Financial Forecasting

The competitive business world, which is characterised by expanding opportunities and rapidly changing market situations, strategic planning has proved to be of greater significance not only for growth but also survival. The strategic plan of a company defines its corporate purpose, scope, objectives and strategies. Financial manager, being a key member of the top management group that formulates strategic plan must – advice the strategic planning group about the financial implications of various alternatives, ensure to choose financially feasible strategic plan, be able to translate the strategic plan into a long-range financial plan and assist in the development of budget.

In addition to the effective strategic planning, a company should be able to foresee the future business activities to gain competitive advantage. Thus, a long-term financial plan represents an outline of what a firm intends to do in the future. Financial forecasting is an indication of company's financial fitness. So, it is essential for the companies to pay attention towards spending sufficient time and adequate resources on financial forecasting. It is the process of analysing past events and estimating future business activities or projecting future business performance – sales, costs and earnings. Broadly, financial forecasting includes sales forecasting, preparation of Proforma statements and estimating external funds requirement.

Sales forecast is the starting point of forecasting and is a critical task for any company. It is a self-assessment tool as it conveys the financial performance of a company. As it forms the basis of estimating budget of a company, any inaccuracy in sales forecasting might influence the future direction of the company. Next comes the preparation of Proforma statements which constitutes preparation of Proforma income statement and Proforma balance sheet. organisation, a company may not able to meet its financial requirement through internal sources alone. This requirement of funds, necessitate the companies to depend on external funds.

Commonly, there are three important techniques to prepare Proforma statements – Percent to sales method, budgeted expense method and combination method. The balancing figure in Proforma balance sheet will tell you the amount required to be borrowed through external sources. In an expanding business organisation, a company may not able to meet its financial requirement through internal sources alone. This requirement of funds, necessitate the companies to depend on external funds

The concept of forecasting can be discussed by using Dr. Reddy's Laboratories Ltd, a leading player in the Indian Pharmaceutical Industry (IPI). The industry has come a long way from a negligible position in the pre-independence period to an emerging industry in the world. Dr. Reddy's being a dominant player in the IPI has come across many milestones. The company's core strength being innovation and investment in research and development (R&D) proved to be an added advantage over the other players. The company adopted both the organic and inorganic means of growth. Since, forecasting of financial needs forms a strong pillar of the company's strategic growth due importance should be given in preparing the financial forecast plan.

The case study tries to achieve the following objectives – taking into consideration the factors that influence the sales of a company in the pharmaceutical industry, what is the relevance of forecasting sales of Dr Reddy's?; In a highly fragmented and organised Indian pharma industry– What is the need and relevance of projecting the company's operating and financial position?;

To what extent, a company's operations should be financed through external sources of funds?

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