can transition to annual income statements.

Also, keep in mind factors outside of sales; market conditions, global environmental, political, and health concerns, sourcing challenges (including pricing changes and increased variable costs) and other business disruptors can put the kibosh on your carefully constructed forecasts if you leave them out of your considerations.

Start with a reasonable estimate of the units sold for the forecast period, and multiply them by the price per unit. This value is your total sales for the period.

Next, estimate the total cost of producing these units (i.e., the cost of goods sold, or COGS; sometimes called *cost of sales*) by multiplying the per-unit cost by the number of units produced.

Deducting your COGS from your estimated sales yields your gross profit margin.

From the gross margin, subtract expenses such as wages, marketing costs, rent, and other operating expenses. The result is your *projected operating income*, or *net income*.

Using these figures, you can create an income statement:

Profit/Loss	Year One	Year Two	Year Three	Year Four	Year Five
Sales	\$4,723,047	\$5,184,298	\$5,675,431	\$6,123,984	\$6,593,380
COGS	\$3,307,023	\$3,630,046	\$4,063,937	\$4,288,014	\$4,616,685

Gross Margin	\$1,416,024	\$1,554,252	\$1,701,494	\$1,835,970	\$1,976,695
G. Margin (%)	29.98%	29.98%	29.98%	29.98%	29.98%
Operating Expenses					
Wages	\$400,000	\$420,000	\$442,000	\$463,000	\$485,000
Taxes/Benefits	\$137,021	\$142,570	\$150,874	\$159,021	\$164,997
Marketing	\$35,000	\$40,500	\$42,750	\$46,875	\$51,974
Rent	\$135,000	\$137,000	\$139,000	\$141,000	\$143,000
Utilities	\$37,000	\$38,475	\$39,543	\$40,485	\$41,993
Depreciation	\$50,000	\$50,000	\$50,000	\$50,000	\$50,000
Professional, Merchant, and Administrative Fees	\$110,435	\$129,854	\$144,347	\$160,852	\$173,031
Other	\$101,299	\$117,043	\$133,971	\$145,256	\$155,307
TOTAL OPERATING EXPENSES:	\$1,005,755	\$1,075,442	\$1,142,485	\$1,206,489	\$1,265,302
Operating Profit	\$410,269	\$478,810	\$559,009	\$629,481	\$711,393
Interest	\$0	\$0	\$0	\$0	\$0
Taxes	\$16,783	\$42,976	\$67,125	\$84,963	\$97,224
Net Profit	\$393,486	\$435,834	\$491,884	\$544,518	\$614,169
Net Margin (%)	8.33%	8.41%	8.67%	8.89%	9.31%

2. Cash Flow Statement

Tracking your estimated cash inflows and outflows from investment and financing, combined with the cash generated by business operations, is the purpose of a cash flow projection.

Investment activities might include, for example, purchasing real estate or

investing in research and development outside of daily operations.

Financing activities include cash inflows from investor funding or business loans, as well as cash outflows to repay debts or pay dividends to shareholders.

A reliable and accurate cash flow projection is essential to managing your working capital effectively and ensuring you have all the cash you need to cover your ongoing obligations while still having enough left to invest in growth and innovation or cover emergencies.

Drawing from our income statement, we can create a basic cash flow statement:

Cash Flow	Year One	Year Two	Year Three	Year Four	Year Five
Cash Inflow					
Investments Received	\$800,000	\$0	\$0	\$0	\$0
Cash from Sales	\$4,723,047	\$5,184,298	\$5,675,431	\$6,123,984	\$6,593,380
Total Cash Inflow	5,523,047	\$5,184,298	\$5,675,431	\$6,123,984	\$6,593,380
Cash Outflow					
Preliminary Expenses	\$17,500	\$0	\$0	\$0	\$0
Direct Cash Spending	\$3,997,869	\$4,398,782	\$4,822,891	\$5,191,740	\$5,622,831
Cash to Payables	\$548,804	\$632,980	\$673,086	\$719,643	\$741,406
Inventory Increase	\$178,954	\$13,231	\$9,348	\$7,334	\$4,993
Long-Term Assets Purchased	\$475,000	\$0	\$0	\$0	\$0
Total Cash Outflow	\$5,218,127	\$5,044,993	\$5,505,325	\$5,918,717	\$6,369,230

Net Cash Flow	\$304,920	\$139,305	\$170,106	\$205,267	\$224,150
Cash Balance	\$304,920	\$444,225	\$614,331	\$819,598	\$1,043,748

3. The Balance Sheet

Providing a “snapshot” of your businesses’ financial performance for a given period of time, the balance sheet contains your company’s assets, liabilities, and owner’s equity.

Assets include inventory, real estate, and capital, while liabilities represent financial obligations and include accounts payable, bank loans, and other debt.

Owner’s equity represents the amount remaining once liabilities have been paid.

Ideally, over time your company’s balance sheet will reflect your growth through a reduction of liabilities and an increase in owner’s equity.

We can complete our triumvirate of financial statements with a basic balance sheet:

Balance Sheet	Year One	Year Two	Year Three	Year Four	Year Five
Assets					
Current Assets					
Cash	\$304,920	\$444,225	\$614,331	\$819,598	\$1,043,748
Inventory	\$178,954	\$192,185	\$201,533	\$208,867	\$213,860
Total Current Assets:	\$483,874	\$636,410	\$815,864	\$1,028,465	\$1,257,608
Long-Term Assets					
Long-Term Assets	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000
Accumulated Depreciation	\$50,000	\$100,000	\$150,000	\$200,000	\$250,000

Total Long-Term Assets:	\$425,000	\$375,000	\$325,000	\$275,000	\$225,000
Miscellaneous Assets					
Intangible Assets	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500
Total Misc. Assets:	\$17,500	\$17,500	\$17,500	\$17,500	\$17,500
Total Assets:	\$926,374	\$1,028,910	\$1,158,364	\$1,320,965	\$1,500,108
Liabilities and Capital					
Liabilities	\$0	\$0	\$0	\$0	\$0
Accounts Payable	\$50,321	\$54,745	\$59,028	\$63,143	\$67,202
Total Liabilities:	\$50,321	\$54,745	\$59,028	\$63,143	\$67,202
Capital					
Paid-In Capital	\$750,000	\$750,000	\$750,000	\$750,000	\$750,000
Retained Earnings	\$0	\$393,486	\$829,320	\$1,321,204	\$1,865,722
Earnings	\$393,486	\$435,834	\$491,884	\$544,518	\$614,169
Total Capital:	\$1,143,486	\$1,579,320	\$2,071,204	\$2,615,722	\$3,229,891
Total Liabilities and Capital:	\$1,193,807	\$1,634,065	\$2,130,232	\$2,678,865	\$3,297,093
NET WORTH:	\$1,143,486	\$1,579,320	\$2,071,204	\$2,615,722	\$3,229,891

Best Practices for Effective Financial Projections

Like a lot of other business processes, financial planning can be complex, time-consuming, and even frustrating if you're still using manual workflows and paper documents or basic spreadsheet-style applications such as Microsoft Excel.

You can get free templates for basic financial projections from the Service Corps of Retired Executives (SCORE), but even templates can only take you so far.

Without a doubt, the best advantage you can give yourself in creating effective and accurate financial projections—whether they're for the financial section of your business plan or simply part of your ongoing business planning—is to invest in comprehensive procure-to-pay (P2P) software such as PLANERGY.

In addition to helpful templates, best-in-class P2P software also provides a rich array of real-time data analysis, reporting, and forecasting tools that make it easy to transform historical data (or market research) into accurate forecasts.

In addition, artificial intelligence and process automation make it easy to collect, organize, manage and share your data with all internal stakeholders, so everyone has the information they need to create the most useful and complete forecasts and projections possible.

Beyond investing in P2P software, you can also improve the quality and accuracy of your financial projections by:

- **Doing your homework.** Invest in financial statement analysis and ratio analysis, with a focus not just on your own company, but your industry and the market in general. Learn the current ratios used for liquidity analysis, profitability, and debt and compare them to your own to get a more nuanced and useful understanding of how your company performs internally and within the context of the marketplace.
- **Keeping it real.** It can be all too easy to get carried away with pie-in-the-sky optimism when forecasting the future of your business. Rose-colored glasses aren't exclusive to startups and small businesses; over-inflated estimates can hobble even veteran organizations if they don't practice good data discipline and temper their hopes with practical considerations.

Focus on creating realistic, but positive, projections, and you won't have to worry about investors or lenders glancing askance at your hard work.

- **Hoping for the best, but planning for the worst.** Run two scenarios when performing your financial projections: the best-case scenario where everything goes perfectly to plan, and a worse-case scenario where Murphy's Law holds sway. While actual performance will undoubtedly fall somewhere in between the two, having an upper and lower boundary appeals to investors and lenders who are assessing your company's financial viability.

Financial Projections Help You Reach Your Goals for Growth

From startups to global corporations, every business needs reliable tools for financial forecasting.

Take the time to create well-researched, data-driven financial projections, and you'll be well-equipped to attract investors, secure funding, and chart a course for greater profits, growth, and performance in today's competitive marketplace.

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