

# Forecasting – why bother?

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Let's be honest, forecasting will never be 100% accurate.

Forecasting should be seen for what it is: 'guessing'. Still, there is value in trying to pre-empt what the future holds. And there are ways of making a more educated 'guess'.

This article explains why forecasting is an imperative, not an option. It sets out six principles for making good forecasts, to manage the risks and uncertainties of the business environment while grasping the opportunities. A second article, in the next edition of Knowledge, will look at the application of those principles in day-to-day operations.

## Who needs forecasts?

If your business is committed to identifying, responding to and taking advantage of changes in demand, forecasting takes on a different and critical dimension.

Essentially, every business requires a forecast. Yet many fail to reflect the importance of this activity in their processes, measures and behaviours – and they do not establish the correct accountabilities across the organisation. The people who should be ensuring that the forecasting process supports business decision-making are effectively abdicating responsibility.

The process then falls prey to those functions and individuals who have a 'vested interest', who each pursue an approach that suits only their needs. This leads to friction, poor decisions and – ultimately – sub-optimal performance.

Suppose, instead, we accept the need for a robust view of the future, and define organisational roles and responsibilities to support integrated forecasting. Doing this, we raise the game to a new level: where different views across the business are aligned; and the collective knowledge of contributors to the forecast is used to identify and manage risks and opportunities more proactively.

## The forecast is always inaccurate...but can be improved

Most doubts about forecasts centre on their inaccuracy. However, forecasting can be radically

improved by creating the feedback and improvement loops that highlight the causes of inaccuracy and drive action to reduce or remove them.

Some causes are behavioural. A typical hurdle is fatalism: accepting the inaccuracy of forecasts, without envisaging how they can be improved.

There will always be 'external' factors that affect our ability to guess accurately; but many more that we can influence. Once we identify the levers that control these factors, we can track and adjust them to improve our predictions. We can also avoid problems (often self inflicted) experienced in the past.

StrataBridge has helped many organisations to extract business value from their demand forecasting by establishing the resources, processes and behaviours required. We have established that the following six principles will guide a company in any industry over the major hurdles:

- Let the decision-making needs of the business shape the forecasting process.
- Integrate the financial and volume view of the business.
- Focus the process on the real drivers of change.
- A forecast is as good as the assumptions on which it is based.
- Seeking and reconciling different views can add value.
- Collaboration leads to a more robust view.

## Decision-making needs

Undoubtedly, every business needs a trustworthy view of what lies ahead, to make sound decisions. Therefore your business's decision-making needs should shape its forecasting processes.

Don't overlook the range of decision-making needs in the business. Often the focus is on supply-chain decisions; but there are many uses and users across the other functions in the business.

For example, the sales function can use the forecasting process to direct, motivate, measure and reward the sales force. Finance can use it to communicate future financial performance to senior management and the investment community.

The forecasting process should focus on delivering, not 'one set of numbers', but an 'integrated set of plans' that meets the varied needs of all its users without bias.

## Financial and volume views

In particular, this integrated set of plans needs to address the disconnect that often exists between the Finance and Sales functions. Many organisations (some unconsciously, some intentionally) have separate processes: one to create the financial view – “the budget”; and the other to create volume projections – “the forecast”.

Clearly, sales volume forecasts alone do not fully support business decision-making. Having separate processes merely creates multiple, confusing sets of numbers – not to mention the duplicated effort and tension across the organisation.

Unhealthy competition can arise between the budget process and the forecasting process. Almost inevitably, “the budget” wins – but, in our experience, both processes are sub-optimised as a result.

## Real drivers of change

Data is swamping most organisations today. Too often, this distracts attention from the few key drivers that will actually determine the shape of future demand in your environment.

Understanding these drivers is imperative. In addition to demand patterns, they also shape the supply chains you need, the proposition your business is best positioned to offer, and the opportunities you can exploit to capture future profit.

Identifying the key drivers is straightforward if you have defined the future you want your organisation to create, and its strategic direction towards that future, in a meaningful way (see Knowledge Summer 2002: “Unlocking the chains of current reality”).

## Underlying assumptions

Too many organisations waste time and effort refining 'the numbers' – without paying enough attention to the assumptions behind them.

Consider this example. The marketing department's forecast of 2000 units assumes that a new campaign will have a dramatic uplift on previous sales figures. The sales department, however, has a

forecast of 1400, because a key customer looks likely to de-list a particular product and a key competitor is about to launch a new challenger product. Logistics' forecast is 1500 because sales were 1500 this time last year. Finance has a forecast of 1750 – because that's what is in the budget. Sound familiar?

Unless assumptions are shared and reconciled, there will be constant disagreement about the numbers. So the forecast will fail in its purpose – to support decision-making that ensures effective operation of the business.

## Reconcile views

The objective is not for one department or function's forecasts to 'win' against the others. An integrated approach delivers far more benefits.

However, trying to reconcile different view of the future can bring to the surface deep-rooted beliefs that will polarise otherwise sane individuals. In this situation, logic has little to do with it!

This is another behavioural dimension of forecasting that can make or break your ability to leverage and create synergy between the various sources of knowledge you have across the business.

## Collaboration

If you can envisage how these principles could benefit your own organisation, imagine their potential impact across the supply chain.

In recent years, the concept of 'collaboration' has been quite en vogue. Companies talk about increasing visibility throughout the supply chain as far as the consumer or end user. But few are truly embracing visibility or developing collaborative relationships.

Most companies need to develop more collaborative behaviours internally, before looking outside to external trading partners. Experience is growing on the right structures and incentives to make this happen, as the second article in this series will demonstrate.

## Practice makes perfect

Consistent application of these six principles leads to a more robust view of the future. They create a bias towards identifying risks to, and opportunities for, future performance improvement. They provide a way of establishing forecasting as an integral part of the decision-making processes in the business.

Day-to-day practice of the principles has implications. Habits may need to be broken. Old barriers between individuals and functions may need to be removed. The challenge can be considerable – but is not insurmountable, as our second article will show.