



Author:
Dinesh Shah
Supply Chain Business Solutions
dinesh@supplychainbusinesssolutions.com.au
Ph: +612 9541 0522

NINE GOLDEN RULES OF FORECASTING

Most manufacturing / distribution / Retail businesses need to forecast future demands for their products. At an operational level these forecasts are used to:

- Maintain inventories of finished products
- Plan for replenishment of raw materials and other items
- Plan for production and capacity

Unfortunately most companies are struggling to develop accurate forecasts and this issue often creates friction between the sales/marketing group and the planning/manufacturing group in many companies.

Although we haven't got a magic wand to help you develop 100% accurate forecasts, we can list here a few often forgotten principles/rules/suggestions on forecasting.

1. FORECASTS ARE ALWAYS WRONG

The truth remains - no one can forecast with 100% accuracy. The trick is to establish your targets for forecast accuracy for the various products / product groups you need to forecast and work to achieve those targets.

2. FORECAST ACCURACY MUST BE MEASURED

Many companies do not measure accuracy of their forecasts. You know the very simple rule - nothing gets improved until you start measuring it. An objective measurement of forecast accuracy should be established to help improve forecast accuracy and also to plan for some contingency (may be safety stock) against the potential forecast error.

3. USE AGGREGATE FORECASTS WHERE YOU CAN

Aggregate forecasts are likely to be more accurate than detailed forecasts (for example, forecast of total number of Panadol tablets that will be sold is likely to be more accurate than the forecast of how many '12, 24, 50, 100, 500 Packs' of Panadol will be sold). Hence examine how forecasts are really used and where you can, use aggregate forecasts instead of detailed forecasts.

4. THE FURTHER OUT YOU FORECAST, LESS ACCURATE THE FORECAST WILL BE

However, as a minimum, you need to forecast demands for any product to cover its cumulative lead time and if you import raw materials, the cumulative lead time can easily add up to 3 to 6 months. However, have you ever considered ways of reducing your lead times? Reducing lead times will help you reduce the horizon over which you rely heavily on highly accurate forecasts resulting in more accurate plans.

5. ESTABLISH DIFFERENT DEMAND STREAMS

Depending upon situations, you may want to break your target markets into streams (e.g. major retailers, small shops, direct sales etc) and forecast for each stream / customer group separately.

Also you need to break your demand data into base sales and promotional sales. As a general rule, one should forecast base business and plan for promotional activities.

6. IDENTIFY FORECASTING UNITS / LEVELS REQUIRED

Marketing considers market segments they plan while sales considers categories they control. Both these functions prefer to plan in dollars while production elects to plan in units. Ultimately for planning purposes, you need to develop a forecast by product in units; however, your forecasting system should be flexible enough so that it can aggregate forecasts/actual demands to different levels of details in alternate units and in dollars. Always store the information at the lowest level and provide for the needed flexibility.

7. INVEST IN A FORECASTING TOOL

It amazes me that even today many companies will employ highly intelligent, highly paid executives to spend their time gathering sales data for them to massage it in a Lotus or Excel Spreadsheet to develop a forecast - a process that takes a few days. More often than not, they spend

95% of this time gathering data and 5% of the time in evaluating results.

Investing in a simple but effective forecasting package can free up valuable time of your key managers to do what they are paid to do, Not only that, you will see marked improvement in the results from your forecasting process.

8. MAKE FORECASTING A PROCESS

Too many managers think that a solution to their forecasting problem is to buy a forecasting package, load in history and drop the calculated forecast into the Master Schedule. No matter how much you invest in your solution, the best any forecasting program can do is evaluate history and extrapolate into the future.

This should be considered just a starting point. An effective forecasting process must include

- Analysis of items with low forecast accuracy
- Review of forecasts generated by any forecasting package
- Adjustments for special factors such as promotion and price changes
- Input from people as close to the ultimate customer as possible
- Documenting underlying forecasting assumptions and
- An effective management review and communication step

9. DEVELOP A COMMON LEVEL OF UNDERSTANDING

Do not make assumptions that everyone understands how forecasts are generated and used. It is important for all people involved in the forecasting process to clearly understand the whole process, where they fit in it and what their contribution does to the entire forecasting and planning process. This may require sound education and training, an area very often sadly and badly neglected.

Believe me, if you follow these time proven Golden Rules, you will be able to implement a well-managed forecasting process and the resultant benefits will be very significant. Good Luck!!