

Forecasting Cash Flow: 5 Common Errors

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Cash flow forecasting is one of the most difficult, yet important, aspects of financial management. A cash flow projection shows the expected cash inflow and expenditure of your business, an important tool in predicting how much capital investment is needed, and in making sure you have enough cash available throughout the year. It is also a useful tool in setting realistic business goals and preparing for “worst” case scenarios.

Forecasting your cash flow is essential in determining short and long term funding needs. However, there are many ways this process can go wrong, and ultimately, damage your organization. Below are five of the most common errors businesses make when forecasting cash flow.

1. Under-Committing

Cash flow forecasting is a vital business tool and requires much attention – therefore, it should be allotted sufficient time and resources. It is generally not a good idea to delegate this task to junior-level employees who might lack the understanding of company finances, or overloaded senior staff who lack enough time to dedicate to the area. Top level executives should be part of this process and make it a priority within the company.

2. Being Overly Optimistic

It is human nature to see the glass half-full, and this translates into the business world. One of the main dangers of cash flow forecasting is overestimating sales. On the flip side, organizations tend to underestimate the occurrence and impact of negative events, making it difficult to recognize and plan accordingly for potential “worst” case scenarios. You should always draft [best-case and worst-case forecasts](#) and put them to the test to better prepare for potential positive and negative impacts on cash. Stephen King from *Inc.* states, “With forecasting bank requirements and preparing cash flow projections, realistic views should always be taken about future prospects.” Projections should be supported by past experience and ample research.

3. Not Updating Enough

Most likely, your cash flow forecast is not going to align perfectly with reality. It is very important to regularly compare your actual cash flow with your prediction so you can make necessary adjustments. Susan Ward from *about.com* states, “Keep a close eye on your cash flow, so you can forecast potential cash flow problems and take steps to remedy them.” It is unrealistic to expect a perfect cash flow projection at first; however, if you review your actual results with regularity, little significant variance will occur. It is also important to update your forecast when important new information or cash flow is introduced. Darlene Horton at Sageworks recommends no more than a [5% margin of error](#).

4. Lack of Communication

Avoid operating within a vacuum and include all members and areas in your organization when creating a cash flow forecast. Developing these communication channels is key to creating an exhaustive cash flow projection. Whoever is in charge of forecasting should establish a strong line of communication with anyone in the company who impacts significant cash flow expenditures so they can be integrated in the overall forecasting model. Other staff and members of the management team should review the tentative projection and [ensure that their initiatives are accounted for](#).

5. Late Loans

If you think you are going to need a loan, it is better to get one early. Not only are you more likely to receive the loan, but you are also perceived as being in control of your cash and finances. A

strong cash flow projection will show a loan officer that your business is a good credit risk and a good candidate for a short term loan or line of credit. People tend to overestimate the availability of loans, grants, credit and equity, and this can have a devastating impact on your business later on when you find you do not have enough funding and the bank will not offer you any grants or loans.

It is important to keep a close eye on your cash flow and forecast as realistically and exhaustively as possible. This will ensure greater control over cash and availability of loans and credit. Cash flow projections are one of the most essential and effective tools an organization can create, so make sure this is at the top of your priorities to ensure healthy finances in your organization.

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