Three Methods Of Sales Forecasting

Sales Forecasting By Multiple Methods Is Most Accurate

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Sales forecasting is especially difficult when you don't have any previous sales history to guide you, as is the case when you're working on preparing cash flow projections as part of writing a business plan. Here, Terry Elliott provides a detailed explanation of how to do sales forecasting. –Ed.

There are all sorts of ways to estimate sales revenues for the purposes of sales forecasting.

One point to remember when forecasting is that if you plan to work with a bank for financing, you will want to do multiple estimates so as to have more confidence in the forecast.

How do you do this?

Method #1

For your type of business, what is the average sales volume per square foot for similar stores in similar locations and similar size? This isn't the final answer for adequate sales forecasting, since a new business won't hit that target for perhaps a year. But this approach is far more scientific than a general 2 percent figure based on household incomes.

Method #2

For your specific location, how many households needing your goods live within say, one mile? How much will they spend on these items annually, and what percentage of their spending will you get, compared to competitors? Do the same for within five miles (with lower sales forecast figures). (Use distances that make sense for your location.)

Method #3

If you offer say, three types of goods plus two types of extra cost services, estimate sales revenues for each of the five product/service lines. Make an estimate of where you think you'll be in six months (such as "we should be selling five of these items a day, plus three of these, plus two of these.") and calculate the gross sales per day.

Then multiply by 30 for the month.

Now scale proportionately from month one to month six; that is, build up from no sales (or few sales) to your six month sales level. Now carry it out from months six through 12 for a complete annual forecast.

Don't Just Do One Sales Forecast

Instead of forecasting annual sales as a single figure, use one or two of the sales forecasting methods above and generate three figures: pessimistic, optimistic, and realistic. Then put the figures in by month, as depending on your business, there could be HUGE variations by month. (Some retail firms do 50 percent of their gross sales around Christmas, from the end of October to the end of December, for example, yet barely get by June through August.)

Include Expenses

Now put in your expenses by month, including big purchases by season (or however you buy materials/goods). Remember, you may buy materials or inventory in say, July, for Christmas, yet not get all of your receipts until 45 days after Christmas. There can be big cash flow implications. Also, will you be buying vehicles? Capital equipment? Make sure to show depreciation expense.

In your expenses, put in an allowance for bad debts. Figure how much of your sales are by cash, how much by credit card, how much by your extending credit. Deduct say four percent or more for credit card expense for that portion sold by credit card. For the latest on credit card fees for Small Business see Credit Card Transaction Fees Rising for Canadian Small Business and Tribunal Says no to Credit Card Fees Relief. For payroll expenses, put in estimated tax withholding payments quarterly that must be paid to the government.

If you're going to a bank for financing, be able to answer questions such as, have you made an allowance for a reserve cash account, for your slow months, but also in case you have to quickly replace a vehicle or equipment? You say you'll charge x dollars for your product, but what happens when your competition cuts the price by 33 percent and still makes a profit?

How specifically will you grow your business-- selling more to existing customers, selling existing products to new customers, selling new products to existing customers, and selling new products in order to attract new customers? They're going to want to see if you've got a real plan.

Remember that it is acceptable (and realistic) to have a negative cash flow projection for the early months of your cash flow projection period.

Summary

I guess you can see that instead of estimating one big sales figure for the year when sales forecasting, a more realistic monthly schedule of income and expenses gives you far far more information on which to base decisions. That's what "keeping the books" is designed to do: give YOU information you can make good decisions on.

So in effect, you prepare three cash flow projections, where you vary the percentage of sales or other figures to arrive at three different scenarios: pessimistic, optimistic, and realistic. The pessimistic view should be the "worst case" situation; plan to have enough capital and patience to get through that scenario. If it turns out that the actual results are better than that - great!

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