The quest for the lost crystal ball:

Busting some myths about sales forecasting!

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Many companies see sales forecasting as difficult, time consuming, unreliable and, as a result, best avoided. Given the right set of tools however you'll soon realise that forecasting isn't rocket science. It's a straight-forward and really quite simple process that will provide you with invaluable business intelligence and save you money.

The biggest obstacles to developing proper forecasting that companies typically face are their own preconceptions and attitudes towards it. So it's time to explode a few of the myths surrounding sales forecasting!

In this article, I have gathered together some of the real and some of the perceived problems with sales forecasting that I have encountered in my dealings with a wide range of businesses, along with some suggestions on how to tackle them.

"There's no point in making forecasts because they're always wrong"

Not long ago, I visited a company making consumer products. The Director in charge of the supply chain gave me an overview of the company's operations and production software. I asked how the company generated sales forecasts.

"We don't use any systems for forecasting," the Director replied. "Forecasts are never accurate so we think it's safer to invest in flexibility."

What he meant by flexibility was that the company chose to store enough finished products in its warehouses so it could meet an entire year's demand. Clearly one man's 'flexibility' is another man's 'having millions of dollars tied up in stock simply sitting in a warehouse' – just in case a big order comes in unexpectedly. It may allow the company to be flexible in terms of meeting customer demands for existing products but it's pretty inflexible in terms of enabling new product development, hedging against a demand slump or having access to liquid assets for business expansion. That 'flexibility' came at a high price.

Most companies generate forecasts to help them control purchasing, production, finished product inventories, and the capacity and the accuracy of their forecasting is directly linked to their efficiency and to the quality and level of their services.

There is of course the question of whether inaccurate forecasts are worse than no forecasts at all – but what is hard to argue against is the fact that without sufficiently accurate forecasting companies faced with uncertainties in demand end up creating hefty buffers of:

- merchandise (needlessly large inventories of products that are liable to expire and certainly tie up capital),
- time (costly emergency orders upon a sudden high demand),
- capacity (buying spare equipment and spending additional money on wages in order to prepare for unexpected spikes in demand – capacity that stands idle in normal conditions).

Real flexibility is certainly worth developing – flexibility that allows a business to respond to changing market circumstances – but it's hard to argue that one should be prepared for the unexpected whilst not putting some effort into making the unexpected, well…less unexpected. That's why acquiring the proper forecasting tools is so important. Get it right and you see the results on your balance sheet – get it wrong or simply do nothing and you also see the results on your balance sheet, if you can bear to look.

"Why should I invest in forecasting when it'll never be used?"

Forecasts can be open to interpretation. In ancient times the Oracle at Delphi famously told Croesus that: "If you cross the river, a great empire will be destroyed." Croesus did cross a great river, attack the Persians and saw his own empire destroyed as a result. He simply chose to interpret an ambiguous forecast in the way that suited him and he got it wrong. It's not without reason that obscure pronouncements or those open to a variety of interpretations are described as 'Delphic'.

In many modern companies the same spirit operates. Forecasts are made for different purposes or edited from different perspectives all over the organization. Even if there is only one official sales forecast, it is liable to be modified and interpreted in a number of different ways.

Typically I find that a company's production team will have come to distrust the routinely over-optimistic forecasts churned out by their colleagues in marketing. In one company I came across the favourite forecasting tool was an Excel spreadsheet, which automatically sliced 20% from the sales predictions made by the marketing department. Given those sorts of experiences it is perfectly understandable that the people producing the numbers have serious misgivings about the workability of such arrangements.

It would seem obvious that the production team is far less well placed to predict future sales than – you guessed it – the sales people. Faced with a situation where people in acquisitions, production or inventory feel that they should take charge of managing things outside their own area, the question becomes how to put things right and, in many instances, how to re-establish trust? For the answer I look to companies that have their forecasting in order. In my experience there are two common denominators; assigned forecast responsibilities and constant monitoring of the forecasts.

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The monitoring measures enable companies to learn from their mistakes, but learning also requires a great deal of motivation and that is where the responsibilities come in.

Too often responsibility is assigned at the same time it's decided by whom (and when and how) the forecasts will be created and the two are lumped together; 'it's your job to create the forecast – you're responsible for it'. Wrong.

The ultimate responsibility for a forecast rests with whoever carries the can for the decisions made on the basis of that forecast and the repercussions that stem from those decisions such as possible overproduction, stock shortages or the failure of a campaign that was incorporated into the forecast too late. As long as the acquisitions department is held accountable for overstocks of packaging materials or the production department is reprimanded for surplus production on the basis of forecasts for which they have no responsibility, a sharp buyer or production manager will have a strong incentive to tamper with the forecasts.

"How should I know how much a campaign product will sell?"

Let us imagine a possible scenario: A salesman is requested to provide a sales assessment for a forthcoming campaign. His answer is: "A lot!" After repeatedly being asked to be more specific, he finally snaps: "How should I know? Figure it out yourselves – you know as much about this as I do!" The salesman is on the defensive because he has negotiated a significant deal with a customer, but neglected to set any concrete goals for the transaction or to even begun to assess the risks involved. Unlikely? Sadly situations like this are far more common than they should be.

I have seen too many instances where decisions (regarding product launches, campaigns, orders of seasonal products etc.) are taken without specifying goals for them. If no goals are defined, monitoring the results of those decisions is pointless, which leads to nothing being learned from previous experiences and money being routinely spent only to repeat the same mistakes year after year.

In the top companies, forecasting is an integral part of a meticulous sales planning process. When determining what needs to be done to set and reach the sales targets (what products and measures to use and which customers to invest in), the preliminary forecasts are automatically generated as part of the process. The forecasts will inevitably need updating along the way as we see how the various plans play out, but updating is very easy so long as the basic groundwork is in place.

The experience of successful companies effectively demolishes the main argument that some senior sales people have against taking responsibility for forecasts: "The time I spend on forecasts will take its toll on customer contacts and sales." Just to be clear; forecasting does not detract from sales but, when done right, creates the foundation so that sales lead to solid profits!

"Our demand is so unique that no models can predict it!"

The saying "the perfect is the enemy of the good" has rarely been better deployed than in reference to sales forecasting. When I've recommended calculated forecasts to companies, I have often received replies like: "It wouldn't work. We don't know what our competitors

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have been doing," or "no data on product displays and customer notifications is available," or "even the weather seems to affect the results."

When some companies consider investing in forecasting tools, one gets the impression that it is not enough for a tool to make forecasters more efficient and their forecasts more accurate; they either want a perfect system or none at all. So key account managers spend a good chunk of their valuable time making routine updates to forecasts.

There are tried and tested models for forecasting the demand of seasonal products. They may not yield the perfect result every single time, but they produce a solid assessment. Forecasting models can be updated weekly (or daily, if necessary), the situation monitored on the basis of data and projections made in accordance with patterns established in previous years. Perfect it ain't and never will be – but an informed projection beats the hell out of conjuring up figures purely on the basis of gut instinct or guesswork.

Any student of military history will know how vital intelligence and reconnaissance are. They're rarely perfect but generals who scout out the land and the position of the enemy, who study the terrain, who gather in all the information available to them, keep it in proportion, give it due weight and make decisions accordingly are the generals who tend to win. You want to be Wellington – a little boring but thorough and victorious – not Custer – romantic, dashing but dead.

Surprisingly enough, calculation models can also be extremely useful in situations where experts are at their strongest. Regression models for campaign forecasting (i.e. comparisons with earlier corresponding campaigns) have proven themselves many times over. Moreover, calculations have been extremely beneficial in challenging circumstances, such as during Christmas sales in bookstores where demand explodes in a short time span and the product range is almost completely renewed on an annual basis. (How exactly calculations are useful is another story, which I will touch upon in another article.)

Quit with the excuses already. Say what you want to say!

What am I trying to say:

- Sales forecasting has a direct impact on the level and quality of service experienced by customers as well as the economic viability of a company's operations.
- Sales forecasting is an integral part of careful sales planning, and creates a solid foundation for profitable sales.
- Sales forecasting is a lot easier than you think. The question is not 'Can my company afford to invest in developing forecasting procedures?' but 'can it afford not to?'"

What next?

We at RELEX have extensive experience in making forecast management more efficient

in partnership with an impressive roster of companies. Together with our customers, we have successfully worked on sales planning and forecasting models as well as the use of quantitative forecasting models.

Take the first step towards better forecasting and contact us: tommi.ylinen@relexsolutions.co.uk / +44 7546 124031. An hour's meeting is enough to go through your company's situation and to define the first steps!