Finance Group

Cash pro's

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What is financial forecasting?

Financial forecasting is the process of using past financial data and current market trends to make educated assumptions for future periods. It is an important part of the business planning process and helps inform decision-making.

Effective forecasting relies on pairing quantitative insight with creative evaluation.

- **Why is financial forecasting important?**
- **Forecasting is the basis of every financial decision your company will make in a given time period. Strong financial forecasting practices tend to lead to better financial outcomes, more stable cash flow, and better access to the credit and investment that can help your business grow.**
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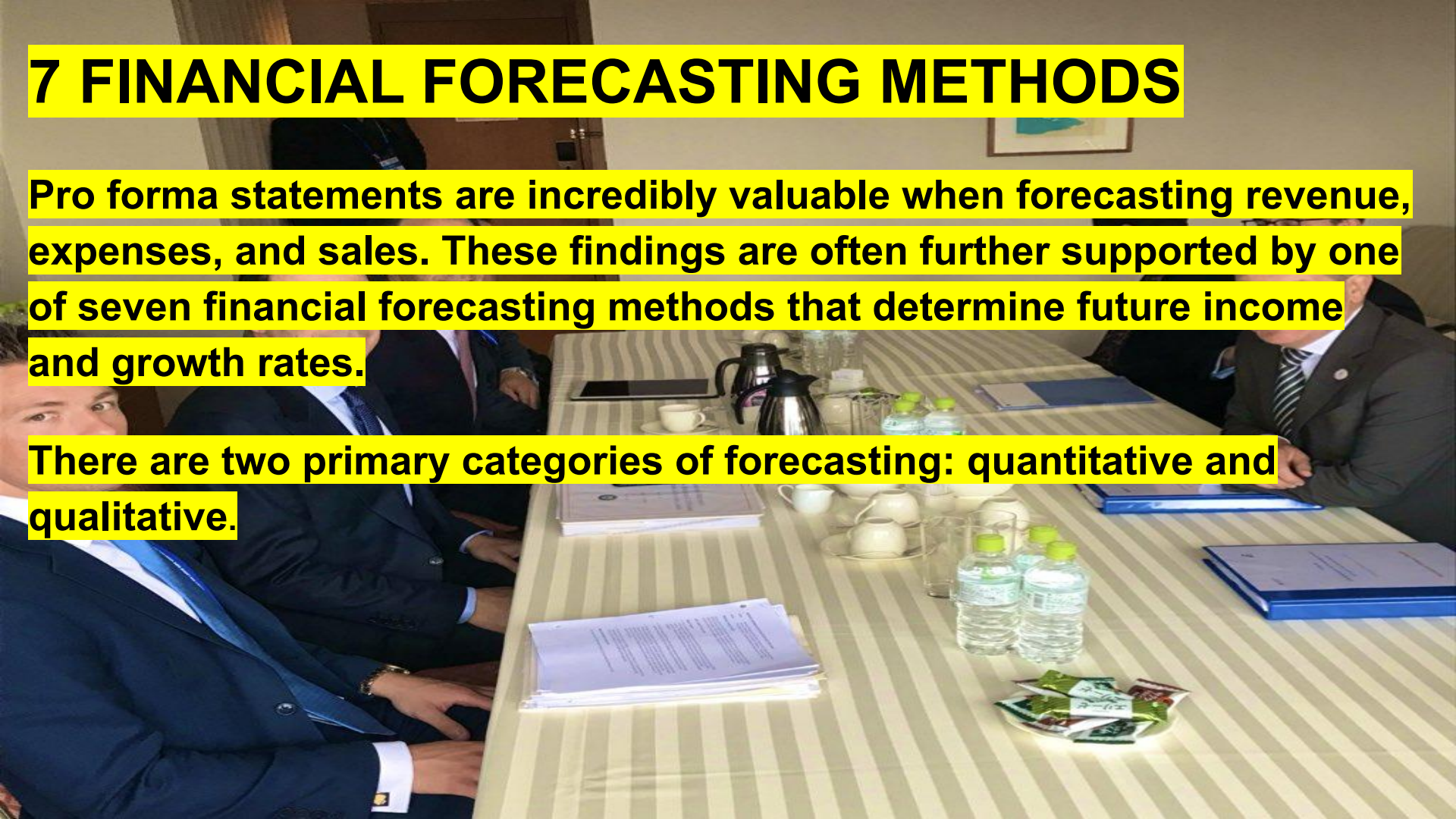
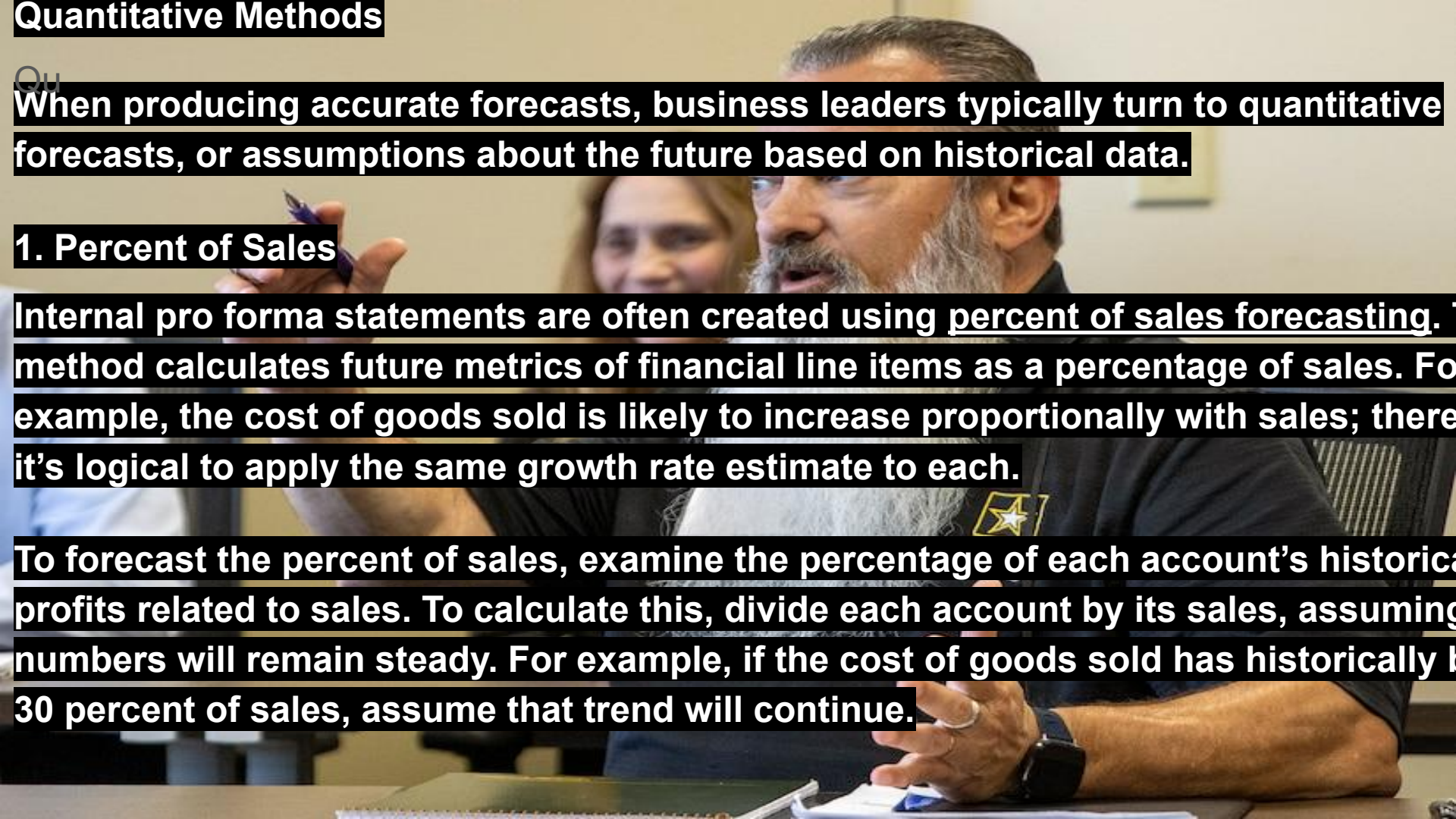
7 FINANCIAL FORECASTING METHODS



Pro forma statements are incredibly valuable when forecasting revenue, expenses, and sales. These findings are often further supported by one of seven financial forecasting methods that determine future income and growth rates.

There are two primary categories of forecasting: quantitative and qualitative.



Quantitative Methods

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When producing accurate forecasts, business leaders typically turn to quantitative forecasts, or assumptions about the future based on historical data.

1. Percent of Sales

Internal pro forma statements are often created using percent of sales forecasting. T method calculates future metrics of financial line items as a percentage of sales. Fo example, the cost of goods sold is likely to increase proportionally with sales; there it's logical to apply the same growth rate estimate to each.

To forecast the percent of sales, examine the percentage of each account's historica profits related to sales. To calculate this, divide each account by its sales, assuming numbers will remain steady. For example, if the cost of goods sold has historically b 30 percent of sales, assume that trend will continue.

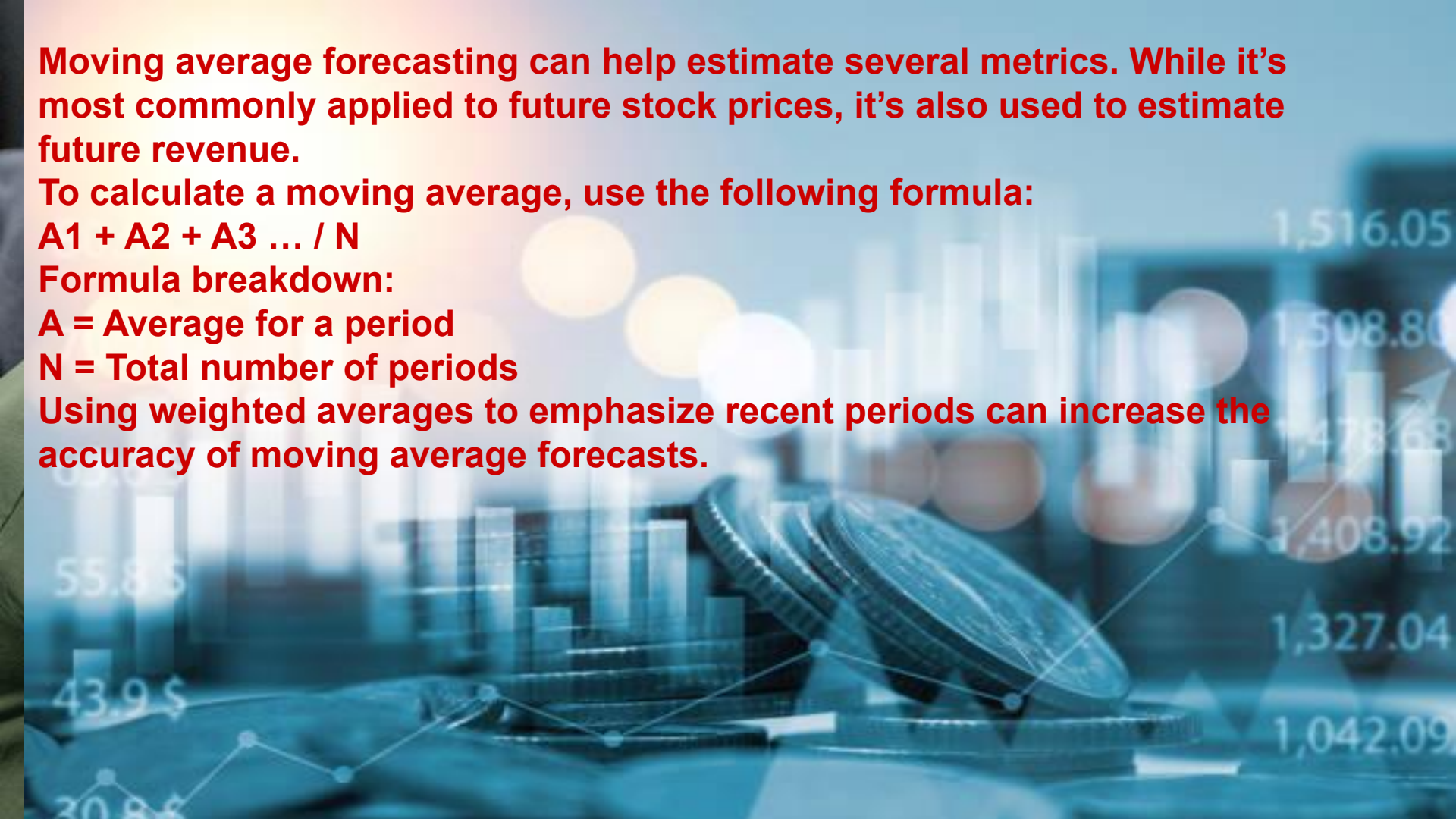
2. Straight Line

The straight-line method assumes a company's historical growth rate will remain constant. Forecasting future revenue involves multiplying a company’s previous year's revenue by its growth rate. For example, if the previous year's growth rate was 12 percent, straight-line forecasting assumes it'll continue to grow by 12 percent next year.

Although straight-line forecasting is an excellent starting point, it doesn't account for market fluctuations or supply chain issues.

3. Moving Average

Moving average involves taking the average—or weighted average—of previous periods to forecast the future. This method involves more closely examining a business’s high or low demands, so it’s often beneficial for short-term forecasting. For example, you can use it to forecast next month’s sales by averaging the previous quarter.



Moving average forecasting can help estimate several metrics. While it's most commonly applied to future stock prices, it's also used to estimate future revenue.

To calculate a moving average, use the following formula:

A1 + A2 + A3 … / N

Formula breakdown:

A = Average for a period

N = Total number of periods

Using weighted averages to emphasize recent periods can increase the accuracy of moving average forecasts.

. Simple Linear Regression

Simple linear regression forecasts metrics based on a relationship between two variables: dependent and independent. The dependent variable represents the forecasted amount, while the independent variable is the factor that influences the dependent variable.

The equation for simple linear regression is:

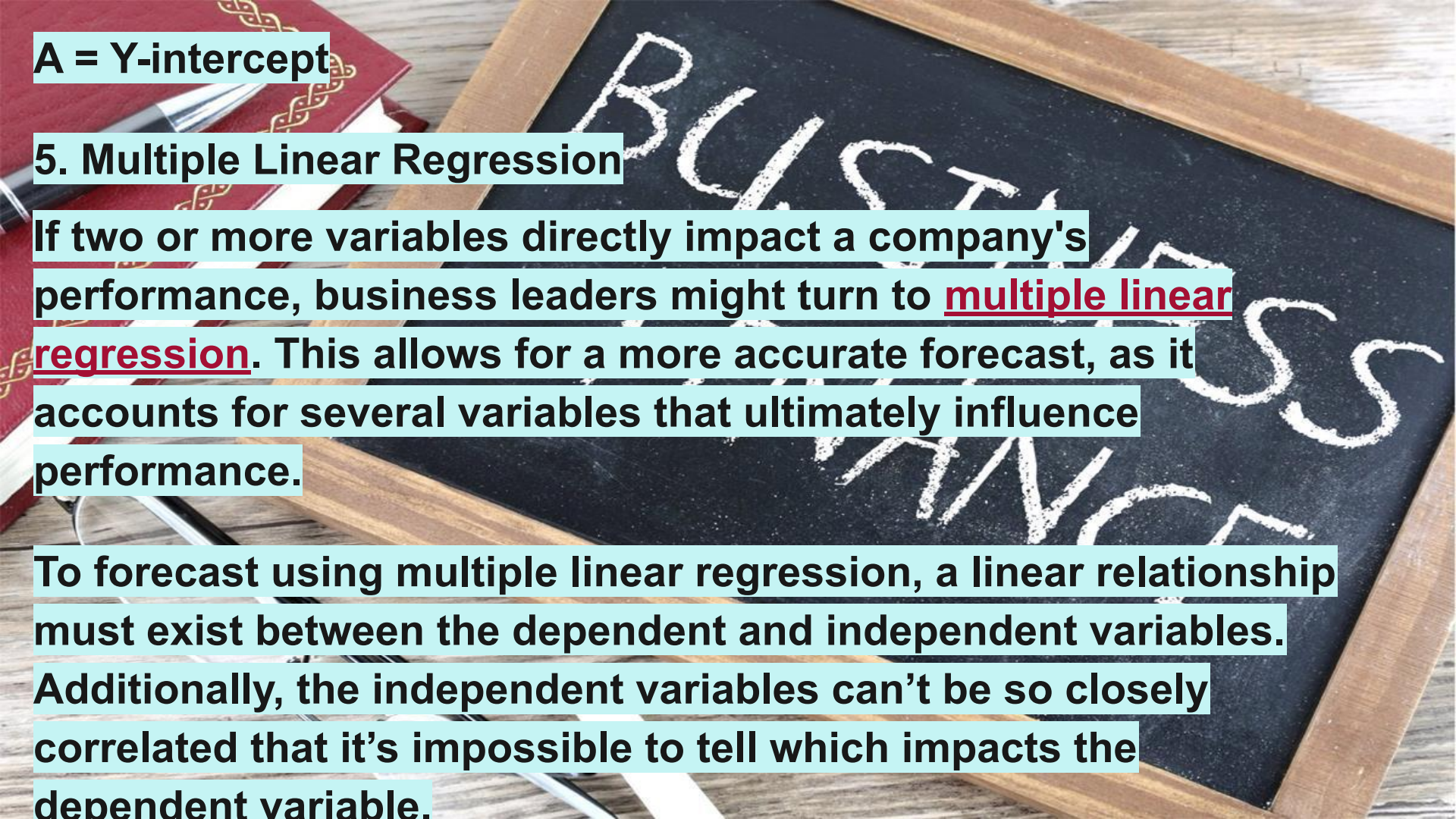
$$Y = BX + A$$

Formula breakdown:

Y = Dependent variable (the forecasted number)

B = Regression line's slope

X = Independent variable



A = Y-intercept

5. Multiple Linear Regression

If two or more variables directly impact a company's performance, business leaders might turn to multiple linear regression. This allows for a more accurate forecast, as it accounts for several variables that ultimately influence performance.

To forecast using multiple linear regression, a linear relationship must exist between the dependent and independent variables. Additionally, the independent variables can't be so closely correlated that it's impossible to tell which impacts the dependent variable.

Qualitative Methods

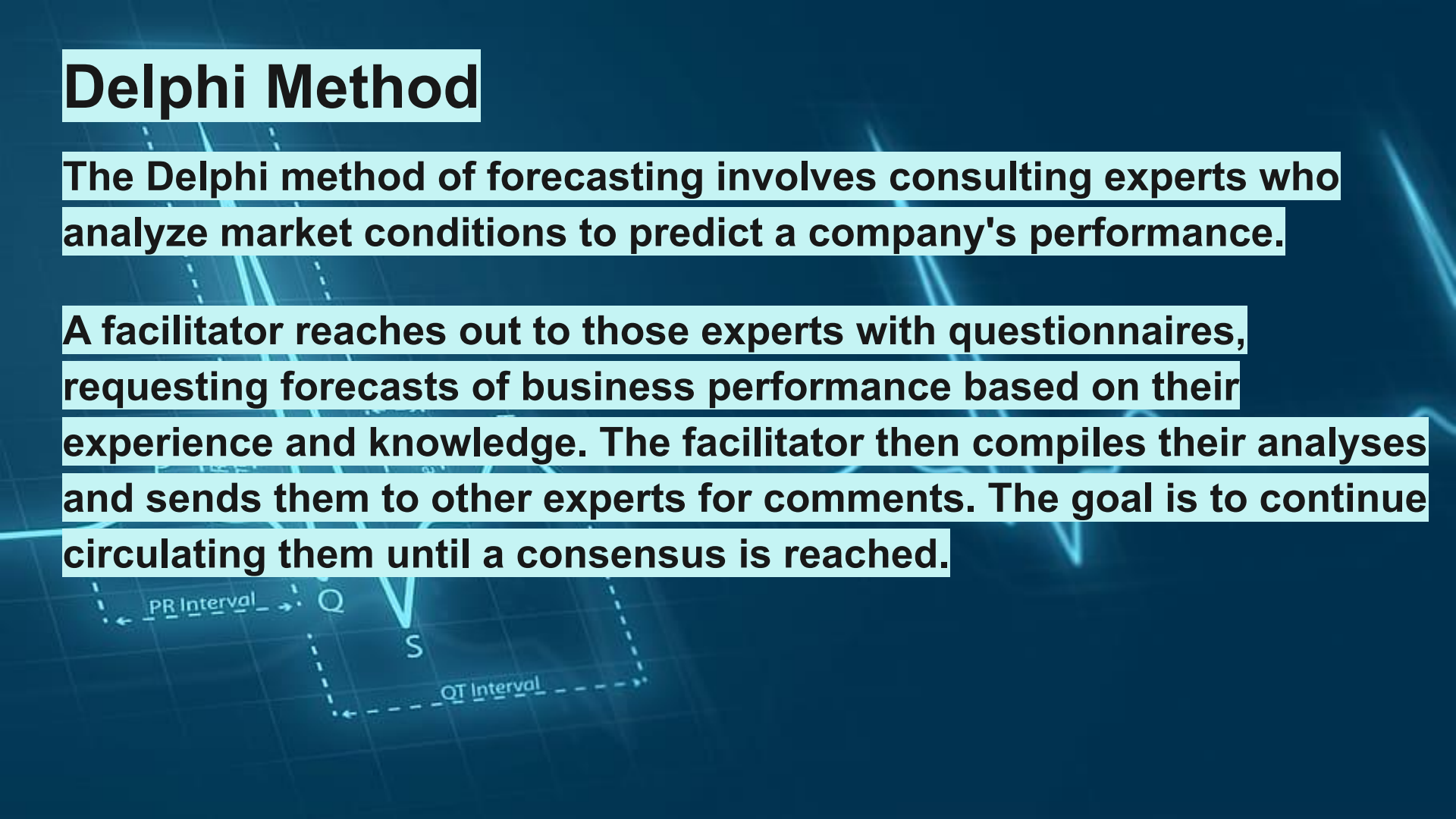
When it comes to forecasting, numbers don't always tell the whole story. There are additional factors that influence performance and can't be quantified. Qualitative forecasting relies on experts' knowledge and experience to predict performance rather than historical numerical data.

These forecasting methods are often called into question, as they're more subjective than quantitative methods. Yet, they can provide valuable insight into forecasts and account for factors that can't be predicted using historical data.

Delphi Method

The Delphi method of forecasting involves consulting experts who analyze market conditions to predict a company's performance.

A facilitator reaches out to those experts with questionnaires, requesting forecasts of business performance based on their experience and knowledge. The facilitator then compiles their analyses and sends them to other experts for comments. The goal is to continue circulating them until a consensus is reached.

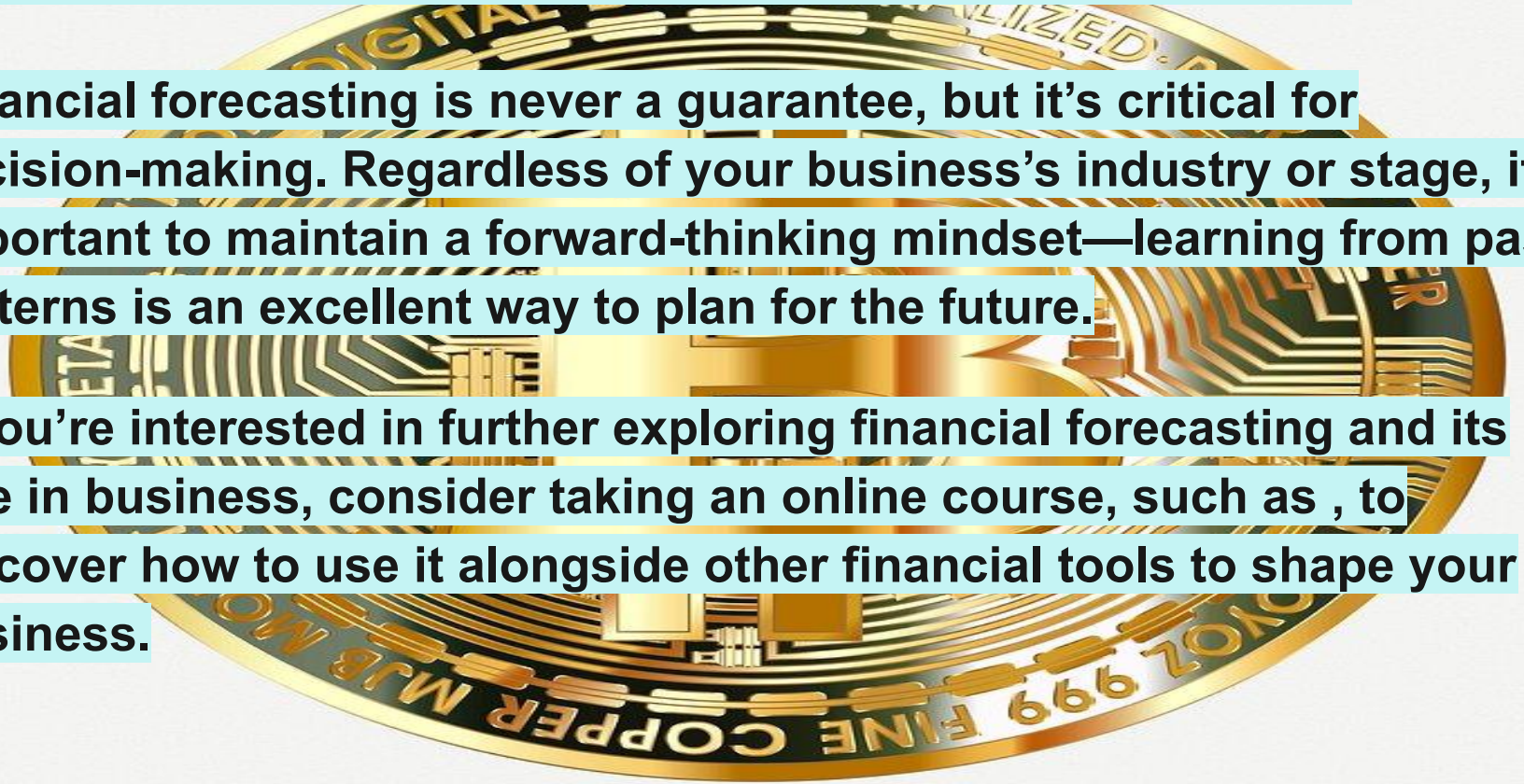


Market Research

Market research is essential for organizational planning. It helps business leaders obtain a holistic market view based on competition, fluctuating conditions, and consumer patterns. when historical data isn’t available. New businesses can benefit from financial forecasting because it’s essential for recruiting investors and budgeting during the first few months of operation.

When conducting market research, begin with a hypothesis and determine what methods are needed. Sending out consumer surveys is an excellent way to better understand consumer behavior when you don’t have numerical data to inform decisions.

IMPROVE YOUR FORECASTING SKILLS



Financial forecasting is never a guarantee, but it’s critical for decision-making. Regardless of your business’s industry or stage, it’s important to maintain a forward-thinking mindset—learning from past patterns is an excellent way to plan for the future.

If you’re interested in further exploring financial forecasting and its role in business, consider taking an online course, such as , to discover how to use it alongside other financial tools to shape your business.

Create Financial Forecasting

Why is financial forecasting important?

Financial forecasts allow you to make more informed business decisions rooted in facts and data. Getting in the habit of creating a monthly financial forecast allows you to plan your next steps in relation to funding, operations, and budgeting. Using historical data, you can look to the future of your business to decide whether it's a good time to hire new staff or fund a new project. Financial forecasting encourages businesses to set more realistic goals in the future.

Factors affecting financial forecasting

Financial forecasting involves analysing data as a basis for future predictions. However, there are also a few factors affecting financial forecasting that come from wider market trends and global events.

1. Economic conditions: Both economic and industry-specific trends should be factored into any financial model.
2. Latest technology: Technological advances may have an impact on your business prospects irrespective of past sales trends. Will advances in technology render current products obsolete?

3. Market competition: Is your industry flooded with competitors? Do you need to factor new marketing techniques into your financial forecasts?

4. Changes to demographics: Changes to neighbourhood demographics such as age and household income could be an important factor to consider in forecasting.

5. Seasonal business cycles: Some industries are impacted by seasonal trends. The retail industry trades heavily during the winter holiday season, while the travel sector trades heavily during the summer months.

Although these factors are somewhat predictable, you should also consider a risk assessment for unforeseen macroeconomic risks like pandemics and natural disasters. What are the best and worst-case scenarios for your business?


Thank you!