WHITE PAPER

How to Develop an Effective Sales Forecast

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Introduction

The ability to effectively forecast sales can have a significant and positive impact on sales and operations as well as the overall financial health of a corporation. The opposite is true when a forecast is inaccurate. It is therefore important to ensure that the processes and systems you have in place for sales forecasting are optimized given your current situation. Frequent review and assessment of your forecasting system will help keep it up to date with changes in the corporation as well as improvements in technology and Best Practices.

An effective Sales Forecast can have a positive impact on:

- Financing and Valuation
- Inventory Management
- Order Management
- Sales Headcount Capacity Planning
- Sales Revenue
- Visibility into Sales Activities

This paper addresses how to develop an effective sales forecast. Questions will be posed to prompt you to consider what needs to be addressed in order to develop your sales forecasting system. Information here should be valuable to those new to forecasting as well as those who have been doing this for some time. Those with existing processes and systems in place can perform a gap analysis on what they already have in place and what we are proposing here.

Forecast Elements Addressed in this Paper:

- Purpose of the Forecast
- People Involved
- Processes
- Measuring Success

With the advanced sales forecasting software available today it is important to remember these tools are only as accurate as the data they rely on to produce their forecasts. Companies often spend more time and energy on the software solutions than they do on the processes, procedures and educating forecasters.

Since software applications rely on human input it is equally important to focus on the issues that impact the human side of the equation. Processes and procedures should be determined before selecting and implementing a software solution. It is better to find the software that works for your unique situation instead of having to conform to limitations in forecasting software purchased before all the processes have been identified.

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The Purpose of the Forecast

Why is the forecast being produced?
Most sales forecasts begin as their name implies as a sales reporting tool to forecast sales revenue. They are often used by the VP of Sales to manage their direct reports and to provide feedback up to the next level of executive management, board level directors, and or business owners. It makes sense that many of the reporting tools are designed solely with the intent of producing reports for sales, but there are other uses for it outside sales.

These uses include: Sales Revenue Forecasting, Inventory Planning, Operations Planning, and Marketing. Other departments may also have a use for this information. Keeping these uses and their respective departments in mind when developing a forecast can yield benefits throughout the organization.

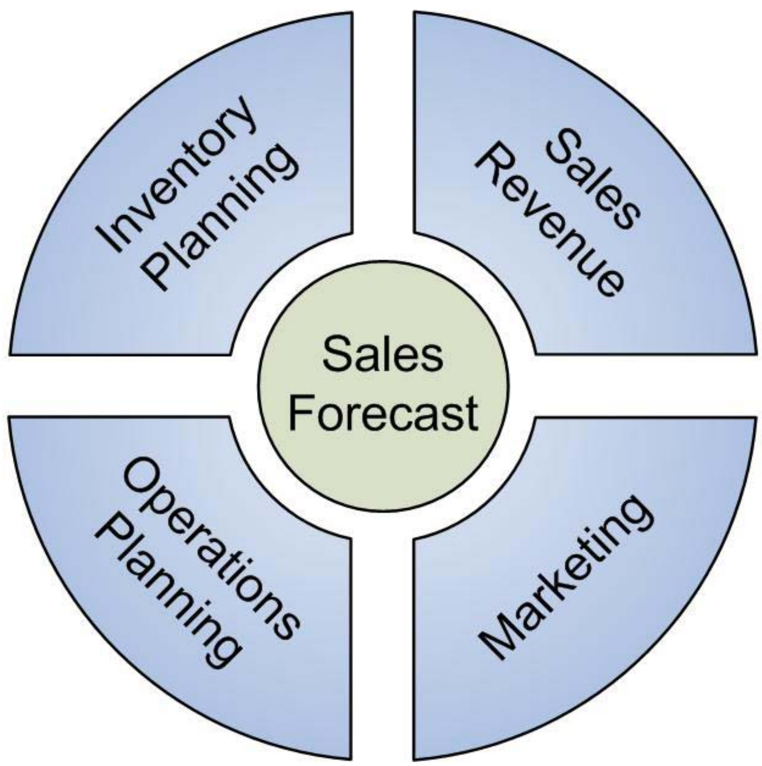

Figure 1: There are more customers for sales forecasts than just sales. This is why it is important to consider the other departmental needs when developing a sales forecast.

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People Involved

Who will use the forecast?
Who are the intended users of your forecast? As discussed in the section concerning the purpose of the forecast there is a good chance people outside of Sales will be interested in the forecast. It is therefore wise to touch base with other departments before designing a forecasting process. Once the word gets out you may have multiple departments with a vested interest in the end product.

There needs to be a balance between allowing multiple forecast users outside sales to have their input while still addressing the core needs of sales. There is a difference between needs and wants and this process can easily become overcomplicated.

Who is managing the process?
There needs to be a point person responsible for managing the sales forecast process and ensuring deadlines are being met. This process, depending on complexity and size of the sales organization can be managed by a: Sales or Financial Analyst; Sales Operations Manager; Sales Finance Manager or similar positions. It is beneficial if this person reports to the VP of Sales for whom the report is primarily being developed.

Who is doing the forecasting?
In most cases salespeople will be doing the forecasting. Since this is not considered by many of them as a productive use of their time and certainly not a revenue generating activity you need to be aware of their level of commitment to the process***. This is often one of the weakest links in the forecasting process.***

One method of ensuring cooperation from your forecasters is to tie the forecasting responsibility into the sales person's compensation plan and reference it in their job description. You will most likely encounter those who procrastinate or blame their late or incomplete forecasts on the forecasting tool (software). The tool can often be an area of concern, but even when a great tool is in place you will still see many of the same empty excuses. This is why tying the forecast to the compensation plan is often needed to increase participation and quality of forecasts.

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Processes

Forecast Data
Consider what information you need to be able to build your forecast. What data fields are important for your forecast? Depending on your sales model you may choose to track units by customer or channel partner and apply the price within the reporting tool itself. Some sales models with variable margins may be better suited to collect both units and revenue. What you track needs to be determined in advance and it is often wise to account for future needs by building in at least the ability for more detail.

Forecast Sources
Best Practice methodology in sales forecasting incorporates a mix of data and input from multiple sources. This provides greater visibility to different perspectives and adds checks and balances to the data.

Here are four major components frequently used in formulating an effective Sales Forecast:

- Sales Pipeline (The High Probability Opportunities)
- Historic Run Rate
- Field Forecast
- Sales Management Discretion

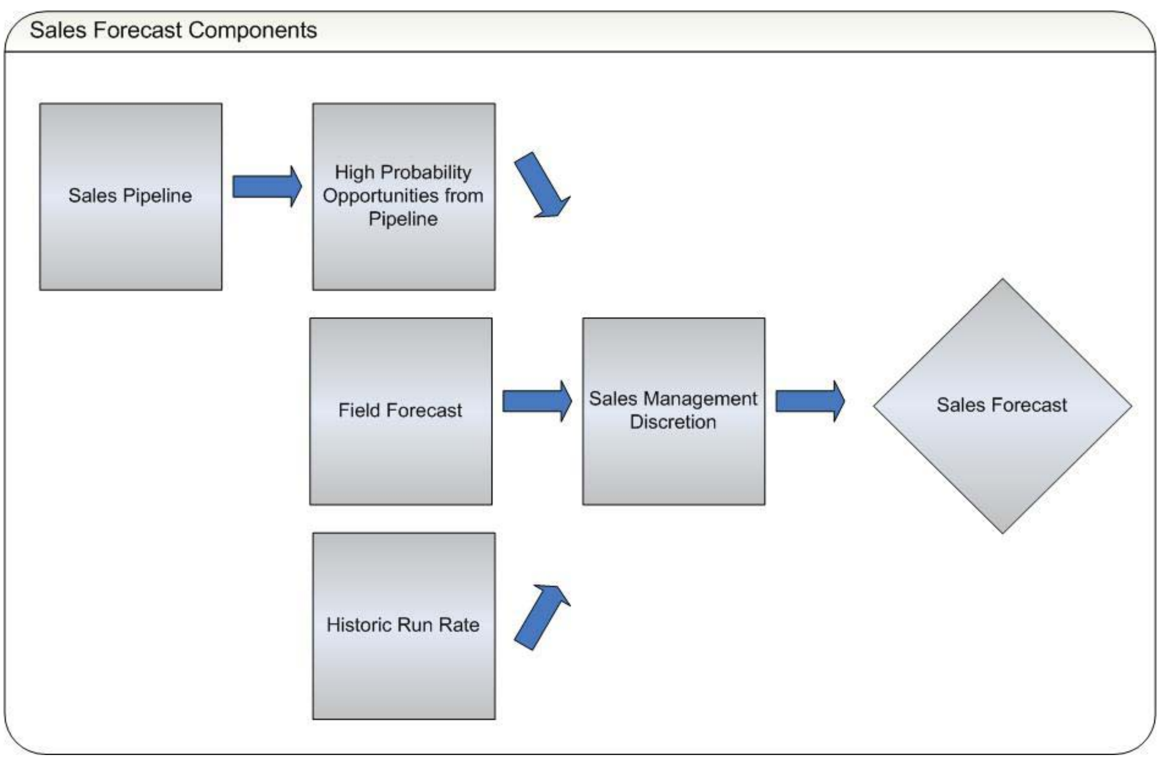

Figure 2: It is important to collect forecast data from various perspectives and to apply management discretion to the data before it becomes the sales forecast.

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Sales Pipeline
The sales pipeline is metaphorically speaking, a pipe through which opportunities pass on the way to becoming a sale. It can be segmented by stages based on a company's sales cycle. As opportunities pass from stage to stage, the likelihood of the opportunity becoming a sale increases. Some opportunities will not make it through all the stages and may be removed at any stage.

Opportunities in the sales pipeline that have a high probability of closing within a defined time period can then be included in the sales forecast. The probability metric needs to be defined by sales management and often includes opportunities with approx. 80% or greater probability of closure in a given month. This probability metric will vary from company to company based on the complexity and length of the sales cycle. A sales person is responsible for their individual pipeline report. The sales pipeline is a consolidation of input from individual sales people and is considered a top-down approach to the forecast.

Historic Run Rate
The historic run rate refers to sales data which shows past performance. It helps to fill in the gaps between the sales pipeline data and where the actual sales history indicates the forecast should be. This can include a few months back from the current forecast period or more depending on the situation. Having a prior year's worth of data can help show the month to month fluctuation inherent in the company's business cycle while the most recent months can give a closer indication of actual revenue.

Example: if the sales pipeline "high probability opportunities" show $500,000 for March while the actual revenue for January and February was $1,500,000 and $1,750,000 respectively. There is a gap of $1,000,000 to $1,250,000 between the prior month's actual revenue and the Sales Pipeline. If we also know that in the prior year the month to month growth was steady from Jan through March we can expect a similar pattern for March baring any unforeseen issues.

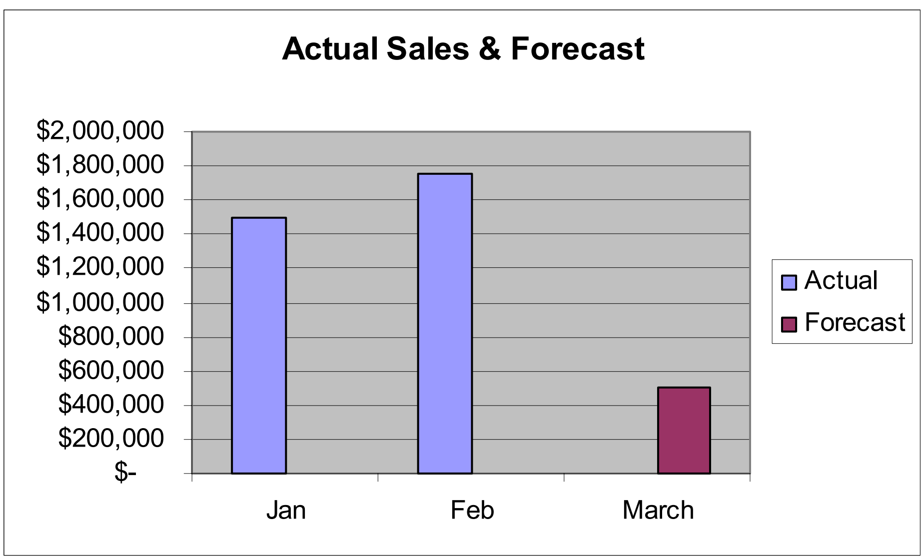

Figure 3: Comparing current month forecast with prior months historic run rate data can help in determining what the current month forecast should be.

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Using historic data is not a quick fix as there are many factors that need to be considered and analysis done on the data. Typically a longer period of historic data is useful in helping to identify any up ticks represented by non-repeat business. This component adds an analytical element to the forecast based on trend analysis input. Longer historic periods can help show month to month patterns.

Field Forecast
The field forecast comes from the sales managers in the field and is usually vetted as it makes its way up the sales management chain of command. The field level managers have closer visibility to their sales people's forecasts and are often aware of deals that may not have been included in the pipeline. This is represents a "bottom-up" forecast. The field managers may tip their hand a little more in this format as their opportunities are not as visible in this forecast as those in the pipeline. Let's face it, there are salespeople and sales managers who sandbag and this format allows them to give a little more visibility into the value of their opportunities without them putting all the cards on the table. We are dealing with human nature here and with sales people and managers insulating themselves from what they may perceive as micromanagers above them.

Sales Management Discretion
Sales management discretion provides for last minute checks and balances on the forecast data from the other three sources. There may be situations where the historic data includes a set of transactions that for one reason or another may not continue to occur, or a product line may have been discontinued or a major client may no longer be planning purchases. There may be deals in the pipeline that are duplicated by two or more sales people. Management can adjust for these anomalies in the pipeline and historic run rate as well as add their input to the mix. This is the component in the sales forecast where the other data sources are combined and management discretion applied.

How often is the report needed?
Is the forecast needed weekly, monthly, or quarterly? Different users may have different needs concerning frequency.

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Measuring Success

How is success being measured?
There are several components to the forecast process which can be measured to determine the level of success.

- Accuracy of Forecasts
- Meeting Deadlines
- Participation Rate
- Value of Forecast

Accuracy of forecasts can be measured by providing actual results side by side with previous time period forecasts. This can provide a level of visibility into the accuracy of the forecast as well as the individual contributors. Providing feedback to those who submit forecasts should help them improve their accuracy as well as inform them that management is monitoring their performance.

Deadlines should be established for the various stages of the forecast process so that participants have adequate opportunity to create, review and submit their forecasts.

The participation rate measures the amount of forecasters who are turning in their forecasts. Tying the forecasting responsibility to sales compensation will help ensure deadlines are being met and forecasters are participating.

The value of the forecast needs to be assessed by the Sales VP to determine whether the information being collected is resulting in useful and actionable information. This assessment can help ensure the forecast tool stays current with the needs of the corporation and adapts to changes in the sales model.

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Conclusion

Whether you address these considerations from the start of your sales forecast process planning or use them in a gap analysis with what you have in place you will be better prepared to deal with the issues that affect the accuracy of you forecasts. There are equally as many similar considerations in developing a sales pipeline, and since the forecast is dependant upon the pipeline for input it also needs to be well designed.

The saying "garbage –in, garbage-out" certainly applies to the forecasting process. "Garbage" can include: mistakes; duplication; sand bagging; apathy; etc. Identifying and limiting the "garbage" in the process will certainly help increase accuracy of the forecast.

More Information

To learn how **Gilmore Lewis, LLC** can help your organization develop an effective sales forecast please visit our website or call us at the number below.

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