

Financial Forecasting for SMEs

Top tips for understanding your financial performance



Financial forecasting plays a pivotal role in SME success. However, the significance of forecasting is often underestimated by business owners and their management teams.

Forecasting is a strategic planning process that empowers you and your management team to effectively address uncertainties about the future. It relies on historical and current data to identify trends and uses this information to predict future outcomes.

Forecasting various scenarios for the company's future can be invaluable when making critical decisions, including:

- **Recruitment of New Talent:**
Determining when and how to expand your workforce.
- **Investment in New Equipment or Inventory:**
Assessing the timing and scale of capital expenditures.
- **Pursuing New Sales Opportunities:**
Identifying potential market opportunities and their impact on revenue.
- **Investment in Marketing:**
Allocating resources for advertising and promotional activities.
- **Acquisition of Another Business:**
Evaluating the financial implications and potential benefits of mergers or acquisitions.

Moreover, forecasts serve as a foundation for developing a financial budget, crafting cash management plans, and charting a course for your company's short-term and long-term strategic vision.

Why it matters

As a business owner, you will often find yourself dealing with the here and now. It's a common problem for owners, who can become absorbed by pressing issues, leaving limited room for forward-looking initiatives. However, it's crucial to incorporate forecasting into your managerial approach to sustain a competitive advantage. Neglecting comprehensive and routine forecasting can leave your business vulnerable to unexpected and avoidable financial challenges.

Follow the advice in this guide to establish a roadmap for your company's immediate and long-term strategic objectives, ultimately ensuring financial success.



Crunch your data

1. Define Your Financial Goals:

Begin by setting well defined and specific financial goals. These could include revenue targets, profit margins, or cash flow objectives. Ensure your objectives align with your broader business strategy.

2. Gathering Historical Financial Statements:

Collect your past financial statements (income statements, balance sheets, cash flow statements) for at least the past three years. These records will serve as the foundation of your future projections.

3. Choose Your Forecasting Period:

Establish the time frame for your forecasts. It's common to formulate yearly forecasts, you may also consider generating quarterly or monthly projections for a more granular and precise approach to your planning.



Plan and predict

4. Sales Forecast:

Estimate your sales revenue. Break it down by product or service if applicable. Consider market trends, customer behaviour, and seasonality. Be realistic and conservative in your estimates.

5. Expense Forecast:

Project your operating expenses, including salaries, rent, utilities, marketing, and other overhead costs. Look at historical data and factor in potential changes or cost-saving measures.

6. Cash Flow Forecast:

Create a cash flow statement to track how money moves in and out of your business. Include accounts receivable, accounts payable, and inventory turnover. Ensure you have enough cash to cover operational needs and taxes.

[Click here](#) to find out more about effective cash flow management at our dedicated hub.

Company Income Statement

	Historical Results			Forecast Period		
	2020	2021	2022	2023	2024	2025
Revenues	73,145	80,460	90,115	100,027	111,030	123,244 ¹
Cost of Goods Sold (COGS)	29,345	31,874	33,367	38,931	43,213	47,967 ²
Gross Profit	43,800	48,586	56,748	61,096	67,817	75,277
Expenses						
Marketing & Advertising	14,457	15,893	17,167	18,712	20,396	22,232 ³
General and Admin	7,625	7,974	8,345	9,000	9,000	9,000 ⁴
Depreciation and Amortisation	11,456	10,652	10,137	5,240	5,856	5,790 ⁵
Loan Repayments	6,000	6,000	0	12,000	6,000	0
Total Expenses	39,538	40,519	35,649	44,952	41,252	37,022
Earnings Before Tax	4,262	8,067	21,099	16,144	26,565	38,255
Taxes	5,784	8,478	10,624	9,629	10,782	14,745
Net Earnings	-1,522	-412	10,475	6,515	15,783	23,510

Assumptions

¹ Based on historic average annual revenue growth of 11%

² Based on historic average annual COGS as 40% of revenue

³ Based on 9% annual increase in marketing and advertising costs

⁴ Based on historic average annual G&A of £7,981

⁵ Based on projected lower investment in assets through 2023 to 2025

7. Balance Sheet Forecast:

Prepare a projected balance sheet that comprehensively outlines your assets, liabilities, and equity. This invaluable financial document offers a detailed snapshot of your fiscal position at a predetermined point in time.

8. Forecast Income Statement:

Generate a projected income statement, which shows your revenue, expenses, and profit or loss for the forecast period. Ensure it follows the basic equation: Revenue minus Expenses = Profit (or Loss).

9. Sensitivity Analysis:

Consider different scenarios by performing sensitivity analysis. What happens if your sales are lower than expected or if expenses increase? This helps you assess risk and make contingency plans.

10. Create a Budget:

Based on your forecasts, develop a detailed budget that allocates resources to different areas of your business. A budget helps you track performance against your projections.



Implementing your insights

11. Monitor and Update:

Regularly compare your actual financial performance to your forecasts and budgets. If there are significant variances, investigate the reasons and adjust your plans accordingly.

12. Seek Professional Assistance:

If you're not comfortable with financial forecasting, consider hiring an accountant or financial consultant. They can provide expertise and guidance to improve the accuracy of your forecasts.



Determine long-term vision

13. Use Forecasting Tools:

Invest in specialised accounting software to create and manage your forecasts. These tools can streamline the process and provide helpful templates.

14. Long-Term Planning:

In addition to short-term forecasts, consider creating long-term financial projections, typically spanning 3-5 years. This can help you outline your business's growth and expansion plans.



Remember that financial forecasting is an ongoing process. These forecasts help identify potential influences on strategies and goals. Accurate predictions of demand and trends are crucial for managing seasonal variations, sudden shifts in demand, competition, labour issues, and economic fluctuations.

Regularly revisiting and adjusting your forecasts will help you make informed decisions and navigate the ever-changing and challenging landscape of running an SME.

At Capify we offer a range of business loans to help support small businesses throughout their growth journey. If your forecasting highlights the need for some short-term financial support, our specialised SME business loans can help. Check to see if you're eligible for one of our loans with our [online eligibility checker](#). Or, if you'd prefer to talk to a member of our team, we'd be happy to guide you through the process.

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