Forecasting Sales for Your Start-Up Business

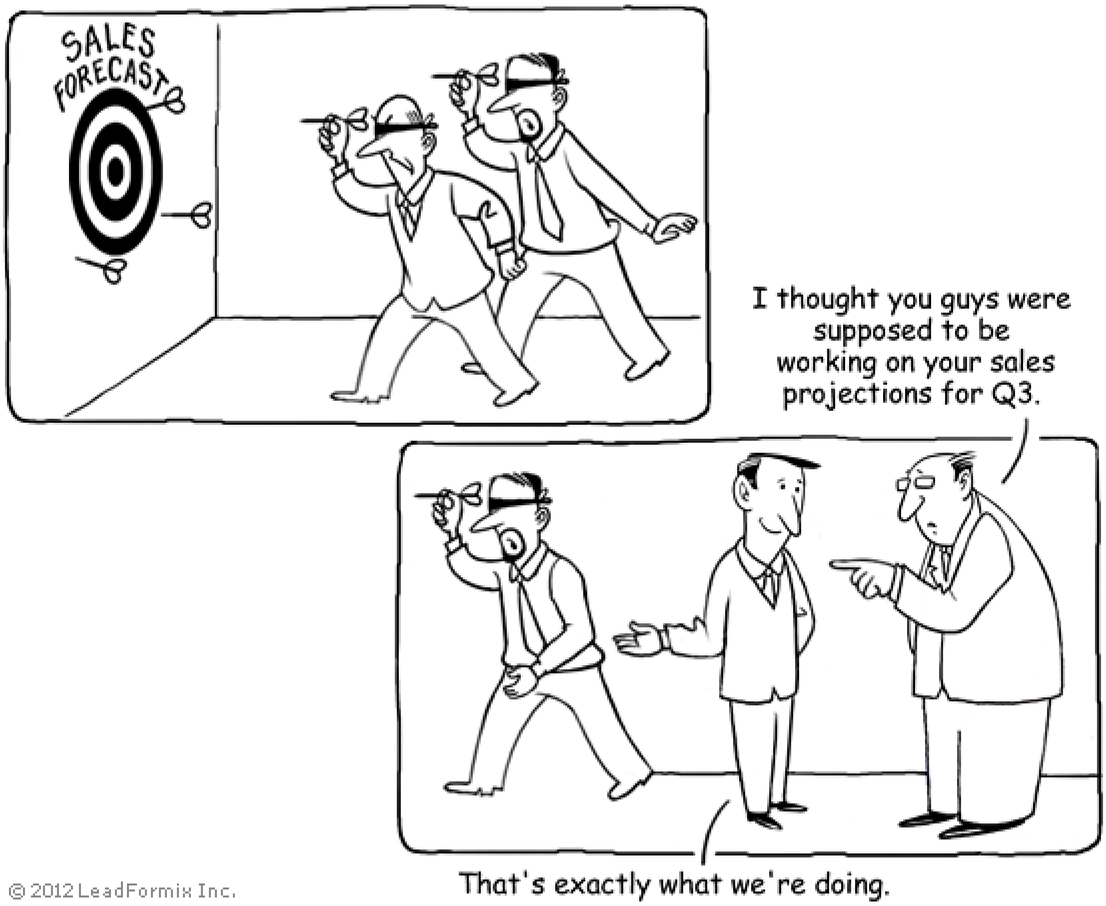
In this case study article, I'll share with you steps you can take to know **how to forecast sales for your start-up business**.

Starting a new business is both exciting and nerve racking at the same time. Often the excitement stems from the anticipation of achieving your ultimate hopes and dreams (i.e. being your own boss; determining your destiny; generating wealth for your family, etc.). However, there are no guarantees in business.

The uncertainty associated with not knowing how consumers will respond to your product/service; or not being sure how much money is required to maintain the business through its start-up phase are a couple of issues that create real anxiety for new business owners.

The number one source of fear for new business owners is the inability to accurately predict the amount of revenue they will generate in the early stages of the business.

Forecasting your start-up expense and monthly operating expenses are not difficult to do; however, forecasting how many people will buy that new product/service when the business is new is a much tougher task.



One big problem is, this source of fear does not arise for many new business owners until after the business opens. Prior to opening the business the sales forecast on paper indicates revenues will flow, cash will be available and profits will be made. The new business owner is giddy about the possibilities. Then the business opens. At that point, the business owner comes face-to-face with the reality related to the difficulty and the necessity to produce sales. Now the real pressure is on.

So, the question is, how do you approach forecasting sales/revenue for your new business? There is no magic answer or can't miss method, but there are ways to forecast revenue that provide more realistic estimates. Recently, I counseled two women who are starting a business. The following describes how we developed a first draft of their sales forecast.

Helen and Dorothy’s Sales Forecast

Helen and Dorothy are starting a hair salon and spa. Helen is a stylist and has several years of experience in the business. Dorothy is an experienced administrative and financial manager and the combination of their skills brings the required expertise to the venture.

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Before describing their forecast, let’s look at first things first. There is a logical process to starting a business and Helen and Dorothy have completed the first two steps.

Step 1 is define your business,. Here you describe exactly what your business does by answering questions such as: What need or problem does my product/service solve? How is it different than others that solve the same problem? Who is the customer, etc.? Helen and Dorothy have done an excellent job of defining their business.

Step 2 is research the business idea. In other words, learn as much as possible about the type business you are starting: how the industry works, and the market for your product/service. Helen’s experience in the business has provided a great deal of information about the business/industry/market; however, they are not totally relying on her knowledge as the only source. The two of them have also conducted additional research by interviewing other business owners, consumers and studying industry data and reports.

Now they are in **Step 3**, which is to plan the business. The planning step consist of three areas:

- Marketing Plan
- Operations Plan
- Financial Plan

Helen and Dorothy have completed their marketing and operations sections of their plan and now they are engaged with the financial plan. Like many new businesses, start-up cost and monthly operating expenses were relatively easy to identify. The challenge came when attempting to forecast sales/revenue.

First draft of forecast

Helen and Dorothy plan to have a total of 6 stylists (including Helen) working in the salon. They were projecting first year sales of $405,000. Start-up cost is $25,000, monthly operating expenses are $6000 and gross profit margin is 50%. Below is a highlight of our conversation.

Earl: How will you generate $405,000? Describe your assumptions.

Helen & Dorothy: We will have 6 stylist; each stylist will service 5 clients per day at an avg. of $45 per client = $225 per stylist, $225 x 6 days = $1350 per week; $1350 x 6 stylist = $8100 x 50 weeks = $405,000.

Earl: On paper, this looks good but once that sign on the door says, “Open,” it’s not about what’s on paper, it’s all about how many are consumers are walking through the door. Have you identified the other stylists, and if so, what level of sales are they generating now?

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Helen & Dorothy: We have identified the stylists, we know one of them is generating around $90,000 per year, but we don’t know kind of revenue the others are making.

Earl: How many are definitely committed to work in your shop?

Helen & Dorothy: Two of the stylists are definitely coming– the one with the $90,000 in sales and one other. The other three have said they are strongly interested in coming.

Earl: Does your projected profit margin include other costs (products, styling supplies, etc.) other than the amount paid to the stylist?

Helen & Dorothy: As we were talking I was thinking about that. Let's assume gross profit margin is 45%.

Earl: Here's what you should consider. You are investing at least $25,000 (and probably more) in your business and you have forecast your sales based on a perfect world scenario. I am sure you want a successful business and a return on your investment. Therefore, you should create a forecast based on more realistic and known information.

In response to this advice, here is what we developed as a first draft of a more realistic forecast.

1. Operating expenses are $8,000 per month, $96,000 per year. Profit margin is 45%. Revenue required to breakeven is $17,778 per month ($8000/.45% = $17,778); $213,334 per year ($96,000/45% = $213,334).
2. Currently, Helen (stylist #1) is generating approximately $100,000 is sales per year working in someone's salon. If she maintains the same rate of sales in her own salon, her sales will contribute $45,000 ($100,000 sales x 45% profit margin = $45,000) toward the business's operating expense budget of $96,000.
3. Instead of assuming all five of the new stylist would start when the salon opens, Helen and Dorothy decided to only include the two stylists who were committed to working in their salon. They also decided to be more conservative in their expectations of the two stylists. First, they assumed stylist #2 and stylist #3 would not begin until the third month of operation (just in case). Second, rather than using a sales forecast of $90,000 per year for stylist #2, they would forecast 80% ($72,000 per year). Since they did not have sales information for stylist #3, until they had an opportunity to speak with her, they forecasted her sales at 50% ($45,000 per year) of stylist #2's original $90,000.
4. Total sales forecast for the three stylist in year 1 is: $100,000 (stylist #1) + $72,000 (stylist #2) + $45,000 (stylist #3) = $217,000. Sales required to breakeven $213,334.

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Now based on the forecast, let’s see how much Helen and Dorothy need to start the business.

	Start-Up	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Begin Cash		-25,000	-29,250	-33,500	-33,362	-33,224	-33,086
Sales #1		8,334	8,334	8,334	8,334	8,334	8,334
Sales #2				6,000	6,000	6,000	6,000
Sales #3				3,750	3,750	3,750	3,750
COG/COS (55%)		4,584	4,584	9,946	9,946	9,946	9,946
Oper. Exp.	25,000	8,000	8,000	8,000	8,000	8,000	8,000
End Cash	-25,000	-29,250	-33,500	-33,362	-33,224	-33,086	32,948

Here’s what they have learned about the financial picture of their business.

1. The amount needed to start the business is at least $33,500 (see month 2 above) since this represents the highest cash shortfall.
2. They have a roadmap for making the business work financially.
3. In order to realize a significant net profit in the business, additional sources of revenue are required (i.e. more sales from stylists 2 and 3, additional stylist, etc.).

*Please note: The above forecast is for illustration purposes only. The sales amounts are the same every month just to demonstrate the concept.

The lesson to be learned is base your sales forecast on the most realistic information you can get and not on a scenario that just works on paper. Remember, the business is about the money. If the money does not work, the business does not work and it fails. Know what your business requires financially and develop a realistic plan to achieve it.

If you are serious about being successful in business, you are willing to pay the price to get there. The price includes being a student of business and continuing to equip yourself with proven methods of success.

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