"Using Financial Statements to Grow Your Business"

I have had people tell me that, while they understand why financial statements are necessary, they believe using them to run their business is like driving a car by looking into the rearview mirror. It's true that historical financial statements have limited usefulness for decision-making. However, forward-looking or forecasted financial statements can be a powerful tool to help you grow your business.
To get the most out of your forecasted financial statements you should (1) start with your long-term goals, (2) go beyond the income statement, (3) identify milestones and incentivize employees to achieve them, and (4) monitor your progress.

Start with your long-term goals

Hopefully it's apparent that the financial statements I'm referring to are not the stereotypical budget you hastily prepare, by adding x% to last year's revenues and expenses, and then stick in a drawer until next year. Instead, these financial statements should be based on your long-term goals.
For example, assume your goal is to sell your business in five years for $10 million. You know that businesses in your industry typically sell for five times net income, so you need net income of $2.5 million five years from now to achieve your goal. You can work your way up the income statement to determine the revenues that you need to generate that specific net income and then fill in the rest of the details. Finally, you can forecast income statements for years one through four to get from where you are today to where you want to be in five years.

Go beyond the income statement

No one ever bought a vacation home with net income. To do that, you need cash flows. So, while forecasting the income statement is a great first step, you also need to forecast the balance sheet.
Growing a company generally requires upfront cash investments in advertising, inventory, equipment, personnel, etc. To be successful, you need to be able to predict when you will need that cash and where it will come from. How much extra cash do you need? Can it be generated internally? Will you need additional debt or equity financing? The only way to answer these questions is to forecast the balance sheet.

As an ancillary benefit, simply going through this process can help keep you focused on managing the balance sheet. For example, an active focus on reducing the time it takes to collect accounts receivable can accelerate your cash flows and reduce bad debts. Both will reduce the amount of external financing needed to fund your growth.

Identify milestones and incentivize employees to achieve them

One of the primary benefits of creating forecasted financial statements is to create expectations for employees in carrying out their job functions that lead towards your long-term goals. By soliciting feed-

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back from key managers and employees in the forecasting process you can create buy-in for the overall objective.

An important element of any growth initiative is incentivizing your key managers and employees to align their goals with your goals for the company. Ideally, the milestones on which you base incentives should be a challenge to achieve, but also attainable, objectively measurable and based on things which your employees can affect.

The costs of these incentives should be included in your forecasted financial statements.

Monitor your progress

I recommend rolling financial statements for each of the next 12 months and then yearly financial statements from that point as far into the future as is practical. Each month you should compare your actual results with the forecasted financial statements to ensure the long-term goal is realistic and that you're on target. If you're not on target, or if circumstances have changed, you should update the financial statements to reflect your revised expectations.

Reviewing your progress monthly you will renew your focus on your long-term goals and improve your chances of success.

If you follow these recommendations you will find that your financial statements become less like a rearview mirror and more like a roadmap for growing your business. Clearly identifying your goals and monitoring your progress will give you peace of mind and the process will provide you with deeper insights into your business.

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