ChangeBEAT

The art, and the science, of sales forecasting

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Abstract

A business's future success depends crucially on its ability to forecast. Yet surely it's rather unreasonable to expect anyone to know precisely what will happen tomorrow, never mind next month or next year?

After all, customers have been known to change their minds. There's the state of the economy, changes in technology, competitive action, new fashions, tastes and political agendas. How many oil company directors got their forecasts for the third quarter of 2000 right? And how many fund managers forecast the dotcom boom and bust?

To make matters worse, a canny sales force may learn that bullish forecasts lead to high quotas or the loss of opportunity for "stretch" bonuses. Other sales professionals are, by their nature, incurable optimists, who stay positive long after the bid is lost.

Sales forecasting requires skill, judgement, prior knowledge of unforeseen events, farsight and luck - or a systematic approach.

A systematic approach

Part of the problem with forecasting is that everyone has a different view on how it should be done. This inconsistency of approach would never be tolerated in other parts of the business. Would we allow coders to use different standards? Or our manufacturing line to make it up as they went along?

Accurate forecasts are based upon a consistently applied methodology.

The seven steps to successful forecasting:

1. Clearly define forecasting terms.
2. Ensure everyone understands the scope of the forecast.
3. Have a policy for dealing with grey areas.
4. Apply standard win chance definitions.
5. Define the process for building the forecast.
6. Analyse the consolidated data.
7. Apply management judgement once for internal management and once again for external stakeholders.

The language of forecasting

Words mean different things to different people. If the sales manager and the finance director mean different things by the term “revenue”, then just how useful is a revenue forecast?

Here are some examples of terms which can confuse, along with suggested definitions:

Forecast items are expected to happen, but are not contracted yet.

Pipeline or Cover comprises items that we hope will bear fruit, but cannot yet count on.

Forward Order Book (or FOB) is the value of sales already contracted. It can be measured in terms of cash value or the time taken for the business to deliver all of the outstanding work.

Sales is orders taken, or contracts closed and is usually measured in terms of the cash value of the contract. A sale is an event.

Revenue is the amount of money that flows into the Profit and Loss (P&L) account. Whether a sale can be recognised as revenue in the P&L depends on factors such as the elements of the order (hardware, licence, service, etc), how long it takes to deliver, and accounting practices.

What to include? What to leave out?

Most organisations prepare more than one forecast. It is vital that everyone involved in preparing a forecast understands who will be using the figures and for what purpose. An internal forecast clearly needs to be as realistic as possible, so that the management can run its business. The external forecast needs to reflect the information needs of its audience.

Grey areas

There are many unknowns and so many grey areas in forecasting, and in most organisations each individual handles grey areas differently. If your job is to consolidate the sales forecast, it doesn't matter how good you are, it is just not possible to build a realistic forecast on such a fluid foundation. These grey areas must be treated in an agreed, standardised way.

Take, for example, the point at which a sale is "recognised". Should this be only when a contract is signed? If not, when? If there is no clear definition then how will you know when commission becomes due?

Taking the chance out of win chance

Now we stray into the realm of the crystal ball. How do we deal with all those contracts that we hope to win, but haven't yet? This is the main source of confusion in sales forecasting.

Forecasting grey areas

- How do we treat bids before the customer makes a decision?
- When is a sale made?
- What if the customer can terminate the contract early?
- How do we treat a letter of intent?
- What if the customer has told us that we have won, but we have nothing in writing?
- How should we forecast a competitive bid?
- What if our "gut feel" is negative even though we are being told we are in with a chance?

It is normal practice to assign some sort of win chance to uncontracted business, and this can, in theory, be a big help in sorting the wheat from the chaff. However, different people assign win chances in very different ways, ranging from the wildly optimistic, "Yes, the first call went so well that it's a dead cert" to the terminally pessimistic, "I know they've signed the contract, but if something can go wrong, it will."

This leaves the person consolidating the sales forecast on shifting sands. How are they supposed to know what the real picture is? As the deadline approaches, thinly disguised hysteria sets in.

The golden rule of best practice forecasting is; *standardise the way win chance is assigned, and base it on facts, not gut feel.*

The forecasting process

It is important to be clear on who is forecasting what, for whose use, when and how.

Who and what?

In some organisations the Sales Director produces the company-wide revenue forecast. In others, he or she only produces the sales forecast and the delivery function reports on revenue from contracts.

For whose use?

Typically a forecast for use by stakeholders would be presented differently from one for management use.

When and how?

Every company has its own procedures and timescales to work to. Forecasting deadlines should be set to fit with the timing of senior management meetings.

For example, a medium-sized PC dealership in North London collects a sales and revenue forecast from every sales professional by the second Friday in every month. The forecasts are presented on a pre-set, spreadsheet template. They are then consolidated by the Sales Director, who presents them at the Board meeting during the third week of the month.

The sales forecast is tactical, a short-term view. So you must clearly define the period to which it relates. Don't second-guess your business plan every month. Planner's droop is a common affliction even amongst the best forecasters. The further into the future you look, the more contracted and forecast items fall away. Reverting to the business plan for longer-term figures will restore the robustness of your business outlook.

The final judgement

Spreadsheets and other IT advances have made forecasting so much easier but it's important not to be too mechanistic in your data analysis. Analyse the data in different ways and keep a record of your forecasts. After a few months go back over the forecasts and compare them to the actual achievement. You will quickly be able to see sources of inaccuracy, which knowledge you can use to improve your future forecasts. Apply management judgement to the forecast only **once** for internal purposes and then **once again** for external stakeholders.

At this point, you'll be as well informed as you're ever going to be. So call the number.

For external use only

The way you present the forecast to your stakeholders will very much depend on your relationship with them. But whoever they are, a wildly fluctuating forecast will not inspire confidence in your ability to meet the business plan.

Many external stakeholders take a very much less censorious attitude to those who overshoot forecasts than to those who underachieve them. Therefore, you may want to be a little cautious rather than simply give your most realistic view. After all, a truly realistic, balanced forecast, must, by its very nature, have an equal chance of under- and over-performance. The future is full of surprises, but why not make sure that your stakeholders only have pleasant ones?

About the author

Ian Henley, chairman of *ChangeBEAT*, is recognised in the IT software and services market as a leading expert in improving business performance. He specialises in business strategy, marketing and sales and is well known through industry publications and Intellect where he provides advanced sales and commercial management training.

ChangeBEAT defines, develops and executes change programmes that help achieve enduring business benefit rapidly and reliably. Our people have practical field experience, and are equipped with WingBEAT, our proven change methodology, and our extensive tools. We are professional, pragmatic and action oriented.

For further information call **+44 (0) 208 446 6946** or visit ***www.ChangeBEAT.com***