Cash Flow Projection: What Is It and How to Do It

Money may not actually make the world go 'round, but it certainly spins the wheels of commerce.

And whether you're a small business owner or working at a large corporation, ensuring you have a sufficient cash balance to cover your obligations while still having enough left over for innovation, investment, and emergencies can be challenging.

That's why *cash flow projections*—which help you look ahead and manage cash inflows against cash outflows—are such an important part of building a successful business.

Taking the time to master cash flow projections can help you make better, more informed decisions, so you can keep your business firing on all cylinders in today's competitive and complex global economy.

What is a Cash Flow Projection?

Cash flow projections and *cash flow forecasts* are often treated as interchangeable terms in many contexts. However, they are differentiated based on actual cash flow (forecasts) vs. hypothetical spend (projections).

Cash flow projections are often used to run potential outcomes in order to estimate the impact of a given decision, while forecasts are more literal. Accordingly, cash flow projections for a given period are often based on cash flow forecasts for that same time period.

Cash flow forecasts and projections can be conducted for any accounting period; it's quite common for cash-hungry small businesses to conduct a cash flow forecast weekly, for example.

Businesses use both annual cash flow forecasting *and* projections to help them

plan their spend and predicted cash balances for the year ahead, although both are updated at regular intervals as projected revenue and expenses are compared to their actual equivalents.

Positive cash flow (or being *cash flow positive*) indicates you have more money coming into your business than flowing out at a given point in time. *Cash flow negative* (or having a *negative cash flow*) refers to the opposite condition, which businesses can and do strive to avoid at all costs, given that an estimated 82% of small businesses fail due to cash flow problems.

It's important to note that cash flow is related to, but distinct from profitability. Profit measures the amount of cash remaining after all your expenses are covered, not the inflow and outflow of cash.

In a perfect world, both conditions coincide at all points. However, effective cash flow management might mean sacrificing profitability in the short term to protect business continuity and support even greater profits later—or showing a hefty profit on your income statement while actually running cash negative.

Consider this example:

Company X has monthly sales of $2,500,000. At the beginning of the month, the accounting team estimated rent, payroll, and materials would cost $1,900,000. This seems to indicate a clear profit of $600,000. However, two clients still haven't paid what they owe for the month, and their total invoices come to $850,000.

Suddenly, instead of a healthy profit, you've got a $250,000 shortfall on the books. This isn't necessarily a business killer if it happens only occasionally. But if it becomes a regular occurrence, Company X will soon find itself unable to pay its employees and lenders on time, and without the resources needed to expand production or invest in new products.
Staying cash positive is crucial to the longevity and competitive performance of your business—not to mention your bank account.

Executed properly, a cash flow projection gives you a clear picture of what's ahead in your payables and receivables, helping you make smarter business decisions while minimizing cash flow risk.

The clearer your understanding of your future cash flow, the more effectively you can choose when and where to direct your resources.

Key Benefits of Performing a Cash Flow Forecast or Cash Flow Projection

In addition to protecting your company's financial health by providing a reliable estimate of your accounts payable and accounts receivable activity for the near future, cash flow forecasting:

- ### Can reveal potential weaknesses and inconsistencies that raise expenses

  With a clear picture of the amount of money flowing in and out of your business across time, you can use both your projection and analysis of past spending activity to uncover time periods and spend categories where expenses are higher than they should be. These "hot spots" can indicate extra costs created by process inefficiencies, maverick spend, or seasonal conditions that affect your particular business or industry.

- ### Can help you tame spend and protect liquidity—and profitability

  The clearer your understanding of your future cash flow, the more effectively you can choose when and where to direct your resources. Whether you're budgeting for short-term loan payments, investing in new product development, or working with your suppliers to capture early payment discounts, having an accurate view of your actual cash flow will ensure you've got the capital you need, whether you're looking at next month or at the year ahead.

- ### Can help you evaluate new strategies and ideas

  With aid from the right digital tools, you can use cash flow projections to

predict the potential impact of different business decisions. Will a pricing increase drive away customers, reducing revenue? Will investing in sustainable materials for a flagship product attract enough new business to counterbalance the materials cost? Can the company take on a short-term loan during the busy season and pay it off in time to avoid shortfalls during the off months? Answering questions like these is much easier with the help of cash flow projections and cash flow forecasts that are based on accurate and complete data.

The Importance of Spend Visibility in Creating Cash Flow Projections

Before you prepare your cash flow forecast or cash flow projection, it's critical to have the highest possible visibility into your spend data. Without a complete picture of all your spend, your estimates won't be as accurate and might even cause you to go cash negative at the worst possible time.

Investing in a complete procurement solution like PLANERGY gives you full control over, and visibility into, your spend activity.

Centralized, cloud-based data management, combined with supplier integration, guided buying, and electronic invoicing, eliminates dangerous cash flow risk factors such as rogue spend and invoice fraud.

All your spend data is captured and stored in a central server, where it can be accessed securely in real time. Everyone from buyers on up through the chief financial officer (CFO) has leveled, role-appropriate access.

Full integration with your accounting software, sales and customer relationship management (CRM), and enterprise resource planning (ERP) systems—along with support for dozens more—enriches your datasphere and can provide additional context and insights that will further improve your forecasts and business decisions.

Process automation, powered by artificial intelligence, eliminates human error and waste, as well as the bottlenecks that can keep you from paying your bills strategically or collecting customer payments efficiently.

And with help from advanced analytics, your team can use templates to create accurate and complete forecasts, budgets, and financial reports, or customize their own for maximum strategic utility and convenience.

Optimizing your Procure-to-Pay (P2P) processes from end to end and ensuring you have complete and accurate data will ensure you can create cash flow forecasts and projections you can rely on for smarter, more strategic decision making and financial management.

How to Perform a Cash Flow Forecast and Projection

Creating an actual cash flow projection isn't necessarily time-consuming or difficult. However, it does require some preparation and, of course, the cleanest, most accurate spend data you can get.

When preparing your cash flow forecast and projection, keep three things in mind:

- ### Keep your estimates conservative and realistic

  Erring on the side of caution—and leveraging the insights drawn from your historical spend data—can keep you from making potentially costly business decisions.

- ### Update your forecasts and projections regularly

  Monthly projections may not require many updates, but the longer the period forecasted, the more numerous and frequent your updates should be. A lot of things can change over the course of a quarter or year, so be sure to account for changes in revenue and expenses as events unfold.

- ### Don't forget to factor in variable expenses

  Seasonal businesses will have a much different outlook for cash inflows

and outflows than a year ’round retailer.

Using your cash flow assumptions (i.e., the total projected cash flowing in and out of your business for the time period you’re projecting), you can create a monthly cash flow forecast, and then use that to create a cash flow projection, by following a few basic steps.

1. Bring Total Ending Cash Forward

If this is your first cash flow forecast, use your reconciled cash balance. If you’re working from a cash flow forecast from the previous month, use last month’s ending balance as the starting balance for the cash flow statement you’re creating for the month ahead.

So if, for example, you’ve reconciled your bank statement and have an ending cash balance of $500,000, use this value at the top of your new cash flow forecast.

2. Estimate Sales

If you have $2,000,000 in customer invoices due in the coming month, and you estimate 75% will pay in full, then you would record $1,500,000 as income from customer payments.

3. Estimate Additional Revenue

If sales are your only revenue, you can jump ahead to step 4. If not, add any other revenue you expect to receive (e.g., rental income, interest) below sales revenue. Add this value to your revenue to get your Total Incoming Cash.

4. Estimate Your Regular Expenses

Add up all your estimated expenses for the coming month and record each of them as a line item. Examples include rent, wages, insurance, utilities, etc.

5. Estimate Your Seasonal or One-Off Expenses

Any seasonal expenses or one-off costs that occur exclusively in the month being forecast receive their own line item. For example, quarterly fees for Web hosting

would only appear in the month they're paid.

6. Deduct Expenses from Income

After you've toted up your cash inflow and cash outflow, subtract your expenses from your income to calculate your cash flow for the month.

7. Add Your Beginning Cash to Your Estimated Cash Flow

Combine your beginning balance with the total monthly cash flow value and record it at the bottom of the cash flow forecast. This is your estimated ending cash balance for the month, and the value you'll use for the beginning balance on next month's cash flow statement.

Let's take a look at a sample cash flow forecast:

Cash Flow Forecast	**May 2021**
Beginning Cash	$5,000
75% Sales	$15,000
Rental Income	$1,500
Total Incoming Cash:	$16,500
Outgoing Cash	
Utilities	$200
Rent	$2,000
Insurance	$100
Wages	$2,500
Web Hosting (Quarterly)	$200
Total Outgoing Cash:	$5,000
Cash Flow for May 2021:	$11,500
Ending Cash Balance:	$16,500

To perform a cash flow projection using our cash flow forecast, we need a cash flow forecast that covers the time period we're using for our projection and a

variable to consider.

Let’s assume you’re interested in hiring a consultant to come in and perform a weeklong training course for your purchasing team on sustainable procurement.

Assuming the training will be performed and still allow your staff time to perform their regular duties, it’s easy enough to predict the impact on cash flow for the single month; simply add the consultant’s fee as a line item under outgoing cash.

To project the long-term impact of the training on your cash flow, however, you would need forecasts covering, say, a year. Using historical data and estimating the likely impact created by the training, you can modify your assumptions for each month and the year itself.

For example, will more sustainable procurement practices increase materials costs and reduce available cash? Will they reduce expenses by eliminating and replacing high-risk, non-ecologically minded suppliers in your supply chain?

Will revenue increase due to attracting new customers who prefer to purchase goods from companies who prioritize sustainable goods—and will this increase be enough to offset any associated marketing expenses that come from promoting the change?

Will sustainable sourcing practices allow the company to secure new investors and other funding from new sources?

Answering these questions and adjusting your forecasts accordingly will help you understand the likely impact of the training on your overall cash flow in the year ahead.

Short of a crystal ball, no one can predict the future with absolute certainty. However, estimating your cash flow as accurately as possible in your forecasts will greatly increase the usefulness of your short-term and long-term cash projections.

Protect and Grow Your Business with

Accurate Cash Flow Projections

It's not just what you spend, but when, where, and how you spend it. Make sure you've got the tools you need for complete and accurate cash flow projections and forecasts, perform them regularly, and don't be afraid to take the long view when balancing profitability and positive cash flow.

Taking the time to practice responsible cash flow management ensures your company will have the capital it needs, when it needs it—and the flexibility to strike when the iron's hot for growth and innovation.

What's your goal today?

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