

Building a Better Cash Forecasting Model in Manufacturing: Start with the Right Focus

In manufacturing, cash forecasting is both an art and a science. Between fluctuating material costs, long lead times, and dynamic supplier relationships, it's easy for forecasts to drift from reality. Many companies rush to build complex forecasting models — but the real starting point is much simpler: understand where your biggest forecasting gap lies.

Cash flow in manufacturing typically revolves around four major components: Inventory, Accounts Payable (AP), Accounts Receivable (AR), and Fixed Assets.

Before creating a new forecasting model, assess which of these components drives the largest error or variance in your forecast. For illustration, let's assume our biggest challenges are in Accounts Payable and Inventory — two areas that are deeply interconnected.

1. Understanding Accounts Payable

AP balances rise when we receive inventory and fall when we pay invoices. To forecast it accurately, start with receipts:

- Apply the 80/20 rule — focus on your largest inventory items.
- Partner with your production planner to understand when materials are needed.
- Build a simple table of major inventory items, their supplier names, and expected receipt dates.
- Start with your ending AP balance and add forecasted receipts for the next 12 months.

Then, move to disbursements:

- Get supplier payment terms from your sourcing team.
- Link these terms to your material receipt schedule.
- Build a cash disbursement schedule to project when payments will actually occur.

2. Forecasting Inventory

Since we already have expected material receipts, the next step is estimating consumption.

Here's the process:

- Obtain the production plan (how many units you'll produce each month).
- Pull a costed Bill of Materials (BOM) from your ERP system.
- Estimate material consumption based on production volume.

Example:

If Product A uses materials 1, 2, and 3 (each costing \$10) and you plan to produce five units next month, material consumption = \$50. Add labor and overhead (say \$10), and you get \$60 total monthly inventory consumption.

3. Connecting the Dots

Now you can model balances for both areas:

- $AP\ Balance = Beginning\ AP + Goods\ Receipts - Disbursements$
- $Inventory\ Balance = Beginning\ Inventory + Goods\ Receipts - Consumption$

These two components alone capture a significant portion of your cash flow drivers.

4. Bringing It All Together

Once your model includes all four components, your cash flow becomes clearer:

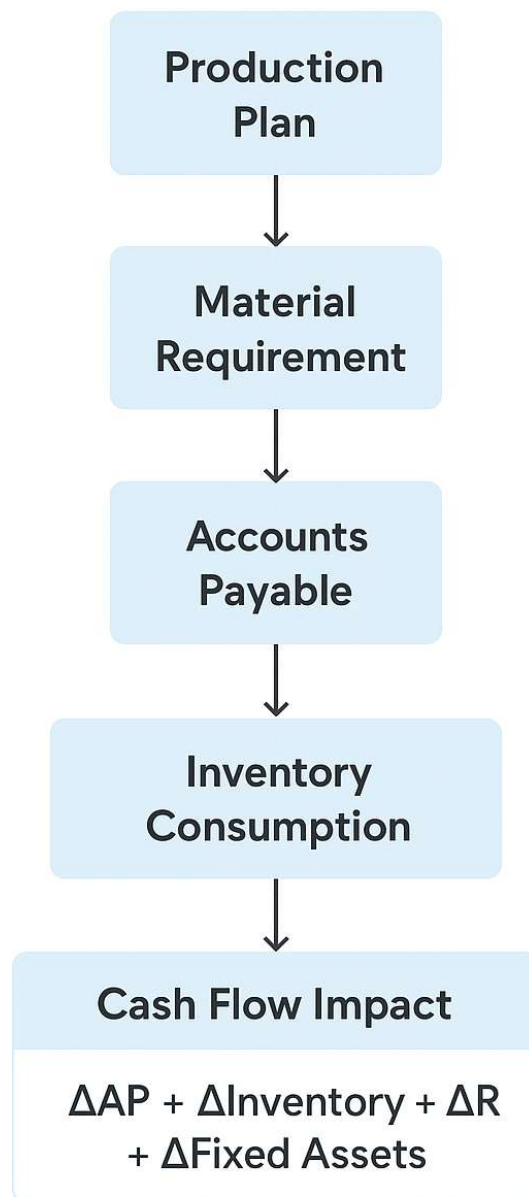
$Cash\ Flow = Change\ in\ AP + Change\ in\ Inventory + Change\ in\ AR + Change\ in\ Fixed\ Assets$

This provides a dynamic picture of how operational activities translate into cash movement.

5. Visual Summary

Below is a simplified visual of the process:

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Final Thought

Before implementing any complex forecasting system, first pinpoint where your forecast is most inaccurate. Then build focused, data-driven models around those areas.

Sometimes, the biggest improvement in forecasting doesn't come from technology — it comes from clarity, collaboration, and simplicity.

💬 What's been the most challenging part of cash forecasting in your organization — AP, AR, or Inventory? We would love to hear your thoughts in the comments.

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