Projecting Your Best- and Worst-Case Financial Scenarios

BEST CASE VS. WORST CASE

Financial forecasts allow you to map the impact of changes in strategies and tactics in pursuit of your business goals.

For this reason, it's recommended you forecast for multiple scenarios in order to:

- Plan for expected financial returns or losses
- Stay proactive in your business decisions
- Mitigate risk by planning for worst-case scenarios

Most often, business owners will plan for a few different scenarios: **base (or regular) case**, **best case** and **worst case**.

Your **base-case scenario** is the average financial outcome that is most likely to happen if you make no real changes.

Your **best-case scenario** is the best possible financial outcome if everything goes according to plan.

Your **worst-case scenario** is the most unfavorable possible financial outcome for your business.

Creating helpful and actionable projections takes time and effort, especially the first time through.

To create your first scenario, follow these steps:

1. Start with your existing Income Statement/Profit and Loss Statement, and review every category of revenue and expense. Think about the changes you want to make, and list the different assumptions that could impact your scenarios *(e.g., operating expenses may increase or decrease)*.
2. Review your market research, and add or adjust any assumptions that reflect possible changes in the market or industry.
3. Fill in the details of those assumptions *(e.g., transportation cost stays the same (**base case**), they increase (**worst case**), or they decrease (**best case**))*.
4. Then project the values into the appropriate financial statement *(e.g., transportation cost remains at $5,000/yr (**base case**), they increase by $3,000 (**worst case**), or they decrease by $1,500 (**best case**))*. Take particular note of action items that can help you reduce expenses and increase revenues.

For a better understanding, check out the best case/worst case example.

BEST CASE/WORST CASE EXAMPLE

3-Year Income Statement				Best Case/Worst Case Projections: Year 4					
	Y1 Actual	Y12 Actual	Y3 Actual	Base-Case Scenario	Best-Case Scenario	Worst-Case Scenario	Base-Case Assumptions	Best-Case Assumptions	Worst-Case Assumptions
REVENUE (SALES)									
Installation	$200,000	$400,000	$560,000	$616,000	$1,008,000	$420,000	Annual 10% growth over last 3 years	Added new installer 80% increase	Regional economic slump 25% decrease
Bio locks		$60,000	$75,000	$82,500	$120,000	$48,750	Annual 10% growth over last 3 years	Social media blitz 60% increase	New public study shows decreased effectiveness by 35%
Basic locks			$112,000	$123,200	$134,400	$84,000	Annual 10% growth over last 3 years	New installer increased capacity 20%	Regional economic slump 25% decrease
Total Revenue (Sales)	**$200,000**	**$460,000**	**$747,000**	**$821,700**	**$1,262,400**	**$552,750**			

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COST OF GOODS SOLD									
Basic locks	0	0	$89,600	$94,080	$85,120	$103,040	5% annual increase expected	New supplier brings 5% savings	Lost supplier, new supplier brings 15% increased cost
Bio locks		$8,000	$10,000	$10,000	$9,000	$11,500	No change	Supplier gave quantity discount of 10%	Lost this supplier as well, new supplier brings 15% increased cost
Total Cost of Goods Sold	**0**	**$8,000**	**$99,600**	**$104,080**	**$94,120**	**$114,540**			
Gross Profit	**$200,000**	**$452,000**	**$647,400**	**$717,620**	**$1,168,280**	**$438,210**			
EXPENSES									
Salary expenses	$100,000	$100,000	$100,000	$100,000	$125,000	$50,000	Owner salary the same	Owner 25% raise	Decreased owners' salary
Payroll expenses	0	$75,000	$125,000	$125,000	$165,000	$75,000	Kept same team	Added an installer	Reduced size of team
Payroll taxes and benefits	$15,000	$26,250	$33,750	$33,750	$43,500	$18,750	Same payroll t axes and bens—kept same team	=(165k+125k)*.15	= (75k+50k)*.15
Outside services	0	0	0	0	$100,000	0		Training expense around operation of machine	Free online training available

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EXPENSES									
Supplies (office and operating)	$12,000	$15,000	$20,000	$20,000	$18,000	$20,000	No change	Changed lease to more efficient copier	No change
Repairs and maintenance	0	0	0	0	0	$5,000		No repairs	Repaired used manufacturing equipment
Advertising	$5,000	$5,000	$5,000	$5,000	$4,000	$5,000		More efficient use of social media	Spending remains same
Car, delivery and travel	$5,200	$10,400	$10,400	$10,400	$14,000	$45,400	No change	Extra travel costs for increased installations	Had to replace vehicle
Accounting and legal	0	0	0	0	0	$1,000	Continued to be done by owner and spouse. Worst case: New accounting laws require outside help.		
Rent & related costs	$6,000	$24,000	$48,000	$48,000	$45,600	$52,800	No change	Bartered bio system & maintenance for decreased rent	Rent goes up 10%
Telephone	$1,440	$3,380	$3,380	$3,380	$3,000	$3,500		New, less expensive plan that includes more people	Contract increase
Utilities	0	$11,000	$21,000	$21,000	$19,000	$24,000		Lowered with LED light install	Price increase
Insurance	$8,000	$13,000	$24,000	$24,000	$20,000	$27,000		Drivers took extra training for insurance rebate	Price went up due to minor accidents

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EXPENSES									
Taxes (personal property tax, real estate, etc.)	0	0	$2,400	$2,400	$2,400	$2,650		Personal property taxes remain the same	Personal property taxes (on machine) increase
Interest	0	0	$9,000	$9,000	$9,000	$9,000		Static—$25K depreciation (half year first and last year w/ rest straight-line depreciation)	Static—$25K depreciation (half year first and last year w/ rest straight-line depreciation)
Other expenses (specify)									
Other expenses (specify)									
Misc. (unspecified)									
Subtotal Expenses	**$152,640**	**$283,030**	**$414,430**	**$426,930**	**$539,500**	**$364,100**			
Reserve for Contingencies									
Total Expenses									

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EXPENSES									
Net Profit before Taxes	$47,360	$168,970	$232,970	$290,690	$628,780	$74,100			
Federal Income Taxes	$9,472	$33,794	$46,594	$58,138	$125,756	$14,820			
State Income Taxes	$2,368	$8,448.50	$11,648	$14,534.50	$31,439	$3,705			
Local Income Taxes	0	0	0	0	0	0			
Net Operating Income	$35,520	$126,727.50	$174,728	$218,017.50	$471,585	$55,575			

IMPROVING YOUR FORECASTING PREDICTIONS

After you run your best- and worst-case scenarios, consider the following checks and balances:

Collaborate with Others

- Gather input from your team to gain valuable insights.
- Have an optimist and a pessimist in the room– advising/looking at your projections.
- Run your ideas by others to gain different perspectives.

Compare, Project and Assess

- Compare your projections to similar companies.
- Leverage technology to analyze data. An Excel spreadsheet can be your friend.
- Identify multiple *key performance indicators* (KPI) to remove bias.

Regularly Assess Your Projections

- Ask the challenging questions.
- Take note of action items that can help you reduce expenses and increase revenues.

ACTION ITEMS

Spend some time researching your market and reviewing your business goals and strategies. Then create a financial forecast for your business. Depending on your business goals, plan for three to five years out.

Before you dive into your forecast, consider these questions:

1. *What are your assumptions and predictions about your industry, your company and other factors that could impact your revenue and expenses over the next three to five years?*
2. *How will you monitor the market? What changes will you make if you're not meeting certain goals?*
3. *What's your plan if the worst-case scenario comes true? Are you ready if your best-case scenario comes true?*
4. *Are your projections realistic? How will you incorporate new data?*

Conclusion:

Developing financial scenarios can help you get a sense of all the possibilities. Equipped with these projections, you'll be able to use this information to make more-informed financial decisions for your business.