Percentage of Sales Method of Financial Forecasting

Usually the easiest forecast for a firm to make is its sales forecast. The firm knows how its sales have grown in the past, and it knows what its marketing strategy and marketing budget will be in the future. Furthermore, most other costs are usually (and mainly) a function of sales. Consequently, it is usually advantageous for a firm to first forecast its sales.

Once the firm has an estimate for its sales, it can calculate what its other costs will have to be to satisfy these sales. The firm can determine what percentage of individual costs are fixed and not fixed; and then it can use this analysis to forecast future expenses as a percentage of sales.

This analysis can be combined with the projected sales number to generate pro forma financial statements. These simple steps are called the percentage of sales method of financial forecasting. It is logical and effective.

Individual investors who are interested in investing in a firm can undertake the same procedure to gain insight of a firm's prospects. Individual investors will not have access to exactly the same information as managers; but using reasonable assumptions for numbers they do not have, individual investors can have access to roughly the same information as managers and other insiders inside a firm.