

Forecasting for Business Success: Top-Down versus Bottom-Up Methods

"It is far better to foresee even without certainty than not to foresee at all." Henri Poincare, Chaos Theory Physicist, "The Foundations of Science"

The art and science of business forecasting have been around since the first trading posts. Many business owners consider the process to be about as reliable as reading tea leaves. Yet, many Executives succeed or fail based on their ability to foresee the future.

Forecasting is imperative for goal setting, budgeting, pricing, sales estimates, production capacity, and business model infrastructure assessment. There are three main planning tools available. They are the "Top-Down," "Bottom-Up" and the hybrid approach. Which method is best for your business?

Top-Down Forecasting

This system starts with the macro view. It begins with industry estimates and works down to individual departments, products, and services. Top-Down forecasting goes from the general to the specific.

For example, in sales forecasting, you start with the total market capitalization for your industry. This would then be broken down by product lines and types. What is the total market share you can expect to capture? How long will it take you to do it? What resources will you need to be successful?

Estimates are most accurate when there is a significant amount of industry data available. The more information you have for forecasting the better. Market trends and patterns are much easier to identify when supply and demand forces are similar for specific products and geographic areas. This process is also useful for startups when there have been little or no sales yet.

For financial budgeting purposes, aggregate budgets would be calculated using industry best practices and guidelines. They would then be allocated to particular departments and ultimately to specific products and services.

The largest problem with Top-Down forecasting is that all products and regions are combined. This tends to average the low and high numbers in the analysis. The projections do not represent any one product or geographic location. Trends and patterns are generalized.

Bottom-Up Forecasting

In contrast to Top-Down forecasting, the Bottom-Up process begins with the micro view and builds to a macro view. It starts with individual product sales and production estimates. Each department presents their projections going forward. The totals are added together to form the big picture. The component parts are used to create a forecast for the entire business. It goes from the specific to the general.

The advantage of Bottom-Up forecasting is it focuses attention on the assumptions underlying specific sales, expenditure and profit margins for each product and service. Managers and employees are much more involved in the planning process in Bottom-Up forecasting than in the Top-Down method.

The Bottom-Up system is very helpful for setting sales, production and hiring goals for purposes of allocating resources to specific items to obtain your objectives. Forecasting tends to be more accurate for businesses that are seasonal in nature or experience wide swings in sales and profits.

One of the primary disadvantages of Bottom-Up forecasting is that errors at the micro level are amplified as they approach the macro level. They are compounded during the expansion process. Assumptions should always be challenged and improved as necessary.

Hybrid Approach for Better Accuracy

The third method is a hybrid of the Top-Down and Bottom-Up models. The objective is to accentuate the advantages of both systems while minimizing their disadvantages resulting in more accurate estimates. The two methods act as a check and balance process for each other. Top-Down estimates are contrasted with Bottom-Up projections to yield a more holistic view.

The hybrid approach works well when there is very little industry data available and when department managers either over or underestimate their sales and production goals. Differences in estimates are reconciled to generate more dependable results.

Which Method is Best for Your Business?

Forecasting is essential for proper business planning and decision making. It is required for monitoring cash flow, identifying break-even points, assessing debt payback capabilities, securing outside financing, and maximizing profits. Processes range from educated guesses to very complicated and sophisticated mathematical modeling.

Top-Down and Bottom-Up systems each have their own strengths and weaknesses. Hybrid methods are used to maximize the advantages and minimize the disadvantages in order to increase the reliability and dependability of each system.

The best model depends on the nature of each individual business. We believe constant

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improvement in forecasting skills is mandatory for long-term success.

How We Can Help You

[Pacific Crest Group \(PCG\)](#) provides professional services that keep your business focused on your critical objectives. We provide strategic Accounting and Human Resource (HR) services created specifically to help you meet your goals. Through exemplary customer service, clearly defined policies and procedures as well as a forward-looking perspective, we provide the outsourced solutions your business needs to grow. A PCG professional is happy to meet with you to discuss solutions for your unique requirements designed to maximize all of your business opportunities.