

A Note on Projections for a Company

How to Make Financial Projections for Your Business

Creating a comprehensive business plan is one of the most critical steps for any business owner aiming for success. An integral part of this plan is the financial projection, which can attract the attention of investors, potential partners, and key employees. A well-done financial projection not only gives you insight into the future of your company but also provides the foundation for making strategic business decisions.

This article will break down what a financial projection entails and how to create one that positions your business for long-term success.

Key Takeaways

- A financial projection is a collection of financial statements that forecasts future performance.
- The financial projection process can be simplified into five steps: sales projections, expense projections, balance sheet projections, income statement projections, and cash flow projections.
- Financial projections offer numerous advantages, such as forecasting future performance, ensuring cash flow stability, and guiding strategic growth decisions.

Here's What We'll Cover:

- What Is a Financial Projection?
- How to Create a Financial Projection
- What Goes Into a Financial Projection?
- What Are Financial Projections Used for?
- Financial Projections Advantages
- Conclusion

What Is a Financial Projection?

A financial projection is essentially a set of financial statements that estimate a company's future revenues, expenses, and cash flows. These forecasts help outline your expected income, cash inflows and outflows, and overall financial health, making them invaluable for lenders and investors alike.

Most projections cover the first 3-5 years of a business, although some may extend up to 10 years. While projections, especially in the early stages, rely heavily on educated guesses, they should be rooted in thorough market research, industry data, and comparable business analysis. It's crucial that financial projections remain realistic—investors can easily detect overly optimistic estimates.

How to Create a Financial Projection

Financial projections help business owners gain a clearer understanding of the financial outlook of their company. Here's how you can create accurate financial projections for your business:

1. Start with a Sales Projection

Begin by estimating your business's potential sales. For established businesses, historical sales data can serve as a foundation. Analyse trends like seasonality and consider external factors such as market conditions, regulatory changes, or supply chain challenges.

New businesses, however, will need to rely on extensive industry research to forecast future sales. Understanding market demand and customer behaviour will help generate more realistic sales projections.

2. Create Your Expense Projection

Next, develop an expense projection. This involves estimating both fixed and variable costs. While you may have better control over internal expenses, be sure to account for external uncertainties like price inflation, supply chain disruptions, and unexpected events (natural disasters, equipment breakdowns, etc.). Adding a 10-15% buffer to your projections helps prepare for these unexpected costs.

3. Create Your Balance Sheet Projection

A balance sheet projection provides a snapshot of your company's financial position, including assets, liabilities, and equity. For startups, this projection requires research and assumptions, while established businesses can leverage historical data to estimate future balance sheets. Cloud-based accounting software can simplify this process.

4. Make Your Income Statement Projection

An income statement projection outlines your expected profits or losses over a period. For existing businesses, use previous income statements as a basis. For startups, make reasonable estimates based on market research and competitor data. It's essential to remain grounded in reality when making these projections to maintain credibility with potential investors.

5. Create Your Cash Flow Projection

Finally, a cash flow projection forecasts the inflows and outflows of cash over a specific period. This projection, linked to your income statement and balance sheet, offers insight into how much liquidity your business will have at different stages. Established businesses can rely on historical cash flow statements, while startups must closely examine the timing of revenues and expenses to ensure a steady flow of cash.

What Goes into a Financial Projection?

An accurate financial projection includes several key components:

1. Income Statement

The income statement summarizes revenues and expenses over a specific period, such as a quarter or year. Key components include:

- **Revenue:** Total earnings from sales.
- **Expenses:** Costs incurred, including product costs and operational overhead.
- **Pre-Tax Earnings:** Income before taxes are deducted.
- **Net Income:** Total revenue minus expenses, reflecting the company's profitability.

2. Cash Flow Statement

The cash flow statement tracks the movement of money in and out of the business. It is broken into:

- **Cash Revenues:** Estimated cash sales for a set period.
- **Cash Disbursements:** Expected cash expenditures.
- **Net Cash Revenue:** Cash revenues minus disbursements.

3. Balance Sheet

The balance sheet reflects the company's financial standing at a given point, focusing on:

- **Assets:** Valuable company-owned resources (inventory, property, etc.).
- **Liabilities:** Any debts or obligations owed by the business.
- **Equity:** The difference between assets and liabilities, indicating ownership value.

What Are Financial Projections Used For?

Financial projections are valuable tools for a variety of purposes, including:

- **Internal Planning and Budgeting:** Projections help in allocating resources and planning for business milestones.
- **Attracting Investors and Securing Funding:** Investors and lenders use financial projections to assess the viability of your business and the likelihood of repayment.
- **Evaluating Performance and Identifying Improvement Areas:** Financial projections provide benchmarks to measure the company's financial health over time.
- **Making Strategic Business Decisions:** Projections assist in determining the optimal timing for major expenditures or expansions.

Financial Projection Advantages

Creating financial projections offers numerous benefits:

- Helps make informed financial decisions.

- Provides clarity for growth strategies and business expansions.
- Demonstrates repayment plans to lenders and investors.
- Pinpoints key financing needs.
- Assists in optimizing pricing strategies and production plans.
- Facilitates better management of future cash flows.

Conclusion

Financial projections are essential to any business's success, whether you are in the early stages of a startup or running an established company. By following best practices and using reliable tools like accounting software, you can create realistic financial forecasts that guide your business's strategy and secure the necessary funding for growth.

For those seeking an efficient way to generate these reports, platforms like FreshBooks offer helpful tools to simplify financial forecasting and provide valuable insights into your business's performance.

To know more about our services then contact us on:

Mobile: +91-8851671107

Email: connect@slmconsulting.in

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