How a Good Sales Forecast will help You Manage

Do you hate forecasting? Or fear it? Join the crowd. It might be related to fear of math, or the common fallacy that forecasting takes some special skills and experience, as if you needed an MBA or CPA title to do it.

And that’s a damn shame, because sales forecasting can be the simplest and best first step to better management, and it takes no special knowledge beyond what you have to know to run a business.

Perhaps these two amazing facts will help:

1. Business forecasts are always wrong. We're human. We don't predict the future well.
2. Even though they're wrong, business forecasts are still vital to running a business well. They're as useful to management as a GPS is to navigation. It tells you where you are.

Value your own business knowledge

One of the first big hurdles to get over is that the owner’s educated guess, looking at how next year will be different from this year or last year, is almost always better than an econometric model or data analysis. I learned this right during several years as a vice president in a market research firm. All the technical methods are based on data from the past. In one professional market forecast after another, I saw that the best guesses of the actual humans working in the market – product managers and business owners – were always better than the sophisticated models.

For almost all business owners, there is no forecasting technique better than comparing next year to this year and last year. Break your sales into meaningful categories, five or 10 at most, which should be compatible with your sales reports coming out of your accounting. Then make status quo the base case, projecting no changes for next year; and then think through what might change, for what categories, in what direction, and how much.

For new businesses, or new products, think through the drivers and make reasonable assumptions. A new restaurant might forecast sales based on chairs and tables, opening hours, and slowing increasing customers over time. A new web business might base its forecast on predictable web traffic, online marketing expenses, and conversion rates. For almost all businesses it’s at the very least unit sales times average prices. It’s not just a wild guess.

Connect the dots

The goal isn’t even being right. It’s connecting dots. It’s associating sales with drivers of sales, like price, channels, capacity, and traffic. It’s about laying out assumptions so you can track what happens and identify the surprises, opportunities, and warnings. Your business is unique. You know what makes your sales work. Your sales forecast lays your business understanding down into rows
and columns.

For example, if you’re running a restaurant you know your capacity in chairs and tables and operating hours, and you know how and when events, promotions, and seasonality affects your sales. Or if you have a business driven by email marketing, you know all about your list size, the effectiveness of some lists over others, and performance metrics like emails sent, emails opened, clicks, and conversions. And subscription businesses know about retention rates, costs of customer acquisition, developing traffic, and improving conversions.

Never forecast sales in a vacuum. Your sales depend on how much you spend and what you spend it on. That’s what you want to manage.

Then review and revise every month

The business value of your sales forecast is the management it generates. Turn your sales forecast into a regular process of review and revision that drives ongoing management. Set a specific regular review on a given day, like the third Thursday of every month, to compare the forecast to actual results and harvest the management you’ve sewn.

Whether it’s you alone or you and your management team, look into the details of plan vs. actual analysis. Subtract planned sales from actual sales and calculate the difference (called variance). It only takes an hour or two per month, and it generates action points, warnings, and opportunities.

With each point of difference, ask the relevant questions: Are you pricing too high or too low? Are your products getting from distributor to retailer in the right volumes? Have new trends or new competition arisen? You’ll find that following up on the variances keeps you on top of your business. It’s a real-world business GPS. You add where you are to where you wanted to be, and the sum is better decisions.

Conclusion: welcome to business planning

I’m big on business planning. Google “business plan expert” and you’ll find me there. But I’ve learned over decades of business planning that what matters is not the plan but the management the plan causes. And the sales forecast is a great example, because it’s a matter of how our minds work. Do a forecast, manage plan vs. actual results, and you are getting the benefit of business planning.