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The Importance of a 13-Week Cash Flow Forecast

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It is no secret that the recent pandemic has wreaked havoc on the global economy, pressuring businesses across all industries to take severe measures to “weather the storm” to ensure their survival. As businesses, both large and small, are forced to rapidly address their liquidity positions, we increasingly hear about actions aimed at preserving cash that have included asset sales, drawdowns of revolving lines of credit, site closures, employee layoffs, vendor negotiations, employee compensation adjustments and furloughs.

Given that cash is the “lifeblood” of any business, measures such as these are often necessary. However, through times of business expansion and contraction, we have witnessed organizations expending substantial time and resources developing tactics around either/or cash generation and cash preservation. As a result, we strongly recommend to our clients that they invest the time and resources towards developing a basic but often overlooked management tool; a 13-week cash flow forecast model (the “cash flow forecast”). In this brief summary we will talk about the key components of a cash flow forecast as well as a few of its key benefits, namely in empowering organizations to make thoughtful, informed decisions that are data driven in nature.

The Forecast and Key Components

The cash flow forecast is a real-time model that breaks down the cash inflows and outflows of a business into discrete parts and it provides the most accurate depiction of a business’s financial health (or lack thereof) as well as valuable insight into the drivers of that health.

It is important to note that development of this model should incorporate the involvement of senior leadership that provides input into the underlying assumptions *and is willing to provide* potential ownership re: the development and reporting of specific categories and / or line items. These owners need to change their mindset to one of “cash in and cash out” rather than “what hits the P/L” (example: sales mean nothing if they can’t be converted to cash). While the high level components of a cash flow forecast are shown below, each of the key component buckets should be segmented into specific line item components labeled with sufficient detail in order to create period by period comparisons (for example, “Leases” may be a line item within Cash Disbursements). Key component buckets include:

- **Beginning Cash Balance:** Recommend calculating on a Book Cash basis and will require a Bank to Book cash reconciliation.

- **Cash Receipts:** Typically consists of both the collection (both amount *and* timing) of existing A/R as well as future sales and their associated collection (both amount *and* timing); segmentation by key customer with appropriate DSO assumptions. Include misc. sources of cash as well.
- **Cash Disbursements:** Break out into operating cash, investing cash and financing cash disbursements (subtotals). Operating cash disbursements can be thought of as normal course payments for items such as payroll, supplies, rent, etc. Investing cash disbursements can consist of several different things but the main line items we typically see needing attribution are capital expenditures. Financing disbursements relate to debt, equity, dividends. The most common relate to interest expense or principal payments on loans.

The beginning cash balance adding forecasted weekly cash receipts less forecasted weekly cash disbursements can provide a real-time view on the organization's liquidity. The analysis should then be rolled forward each week. While opinions differ on the appropriate time period, 13 weeks is generally considered a good midpoint period; short enough to provide real-time visibility and accuracy (one calendar quarter) but long enough to provide the business insights that can be strategic in nature.

The Benefits of Visibility in Decision-Making

We subscribe to the theory that enhanced visibility into the go-forward liquidity position of an organization can be empowering and can result in thoughtful, informed and data driven decisions. Among the numerous benefits of a cash flow forecast are the following:

1. **Allow the business to identify and enhance cash systems and controls**—Numerous issues can be identified and addressed such as how cash disbursements are administered (process), how the business can understand amount and timing of financing requirements, how sales are forecast with associated cash receipts and when the business may hit roadblocks that don't allow it to fund key operating costs such as payroll. These are just a few of the benefits.
2. **Allows the business to address its sales and collection process**—Perhaps certain key customers (or profiles) don't pay as timely as others, the business may not be invoicing correctly or in a timely manner, appropriate mechanisms, systems may not be set up to accurately record sales, discounts and importantly capture cash receipts. We have found on numerous occasions that businesses don't actively monitor and aggressively follow-up on delinquent A/R or offer incentives (assuming make economic sense) to accelerate collections. Sales don't mean anything if they cannot be collected.
3. **Allows the business to identify non-core assets and create asset disposition plans**—In these circumstances, businesses are forced to address assets that are non-core in nature to key business operations. These may be real estate, inventory, certain business lines that may be unprofitable, etc. If assets are non-core to operations and they can be monetized they should be or at least there should be some consideration of this possibility. Not only does this allow a business to generate cash but it also removes management distraction and time from administering these assets.
4. **Allows the business to address its vendors in a critical manner**—With a cash flow forecast the theoretical becomes the actual and a light can be shone on vendors regardless of type that are bleeding cash from the business but may not be generating significant ROI. With a forecast, the amount, timing, magnitude of these disbursements can be readily understood and this can lead to better process on the front end in terms of identifying and approving vendors and vendor relationships.

We have found on numerous occasions that businesses, regardless of whether they are in expansion of contraction mode, have found the benefits of a cash flow forecast to be significant as it illustrates in a dispassionate manner how the resources of the business are being allocated. With this knowledge, data driven decisions can be formulated.

Once the forecast is prepared, it will be critical for the business to pressure test assumptions on a weekly basis, understanding actual versus forecast receipt/disbursement results versus prior assumptions and most importantly, understanding the reasons behind any key variances (are they permanent or timing in nature and why?). With the benefit of measurement, forecasts can be further refined for the business while key processes are bolstered, putting the business in a more advantaged position and enhancing the probabilities for future success.

How Can We Help?

M4 Advisors is a business advisory firm focused on working for a diverse array of parties with interests in companies facing operational and financial challenges and delivering upon solutions for those key stakeholders. Our extensive business experience working as operating partners and as executives has provided us with a unique experience set and the ability to seamlessly flex into challenging situations and drive actionable results via three core service lines of business:

- Turnaround and Restructuring
- Transaction Advisory Services
- Performance Improvement

Please contact us to see how we might help either by email (tmcinerney@m4adv.com) or by phone (917-816-2685).