

# Forecasting is Like the Weather!

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Joe from the Sales Department says “make a million– we’ll sell them–NO PROBLEM!” Don’t let famous last words like these influence your forecasting. You could end up being as popular as the local weather forecaster who predicted the blizzard of the century, and it didn’t snow a single flake.

Forecasting is the process by which an organization attempts to accurately estimate the outcome of some future event. Historically, businesses use forecasting to estimate future sales so that budgets can be allocated, capacity can be assigned, labor can be effectively deployed and, from a strategic perspective, business and operational issues can be identified and resolved ahead of time.

Experience, however, shows that a company’s forecasts can be notoriously off. I spent about six months re-engineering the supply chain of a multinational subsidiary. Their sales forecast, by SKU, was as much as 115% off most quarters, due to tactical actions from their competitors. We ended up disabling the forecasting process from supply chain management to resolve these associated problems.

Figures 1 & 2 illustrate how information flows are changed by business re-engineering. The key to using forecasting is that it must provide opportunities for reducing uncertainty in committing resources.

There are two important considerations. First, forecasting should drive tactics and not processes. That is, given a forecast market demand, determine the level of sales activity and marketing programs that need to be in place to achieve the targets set by the sales forecast. Also, sales and marketing can use sales forecasts to determine how best to counter competitor action to achieve their goals.

The second consideration is that, in a tactical situation, forecasting should not be used to commit resources. As far as is possible, a company should not use sales forecasts to allocate production capacity. One builds finished goods inventory on actual SKU movement and not on forecast SKU movement.

Our advice to companies with the latest IT systems in place is to look at how they are using their business information. Can they disengage their forecasting process from the supply chain process? Can they change from Fig. 1 type of information flows to Fig. 2 type of information flows? Careful consideration should be given to maximizing the value and use of forecasts.

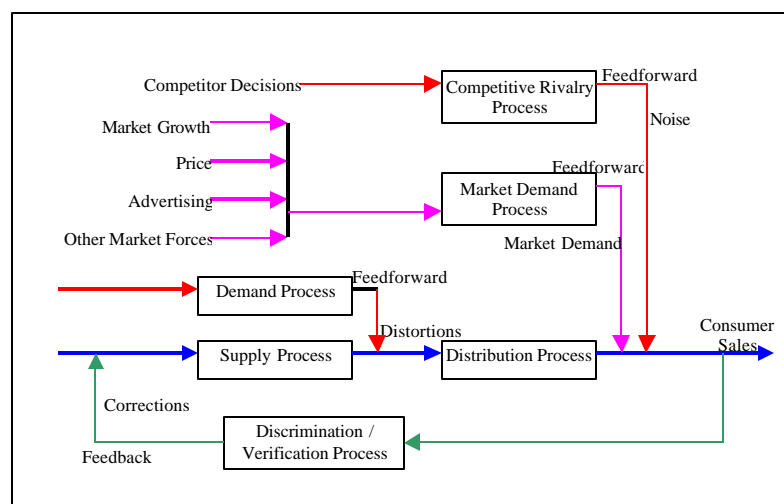


Figure 1: Information Flows Before Business Re-Engineering

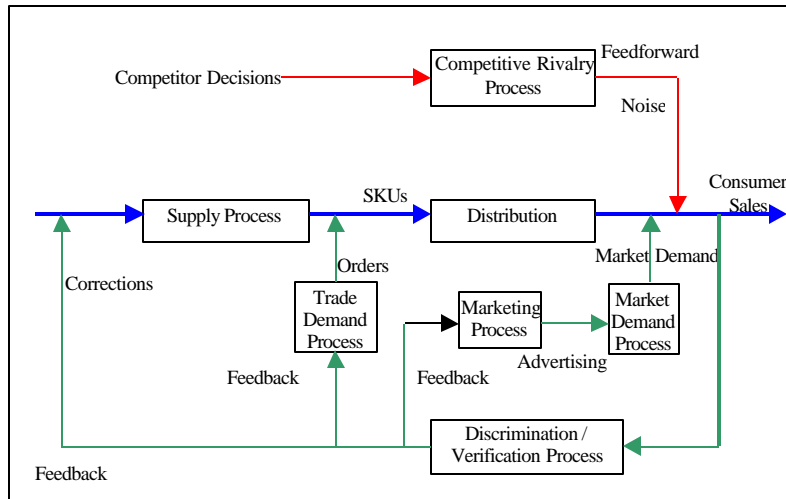


Figure 2: Information Flows After Business Re-Engineering

Figures 1 & 2 illustrate how information flows are changed by business process re-engineering. These figures are called control diagrams and are used to illustrate feedforward and feedback loops.

Feedforward loops are dangerous, as they cause systems to 'run away'. Small errors in the signals are fed forward into the system and amplified by subsequent processes.

Feedback signals are key to systems stability. Small errors are fed back into the system to negate their original effects.

It is important to understand how information flows; the purpose of which is to replace feedforward with feedback information flows.

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