Finance Factsheet: How to Forecast Sales

A sales forecast is an estimate of what revenue a business will generate from the sale of its products or services over a one-to three-year period. Producing one is not an exact science but is an essential part of the business planning process.

This factsheet explains:

- Why you need to produce sales forecasts
- What information you should gather before you can prepare one
- How to prepare and present the forecast.

Why you need sales forecasts

You need sales forecasts in order to:

- show that the business can generate enough sales to make it viable -vital for obtaining initial funding
- plan and manage cash flow
- plan future requirements for resources, such as staff
- plan purchasing, production and marketing activities.

Information you need to gather

If you are going to include a sales forecast in an initial business plan for a funding body, you will need to show sales month by month for one year. You may also need to predict annual sales for the next two years.

Whether your forecast is for one or three years, you will need to gather the following information:

- The market -is there an established market for your product or service. If so, how big is it, and is it declining or expanding? What factors (eg seasonal and fashion) are affecting it now and are likely to affect it in the future?
- Customers -who are your existing and potential customers? How many of them may buy your product or service, and how often? What prices are they willing to pay?
- Capacity -what is your capacity to produce, and how could staff numbers and the size of the marketing budget affect it in the future?
- Competition -who are your existing and potential competitors? Who are their customers and what prices do they charge?
- External factors -what effect might political, economic, socio-cultural, technological, environment and legal (PEST EL) factors have on your business and your customers' attitudes?

Preparing your sales forecast

You need to produce a sales forecast for each of your products or services. If your business has been trading for some time, you should have historical sales figures on which to base your forecast. Any underlying trends that these reveal should be taken into account, along with all the other information you have gathered.

If you are just starting up a business, you will have to rely completely on the information you have gathered. This means that it is absolutely essential that it is based, as much as possible, on up-to-date market research. Armed with this information, you will need to consider:

- What volume you might sell (month by month)
- What price you will sell at -which, in turn, will affect the volume of sales
- How many customers you might sell to -which will depend on how many sales you expect to be one-offs and how many to be repeat business.

Bear in mind that is very difficult to predict sales exactly, so a good forecast allows for factors that affect sales and builds in a margin for error. It is a good idea to calculate some 'what if' scenarios to show what might happen if your business reached just 80% or 90% of your predicted sales target, or perhaps exceeded it.

Presenting your sales forecast

Once you have decided on possible volumes and prices, you should present the information in a readily accessible form. A spreadsheet (such as Excel or Lotus 1-2-3) is usually the best way of doing this. It also helps you to consider a number of 'what if?' scenarios, allowing you to instantly see the effects of changing one or more figures.

Going one step further, you can also produce graphs (using basic word processing computer programs) to give a visual picture of your forecasted sales either by volume or value. As the year progresses, you can plot actual sales in a different colour and so see at a glance how accurate your forecast has been.

Once you have been in business for at least a year, you can use 'moving averages ' on your graphs to help you forecast sales. A moving average shows the level of sales over a given period of time. A three-month moving average smoothes out monthly variations but gives seasonal variations; a 12-month moving average gives a general trend line.

Note that if you are planning to present your sales forecast to a funding body, you will need to precede it with a list of the assumptions on which it is based.