Objective 5.06-A

Employ marketing-information to develop a marketing plan.

Learning the Basics about Sales Forecasts

A **sales forecast** is a prediction of what a firm's sales will be during a specific future time period.

- Sales forecasts can be short-term, intermediate, or long-term in nature.
- Business managers and owners use sales forecasts frequently when making plans for their businesses. Sales forecasts help them to determine:
  - How much to buy
  - What new items to offer
  - How many workers are needed
  - What prices to charge
  - Whether promotion is needed

Approaches to Forecasting

Before choosing a method for forecasting sales, businesses must decide which forecasting approach to take. These approaches are referred to as the:

- **Top-down approach:** In this approach, also known as the breakdown approach, the sales forecast is prepared for the company as a whole. Then, the forecast is broken down into forecasts for specific products, salespersons, territories, product lines, departments, etc.
- **Bottom-up approach:** In this approach, also know as the build-up approach, the sales forecast is prepared by starting with separate forecasts for specific products, salespersons, territories, etc. Then, these individual forecasts are combined into a forecast for the entire company. For example, a shoe company might gather forecasts for each line of shoes or for each salesperson's territory and combine the data to forecast sales for the whole company.

Categories of Forecasting Methods

Quantitative Forecasting:

- Quantitative methods of forecasting sales are based on the results of gathering and analyzing all kinds of numerical market data.
- Numerical data may come from internal sources such as:
  - Sales records
  - Past product/market research
  - Customer surveys that the company has on hand
- Numerical data such as economic trends, population changes, consumer spending, and industry forecasts come from external sources such as government reports, business publications, and trade associations.

Categories of Forecasting Methods

Qualitative Forecasting:

- Qualitative, or judgmental, forecasting methods are based on expert opinion and personal experience.
- The company prepares its sales forecasts by asking knowledgeable people such as experts in the field, sales personnel, customers, and company executives.
- These individuals base their predictions on what they have seen happen in the past as well as no current observations of the economy or of the industry.
- This method is especially common when sufficient historical data isn't available, i.e., for a new business or a less-established market environment.

Methods of Forecasting Sales

Quantitative methods: There are many, many different quantitative methods of forecasting sales.

Unfortunately, many of these methods are highly sophisticated.

For that reason, we are not going to focus on them in this course.

Instead, we are going to focus on the qualitative methods that many small- and medium-sized businesses use to forecast sales

Methods of Forecasting Sales

Qualitative methods:

- **Jury of Executive Opinion**
- o This qualitative method gathers opinions from a group of company executives that meets together to predict sales.
- o The executives' predictions are averaged so that the forecast is a composite of their points of view.

- o Advantages:
- Basedonreliable,insideopinion
- Quickandeasytouse

- o Disadvantages:
- Results depend on executives' skills
- All predictions carry equal weight, which is a problem if some executives' predictions are not as relevant/accurate as others

Methods of Forecasting Sales

- **Delphi Technique**
  - This method, also called the expert survey, is a variation of the jury of executive opinion.
  - It involves company executives and outside experts such as university professors, consultants, or industry analysts.
  - It is based on the assumption that several experts can arrive at a better forecast than one.
  - In the Delphi method, predictions are made secretly and then averaged together.

The results of the first poll are sent to the experts, who are asked to respond with a second opinion.

The process is repeated until a very narrow, firm median is agreed upon.

Methods of Forecasting Sales

- Advantages:

  - Can prevent social pressure and groupthink
  - Can prevent forceful individuals from dominating others
  - Can prevent time-consuming discussions or arguments
  - Can gather opinions from those who won't speak out in groups

- Disadvantages:

  - Takes a lot of time to complete multiple rounds of the process
  - Can be expensive

Methods of Forecasting Sales

Sales force composite

- This method gathers opinions from the sales force.
- Each salesperson forecasts his/her sales for a future period.
- The sales analyst then adds those forecasts together to get the sales force composite forecast for the period.

Methods of Forecasting Sales

- Advantages:
  - Accurate forecasts for individual products (The sales force works directly with customers and understands the demand for certain products.)
  - Higher sales totals (When the sales force predicts its own sales, sales personnel are more motivated to achieve those numbers.)
  - Inexpensive to use
  - Provides detailed information

Methods of Forecasting Sales

- Disadvantages:
  - Lacks a long-range view (The sales force may not have enough information about the company's future plans to accurately predict long- term sales.)
  - Sales force resentment due to having to take time away from selling to prepare sales forecasts
  - Forecasts that benefit sales force (A salesperson may forecast sales lower than s/he thinks can be achieved to be sure the forecast is met.)

Methods of Forecasting Sales

Survey of buyer intentions

- This forecasting method gathers information about consumers' plans to purchase products.
- Analysts ask customers (via telephone, personal contact, or questionnaire)

what and how much they intend to purchase in the future.

- This information is gathered to create sales estimates for individual products.
- Then, these estimates are combined to forecast overall sales for the company.

Methods of Forecasting Sales

- Advantages:

- Reasonably accurate forecasts (The forecasts are based on information received from actual users of the product.)
- Easy to control costs (The way in which the surveys are administered is chosen by the company and can be very inexpensive.)
- Outside information is available (For example, *The Quarterly Summary of Buying Intentions* publishes surveys of consumer buying intentions obtained by the U.S. Bureau of the Census.)

Sales Forecasting: The Process

The steps to follow to prepare a sales forecast include:

1. Gather the data that you will use.

- First, look at the past.
- Gather sales figures for individual products or product lines and the company's total sales figures.
- Show whether product and overall sales have been increasing or decreasing.
- compare sales by selling periods. Which times of the year usually have the largest total sales?
- Show sales trends for individual products. For example, Target would look at sales of shoes separately from sales of lamps.
- Compare sales forecasts of years past with actual sales. Have the company's forecasting techniques worked well or are there modifications to be made?
- Note: If a business is new and does not have prior sales data to analyze, forecasters should study the past sales of similar businesses. This information is available from industry publication, government reports, and trade associations.

Sales Forecasting: The Process

- Next, look at what is going on now.

 External changes. These are changes occurring outside the business

over which the business has no control but could have an affect on the company's sales (e.g., a new law that restricts the time of day that a restaurant may sell alcoholic beverages). Forecasters must collect information about changes in such areas as:

i. The competition. Has the number of competitors increased or decreased? Are there new competitive activities that will affect sales? For example, has a competitor dropped prices?

ii. The market. Have your customers (or anything about them) changed? Is the makeup of your trading area changing? For example, has the mall in which your store is located recently lost any stores?

iii. The economy. What is the state of the economy in your market? In your state? Nation? The following economic information is useful when preparing sales forecasts: Gross national product, levels of personal income, employment/unemployment numbers, inflation, consumer spending, and total sales.

Sales Forecasting: The Process

Internal changes. Changes that are going on within the business are under its control. Sales forecasters should gather data about such types of internal changes as:

i. Marketing changes. Have there been changes in your price? Product? Promotional plan? How your product is distributed?

ii. Operational changes. Examples of operational changes include enlarging or remodeling a business or adding a parking lot.

iii. Staff changes. Has the size of the sales force remained the same? Has management changed?

Sales Forecasting: The Process

2. Determine the amount by which your sales increased or decreased last year.

- Use the data that you collected to determine your sales for the prior two years.
- Next, determine the difference between the two years' sales (i.e., subtract the first year's sales from last year's sales; if your answer is positive, your sales increased; if your answer is negative, your sales decreased).

3. Determine the percent of increase or decrease.

- To determine the percent of increase or decrease, divide the amount of sales increase/decrease by the sales for the first year.

Sales Forecasting: The Process

4. Add outside predictions of increases in sales for your trading area from positive economic forecasts, population growth, reduced competition, etc.

- For example, if experts are forecasting that the economy and/or population will grow, add the percent of predicted growth to the company’s percent of increase/decrease in sales.

5. Subtract outside predictions of decreases in sales from negative economic forecasts, reductions in population, increased competition, etc.

- For example, if you learn that a new competitor is expected to reduce your sales, subtract the percent of reduction in sales from your company’s percent of increase/decrease in sales.

Sales Forecasting: The Process

6. Convert your final forecast percentage into a dollar figure.

- Multiply the percent of increase/decrease by last year's sales.
- If you expect sales to increase, add your answer to last year's sales. If you expect sales to decrease, subtract your answer from last year's sales.

Note:

Keep in mind that estimating your sales will be an inexact science. Don't rely too heavily on your projections. If you're going to err, err on the conservative side. It's better to be pleasantly surprised by higher than projected sales versus being caught off-guard by lower than predicted sales.

Resource

Principles of Entrepreneurship Course Guide

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