Cash Planning and Forecasting

Cash is King! The lifeblood of any business is its ability to collect cash and pay bills as well as pay its employees, particularly its owners. Far too often small businesses are profitable, but they do not have enough operating capital to meet their current needs.

Consequently, they may be forced to sell out to a stronger competitor, sell a portion of the company to investors at an undesirable price or close the doors and put the company out of business. None of these alternatives are typically what the owners intended when starting the business.

The ability to forecast cash resources and uses is an art and is by no means a well-defined science. None of us have a crystal ball and any cash forecast which is prepared by the management of a company or their accountant can be no more than a guess as to when the customers pay and when your business will pay its obligations.

Hopefully, the more effort that is put into cash forecasting the better will be the educated guess and the more accurate the resultant picture of the future operations of your business.

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Starting the Analysis

One of the most significant factors to be considered in your cash flow forecast is the volume of sales that will be generated in the next several months and for the rest of the period for which you intend to forecast. Your sales forecast must be as fine-tuned as possible. It may be unrealistic to assume that there is a million-pound market for your product in your area and you will be able to capture a specified percentage of it.

A sales forecast needs to be based on specific facts. These might include your sales history, or the history of similar businesses you have owned or operated, or the competition. In your area, what has been the experience of similar operations?

Some of the questions that should be addressed would include what other factors could I control such as adding new product lines, deleting unprofitable operations, adding a new salesperson, or terminating one that is not producing to quota? In preparing a forecast, you must also take into consideration items such as the seasonality of your business, the relative state of the economy and the period over which you will forecast.

Obviously, your ability to forecast sales for the next month is better than it is for three to five years from now. The amount of detail that must be included in the cash forecast is really a matter of preference. It can be based on per unit sales extended out by the sales price of each type of unit or an average sales volume per day, week or month of your type of business in its current environment.

Cash Collections

Once you have determined a reasonable level of sales and you are comfortable with the forecast you have made, you must address questions such as: what percentage of my sales are received in cash, and what portion are credit sales for which I will have to carry amounts in debtors? For those that are debtors based, how soon is the cash collected? Do I have to wait for customers to pay me or do third parties such as Visa or MasterCard or a debt factor take the customer's account and convert it to cash for me with an appropriate discount?

If you are relying on customer payments for collection of debtor balances you must determine what portion of the debts will be collected in thirty days, sixty days, ninety days and thereafter, and what portion, if any, may never be collected.

To assume that 100% of your sales will ultimately be converted to cash is probably unrealistic especially considering the current economic environment and the tight cash situations that may face some of your customers.

Other sources of cash may be available in addition to sales. Do you expect to bring in a partner or other investors, or can you borrow money from a bank? When will you receive the cash and how much will you get? Part of your cash flow analysis may be to determine how much investment money or borrowings will be required to operate your business.

Once you are comfortable with the cash receipt side of your business, and the timing of the collections of funds from your sales and other sources, it is necessary to consider the expenses and other cash needs of your business operation.

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Business Structure – The Pros and Cons

Company	Sole Trader/Partnership
A company must be formally incorporated with a written constitution in the form of a Memorandum and Articles of Incorporation. There is, therefore, an initial setup cost.	There are no formation costs, but a written partnership agreement is advised.
Companies are governed by the Companies Acts. A company must: - - Keep accounting records - Have the accounts audited* - File accounts and an Annual Return with the Registrar of Companies. This information is available to the public. - Keep Statutory Books showing details of shareholders and directors *Your company may qualify for an audit exemption if it has at least 2 of the following: • An annual turnover of no more than £10.2 million • Assets worth no more than £5.1 million • 50 or fewer employees on average	Sole traders and partnerships are not required by law to have annual accounts nor to file accounts for inspection. However, annual accounts are necessary for the HM Revenue and Customs tax returns.
Companies may have greater borrowing potential. They can use current assets as security by creating a floating charge.	Sole traders and partners are unrestricted in the amount and purpose of borrowings but cannot create floating charges.
Shares in a company are generally transferable ownership may change but the business continues.	
Incorporation does not guarantee reliability or respectability but gives the impression of a soundly based organisation. Personally, there may be prestige attached to directorship.	The unincorporated business does not carry the same prestige.
Tax is payable on directors' remuneration paid via PAYE on the 19th of the following month. Tax is paid by shareholders on dividends under the self-assessment rules, although the first £2,000 of dividends are tax free each year. Unless profits exceed £1,500,000, corporation tax is payable 9 months after the year-end.	For a sole trader or partnership, tax is generally paid by instalments on the 31 January in the tax year and the 31 July following the tax year. For an ongoing business, the tax for 2021/22 is payable: first payment on account on 31 January 2022, second payment on account on 31 July 2022, with any final balance due on 31 January 2023. For a start-up business, this is slightly different and covered in more detail later in this publication.
First year losses in a company can only be carried forward to set against future profits.	Start-up losses generated by a sole trader or a partner in the first four tax years can be set against other income of the year or carried back to the three previous tax years, potentially resulting in a tax refund.
The corporation tax rate is currently 19% irrespective of the level of company profits. Budget 2021 announced that the rate would be increased to 25% from 1 April 2023 where profits exceed £250,000 a year. From that date the 19% rate would only apply to profits up to £50,000 a year with a marginal rate of 26.5% for profits for profits between the two new thresholds.	Profits are taxed at 20% on taxable income up to £37,700 for 2021/22 and 40% thereafter with a 45% rate on income over £150,000. Budget 2021 has announced that the personal tax thresholds will be frozen until 2025/26.
There is both employers' and employees' national insurance payable on directors' salaries and bonuses. The NI charge is greater than that paid by a sole trader/partner, but there is no NI charge on dividends.	A partner/sole trader will pay Class 2 NI of £3.05 p.w. (2021/22) and Class 4 NI dependent on the level of profits, 9% up to £50,270 and 2% thereafter.
Where the business owner is both a shareholder and a director, they have a certain amount of flexibility to control their personal tax liability as they only pay tax personally on what they draw out of the company. Many director shareholders pay themselves a low salary to minimise national insurance and extract the bulk of their income by paying themselves dividends. Where they are in receipt of child benefit, they are able to minimise the tax they pay on that income by keeping their income below £50,000.	Sole traders and partners are taxed on their share of business profits irrespective of the amount that they draw out of their business. Consequently, they are less able to control the level of their taxable income compared to a director/shareholder of their own company.

Disbursements

Certainly, if your business entails sales of stock, you will have to purchase the merchandise from others or purchase the component parts and pay employees to assemble it. This may require a significant outlay of cash before the first pound of sales is generated and received. You should consider how often and in what amount your employees must be paid and when their payroll taxes must be paid over.

Additionally, you need to know the credit trade terms your creditors are willing to advance to you. Do you have to pay for stock items on a C.O.D. basis or can you pay for them thirty or forty-five days after receipt? What expenses must be paid to allow you to convert purchased merchandise to saleable stock? If your production requires utilities to run machines or supplies that are required, such as consumable chemicals or packing materials that must be purchased prior to the sale of the stock, you should consider the timing of these payments.

In addition to the cost of manufacturing, you should consider whether your productive capacity would allow you to generate enough stock to support the level of sales that you are predicting. If the volume of sales you forecast is above your ability to produce today, what changes in your operating environment must be made to meet the production levels? Will you need additional employees? If so, how much will they cost? Do you have to acquire additional machinery for your shop operations? What is the cost of the machinery and when will you have to pay for it? Do you have enough space to cope with the additional activity?

Once you have determined the cost of operating your production or service facilities, you need to consider what other expenses you must pay to keep the doors of your business open. You typically will have to pay rent for your office or manufacturing facility. You must consider how much the monthly payment is and when it has to be paid. Ask yourself if there will be other cash requirements such as a deposit on first and last month's rent. If you are opening a new business, you must consider what your cash requirements are to make your facility ready for your specific needs and purposes. Will you have to buy or rent furniture? Will you need to make tenant improvements or pay deposits for utilities and other services?

You also need to consider many of the overhead items and costs to open a new business that will hopefully be one-time expenses. This may be the cost of incorporating your business, a solicitor's fee for drafting partnership and other agreements, the cost to obtain business licences, approval from the taxing authorities, setting up an accounting system, stationery costs, costs of signs or logos etc.

It may seem like the list of costs and expenses to be incurred is endless. It may even discourage you in moving forward with your business endeavour. However, it is imperative to make the list as detailed as possible to ensure that you have sufficient funds to make your operation ready for business prior to running out of cash. The more detailed the list and the more sufficient information you can provide, the less chance there is of unpleasant surprises as you move down the stream to opening your business.

In addition to determining the amount and volume of expenses and cash outlays you will have to make; it is critical to determine the timing of such payments. As we have discussed in other chapters, there may be a variety of financing alternatives that are available to you. Most of the start-up costs which you incur can be delayed or deferred until you can generate the cash from your operations to help pay them. This needs to be carefully analysed and built into your cash flow analysis. However, a good rule of thumb is to assume that you are going to have to pay your expenses sooner than you think and that you will collect your cash slower than you anticipate. If you work with this attitude, any surprises should be favourable ones.

Cash flow projections can be very slow, time consuming and tedious to undertake. It is often very tempting to hire someone else to prepare the projections for you. There are a variety of individuals who can help you do this, but the critical factor is that they only help. As the owner and operator of the business, you are the only one truly qualified to develop your cash flow projections. You know what it takes to open and operate your business. Certainly, a trained professional can offer guidance and ask pointed questions to be sure you are considering all of the necessary and sometimes hidden costs of operating a business. However, the more effort you put into developing the cash flow projections, the more accurate they will tend to be. This exercise may also help you to pinpoint areas of potential cash savings that you have not otherwise considered.

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