Sales Forecasting

Meaning

Sales forecasting is the process of estimating future sales. Accurate sales forecasts enable companies to make informed business decisions and predict short-term and long-term performance. Companies can base their forecasts on past sales data, industry-wide comparisons, and economic trends.

It is easier for established companies to predict future sales based on years of past business data. Newly founded companies have to base their forecasts on less-verified information, such as market research and competitive intelligence to forecast their future business.

Sales forecasting gives insight into how a company should manage its workforce, cash flow, and resources. In addition to helping a company allocate its internal resources effectively, predictive sales data is important for businesses when looking to acquire investment capital.

Importance of Sales Forecasting

Sales forecasting is a very important function for a manufacturing concern, since it is useful in following ways:

(i) It helps to determine production volumes considering availability of facilities, like equipment, capital, manpower, space etc.

(ii) It forms a basis of sales budget, production budget natural budget etc.

(iii) It helps in taking decision about the plant expansion and changes in production mix or should it divert its resource for manufacturing other products.

(iv) It helps in deciding policies.

(v) It facilitates in deciding the extent of advertising etc.

(vi) The sales forecast is a commitment on the part of the sales department and it must be achieved during the given period.

(vii) Sales forecast helps in preparing production and purchasing schedules.

(viii) Accurate sales forecasting is a very good aid for the purpose of decision making.

(ix) It helps in guiding marketing, production and other business activities for achieving these targets.

Objectives of Sales Forecasting

1. Budgeting

While a sales forecast only offers a prediction, it allows the business owner to make reasoned decisions about how to spend. For example, the owner can use the forecast to set a static budget for each month that covers payroll, rental costs and utilities in order to keep valuable staff during low profit periods. The business owner also can use the forecast to plan implementation of an expensive change initiative right after a peak sales period, because the business can ensure enough working capital to support the project.

2. Staffing

For seasonal businesses that experience a large upswing in demand only at certain times, the sales forecast can help to determine appropriate staffing levels for those periods. Tax preparation services, for example, see heavy demand in the spring. If the forecast calls for double the sales in the spring, the business might hire one additional person, while a forecast of quadruple the sales might call for two or three additional staff members. In other cases, an anticipated slow period may lead the owner to trim hours across the board, rather than reducing total staff.

3. Production/Purchasing

Businesses that manufacture a product also can use sales forecasts to make tentative plans for materials purchasing and production levels. For example, if there is a predictable drop-off in demand during summer months and a correlated drop in material costs due to lower demand, the business might reduce production levels and increase material purchasing during those months. Some businesses choose to use predictable downtime to increase available stock as preparation for anticipated upswings in sales.

4. Investors

A sales forecast also can help business owners secure additional funding. Unlike the present value of a business, typically based on assets, the sales forecast helps to show what kind of return on investment the business is likely to generate for potential investors. A sales forecast that shows projected sales in excess of the present value of the business makes a strong argument for investing, since the investors can anticipate a higher return on investment.

Key Factors Affecting the Accuracy and Reliability of Sales Forecasts

Sales forecasting requires a subjective judgment about an uncertain future. So it is inevitable that actual sales will differ from those forecasts. Key factors that create this variability include:

- **Consumer trends**
  - Demand in many markets changes as consumer tastes & fashions change
  - Affects both overall market demand & the market shares of existing competitors
- **Economic variables**
  - Demand often sensitive to changes in variables such as exchange rates, interest rates, taxation etc.
  - Overall strength of the economy (GDP growth) also important
- **Competitor actions**
  - Hard to predict, but often significant reason why sales forecasts prove over-optimistic

Types of Sales Forecasting

There are two types of forecasting:

1. Short-Term Forecasting:

This type of forecasting can be defined when it covers a period of three months, six months or one year. Generally, the last one is most preferred. The period is dependent upon the nature of business. If the demand fluctuates from one month to another, forecasting may be done only for a short period.

Purpose of Short-Term Forecasting:

a) To adopt suitable production policy so that the problem of overproduction and short supply of raw material, machines etc. can be avoided.

b) To reduce the cost of raw materials, machinery etc.

c) To have proper control of inventory.

d) To set the sales targets.

e) To have proper controls.

f) To arrange the financial requirements in advance to meet the demand.

2. Long-Term Forecasting:

The forecasting that covers a period of 5, 10 and even 20 years. The period here also depends upon the nature of business, but beyond 12 years, the future is assumed as uncertain. But in many industries like ship-building, petroleum refinery, paper making industries, a long term forecasting is needed as the total investment cost of equipment is quite high.

Purpose of Long-Term Forecasting:

a) To plan for the new unit of production or expansion of existing unit to meet the demand.

b) To plan the long-term financial requirements.

c) To train the personnel so that man-power requirement can be met in future.

Techniques of Sales Forecasting

1. Survey of buyers' intentions

Under this method of sales forecasting, first, a list of all potential or prospective buyers is drawn up. Then, a face to face interview with a selected group of potential buyers is conducted. On the basis of the interview, the buyers' intentions are ascertained and an estimate of the sales of the products of the firm is made. This method is a practical method of sales forecasting. This method or approach is, generally, adopted by industrial marketers, i.e., marketers of industrial goods.

2. Opinion poll of sales force

Under this method of sales forecasting, an opinion poll of the sales force is conducted. On the basis of the opinion poll, an estimate of the sales of the firm is made. This method is a very good method of sales forecasting, because the salesmen have a good idea of market conditions. Further, it is less expensive. This method is, generally, used when it is not possible to make use of the first method (i.e., the survey of buyers' intentions).

3. Expert opinion

Under this method, the opinions of the experts are sought, and on that basis sales forecasts are made. The experts may be outside experts or top executives of the firm itself, such as the production executive, marketing executive, finance executive, etc.

4. Market test method

A company may conduct a direct market test, and on the basis of its outcome, sales forecast is made. This method may be used either independently or as a supplement to other methods. It is used more frequently by consumer goods marketers. It may also be used by industrial goods marketers. When this method is used by industrial goods marketers, it is called a market probe.

5. Projection of past sales

Under this approach of sales forecasting, the past year sales of the firm are studied, and by making certain changes in the last year's sales (i.e., by adding or deducting a certain percentage to or from last year's sales), sales forecasts are made. This approach is simple and easy to adopt. It is also the most widely used approach. It is also a safe method for companies engaged in more or less stable industries. However, in many cases, this method is not reliable. Again, this method cannot be adopted in the case of new products or by new companies.

6. Products in use analysis

Under this method, a firm undertakes a census of a number of products or closely related brands already in use in the market, and on the basis of such a census, makes the sales forecast for its products. This method is based on two assumptions. First, it assumes that the future market for a product will vary in direct proportion to the quantity already in use. Secondly, it assumes that the present users of the product of a concern will continue to patronize the same in future.

7. Industry forecast and share of the sales of the industry

Under this method, a company estimates its sales by applying a certain percentage (based on past sales or expected sales) to the sales forecast of the whole industry. The sales forecast for the whole industry can be obtained from the Government or trade associations or other outside agencies. This method is very simple. Besides it is quick and less expensive.

8. Statistical demand analysis

Under this method, the important factors which are likely to cause variations in the sales, such as the population, disposable income in the hands of the people, the prices of the products, advertising programmes, etc., are analyzed, and on the basis of such an analysis, sales forecast is made by a firm for it products. This method has become quite popular with the introduction of computers.

9. Time series analysis

Under this approach of sales forecasting, long-term trends, cyclical changes, seasonal variations and irregular fluctuations in the sales of a concern are isolated (ignored), and the sales forecast is made on the basis of normal trends. This approach is inexpensive. So, it is widely used.