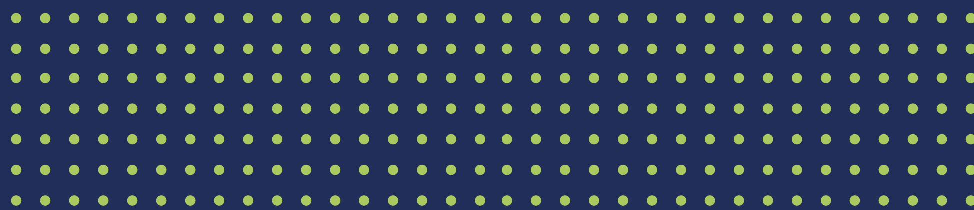
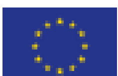
INNOVATIVE ENTREPRENEURSHIP



How to forecast sales?



This project is funded by the European Union.

NI·CO

Project implemented by NI-CO.

How to forecast sales?

This factsheet outlines the importance of sales forecasting and the factors to consider when trying to forecast future sales.

Sales forecasting is a crucial part of setting up and running a business and is essential for ongoing business planning. Forecasting future sales is always uncertain, but it is important for business owners to make credible, evidence-based sales projections in order to plan their business strategy.

Sales forecasting is not an exact science, but is a balance between:

- Facts that can be gleaned from market research, or previous sales figures, such as how often customers might buy a product or service and what they will pay for it.

- A judgement of market conditions and other uncontrollable factors that may affect a business, such as the economic and political climate, seasonal factors or trends.

A sales forecast can stand alone, but it should be closely connected with any sales and marketing plans. It is an integral and fundamental part of the business planning process, as it is central to the projections that are included in profit and loss and cash flow forecasts.

WHY FORECAST SALES?

Forecasting sales is necessary for a number of reasons:

- Cash flow management. This is central to the success of a business, so it is essential to understand how sales forecasting affects the cash flow forecast.

- Planning future resource requirements. A sales forecast can help predict the number of staff needed to produce the necessary products to meet demand or to provide a certain level of service.

- Planning purchasing, production and marketing activities. A sales forecast will help plan for peaks and troughs in demand, and the financial and marketing strategies that will be needed to deal with these.

For a start-up business, the sales forecasts that are produced as a result of market research will help to establish whether the business idea is financially viable.

If a business is already trading, its sales forecast and ongoing market research will help to plan for future growth.

This project is funded by the European Union.

NI·CO

Project implemented by NI-CO.

A sales forecast should show expected sales per month and is normally done for 12 or 24 month periods. Any longer projections are often more difficult to estimate given the length of time they are away.

FACTORS AFFECTING SALES FORECASTING

Prior to developing a sales forecast it is important to consider a number of factors including;

Market awareness

- Confirming if there is an established market for the product or service
- Estimating the size of the market
- Determining is the market growing or declining, and if so, by what percentage each year?
- Establishing the factors are currently influencing that market and what may influence the market in the future
- Reviewing if there are seasonal factors affect sales of the product or service
- Analysing trends or fashions are relevant to the sector

Customer knowledge

- Who the customers for the product or service will be?
- How many of these customers will actually buy the product or service?
- What price are they paying at the minute for comparative products or services?

Capacity

- Is the sales forecast within the limits of current resource capacity and the business' capability to produce the goods or deliver the service?
- How would changes in personnel impact on future capacity?

Competition

- How many competitors does the business have? Even if the business appears to be unique, what is the threat of new competitors entering the market once the product or service has been launched?
- How do the products or services fit into the marketplace?
- How can the business differentiate from what its competitors offer?
- Does the business have flexibility with regard to pricing and the range of products or services offered?

This project is funded by the European Union.

NI·CO
Project implemented by NI-CO.

External factors

• How could political, economic, social, technological, environmental and legal (PESTEL) factors such as oil prices, seasonal trends, interest rates, legislation, political and health issues impact on the business?
• How could the economic climate and other external factors impact on the business and on customers' attitudes?
• What might arise in the future that will have either a positive or negative effect on the sales projections?

PREPARING A SALES FORECAST

Start-up businesses

For any new business they will have no previous sales history on which to base any sort of forecast. Many formal methods of estimating future sales are useful only if the business has been running for some time and has a history of sales trends on which to base a forecast. Accurate information from market research is crucial for anyone making and justifying projections for a start-up business.

Secondary (desk) market research can be helpful, but relevant and specific information can be difficult to find. If no suitable secondary research is available, primary (field) research needs to be carried out with a target customer group. Interviewing potential customers, obtaining 'letters of intent' and testing the market with products or services can provide information with which to estimate potential future sales. For example, someone who is opening a coffee shop could approach potential customers to ask:

• How often do drink coffee?
• On average, how much do you spend on coffee per week or month?

After that, they could calculate how many customers who fit their target customer profile live in the local area. The coffee shop owner could then estimate:

• How often their coffees will be bought.
• How much they can charge for the coffees.

From this information, the coffee shop owner can estimate the total number of sales they expect per week/month/year and the value of those sales.

Existing businesses

If a business is already trading, it should have historical sales data on which to base its forecast, as well as a clearer picture of the market as a whole.

This project is funded by the European Union.

NI·CO
Project implemented by NI-CO.

Every business should keep accurate and up-to-date figures of previous sales on a weekly, monthly and yearly basis. Future sales can be estimated on the basis of current trading levels, that is, existing customers continuing to buy for the foreseeable future.

Alternatively, a business may be in a position where sales have been growing, or even declining, steadily. In this case, previous sales trends should be identified. These trends can then be projected forward to give an estimate of expected future sales.

It is important to talk to key customers about any potential changes in their purchasing patterns and to review market trends regularly. It is also important to take into account the likely effect of any changes in sales strategy, such as new marketing campaigns and price increases or decreases.

Market research should be carried out on a continual basis and this information should be included in the sales forecast.

Impact of pricing strategy on sales forecasts

If a business sells more than one product or service, it should prepare a separate forecast for each item in its range, and forecast:

- By volume (for example, units of the product sold per month).
- By value (for example, sales gained from each product or service sold).
- By a combination of both value and volume.

By considering both volume and value, it is possible to determine a pricing strategy. Is the business going to sell a large volume at low prices (for example a fast food restaurant) or a low volume at premium prices (for example an exclusive restaurant)? It is important to consider what prices the market will tolerate, the cost of producing goods or delivering services and what the business needs to charge in order to make a profit. It may be that raising or lowering the price could impact significantly on sales and therefore it is important to consider the impact of any pricing decisions on total revenue and profitability.

It is important to compare forecasts (and sales records, if appropriate) against the potential capacity to ensure that what you are forecasting is achievable. You need to be sure that you have enough staff and resources to meet the expected production and sales targets or to provide the level of service required.

Other considerations, such as the target market, the location of your business and the quality of the product or service offered, will also contribute to decisions on your pricing strategy.

This project is funded by the European Union.

NI·CO

Project implemented by NI-CO.

Avoiding pitfalls when forecasting sales

In order to give you the best chance to accurately estimate sales you should ;

- Make sure the forecast is based on verifiable, realistic and unbiased market research information.
- Not be tempted to ignore market research if it shows negative results.
- Not make projections solely on the basis of historical performance. Be aware of what else might affect sales in the future and adjust the forecast accordingly.
- Make sure the forecast is achievable in terms of business resources and capacity limits. Is it physically possible to produce the amount of sales being forecast with the personnel, equipment and financial resources available to the business?
- Ensure the pricing strategy used in calculating the sales forecast relate to what is really achievable, making sure prices have not been set too low so that, either way, the forecast is potentially unrealistic.
- Be careful to allow for the possibility that high sales based on an initial promotional surge may quickly drop off. This can result in a need for more intensive marketing and higher ongoing costs once initial interest has peaked.

Sales forecasts should never be overestimated - any assumptions made should be reasonable and achievable. A sales forecast can be used to set targets, prepare budgets, raise finance and analyse staff and other resource requirements. The forecast can also give clues about how a business can shape its future strategy by correlating sales with promotional spending or pricing.

Actual sales results should always be compared against the forecast results. Sensitivity analysis can be used to consider ‘what if?’ scenarios - such as what would happen to the forecast if customer numbers dropped by 10%, or prices were increased by 5%. This will also help to anticipate cash flow requirements and will be useful when adjusting future forecasts.

This project is funded by the European Union.

NI·CO
Project implemented by NI-CO.