

Chapter 3

Planning, Sales Forecasting, and Budgeting

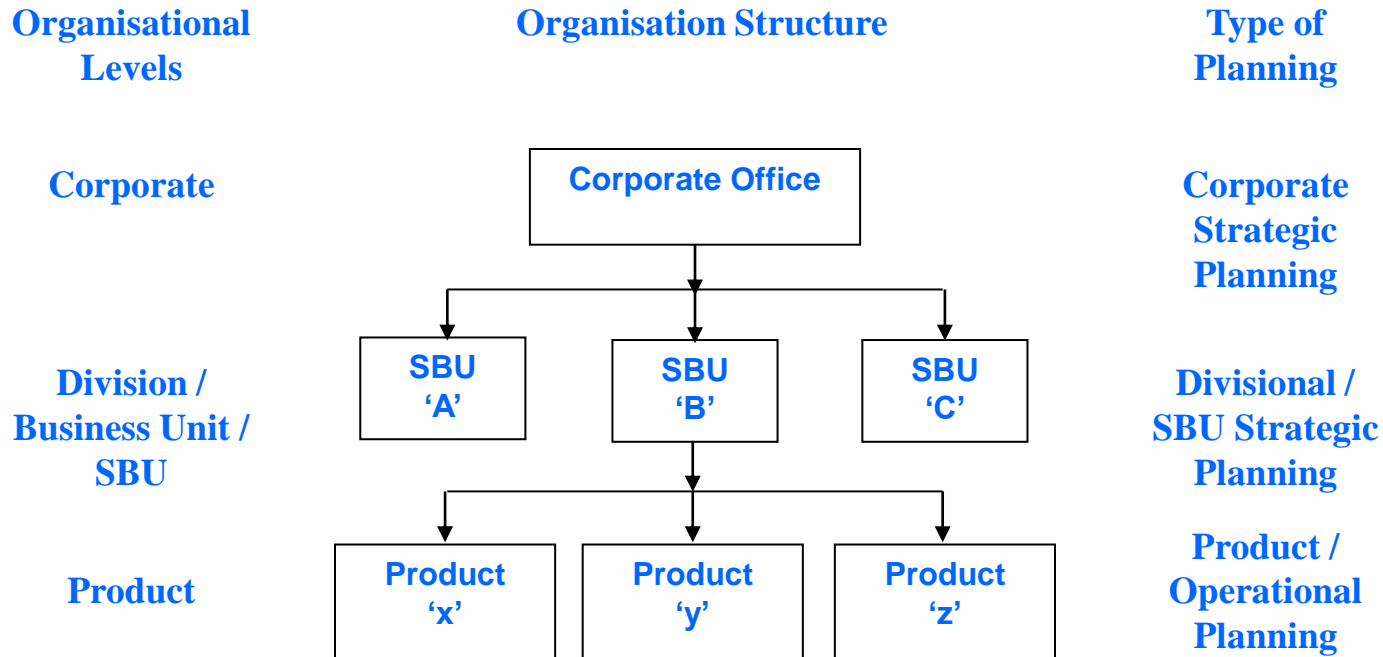
Learning Objectives

- To understand **strategic planning**, its linkage to **strategic marketing** and marketing management
- To know how **sales strategy** is developed from marketing strategy
- To learn **basic terms** used in forecasting, **forecasting approaches**, and **methods of sales forecasting**
- To understand purposes and the process of **sales budget**

Strategic Planning

- **Planning** is deciding now what, how, and when we are going to do
- **Strategic planning** is deciding about the organisation's long-term objectives and strategies
- In a **large organisation**, planning is done at three or four organisational levels, as shown in the figure (in the next slide)

Planning In A Large Organisation



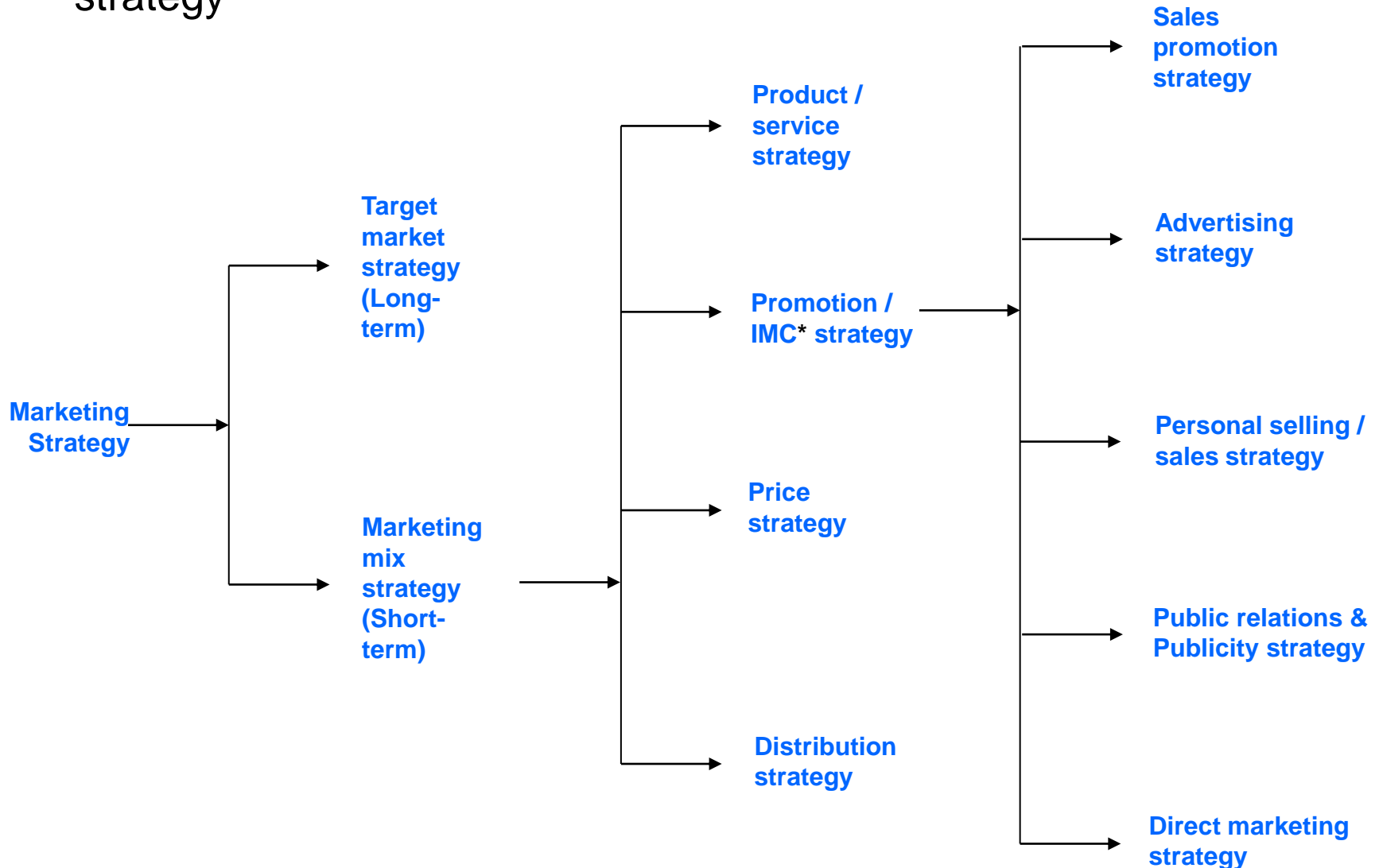
- For effective planning, operations, and control, a large multi-product / multi-business firm divides its major products / services into divisions / strategic business units (SBUs)
- Each SBU has a separate business, a set of competitors and customers, and a manager responsible for strategic planning, performance, and control

Role of Marketing in Organisational Planning

| Type of Planning | Role of Marketing – Key Tasks | Formal Name |
|--|--|--|
| <ul style="list-style-type: none"> • Corporate strategic planning | <ul style="list-style-type: none"> • Provide customer and competition information • Support customer orientation | <ul style="list-style-type: none"> • Corporate marketing |
| <ul style="list-style-type: none"> • Divisional / SBU Strategic planning | <ul style="list-style-type: none"> • Provide customer and competition analysis • Develop competitive advantage, target markets, value proposition, positioning | <ul style="list-style-type: none"> • Strategic marketing |
| <ul style="list-style-type: none"> • Product / functional or Operational planning | <ul style="list-style-type: none"> • Evolve and implement marketing plan including marketing-mix strategy, and sales strategy | <ul style="list-style-type: none"> • Marketing management |

Marketing and Sales Strategies

- Figure below shows how sales strategy is developed from marketing strategy



Components of Sales Strategy

- Classifying market segments and individual customers within a target segment
 - Each firm should first decide on target market segments and if possible, to classify customers into high, medium, low sales & profit potentials
 - Sales strategy is developed accordingly
- Relationship strategy
 - Whether a selling firm should use transactional, value-added, or collaborative relationship depends on both the seller and the customer
 - Each selling firm to decide which segments and individual customers respond profitably to collaborative relationship

Components of Sales Strategy (Continued)

- **Selling Methods**

- These are: (1) Stimulus response, (2) need-satisfaction, (3) team selling, (4) consultative
- Selection of appropriate selling method depends on relationship strategy

- **Channel Strategy**

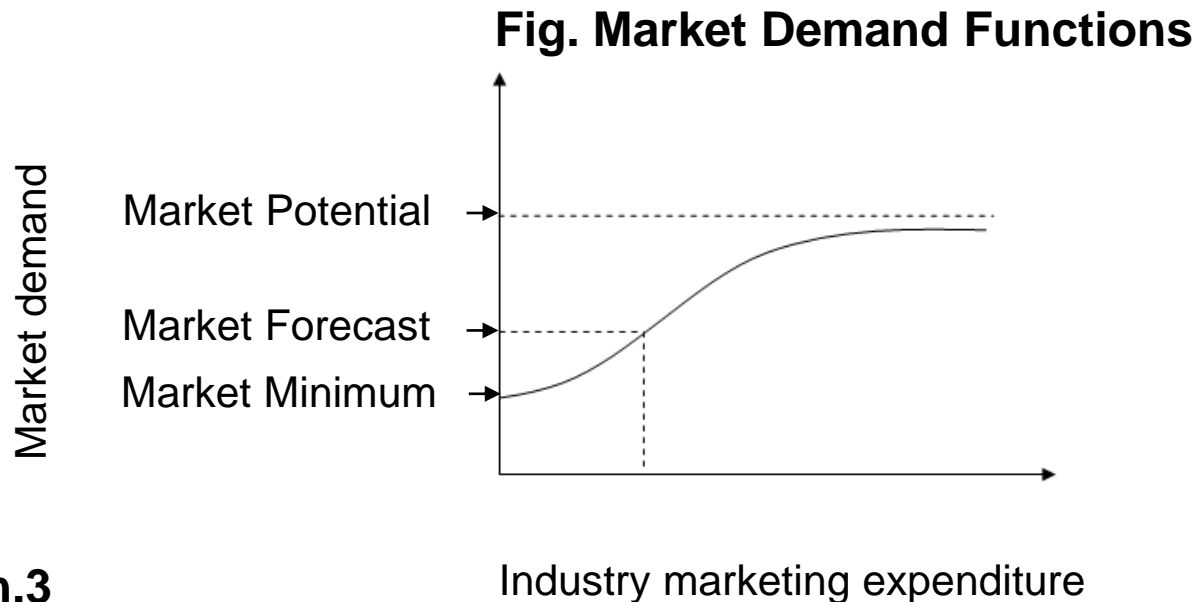
- There are many sales / marketing channels. For example: company sales force, distributors, franchisees, agents, the internet, brokers, discount stores
- Selection of a suitable channel depends on both the buyer and the seller, products / services, and markets

Basic Terms Used in Sales Forecasting

- **Market demand** for a product or service is the estimated total sales volume in a market (or industry) for a specific time period in a defined marketing environment, under a defined marketing program or expenditure. Market demand is a function associated with varying levels of industry marketing expenditure.
- **Market (or industry) forecast (or market size)** is the expected market (or industry) demand at one level of industry marketing expenditure

Basic Terms (Continued)

- **Market potential** is the **maximum** market (or industry) demand, resulting from a very high level of industry marketing expenditure, where further increases in expenditure would have little effect on increase in demand
- **Company demand** is the company's estimated share of market demand for a product or service at alternative levels of the company marketing efforts (or expenditures) in a specific time period



Basic Terms (Continued)

- **Company sales potential** is the **maximum** estimated company sales of a product or service, based on maximum share (or percentage) of market potential expected by the company
- **Company sales forecast** is the estimated company sales of a product or service, based on a chosen (or proposed) marketing expenditure plan, for a specific time period, in a assumed marketing environment
- **Sales budget** is the estimate of expected sales volume in units or revenues from the company's products and services, and the selling expenses. It is set slightly lower than the company sales forecast, to avoid excessive risks

Forecasting Approaches

- Two basic approaches:
 - Top-down or Break-down approach
 - Bottom-up or Build-up approach
- Some companies use both approaches to increase their confidence in the forecast

Steps followed in Top-down / Break-down Approach

- Forecast relevant external environmental factors
- Estimate industry sales or market potential
- Calculate company sales potential = market potential x company share
- Decide company sales forecast (lower than company sales potential because sales potential is maximum estimated sales, without any constraints)

Steps followed in Bottom-up / Build-up Approach

- Salespersons estimate sales expected from their customers
- Area / Branch managers combine sales forecasts received from salespersons
- Regional / Zonal managers combine sales forecasts received from area / branch managers
- Sales / marketing head combines sales forecasts received from regional / zonal managers into company sales forecast, which is presented to CEO for discussion and approval

Sales Forecasting Methods

| Qualitative Methods | Quantitative Methods |
|--|---|
| <ul style="list-style-type: none">• Executive opinion | <ul style="list-style-type: none">• Moving averages |
| <ul style="list-style-type: none">• Delphi method | <ul style="list-style-type: none">• Exponential smoothing |
| <ul style="list-style-type: none">• Salesforce composite | <ul style="list-style-type: none">• Decomposition |
| <ul style="list-style-type: none">• Survey of buyers' intentions | <ul style="list-style-type: none">• Naïve / Ratio method |
| <ul style="list-style-type: none">• Test marketing | <ul style="list-style-type: none">• Regression analysis |
| | <ul style="list-style-type: none">• Econometric analysis |

Executive opinion method

- Most widely used
- **Procedure** includes discussions and / or average of all executives' individual opinion
- **Advantages:** quick forecast, less expensive
- **Disadvantages:** subjective, no breakdown into subunits
- **Accuracy:** fair; **time required:** short to medium (1 – 4 weeks)

Delphi method

- **Process** includes a coordinator getting forecasts separately from experts, summarizing the forecasts, giving the summary report to experts, who are asked to make another prediction; the process is repeated till some consensus is reached
- Experts are company managers, consultants, intermediaries, and trade associations

Delphi Method (Continued)

- **Advantages:** objective, good accuracy
- **Disadvantages:** getting experts, no breakdown into subunits, **time required:** medium (3/4 weeks) to long (2/3 months)

Salesforce composite method

- An example of bottom-up or grass-roots approach
- **Procedure** consists of each salesperson estimating sales. Company sales forecast is made up of all salespersons' sales estimates
- **Advantages:** Salespeople are involved, breakdown into subunits possible
- **Disadvantages:** Optimistic or pessimistic forecasts, medium to long **time required**
- **Accuracy:** fair to good (if trained)

Survey of Buyers' Intentions Method

- **Process** includes asking customers about their intentions to buy the company's products and services
- Questionnaire may contain other relevant questions
- **Advantages:** gives more market information, can forecast new and existing products, good **accuracy**
- **Disadvantages:** some buyers' unwilling to respond, **time required** is long (3-6 months), medium to high cost

Test Marketing Method

- Methods used for **consumer market testing:** full blown, controlled, and simulated test marketing
- Methods used for **business market testing:** alpha and beta testing

Test Marketing Method (Continued)

- **Advantages:** used for new or modified products, good **accuracy**, minimizes risk of national launch
- **Disadvantages:** Competitors may disturb if some methods are used, medium to high cost, medium to long **time required**

Moving Average Method

- **Procedure** is to calculate the average company sales for previous years
- Moving averages name is due to dropping sales in the oldest period and replacing it by sales in the newest period
- **Advantages:** simple and easy to calculate, low cost, less **time**, good **accuracy** for short term and stable conditions
- **Disadvantages:** can not predict downturn / upturn, not used for unstable market conditions and long-term forecasts

Exponential Smoothing Method

- The forecaster allows sales in certain periods to influence the sales forecast more than sales in other periods
- **Equation used:**
Sales forecast for next period = $(L)(\text{actual sales of this year}) + (1-L)(\text{this year's sales forecast})$, where (L) is a smoothing constant, ranging greater than zero and less than 1
- **Advantages:** simple method, forecaster's knowledge used, low cost, less **time**, good **accuracy** for short term forecast
- **Disadvantages:** smoothing constant is arbitrary, not used for long-term and new product forecast

Decomposition Method

- **Process** includes breaking down the company's previous periods' sales data into components like trend, cycle, seasonal, and erratic events. These components are recombined to produce sales forecast
- **Advantages:** Conceptually sound, fair to good **accuracy**, low cost, less time
- **Disadvantages:** complex statistical method, historical data needed, used for short-term forecasting only

Naive / Ratio Method

- **Assumes:** what happened in the immediate past will happen in immediate future
- **Simple formula used:**
$$\text{Sales forecast for next year} = \text{Actual sales of this year} \times \frac{\text{Actual sales of this year}}{\text{Actual sales of last year}}$$
- **Advantages:** simple to calculate, low cost, less **time**, accuracy good for short-term forecasting
- **Disadvantages:** less **accurate** if past sales fluctuate

Regression Analysis Method

- It is a statistical forecasting method
- **Process** consists of identifying causal relationship between company sales (dependent variable, y) and independent variable (x), which influences sales
- If one independent variable is used, it is called **linear (or simple) regression**, using formula; $y=a+bx$, where 'a' is the intercept and 'b' is the slope of the trend line
- **In practice**, company sales are influenced by several independent variables, like price, population, promotional expenditure. The method used is **multiple regression analysis**
- **Advantages:** Objective, good **accuracy**, predicts upturn / downturn, short to medium **time**, low to medium cost
- **Disadvantages:** technically complex, large historical data needed, software packages essential

Econometric Analysis Method

- **Procedure** includes developing many regression equations representing (i) relationships between sales and independent variables which influence sales, and (ii) interrelationships between variables. Forecast is prepared by solving these equations
- Computers and software packages are used
- **Advantages:** Good **accuracy** of forecasts of economic conditions and industry sales
- **Disadvantages:** need expertise & large historical data, medium to long **time**, medium to high cost

How to Improve Forecasting Accuracy?

- Sales forecasting is an important & difficult task
- Following **guidelines** may help in improving its accuracy
 - Use multiple (2/3) forecasting methods
 - Select suitable forecasting methods, based on application, cost, and available time
 - Use few independent variables / factors, based on discussions with salespeople & customers
 - Establish a range of sales forecasts – minimum, intermediate, and maximum
 - Use computer software forecasting packages

What is a Sales Budget?

- It includes estimates of sales volume and selling expenses
- Sales volume budget is derived from the company sales forecast – generally slightly lower than the company sales forecast, to avoid excessive risks
- Selling expenses budget consists of personal selling expenses budget and sales administration expenses budget
- Sales budget gives a detailed break-down of estimates of sales revenue and selling expenditure

Purposes of the Sales Budget

- Planning
- Coordination
- Control

Sales Budget Process

- Many firms follow a process for preparation of annual sales and company budgets. It generally includes:
 - **Review** past, current, and future situations
 - **Communicate** information to all managers on budget preparation – guidelines, formats, timetable
 - **Use build-up approach**, starting with first-line sales managers
 - **Get approval** of sales budget from top management
 - **Prepare budgets of other departments**

Key Learnings

- **Strategic planning** is deciding about the organization's long-term objectives and strategies
- **Strategic marketing** has a role at divisional or strategic business unit (SBU) level of strategic planning by providing market information and developing competitive advantage, target markets, value proposition
- **Sales strategy** is developed from marketing strategy through marketing-mix and promotional strategies
- **Components of sales strategy** includes classification of market segments / customers, relationship strategy, selling methods, & channel strategy

Key Learnings (Continued)

- Two basic **approaches of forecasting** are: top-down (or breakdown), and bottom-up (or build-up)
- **Sales forecasting methods** are broadly classified as: qualitative and quantitative
- **Qualitative methods** include executive opinion, delphi method, salesforce composite, survey of buyers' intentions, test marketing
- **Quantitative methods** consist of moving averages, exponential smoothing, decomposition, naïve/ratio, regression analysis, econometric analysis
- **Sales budget** gives a detailed estimates of sales volume and selling expenses. Its purposes are planning, coordination, and control