Sales Forecasting

A sales forecast will be a key part of your company's financial planning process. A sales forecast is a prediction of the amount of future sales your company expects to achieve over a certain period of time. Think of a sales forecast as a tool to help evaluate the health of an established company or the feasibility of a new business venture.

Preparing a Sales Forecast

Sales forecasts for established companies are usually based on past sales performance. A forecast also takes into account such factors as the current economy, sales trends, company goals and capabilities, and what the competition is currently doing. There are four general steps in preparing a sales forecast:

1. Analyzing current conditions. Analyze the current company and market conditions. Do this through market research and by updating your SWOT analysis chart to analyze strengths, weaknesses, opportunities, and threats.
2. Reviewing past sales. Review your company's past sales figures. You can usually use past sales to project future sales. Sales often show seasonal variations. For example, you would sell more skis and sleds in the winter and more shorts and sandals in the summer. If you do not have past sales data because you are starting a new business, you will need to research general sales history for your industry. You can obtain this information from industry associations and by asking similar businesses outside your area.
3. Making educated predications about the future. Is there something in the future that could cause a change in your future sales? Will you need more or less promotion, or perhaps different types of promotion? Will you need more employees to accommodate these changes? Should you increase or decrease prices?
4. Estimating your future sales for a specific time period. Ask yourself if these sales will bring in more income than you expect to spend. Will these sales be enough to make a profit?

Sales Forecasting Techniques

There are many methods for estimating sales. Often, more than one technique is used to help make predictions as accurate as possible. This is because most techniques cannot take into account all of the factors that can impact sales. If you plan to work with a bank to help finance your new business venture, you will probably want to make multiple sales forecasts. For example, make one that represents a best-case scenario, one for a worst case scenario, and one in between. This will lend more credibility to your business plan. Here are some common forecasting techniques:

- <u>Full Capacity</u>. This technique is pretty simple: you forecast selling as many products (or performing as many jobs) as you can. Often a young entrepreneur who is going to school has only so much time to devote to the business. For example, if you can spend 10 hours a week making candles, and you can make 20 candles an hour, your full capacity for a week would equal 200 candles. If it turns out that you can't sell all you can make, you'll need to adjust your forecast.
- <u>Observational Data</u>. One of the best ways to forecast sales is to observe your competitors' customers. For example, if you are opening a restaurant, you could sit in the restaurants your target customers frequent that are near your desired location. You could note such things as the number of customers who ate in the restaurant, how much they spent, and what they ate. This data would help you forecast your own sales.
- <u>Number of Customers versus Distance</u>. This technique is used primarily by businesses in which the customer must visit a physical store to make purchases. Examples include a hair or nail salon, a dry-cleaning business, and a car-wash. You would determine the number of households living within 5 miles of your business location that use your product/service. Then estimate how much they will spend for these items per year. Estimate what percentage of money they will spend with you as compared with your competitors.
- <u>Market Share</u>. If the main portion of your goods is sold via the Internet or by catalog, you first estimate your market share in terms of customers in your shipping range. Then calculate how often and how much the people in your market share might buy from you per year.

Think Critically

1. Why is sales forecasting important?

2. List the four general steps to preparing a sales forecast.

3. Name four common sales-forecasting techniques.

4. Why is it important to make more than one type of sales forecast?

5. Which sales forecasting technique do you think makes the most sense for your business plan? Why?