DP IB Business Management: HL

Your notes

4.3 Sales Forecasting

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Benefits & Limitations of Sales Forecasting

An Introduction to Sales Forecasting

- Sales forecasts **predict future revenues** based on past figures, including
  - The volume and value of sales
  - The size of the market
  - Sales as a result of promotional activity
  - Sales as a result of cyclical factors
- Sales forecasts are an important tool to **support planning** and can improve the **validity** of **cash flow forecasts**
- Businesses use sales forecasts to **determine resource requirements**

Diagram: illustrating a typical sales forecasting process

Sales Forecasting can help businesses to identify the resources it will need in the future

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- In order to **construct effective sales forecasts,** businesses use a range of **techniques,** including
  - **Market research**
    - Can include primary and secondary research sources
    - May rely on **test marketing** to understand customer reactions
    - **Sample size** needs to be sufficient to provide high data **confidence**
  - **Extrapolation**
    - Using **historical data** to identify and **extend trends** to predict future sales
    - Typically uses a **line of best fit** to make predictions
    - Requires strong **correlations** between data sets such as spending on promotional activity and sales revenue
  - **Time series analysis**
    - Identifying **underlying trends** from past sales figures recorded at regular intervals
    - Must take into account **seasonal**, **cyclical** and **random** variations

Factors that Require Sales Forecasts to be Adjusted

- Developing **accurate sales forecasts** is a skill and requires an understanding of several factors which can influence the reliability of the forecast. These include
  - Consumer trends
  - Changing economic variables
  - The actions of competitors

Consumer Trends that Require Sales Forecasts to be Adjusted

Factor	Explanation
Seasonal variations	▪ Demand for certain goods is seasonal ▪ Events such as **major religious festivals, holiday periods and annual events** impact demand for a wide range of products ▪ E.g. sales of basic homewares increase when students start university each September

Fashion	▪ Fashion is often led by celebrities and their influence can have a relatively **short-term impact** on sales ▪ E.g. When Hollywood legend Megan Fox appeared in September 2021 at a star-studded event in a Boohoo dress the company's sales unexpectedly soared by over 400% during that month
Long term trends	▪ Consumer behaviour, attitudes and spending habits **change over time** ▪ In recent years environmentally-conscious consumers have led to many businesses amending sales forecasts to reflect increased demand for green products ▪ E.g. In late 2022 vehicle manufacturer Ford increased its sales forecasts for electric vehicles by almost 70%

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Changing Economic Conditions that Require Sales Forecasts to be Adjusted

Factor	Explanation
Economic growth	▪ During periods of **economic growth**, **increased consumer incomes** will lead to higher than forecast sales ▪ The opposite will occur during periods of **economic slowdown** and sales may be less than forecast
Inflation	▪ The general increase in prices over time **reduces consumers' spending power** ▪ Firms may revise their sales forecasts downwards during periods of rising inflation ▪ Firms may revise their sales forecasts upwards during periods of falling inflation
Unemployment	▪ Increased levels of unemployment are often experienced during periods of **recession** and tend to be a key cause of **reduced spending in the economy** ▪ Sales forecasts for **lifestyle** and luxury goods may reduce as consumers focus their spending on essentials
Interest rates	▪ When **interest rates** rise borrowing becomes **more expensive for consumers** ▪ Businesses that sell products that consumers frequently buy on **credit** may therefore adjust their sales forecasts downwards

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	▪ E.g. Property sales in a country are set to drop to 1.01billion in 2023 from 1.27b in 2022 causing many estate agencies to adjust their sales forecasts downwards
Exchange rates	▪ Where the value of UK sterling falls against other global currencies, overseas consumers will find British **exports** become relatively cheaper ▪ Businesses that sell products overseas or that **cater for tourists** visiting the UK may adjust their sales forecasts upwards to reflect the expected increase in demand **from a cheaper £** ▪ E.g. *Visit Britain* expects the number of tourists entering Britain in 2023 will be 14% higher than in 2022

Changing Economic Conditions that Require Sales Forecasts to be Adjusted

Factor	Explanation
Actions of competitors	▪ Sales forecasts must consider **short-term actions of competitors** such as **sales promotions** as well as longer-term strategies such as **changes to product ranges** and expansion plans ▪ Competitor actions are difficult to predict so the use of past data to predict future sales may be limited as a result ▪ E.g. UK Company Marks and Spencer announced plans to open twenty new high street stores in 2023, partly in response to the closure of several key competitors including Debenhams

Evaluating Sales Forecasts

The Difficulties of Sales Forecasting

- Sales forecasting usually involves **the use of past data** to predict the future
- In the short-term, sales forecasts are likely to reflect the recent past
- Longer-term sales forecasting is often more problematic as **several factors affect its reliability**

Diagram: reasons why sales forecasting is hard

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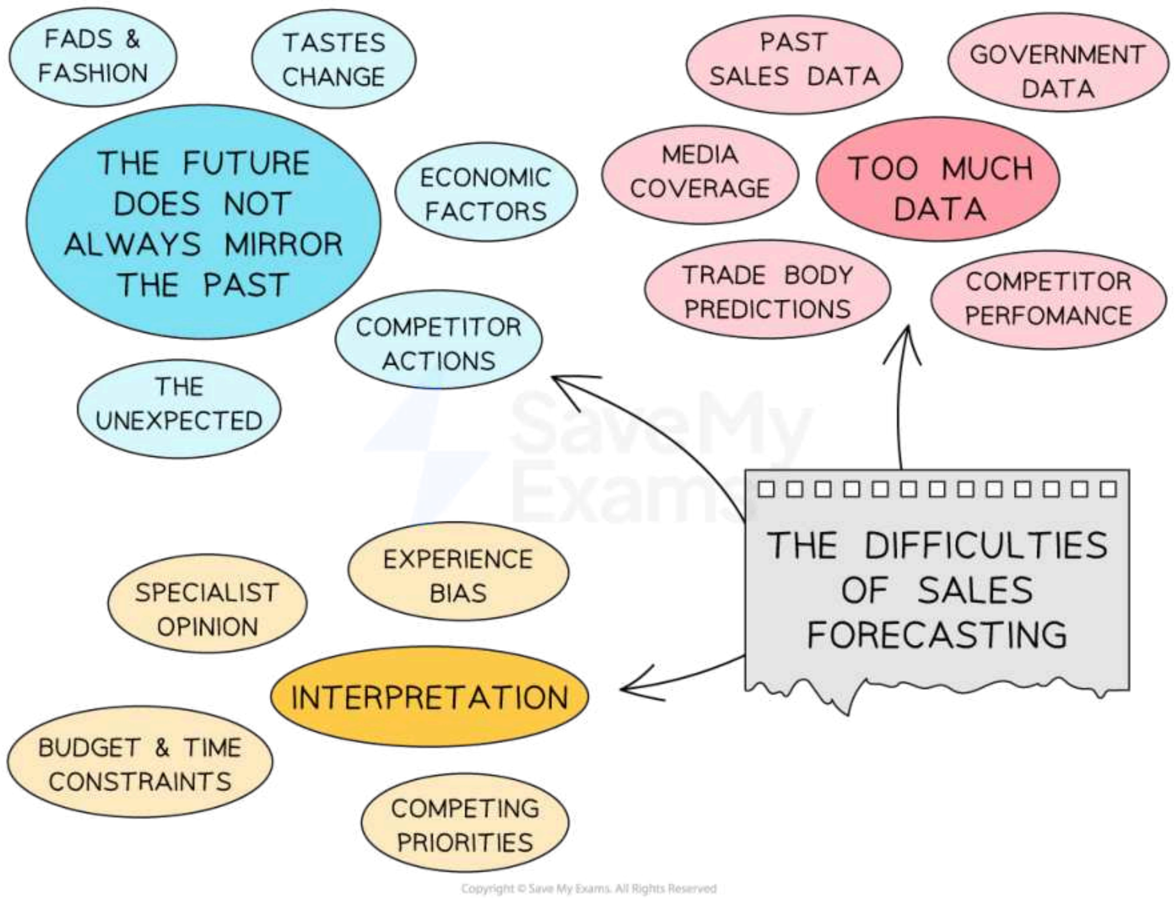

The Difficulties of Sales Forecasting

Effective sales forecasting requires skill, time and the accurate use of timely data

- Smaller businesses in particular may **lack the experience or specialised personnel** to construct, analyse and interpret sales forecasts
    - It is difficult to avoid **experience bias** (e.g. opinions of the future based on experiences in the past)
    - Businesses may face problems in constructing sales forecasts that ignore the priorities of key **stakeholders**

The future seldom repeats the occurrences of the past

- Sales forecasts will rarely reflect the **full range of external influences** that can affect future inflows, such as fashions, trends and the actions of competitors

Too much data blurs the analysis

- Internal data, such as **previous sales figures**, will be a key source of information when constructing forecasts
- Selecting the most appropriate external data is extremely challenging and requires careful evaluation

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The Advantages of Sales Forecasting

Advantage	Explanation

Financial planning	▪ Sales forecasts can be used to create **budgets**, set **pricing strategies** and make **financial preparations**
	  ▪ Better cash flow management improves financial stability
	  ▪ Finance can be sourced in advance
	▪ Sales forecasts can provide a **benchmark** against which actual performance can be measured
	  ▪ Helps identify **areas for improvement** and **set targets**

Resource planning	▪ Sales forecasts support **production schedules and stock management**
	  ▪ Helps prevent overstocking or **stockouts** which reduces associated costs and improves reliability
	  ▪ **Negotiate in advance with suppliers** and ensure a **smooth flow of materials** to meet production requirements
	▪ Sales forecasts help to determine **staffing** and **capital equipment requirements** in advance
	  ▪ Less reliance on expensive temporary solutions such as **leasing** or **subcontracting**

Marketing strategy	▪ Helps in **planning new product launches** or updates to existing products
	  ▪ Sales projections can determine the **best time to introduce new products**
	▪ Determine **promotional activity**
	  ▪ Products expected to have high demand may need less advertising
	  ▪ If sales are projected to be slow sales promotions can be planned to stimulate demand in advance

Stakeholder confidence	▪ Accurately forecasting sales allows a business to **improve customer experience**
	  ▪ Can ensure product availability and timely deliveries
	▪ Reliable sales forecasts can **increase the confidence of shareholders**
	  ▪ Well-managed sales performance improves a company's reputation and makes it more attractive to potential investors
	▪ **Banks** may be **more willing to lend** to businesses that are able to predict future performance with confidence

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Examiner Tips and Tricks

When evaluating sales forecasts, always carefully consider how the sales forecast is constructed.

- Which data was used in its construction?
- How reliable or accurate are the data sources underpinning the forecast?
- How experienced was the person constructing the forecast?

You may even conclude that no sales forecasting is better than a poorly-constructed, biased attempt!