Fred: Right, we have a big challenge here today…and a big opportunity. This month’s senior managers’ meeting ended in what you might call “disarray,” but was probably closer to an “unseemly brawl.”

Colin: That must have been about the absence of donuts as part of our cost-cutting exercise.

Stan: I’m glad to see that hasn’t affected our meeting.

Colin: Hold on, I paid for those out of my own pocket…

Fred: No, no – the row was about their monthly sales performance report, which, as I’m sure you know, has three pages on “performance against plan”—one from Marketing Analytics, one from Finance, and one from Supply Chain.

Colin: What was the problem?

Fred: Um, put simply, their numbers were different.

Stan: ‘Scuse me, but how’s that a problem? The numbers always are different.

Fred: Well, the new CEO wasn’t too amused. He couldn’t tell if we were ahead of the game (Marketing), behind the game (Finance), or just about spot on (Supply Chain).

Colin: Mmm. That symmetry is appealing…

Fred: But the CEO had asked for, and I quote: “One consistent report that will tell me how our business is performing against our sales forecasts and financial and manufacturing plans.”

Colin: Hold on. Let’s make sure we understand what he’s saying here. So…it’s a comparison between the sales forecast that comes out of Marketing Analytics and the Financial Plan (Budget) together with the Manufacturing Plan (Supply Forecast).

Fred: I’m not so sure about that. I think the big trap is looking for comparisons. Our plans have different purposes, so why should they be comparable? Let’s go back to basics and share what we each mean by “forecasts” and “plans.” I’ll kick off from a marketing viewpoint.

It’s our job to produce the external sales forecast. This is the “most likely” sales—based on a set of consistent assumptions. There is, of course, the human condition to deal with here. Some of my marketing friends can be tactically pessimistic – heaven forbid I would use the word “sandbagging” here – in order to beat the forecast and improve my…um, sorry, their…chances of getting a substantial bonus. Others tend to be rather optimistic, believing their marketing skills will “enhance the brand” to more than what might be thought a reasonable degree. Colin?

Colin: Finance recognises the budget as the only valid business plan. Of course, it is a key indicator of business performance, but it’s tied in with external stakeholders, guidance, earnings per share. It’s a business target more than a pure forecast. So I ask myself, what’s the point of reporting how accurate the budget is against sales? Accuracy reporting’s not as important as making the variance between forecast and plan visible. Then we can have a meaningful discussion on what action or steps we need to take.

Stan: This is a big opportunity to change things for the better. My guys find it odd that the supply, or manufacturing, plan should be judged on its proximity to the external...
sales. Rather, it’s essentially an exercise in risk management. We know the sales forecast will be inaccurate, and hence we run the risk of either carrying too much stock, which has a financial penalty, or too little stock, with an adverse effect on customer-service levels.

Colin: Right! Well done. We now have real context of what we believe our core accountabilities are. Let’s go back and see how we design insightful reports that reflect our performance. Kick it off, Fred.

Fred: Sure. As we are accountable for producing the external sales forecast, we need to show how good we are at producing an accurate forecast. Let’s start with the new forecasting software we use to produce the initial statistical forecast. I like it – it lets us see seasonality, it lets us choose from a basket of extrapolation models…and change the amount of back history…and…well, lots more stuff.

Colin: That’s a great marker. So, one component here is the best statistical projection.

Fred: Yes, but our product managers modify these forecasts to account for any changes in the market – new entrants, higher competitive pressures, more or less sales-force effort. They add marketing intelligence.

Colin: So we now have a forecast that’s the best statistical projection plus marketing intelligence. Let’s call that the “most likely forecast.” It would be good to monitor accuracy against both the best statistical projection and the most likely forecast – then we’ll see just how much the marketing intelligence component improves the best statistical projection. This would make it clear if the product managers are introducing false biases.

Stan: Ooh, I’d like to be in that meeting…

Colin: All right. The final issue here would be to project growth required to the end of the year to meet budget. It might look like this (Figure 1). The yellow line is the year-to-date revenue. The red line is the performance needed for the rest of the year to meet the budget, which is the blue line.

Fred: I like the flow here. We develop a forecast, we see how good it is, we see where value is added during the process…and now we’re in good shape to see if we can meet our financial goals. We don’t need to know how “accurate” the budget is – just how far away from it we might be.

Colin: One more thing. Let’s say sales aren’t going too well in the first half of the year. At first, we always hear “there’s plenty of time to catch up.” But as that time diminishes, the required change in performance that has to be engineered increases. I think we should create an index of, I don’t know… “Change in Sales Growth over Remaining Year Necessary to Achieve Budget Target.”

Stan: Not bad, Colin, not bad – but are you quite certain that title’s long enough?
Colin: All right, how about the Catch-Up Index? But what it tells the team is that from, say, September onwards, in order to achieve the budget we’ll have to engineer a 70% increase in sales growth.

Fred: Which should focus minds a bit! So, in summary, we have a report that shows how we see sales going, where we need them to go, and how hard we need to work to get on target. And it’s all transparent.

Colin: Good stuff. And there’s another way of showing progress. It’s called a Z Chart. We record monthly sales along the horizontal axis, cumulative sales are shown on – hopefully – an upward growth diagonal, and the moving annual total, or MAT, across the top. At the end of the year it forms…. 

Stan: Let me guess… the letter Z. But it also shows where we are at any time of the year, and whether we’re on track against formal sales targets.

Colin: And we could stick that big red blob in the right-hand corner to indicate the budget target, and see if the actual MAT looks like it’s getting there…. (See Figure 2b)

Stan: So it’s back to me! Well, as I’ve said, I don’t want to see any measurement of forecast accuracy against the demand plan. It’s pointless. I’d go back to showing how well we’re managing the risk associated with the inaccuracy in the forecast.

As a firm believer in a one-step-at-a-time approach, shouldn’t the report show the dollarized excess stock we’re holding, over and above what we need to cover the inaccuracies in the forecast? We’ll have to develop an algorithm to calculate the “allowable” stock, but our ERP system should be able to do that…. We could call it “Extra In-Stock Holdings Over and Above That Needed to Manage the Uncertainty in the Forecast.” So if it’s zero, we aren’t carrying any unnecessary inventory.

Colin: And you thought that title I came up with was dodgy? Listen, this index looks… well, like a variance against an acceptable level of stock-on-hand. Let’s just call it an Inventory Variance.

Fred: Agreed.

Colin: Right. So let’s try to summarise. We’ve outlined the design of a report that shows:

+ How good our statistically produced sales forecast is;
+ Whether this forecast is improved or not by the addition of market intelligence;
+ How well we’re tracking our financial targets;
+ How hard we’ll have to work to catch up if we fall behind our sales target during the year; and
+ A good indication of how we’re managing the risk in the supply chain associated with the uncertainty in the external sales forecast.

Let’s put that forward with a mock-up of what the report might look like…. 

Fred: Excellent! A job well done. See you next month, guys.

Alec Finney has many years of experience in research, logistics, business development, and forecasting – latterly as Strategic Forecasting Manager with AstraZeneca, where he introduced evidence-based forecasting models. Alec serves on Foresight’s Practitioners Advisory Board and also on the Advisory Board for EyeforPharma.

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