How to Forecast Sales

Business Information Factsheet
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Introduction

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

This factsheet outlines the importance of sales forecasting and the factors to consider when trying to forecast future sales. It explains how to prepare a forecast and suggests how pricing strategies can impact on the forecast. It also provides a checklist on how to avoid pitfalls when forecasting and contains hints and tips and sources of further information.

What is a sales forecast?

A sales forecast is a financial projection of the amount of revenue a business will generate from the sales of its products or services. 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.
- **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 a sales and marketing plan. 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 is it necessary to 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.

A sales forecast should indicate expected sales by month. For a start-up business, the sales forecast may cover up to three years so that it can be added to the business plan. For an existing business, the sales forecast will usually cover at least the next 12 months.

Factors to consider when preparing a sales forecast

It is important to ask the following questions when forecasting sales:

Market awareness

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

Customer knowledge

- Is it clear who the customers for the product or service will be?
- Realistically, how many of these customers will actually buy the product or service?
- Do you have detailed customer knowledge to help you determine your strategy on any issues that will affect your pricing policy and sales forecasts?

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?

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 forecast

New businesses

A new business has no previous sales history on which to base a 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 particularly helpful. For example, someone who is considering opening a bed and breakfast business can obtain historical data on bed occupancy levels or visitor numbers from VisitBritain, the national tourism agency (www.visitbritain.org). By multiplying average occupancy levels by price per person per night, while allowing for seasonality, sales projections can be calculated more easily.

If no suitable secondary research is available, primary (field) research can 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 restaurant could approach potential customers to ask:

- How often do you eat out?
- On average, how much do you spend on a meal?

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

- How often their meals will be bought.
- How much they can charge for the meals.

From this information, the restaurant 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 will have historical sales data on which to base its forecast, as well as a clearer picture of the market as a whole. Every business should keep accurate and up-to-date figures of previous sales on a monthly basis. Future sales can be estimated on the basis of current trading levels, that is, existing customers continuing to buy for the foreseeable future.

On the other hand, 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, total revenue 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 French restaurant)? It is important to consider what prices the market will bear, 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.

Checklist for avoiding pitfalls when forecasting sales

- Make sure the forecast is based on verifiable, realistic and unbiased market research information.
- Don't be tempted to ignore market research if it shows negative results.
- Don't 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?

- Does the pricing strategy used in calculating the sales forecast relate to what is really achievable, or have prices 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.

Hints and tips

- 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.

Further information

BIF058 How to Forecast Cash Flow
BIF185 A Checklist for Start-up Market Research
BIF260 An Introduction to Preparing a Budget

Useful contacts

ICAEW (The Institute of Chartered Accountants in England and Wales) is a professional body representing chartered accountants. There is a searchable directory of accountants on its website.
Tel: (01908) 248250
Website: www.icaew.com

ICAS (The Institute of Chartered Accountants of Scotland) is a professional body representing chartered accountants. Its website includes a directory of Chartered Accountants in Scotland.
Tel: (0131) 347 0100
Website: www.icas.com

Chartered Accountants Ireland represents accountants in Ireland and offers a 'Find a Chartered Accountant' directory on its website.
Tel: (028) 9043 5840 (Northern Ireland office)
Website: www.charteredaccountants.ie

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