Metrics for Accurate Forecasting in a Sales Organization

Sales forecasting is viewed as both an art and a science.

From the sales representative's viewpoint, forecasting is something of an art. At times it's a realistic painting providing a complete picture of the sales future, right down to quantities, product mix, timing and customer distribution. Other times, it's more like a modern abstract painting – colorful, disjointed and only loosely resembling reality.

From the sales manager's viewpoint, sales forecasting should be an exact science. Numbers are projected based on the reps' knowledge of their territories, customers and markets. When aggregated, the sales reps' forecasts project revenues and product demand with reasonable accuracy.

In reality, sales forecasting is somewhere between art and science. Sales representatives often do their best to generate accurate projections based on their territory knowledge and expectations. As sales reps project farther into the future, they are more likely to add a "swag" or "plug" number to their forecasts. Swag is generally based on a sales rep's gut feeling or intuition. More often than not swag is reasonably accurate, but the rep couldn't tell you why. When taken in aggregate across a moderately sized sales force, swags often mysteriously work together to generate a reasonably accurate forecast.

Despite the phenomenon of aggregate swags yielding close projections, few managers are comfortable with this approach. They want objective evidence to support forecasts – evidence that will reassure them that the swags are not "silly wild-a** guesses," but are based on realistic expectations. Fortunately, there are a number of metrics that a manager can use to gain reassurance.

Metrics

Metrics used to gauge the viability of sales forecasts can be viewed as backward-looking metrics or forward-looking metrics. Backward-looking metrics are those that examine historical data and identify patterns that might repeat themselves in the future. Forward-looking metrics are based on current data that represent future activity.

Backward-looking Metrics

Backward-looking metrics are generally less accurate than forward-looking metrics, but they provide a quick "litmus test." They provide a high-level view of how the market and company have responded to certain conditions in the past. The expectation is that the market and company will respond to similar conditions in the same way in the future. This is a reasonable assumption, but it does not always hold true.

Some of the backward-looking metrics that are useful to measure the validity of sales forecasts are:

- Historical data
- Call (dial) conversion rates
- Lead conversion rates, and
- Marketing campaign effectiveness

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<u>Historical Data</u>
Historical data represents past sales performance that can be compared with current and projected performance. One may look at year-over-year, month-over-month or quarter-over-quarter performance. For products with very short, fluctuating sales cycles, one might even look at week-over-week or day-to-day performance. In short, the sales manager is looking for past cycles that may continue in the future. Cycles may be seasonal, economic, budgetary or any other pattern that repeats itself and affects sales.

<u>Call Conversion Rates</u>
In a telesales environment, sales representatives make hundreds of calls a week, thousands of calls a year. Over time, a company can measure the percentage of calls that on average are converted to sales. Across individual sales representatives, call conversion rates will vary. Better reps will have higher conversion rates. Newer, less experienced reps usually have lower call conversion rates. By using the number of calls made by a sales representative or call center and their associated conversion rates, a sales manager should have a good idea of how many sales should result.

Conversion rates can be applied at a very granular level, if the volumes are sufficient. Sales managers can look at conversion rates by rep, by call center, by cycle (seasonal, economic, budgetary, etc.), by product, by deal size, etc. By applying finer degrees of conversion rates, sales managers can generate more accurate forecasts. However, there are trade-offs. At some point, the sample size to measure conversion rates can become too small and statistical accuracy will no longer be valid. Also, the cost associated with measuring and applying finer degrees of conversion rates may increase rapidly and no longer justify the resultant level of accuracy.

<u>Lead Conversion Rates</u>
Similar to call conversion rates, the rate at which sales leads are converted to actual sales can also be measured. Leads can be generated in a variety of ways. They can be referrals from existing customers, inquiries at trade shows, responses to marketing campaigns, emails from the web site. Some leads convert to sales easily and rapidly. Others need work to become sales. Finally, some leads will never lead to a sale.

By measuring the percentage of leads over time that actually result in sales (and the volume of the sales), a sales manager can measure the validity of a sales forecast expected from leads.

Like call conversion rates, different types of leads can generate different conversion rates. Leads from referrals may result in a much higher conversion rate than trade-show leads. Leads for simple products may have a higher conversion rate than leads for complex products. Again, the sales manager needs to segment the type of lead and its source and then apply the appropriate conversion rate.

<u>Marketing Campaign Effectiveness</u>
Marketing campaigns increase awareness in a market for a product, offering or company. Often marketing campaigns have a call to action. Marketing campaigns may be direct mail, email, public relations, broadcast or print advertising. The campaign my be a promotion, give-away or contest. Marketing campaigns are designed to drive the target audience to feel good about a company and its products, inquire about a company's products, or purchase a company's products.

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As a company develops a history of running marketing campaigns, it should also measure sales activity before, during and after the campaign. This serves multiple purposes; among them is the ability to anticipate sales as a result of marketing campaigns. As part of the sales forecasting process, the sales manager must account for marketing campaign schedules and adjust sales forecasts accordingly.

Forward-looking Metrics

Forward-looking metrics are based on current, on-going sales activities. They feed off the detail of today's market. Forward-looking metrics help balance the high-level view offered by backward-looking metrics. They look at identifiable deals, current territory activity and verifiable customer plans.

Forward-looking metrics that should be developed to gauge the accuracy of sales forecasts include:

- Leads and opportunities in the pipeline
- Sales cycle stages
- Timeframe to close, and
- Confidence level for viability of each opportunity

<u>Pipeline</u>
Every sales organization should actively manage its lead and opportunity pipeline. Leads are nascent opportunities, not yet fully defined or qualified. Opportunities are leads that have been qualified and valued. Sales representatives should be working on leads and opportunities at every stage in the sales cycle. By keeping their pipeline filled and actively working it, sales representatives should be able to very accurately project their short to mid-term sales. In addition, they should be able to identify and discuss all the risks associated with the forecast.

<u>Sales Cycle Stages</u>
As opportunities move through the various stages of the sales cycle, the sales representative learns more about the customers and the opportunities. With each advance in the cycle – lead, qualification, proposal, justification, pilot/test, close, follow-up – the sales representative should be able to measure more accurately the size of each opportunity and if and when it will close. Successful sales representatives consistently work multiple opportunities in every stage of the sales cycle (pipeline). Forecasts incorporate the sum of this data and knowledge.

<u>Timeframe to Close</u>
A key factor in developing accurate forecasts is estimating the timeframe in which opportunities will close. All opportunities should be projected with a target of when they are expected to close. Using timeframes, a sales manager can project not only how much business will close, but also over what period of time.

<u>Confidence Level</u>
Each sales representative should assign a confidence level to every opportunity. The confidence level rating system may be simple – high, medium, low. Or it may be more complex and involve assigning a percentage, for example, "I am 70% certain that this deal will close in this quarter." Using a confidence level rating system, sales managers can discount or firm up forecasts based on the likelihood of opportunities closing with specified time frames.

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Other Factors

Finally, sales managers must account for other factors outside the normal environment that can affect sales and their timing. Other factors may include natural disasters or weather changes, economic changes (oil prices, interest rates, political turmoil, labor unrest), supplier shortages, etc.

In the end, sales forecasting is not an exact science. The future is subject to unforeseeable changes and sales representatives are reluctant to forecast sales that they are not 100% sure of. However, by using a variety of metrics, a sales manager can check forecasts for "reasonableness" and manage his team and their projections accordingly.

About David P. Wallace

David Wallace is a strong sales and marketing leader with the experience to run your business. David has built relationship-oriented, consultative sales teams in the energy, education, leasing and technology industries. His teams have driven profitable revenue, in one case increasing revenue by 150% within six months while delivering double-digit profit margins to a previously unprofitable business. Working with brand-name clients such as IBM, GE and FedEx, David conceived and implemented strategic marketing programs to deliver product information, measure customer satisfaction, extend business partner relationships and, ultimately, drive revenue.

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