Removing Risk from Your Sales Forecast

WHITEPAPER

EXECUTIVE SUMMARY

Every sales executive knows the feeling of walking into a sales review meeting with the CEO or Board not knowing which parts of the sales forecast are solid and which parts are not. They must look the CEO in the eye and provide as much credible evidence as possible that they know what their outcome is going to be. Despite hours of preparation, drilling the team, scrubbing the key deals and going through the numbers, most sales execs still rely on their gut instinct to provide guidance as to where they think the number will land.

Increasingly, CEOs and other members of the management team expect sales executives to be data driven, to have accurate and credible numbers that can be justified and substantiated by others in the organization. Bad guidance can lead to dire consequences, such as loss of credibility and executive interference in the selling process.

Clearly, understanding the quality of the sales forecast and the risk imbedded within is paramount to achieving sales management success. Yet, according to a recent study by RBInteractive Research Group, only 1 out of 4 executives have a high level of confidence in the sales forecast.

This white paper discusses how best-in-class sales leaders understand the risk they have in their sales forecasts. It will also discuss how they manage their sales forecast, how they use it to build credibility with executive management, and ultimately get the rest of the company to better support their needs -- resulting in their accelerated success.

Using Intuition to Interpret the Bottoms-up Sales Forecast?

All good sales management professionals develop an intuitive understanding of what goes into the forecast, what makes it good and what makes it bad.

They know who the good forecasters are. They walk the halls, stopping to talk to those individuals who are credible and asking their perspective on how things are going and where things are likely to land. They also know who manipulates the forecast: Linda the expert quota shaper is always holding something back that appears right at the end of the quarter to earn her accelerators. And we know the incurable optimists like Joe — always thinking he will book deals much sooner than he usually does. Finally, we tend to instinctively ignore those who just can't forecast at all, like Jim, who thought leg warmers were going to be hot this year.

These sales reps' forecasts are layered on top of their customers' projections: some customers are transparent, some opaque; some customers in command of their businesses, some unsure of what their needs will be. Add in to the mix distributors, channel partners, new products being launched, old products being phased out, and it is easy to see how the forecast gets very complicated and is full of many details that are hard to humanly judge.

Usually, the way sales departments deal with this is that sales managers are trained to scrub the forecasts for the largest customers and opportunities in their pipelines at each level of the sales hierarchy. The smaller customers and prospects, despite the fact that they can add up to a significant part of the total forecast do not get vetted much.

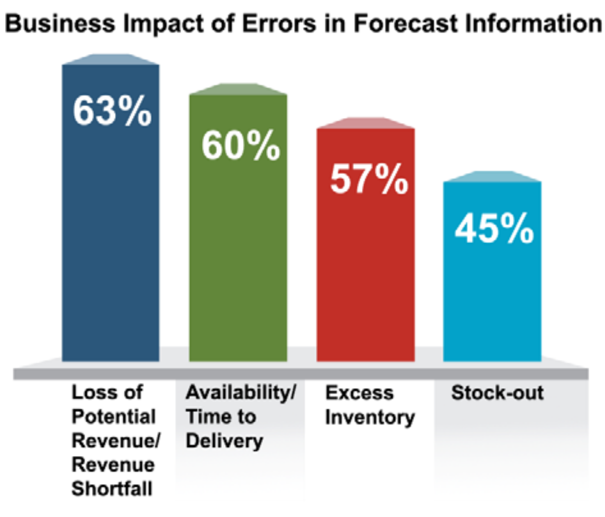
The sales managers' judged forecasts are then rolled up. Finally, the head of sales then makes a call based on these multiple layers of subjective interpretation. This results in enormous complexity and subjectivity in the sales forecast.

Sales leaders usually rely on back of the envelope calculations, their own rules of thumb, and gut instinct to judge the number. But, where rules of thumb tend to work at an aggregate level, they usually fall apart when you get into the details. And, they break when there are significant changes in the pattern of the business.

It is hard to get a clear picture of what is good and what is not good in the forecast. Sales leaders are compelled to use estimation, intuition and guesswork to assess the quality of the forecast and identify areas of risk. It is easy to see why other groups in the company (e.g. Operations, Finance) find it hard to trust the sales forecast, much less act on what the sales forecast is telling them.

A recent survey from RBInteractive Research Group found that most companies saw very specific and measurable negative impacts from forecast errors.

In additional to the overall impact to the business, poor sales forecasts can harm individual credibility and bring friction to inter-departmental working relationships.



Let's look at two real-world examples of that negative impact.

$20 Million of Lost Revenue Due to Stock-outs

A major manufacturer offers a significant number of products in a highly competitive commodity market. Their sales team had forecasted a number of these commodity products to be ordered in the quarter. However, the operations team had little trust in the sales forecast, and would be penalized for excess inventory. Operations decided not to build the forecasted products until the orders had actually been received.

As the quarter came to a close, those forecasted orders did come in, but the operations team had not built the products and could not deliver them. Those orders went into unscheduled backlog and were eventually lost to a competitor who could fulfill them quicker.

The company could have had an additional $20 million in revenue if they had trusted that part of their sales forecast.

Excess Inventory Holding Costs

A component manufacturer that competes on lead-times in their market maintained high levels of inventory across their diverse product lines to ensure that they could always have parts available to meet the customer demand. Unfortunately, this resulted in excess and obsolete inventory that weighed negatively on its earnings and growth. The company needed to stay competitive on lead times, yet not carry excess inventory.

However, the only way they could hold less inventory and still plan to meet customer demand, was to build to a good sales forecast. Unfortunately, they did not have a trustworthy sales forecast for product, so they continued to invest in holding excess inventory. This reduced investment they could be making in growing their top line, like hiring more sales reps or delivering new products.

Good, Adjust, or Toss?

Obviously, businesses would like to avoid these outcomes, but how can sales management help? They are faced with the difficult task of trying to adjust and segment a raw sales forecast across thousands of forecasted items. There are simply too many variables and too much risk in a raw forecast for anyone to manually know exactly which forecast items require the right attention or how to adjust those items.

But, there is hope. Sales management's judgment *process* today is good, but their *systems* are not.

Procedurally, sales management intuitively groups their forecast into three areas:

1. Good (count on it – low risk)
2. Adjust it (apply judgment to make it trustworthy – medium risk)
3. Toss it out (not trustworthy – high risk)

In fact, they are using a good framework – they just need an objective and systematic way to apply that framework across their entire sales forecast.

Until today sales managers have not had a system to assess the quality of a sales forecast and understand which parts are riskier than others in a data-driven fashion.

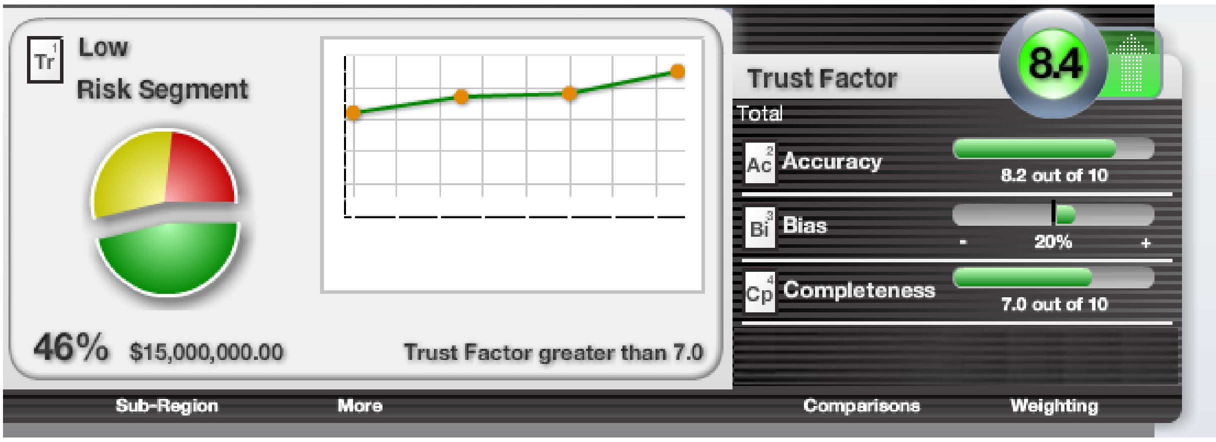
A FRAMEWORK FOR SEGMENTING RISK IN THE FORECAST

The “ABCs” of Forecasting

Sales managers typically rely on several factors in judging the quality and risk of the sales forecast. They’ll look at who’s providing the forecast, what products or accounts are forecasted, and how good those forecasts have been in the past. Specifically, we’ve observed sales managers leveraging the following key metrics (we call these the “ABCs” of forecast quality):

- **Forecast Accuracy:** This is a measure of how accurate the forecast has been in the past. This is more than just evaluating whether your rep Joe always achieves his top line forecast number – it’s whether Joe actually sells the 10,000 red widgets to customers A and B that he said he would last quarter and whether he sells the 15,000 blue widgets to customers C and D that he said he would.
- **Forecast Bias:** This metric tells you whether the sales forecast has been overly optimistic or consistently understated. Sales managers use this metric at many levels – sales reps, regions, customers. They can identify the sandbaggers and overly optimistic reps on their team, and if a customer’s been gaming them by providing overly optimistic sales forecasts.

- **Forecast Completeness:** Sales managers use this measure to determine how fresh or up-to-date the forecast is. A forecast that has not been updated in the recent past is a lot less trustworthy than a forecast that has been updated more recently.



Combining all of these measures into a single number, delivers the Trust Factor™. The Trust Factor is an objective index of the quality of the sales forecast. Utilizing this index a sales manager could segment the raw forecast into three areas:

1. Green/Good: low risk (Ask operations to build it, finance to support)
2. Yellow/Adjust: medium risk (Adjust to make trustworthy)
3. Red/Toss: high risk (Place in upside).

Now, with this framework and the Trust Factor, sales management has the ability to objectively score the quality of the sales forecast and understand the risk in that forecast. They can use the Trust Framework and the Trust Factor to have a data-driven conversation with Operations about the widgets they need to build. They can have a data-driven conversation with Finance about revenue for a particular period. Operations and finance can confidently act on the sales forecast because it is based on reliable objective data – just like the data on which they commonly make decisions.

Furthermore, sales management can supplement their gut feel and "rules of thumb" with data to judge the riskier portions of the sales forecast. For example, Jo-Ann is a conscientious forecaster, consistently completing the entire forecast on time. However, over the past four quarters, she consistently sandbagged her forecasts, leaving her with 70% accuracy and -30% bias. Now, the sales manager might have had an intuitive feel for the fact that Jo-Ann's a sand-bagger. However, with the ABCs of Forecast Quality and the Trust Factor, the sales manager has data to back-up that intuition. He can also use that data to make more precise adjustments to the forecasts he gets from Jo-Ann.

This framework doesn't just apply to sales reps. For example, a sales manager may drill into the red (high risk) area of the forecast to find that risky forecast line items all tie to a few flaky customers. He can use this data to identify those customers who are gaming the company with their forecasts and take appropriate corrective action. Again, the sales manager might have had intuitive feel for some customers' buying behaviors – but with the Trust Factor, he has data to back up that intuition.

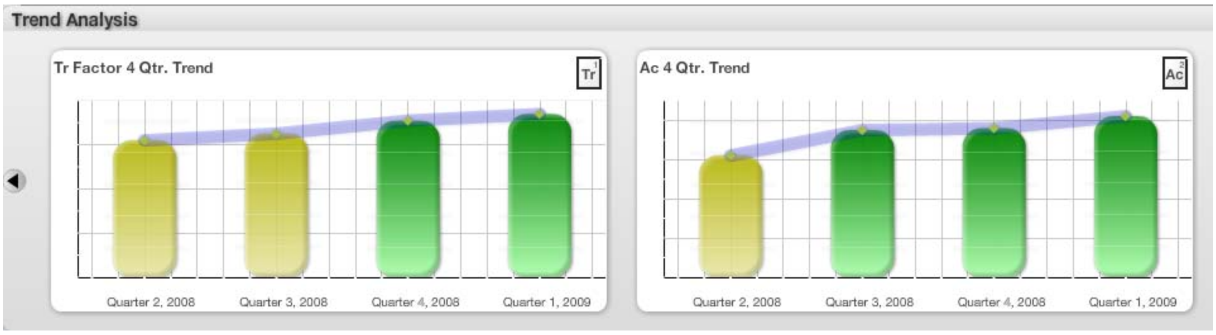
By enabling the organization to see the low risk items, adjusting the medium risk items and improving the high-risk items, sales management can remove the risk in their forecast and focus their energy on the items that enable them to maximize the outcome of that forecast.

Don't Just Segment, Improve

Given this objective framework, a sales manager now has a report card on which he can evaluate forecasters, customers, products and regions. A sales manager's goal could be to make his entire raw forecast green so that he does not have to adjust any part of it. By stack ranking the team based on Trust Factor, managers know where to focus their teams' energy, either on sharing best practices from the best forecasters, or working with marketing to establish more collaborative forecasts for new products, or working with customers to establish better forecasting relationships. A sales manager again has an objective way to evaluate the improvement of each area of the forecast by reviewing trends in the ABCs of forecasting.

More Sales Wins and Increased Forecast Accuracy

A telecommunications equipment manufacturer was in a situation where operations teams would state that the sales and marketing forecast was sometimes 100% wrong. In fact, there was so little trust between the two groups that operations would build to its own forecast without sales and marketing even knowing. However, as one can imagine, inventory overages and stock-outs caused lost orders and write-downs. This highlighted the need for the company to achieve an actionable sales forecast. By following a proven process to forecasting with structure around that process, the company was able to measure forecast accuracy and pinpoint the areas of forecast on which to focus.



Why Do It?

The Trust Factor framework delivers a way for evaluating, segmenting and establishing trust in the forecast – and removing risk. However, applying this framework will require work within the organization and executive attention. Why should a sales executive use valuable sales time to achieve an actionable forecast?

Let's take a couple real-world examples of companies that have achieved a trusted, actionable sales forecast.

Once operations, marketing and sales could see the areas of the forecast that required attention, they were able to increase the forecast accuracy by 25%. Now this telecommunications equipment manufacturer wins more business with shorter lead times and has *reduced inventory levels by up to 25%* – by simply having operations know exactly which elements can be trusted in their forecast.

Decreased Inventories by 20%

The company mentioned previously in this paper that suffered from excess inventory holding costs did address this issue. They implemented a disciplined sales forecasting process and purpose-built sales forecasting solution. With these keystones in place, they began measuring and enforcing forecast accuracy rules. The company quickly determined which products were the high accuracy products and changed its process to "build to forecast" on those products.

The company also found the lowest accuracy products and focused the sales team's energy on improving the accuracy of those products. *Just by building the high-accuracy parts to forecast, instead of to stock, the company decreased its inventory by 20%.* With the improvements it is seeing in forecast accuracy of the other parts, the company expects to decrease its inventory levels another 20%.

A Better Sales Forecast

Many executives intuitively get the value of a trusted, actionable sales forecast. And just about any sales executive would love to remove risk from their forecast and not have that "empty pit in the bottom of my stomach" feeling when they walk into a sales review meeting with their CEO. At Right90, we develop software solutions that help companies consistently achieve business value by making their sales forecast actionable.

Furthermore, leading analyst firms like CSO Insights and AMR Research have published studies that correlate best-in-class forecasters with best-in-class business performance. The top reasons any sales executive should make their forecast better:

Increase Revenue

- 20% higher win-rates from best-in-class forecasters (CSO Insights)
- Nearly 50% of surveyed respondents believe an actionable forecast would result in > 10% revenue increase (RBInteractive Research Group)
- 11% higher overall sales revenue attainment (CSO Insights)

Optimize Inventory

- 17% stronger fulfillment (AMR Research)
- Best-in-class forecasting performers have up to 75% less on-hand inventory compared to worst-in-class performers (RBInteractive Research Group)
- Best-in-class forecasting performers have reduced E&O inventory compared to worst-in-class performers (RBInteractive Research Group)

Improve Sales Performance

- Avoid stock-outs; get operations to build what is necessary to win business.
- Best-in-class forecasting performers have up to 40% less unfulfilled backlog compared to worst-in-class performers (RBInteractive Research Group)
- Reduce sales forecast cycle times by up to 60%

How to Get Started

If you want to understand the risk in your forecast and you are ready to establish an actionable forecast at your organization, you will need to address people, process, and technology. Fortunately, many organizations do not need to drastically adjust their sales forecasting process to establish trust in their forecast; instead they need a system to put structure around the process. Right90 delivers a system to put in place that structure and a technology solution to do all the hard work. The last thing needed is people: your sponsorship as an executive. The next step is yours.

To get more information about Right90 Trust Analytics™, the innovative application that drives confidence in a sales forecast, visit our website at http://www.right90.com/trust

About Right90

Right90 is a market leader in sales forecasting solutions. Right90 delivers a powerful suite of SaaS-based applications that enable companies to generate an actionable sales forecast. By integrating with leading CRM and ERP systems, Right90 applications help companies to drive higher revenue, greater margins and increased sales performance. For more information, visit www.right90.com or call 1-650-638-9090.