Accurate Revenue Forecasting is Vital for Business Success

In my last column, I shared three practical tools that SCORE mentors use with clients to assist them in getting a good handle on financial planning for the business whether it be for a business plan for a new business or just plain managing the business. Each of these three tools depends on revenue forecasting which is one of the most critical elements of financial planning. In this column I will go one step further to share some forecasting insights from the SCORE website.

Accurate forecasting can help you validate the business case for your new product or service and help you build trust among future investors and partners. Poor forecasting, on the other hand, can sabotage your business before it even gets off the ground. And yet, many startups don’t give their forecast the attention it deserves.

If a startup goes under, it’s most often within the first two years and is usually a direct result of poor financial management and the business running out of capital.

The concept of revenue forecasting is pretty straightforward. Simply put, it’s the calculation of the amount of money a company will receive from sales during a particular period. Most companies determine forecasts for a period of time in the future based on actual sales revenue earned in the past. For a startup, this presents an obvious problem with key variables of the forecasting equation being unknown.

As the owner of the business about to make a large investment of time and money into your new venture, solid, accurate projections are the clearest way to also prove to yourself that your investment will be a profitable one.
Informed projections based on in-depth research, quality data and an understanding of your target market back-up your belief in your product or service and show you’ve done your homework to validate your idea as one that’s worth pursuing.

Giving the revenue forecast its deserved place in a business plan isn’t an easy task. So, why is it that forecasts are a challenge for startups? The first step in the process is learning how to avoid what’s referred to as “confirmation bias.” We usually test to prove that our hunches are correct, which is where things can go wrong in the revenue forecast. It’s your job as an entrepreneur to be aware of this pitfall and find ways to reduce or eliminate confirmation bias.

Once you’ve addressed and mitigated your confirmation bias, there are two primary areas of the plan that you need to lock down before you can accurately project revenue for your first twelve months.

1. Understanding Market Demand
Market demand for a product is the anticipated total volume purchased by a defined customer group in a defined geographical area during a defined period of time in a defined environment. Once you understand market demand, you can estimate your company’s potential share of that market.

Also, consider how you’ll gain market share. Will you steal it from your competitors? Or, will your product or service open up opportunities to create new market share? You’ll want to estimate future market demand for your products or services based on the growth of sales in the industry and changes in market share. A place to begin when accessing market demand for your product or service over a competitor could include asking yourself questions like:

- What is the market’s capacity for my product or service?
- Who may enter the market after me?
- What makes my business valuable and can I clearly communicate the value to customers?
2. Sales Forecasting

Here’s where things get a bit more challenging. Accurately predicting future sales is perhaps the most difficult part of the revenue forecasting process. You’ll need to factor in what your management team expects and pair that with the estimated demand for your products or services at your proposed price points.

Think ahead to all the potential company or market shifts and how those changes may impact sales, such as:

- Price changes or promotions
- Seasonal or cyclical factors including economic activity
- Marketing and branding changes
- Erratic events like strikes, fads, or disturbances to the market

Consider quantifying your sales forecasts in terms of ranges rather than absolutes. This communicates to a potential lender, venture capital firm and your partners and staff that you’re the type of owner who’s realistic and operating under a biased methodology. It also gives you the freedom to evaluate and adjust your sales and overall revenue projections after your business gets started and build even greater trust with key players along the way.

Now it’s time to consolidate all your research and newly gained insight and document your startup revenue forecast for your first year of business. The tools that I offered in the last column can help you begin the formal process and documentation of calculating everything from start-up expenses to anticipated cost of goods sold, income statements, and more, as well as run a break-even analysis.

Revenue forecasts are one of the most challenging steps within the business planning process. Rather than go it alone, talk to a SCORE mentor. A SCORE mentor will guide you through each step and help you develop an accurate forecast for your new business.

____________________________________________________

Dean L. Swanson
Southeast Minnesota SCORE
c/o Rochester Area Chamber of Commerce
220 South Broadway, Suite 100
Rochester, MN 55904

www.seminnesota.score.org/

*Dean is a volunteer Certified SCORE Mentor and former SCORE Chapter Chair, District Director, and Regional Vice President for the North West Region