Forecasting Business Revenue

Understanding Forecasting

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What Is Forecasting?

Forecasting is predicting the future, as in the weather forecast says it will rain tomorrow. Forecasting business revenue refers to the process of estimating the level of sales that your company will enjoy over a given period of time. Forecasting business revenue is generally done as part of developing a business plan when a new company starts to determine if the business is viable and what capital is needed to proceed. Established businesses also forecast their business revenue to facilitate business growth and financial control. Forecasting calls for a combination of statistical analysis together with sound judgment. Some research and a good deal of common sense are in order. Estimating total sales for the market for the coming year may not be an easy task. The overall level of sales in a given marketplace could go up or down for various reasons. Ultimately, after considering all the available data and using your best judgment, you can only make your best guess.

What Are The Forecasting Methods?

There are several methods for forecasting and each can be classified as either subjective or objective. The most widely used forecasting methods include the following:

- **Judgmental**
  This is a seat-of-the-pants type of forecasting method. It is purely subjective, simply your best guess. This method is not recommended as it is prone to many biases, not the least of which may be your optimism and overconfidence.
- **The Random Walk**
  This is the simplest of all the forecasting methods. The random walk assumes that it is equally likely that future value will go up or down, and thus current value is projected to future sales. This has been found to be a fairly accurate method of forecasting.
- **Extrapolation**
  The more sophisticated forecasting methods include extrapolation methods (e.g., moving averages, linear regression against time, or exponential smoothing).
- **Econometric**
  Econometric methods typically use regression techniques to estimate the effect of causal variables.
- **Segmentation**
  Segmentation methods are used in forecasts made for the number of people in each segment and their anticipated behavior.

Which Forecasting Method Is Best For Your Business?

Only you can know which forecasting method is best for your business. A number of software packages can help you decide on and implement a forecasting method.

How Do You Forecast Revenue For A New Business?

Forecasting revenues as part of a business plan for a startup is important for many reasons. For example, to determine if the business is viable, to find out what capital will be required to proceed, and to obtain a basis for projecting various expenses. However, it is probably the most difficult part of starting a new venture. Here are some suggestions on how to go about it.

Review Industry/Trade Data

The first step is to obtain and review data that reports total sales for your type of product or service in the geographic area you are planning to serve. This should give you a good idea of what the market is and how many other businesses already exist to serve that market.

Estimate Total Sales For The Entire Market For The Coming Year

The next step is to estimate what the market as a whole will experience in the next year. You may get some idea of this by reviewing several prior years to see what the trend is. Is business increasing? Decreasing? Leveling off? Also, keep in mind the economic climate in general. Is it a period of prosperity? Inflation?

Identify Your "Target Market"

Once you have determined the overall level of sales, you need to decide which segment of the market will provide your business with the best opportunity. This is called your "target market." For example, if your business produces a new soft drink, you may decide that the 13-25 age group is the best target market for this product. Or you may produce a beach bag and decide to market to the southern (warmer) states and California.

Determine Your "Market Share"

Finally, you must determine what portion of the target market's sales your business can reasonably expect to win. This is called your "market share." For example, you may estimate that given the number of consumers and the number of competitors in your area, your business can reasonably capture 10 percent of the market.

How Do You Forecast Revenue For An Established Business?

- **Review your business's historical data**
  Your own business's past performance is the best indicator of what the future year might hold. Review several years to get a true sense of the direction sales have been taking.
- **Review industry/trade data**
  Obtain and review data that reports total sales for your type of product or service in the geographic area you are serving. This will give you an idea of what your competitors have been experiencing.
- **Estimate total sales for the entire market for the coming year**
  As with a new business, the next step is to estimate what the market as a whole will experience in the next year.
- **Estimate sales for your market share**
  Finally, you can estimate what your market share will be. Consider any particular knowledge or insights you have about what's happening in your marketplace (e.g., population has been increasing/decreasing in your area, a new competitor is building across town).

What Else Should You Know About Forecasting Business Revenue?

- **Get help**
  Find and use expert opinions and market studies. If the references listed here (or wherever you can find them) aren't enough, it is likely that the major business schools will have someone that will be happy to assist you.
- **Be conservative**
  When forecasting business revenues, it is best to be conservative. Underestimating your sales will prompt you to raise more capital and keep expenses down. Overestimating sales may result in inadequate funding and overspending.
- **Remember, it's only a rough estimate**
  It is important to remember that, in the end, you are only using your best guess. There is no guarantee that the sales you have estimated will actually materialize. Your estimate is based on assumption, including your ability to accurately determine your target market and market share. Be sure to specifically set out these assumptions whenever providing these forecasts to third parties. Even if you are not sharing your projections with others, listing your assumptions will help you in evaluating your performance in future years.

Call one of SVA's experts to find out how we can help with your business budget and forecast planning.

Source: Broadridge Investor Communication Solutions, Inc.