BUSINESS SEN$E

Next Level Tools for Entrepreneurs & Small Business Owners

SALES SERIES

Revenue Forecasting

Why is this important?

There are a number of benefits to forecasting your revenue. Just like with strategic planning, financial modeling, business operations and organizational development, revenue forecasting is all about managing your cash flow and preparing your company for whatever the future holds so that you're not caught by surprise and can make the best decisions to grow your business. For greater clarity, revenue is the money a business earns from the sale of its products and services. Cash flow is the net amount of cash being transferred into and out of a company. Revenue provides a measure of the effectiveness of a company's sales and marketing, whereas cash flow is more of a liquidity indicator.

There are a few key reasons why you should forecast revenue including building a realistic budget for your business when it's likely that your revenue varies each month. Your future revenue can fluctuate depending on how much you sell, and the overall market conditions which can make it difficult to budget for operating expenses like marketing and promotion, or new expenses like hiring employees.

Revenue forecasting helps bridge that gap, particularly for operating expenses. Your forecast gives you an estimate of how much revenue you'll generate over the next few months, or the entire year. This will allow you to know how much you can budget for sales promotions, new hires, software, and other expenses that change over time.

Vermont Sustainable Jobs Fund

Revenue Forecasting

Revenue forecasting is the process of estimating what your revenue will be over a specific time period—typically quarterly or annually—based on your business' historical and current performance. For instance, if you want to know how much revenue you'll generate next month, next quarter, or next year, a revenue forecast will show you where you're headed at your current pace. A revenue forecast is not a guess, which is why it's vital to use data to build your forecast.

Revenue Projection vs. Forecasting

While some people use the terms "revenue projection" and "revenue forecast" interchangeably, they're not quite the same thing. Let's start with definitions:

Forecast: A revenue forecast is based on the responsible party's assumptions reflecting the conditions it expects to exist and the course of action it expects to take.

Projection: Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows.

Essentially, the main difference is revenue projections account for hypothetical scenarios that may or may not happen. A revenue forecast says "this is how much revenue we expect to generate based on our current conditions." A revenue projection says "this is how much revenue we project if X happens, and here's how much we project if Y happens."

Revenue Forecasting Models and Tools

One of the most important steps in revenue forecasting is to define the assumptions that will guide your calculations. These are the factors that affect your revenue, such as your pricing, sales volume, conversion rate, customer retention, market share, and growth rate. You need to base your assumptions on reliable data, such as your historical sales, industry benchmarks, customer feedback, and market research. You also need to make sure that your assumptions are realistic and measurable, meaning that they reflect the current and expected conditions of your market and that you can track and measure them over time.

Depending upon your industry, size and complexity you may need to create a forecasting spreadsheet that can

include different scenarios, variables and data points. Developing a forecast from different revenue viewpoints such as sales by customer, by product or by season will enable you to more accurately align revenue goals with sales and marketing strategies. A forecast model can be simple or extremely detailed. It is important that your model is able to include actual sales revenue and be adjusted as conditions change.

Bottom-Up Forecasting Model

Bottom-up forecasting is very detailed and uses product and customer data to forecast revenue. It involves taking historical and current sales information and setting targets for each key component in your revenue stream. For instance, you own a specialty food products business with multiple products that you sell direct to consumers on your website and to wholesale accounts. With a bottom-up forecast model, you look at your sales in each channel and create a model that includes different assumptions such as sales to repeat customers, new customer acquisition sales, or sales generated from targeted marketing campaigns and promotions.

For the wholesale customers you could create a detailed model for your top customers that includes a revenue plan for each of them by product. You may also want to model out details such as the effect of adding an additional delivery day, introducing a new product or a price increase. A detailed bottom-up forecast could also start by modeling out detailed sales by product - how many you plan to sell and to whom. A bottom-up forecast is generally higher in accuracy and should align with your strategic business plan as it is based on business drivers such as the capacity of your sales team, proposed marketing spend, or identified new product launch. With a detailed model, you are better able to validate the reasonableness and success of growth projections.

Top-Down Forecasting Model

As the name implies, a top-down forecast is the opposite of the bottoms-up approach. Instead of starting from detailed drivers, you begin with a macro view of your business and industry and work down to revenue.

With this method, you'll start by looking at the total market opportunity and the size of your industry's category. Next, you'll calculate your potential market share. Then you'll use that figure to forecast your potential revenue.

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Straight-Line Forecasting Model

Straight-line forecasting is the simplest model. Straight-line forecasts assume that your revenue will continue to grow at the same rate it has historically. If your revenue has grown 15% for each of the past two years, the straight-line forecast method assumes that same growth rate for the current year.

While this method is arguably the easiest approach, it may not always be the most accurate. As the saying goes, "past performance is not indicative of future results." Meaning that just because you've historically achieved a 15% growth rate, you can't always assume that growth rate won't drastically change next year. Still, the straight-line forecasting method gives you a good foundation to build upon.

Revenue forecasting is not a one-time activity, but a continuous process that requires constant monitoring and revision. You need to update your forecast regularly to reflect the changes in your business environment, such as new opportunities, threats, or trends. You also need to compare your forecast with your actual results to see how accurate your predictions are and what factors are causing the gaps. By updating your forecast regularly, you can identify and correct any errors, adjust your assumptions, and improve your accuracy and reliability.

Revenue Forecasting Guides Business Decisions and Engages Your Team

Revenue forecasting is not only a way to estimate your future income, but also a tool to help you make better decisions for your business. You can use your forecast to set your targets, allocate your resources, evaluate your performance, and identify your strengths and weaknesses. You can also use your forecast to test different scenarios and strategies, such as launching a new product, expanding to a new market, or changing your pricing. By using your forecast to guide your decisions, you can optimize your revenue potential and gain a competitive edge.

Revenue forecasting is not only a task for you as the owner or manager of your business, but also a collaborative effort that involves your team. Share your forecast with your team members, especially those who are responsible for generating or influencing revenue, such as your sales, marketing, and customer service staff. Communicate your assumptions, goals, and expectations clearly and get their input and feedback. You also need to align your forecast with your team's incentives, rewards, and recognition. By sharing your forecast with your team, you can increase their engagement, motivation, and accountability.

Business Sense is a no-fluff source of information that gets right to the heart of what small business owners need: essential tools and informational resources to help their businesses grow. Written by our team of business coaches, this series shares their decades of experience in areas such as financials, operations, sales and marketing, human resources, leadership, and governance. Business Sense is designed to provide entrepreneurs and small business owners in various sectors, including agriculture, forestry, waste management, renewable energy, and environmental technology, with recommendations and practical advice to help their businesses not only survive but thrive.

Our business management coaching and Business Sense Resource Guide are designed to accelerate the growth of the enterprises we work with and expand the leadership capacity of the entrepreneurs who own and manage these businesses.

Let Us Help You and Your Business

The Vermont Sustainable Jobs Fund provides tailored business management coaching, entrepreneurial support, and training to position Vermont-based entrepreneurs and small business owners in our designated market sectors for growth and long-term success. We partner with state government, private sector businesses and nonprofit organizations to build a thriving economic, social and ecological future for Vermont. Learn more at VSJF.org