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Building the Business Case – Forecasting Customer Numbers

In order to calculate our revenue, we need to work out what customers we are going to get.

Expenses are relatively straight forward. We know what our expenses are going to be. The hard part is working out the revenue. We haven't sold this product before so we don't know how many customers we are going to get. We have no idea how many people are going to buy this product. We have got a few places that we can start.

Let's go back to our model. We know that we've got 2.2 million customers on our database so we are going to make some assumptions or educated guesses. We will start with our existing number of customers; we will put that down as an assumption. Go to your assumptions page, at the very top we've got the number of existing Honey Corp customers and that is going to be 2.2 million. We are only going to refer to it once but just to be consistent, I am going to create a named range. I am going to call it HC_cust and I am going to link that through as my starting point.

From that I can work out how many customer's own pets as this is pet insurance product. They are not going to buy our product if they don't own pets. We can use some assumptions around that and we can then assume how many customers we are going to acquire based on those numbers. That is going down this way, but we also need to model this way as well. We need to make some forecast projections about the next ten years. We are going to assume that our market share is going to remain consistent so we will say that we have roughly 6% of market share of the Australian population. We are going to assume that if the Australian population increases our customer base is going to increase as well. How does that sound?

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It's pretty easy to get the Australian population projections. You can quite easily download those from the Australian Bureau of Statistics or whatever country you are in. Go to your problems page and I have some population projection numbers here to save you a bit of typing. Copy those in here, go to your assumptions page and then paste it in. We are actually missing a couple of years. The last couple of years are missing and this is something that happens quite a lot. You get some data and you are missing a little bit or maybe it's been given to you in financial years and you need it in calendar years or the other way round. We often find when collecting the data for a financial model, that the format or the way that we've been given the data is not right. We often need to extrapolate or interpret or make some assumptions about it. What we could do of course, we could highlight the cells and copy across like that; not very good practice though is it. That's pretty accurate because it is in ten years' time. It's not going to make a huge amount of difference. We are only looking a five year NPV, so it doesn't make a massive amount of difference to our model but we do want to follow best practice. Using a forecast function is going to be a much better way of calculating or making some assumptions about what the number will be in the future. The advantage of using a forecast function is that it is much more auditable. You will be able to see the formula and see how it's been calculated. Let's do that.

That is no longer going to be an input assumption. Best practice tells us that the hard coded number, or input assumption should be formatted like that. I have created this format by using this cell style. As this is no longer going to be an input assumption but a formula, I am going to change the background colour to no fill and then use a forecast function. Go into forecast and X is the point on the X axis. That is going to be 2026. Your known Y, so the corresponding points on the Y axis. We are going to fix our reference using F4 or Command T and your corresponding X's are the known years and fix those reference as well. We will copy that across. You can see there, that's used the historical data to forecast out into the future.

Once you are happy with that, we can then use that data to index our customer projections. To do that we need to calculate the customer increase. Let's calculate it here. We will say the second year minus the first year. That will give us the increase, year on year. We then divide that by the base year, not the current year. That means we are getting an increase of

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0.9%, not very much, but that is what we are going to use to increase our number of customers. Copy that across and that's what your formula should look like.

Let's use that percentage increase to increase our number of customers. Go back to your Revenue sheet. Take the 2.2 million customers and increase it by 0.9%. Go to here and multiply by one plus, go back to your assumptions page and use the 0.9%, close bracket and copy it all the way across. That's what your formula should look like.

Once you've got that worked out, we are then going to make some assumptions about the number of customers who own pets. We're a big insurer or a motoring company or something like that and we have millions of customers on our database but when they joined us we didn't ask them do you own pets. We need to make some assumptions. We do a bit of research and we discover that 54% of the general population own pets so we are going to make an assumption that if 54% of the general population owns pets, that means that 54% of our customers will own pets. Is everybody with me so far? Is everybody happy with this? You need to be comfortable with the assumptions that go into your model because you're the one that has to validate those assumptions. We have no idea how many customers we are going to get for this product. But if you are going to go ahead, this is multi-million-dollar project, we need to be comfortable that the assumptions that go into the model can be validated and that if something goes wrong, it's going to come back and you will be able to see what assumptions we've used and you also need to make sure that whoever's approving this project, is comfortable with the assumptions as well and that they really understand the assumptions that you've put into the model.

Let's go to our assumptions page now. Let's put in a 54% pet ownership input. Go to your revenue page and we will multiply it out. You can see that "pet ownership" comes up here. You can tab forward to pick it up. Alternatively, you can go put in multiplied by F3 if you can't remember the named range. Copy it across. That's what your formula should look like.

We sold a similar product last year. It was a life insurance product. It was similar in that it was insurance but it's a very different type of product. We got a 2.2% take up rate. We've never sold pet insurance before so we really don't know what sort of assumption we should use but for lack of anything else, we are going to use the 2.2%. We are going to use direct

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mail and social media directly targeting these customers that we already have on our database. We know from experience that using those sorts of marketing campaigns then you do tend to get that amount or 2.5% every year of your existing customer base and we are going to add that and make that cumulative. Each year we get 2.5% and so on. We are going to use that as an assumption. Of course we are not really comfortable with the assumption here. We really don't know if we've got it right. We are going to do some scenario analysis on this later on. But we need to document that. If we put nothing in there it's going to be wrong, so we need to make an assumption.

Let's go to our assumptions page. Go to Take Up. Put in 2.5%. We are going to name the range and call it Take Up. Go back to your revenue page and we will say 1.1 million multiplied by Take Up and copy across. This is how many customers we expect are going to be taking up our product. That then becomes cumulative number. That there, plus the previous one, plus the previous one and so on. We can do that using a SUM and we can fix the first range and leave the second one floating. Copy across and that's going to increase over time. We are then going to take out some churn and that will give us the Net Cumulative Customers at the end. We are going to use that to calculate our revenue.

Is everybody with me? Because I have actually made a big mistake, a massive mistake in my calculations. It's actually a logic mistake. Can anyone think of what I've done? Pause the video for a moment and have a think about it and then we will work through it together.