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Making analysis to minimize the unknown factors: The business forecasting way

Naresh Kumar Mahto
PhD, Department of Commerce, Lalit Narayan Mithila University, Darbhanga, Bihar, India

Abstract
A forecast is a mere assessment of future events. Business forecasting is made to determine the trend of figures that will tell exactly what will happen in future and also to make analysis based on definite statistical data in order to enable the firm to take advantage of future conditions to a greater extent than it could do without them. While forecasting, one should remember that it is impossible to forecast the future precisely. Inspite of this, we cannot negate the relevance and utility of business forecasting. The forecasts may be for short-term or long term. There are a good number of statistical techniques which provide more accurate forecasts. However, the forecaster must be cautions while selecting a suitable business forecasting technique.

Keywords: analysis of data, business forecasting, cost of forecasting, forecasting techniques, the forecaster

Introduction

A 'forecast' is a prediction of what is going to happen as a result of a given set of circumstances. The dictionary meaning of 'forecast' is 'prediction, provision against future, calculation of production events, foresight, provision'. In business sense it is defined as 'the calculation of probable events'. When estimates of future conditions are made on a systematic basis the process is referred to as 'forecasting' and the figure or statement obtained is known as a 'forecast'. Both macro and micro-economic factors, including such common factors as price levels, inflationary trends, monsoons, international industry trends, governmental changes, cost of finance, the company's own plans, its competition, customer preferences, technological innovation and of course the annual budget. Forecasting may be for a period of three months, five years and even for 20 years periods, but the shorter ones are more widely in use. Short-terms forecasting focus on the movement of the economy through the business cycles and any organization whose business is sensitive to cyclical economic conditions and cyclical demand changes is interested in short-term forecasts- the retail trade and the automotive sectors, for instance. A forecast is a mere assessment of future events. A forecast includes projection of variables both controllable and non-controllable that are used in development of budgets. A budget is a plan, whereas a forecast is a prediction of future events and conditions.

Forecasts are needed in order to prepare budgets. The sales manager will prepare sales forecasts and the Production manager will forecast production and resource requirements. In forecasting events that will occur in the future, a forecaster must rely on information concerning events that have occurred in the past. That is, in order to prepare a forecast, the forecaster must analyze past data and must base the forecast on the results of the analysis.

Forecasters use past data in the following way:

- The forecaster analyses the past data in order to identify a pattern that can be used to describe it.
- The pattern is extrapolated or extended into the future in order to prepare forecast.

The basic strategy is employed in most forecasting techniques and rests on the assumption that the pattern that has been identified in the past will continue in the future. A forecasting technique cannot be expected to give good predictions unless this assumption is valid.

Business Forecasting Process

The business forecasting process consists of the following steps:

1. **Understanding of Past Events:** Observation and analysis of the past behaviour is one of the most vital parts of forecasting. The forecaster should use past data for analysis of changes, behaviour, acceleration of occurrence of events to forecast the probability and degree of occurrence in the future. It should be kept in mind that the past need not repeat again with same degree of occurrence. It is often said that past is the best guide in forecasting the future.
2. **Determination of Phase of Business Activity:** After it is known why business fluctuations have occurred or if there is a reasonable supposition, it is necessary to measure certain phases of business activity in order to predict what changes will probably follow the present level of activity.
3. **Selection and Compilation of Data:** There is an interdependent relationship between the selection of statistical data and determination of why business fluctuations occur. Statistical data cannot be selected and compiled in an intelligent manner unless there is a sufficient understanding of business fluctuations. Likewise, it is important that reasons for business fluctuation be stated in such a manner that it is possible to secure data that are related to the reasons.
4. **Analysis of Data:** The final step in forecasting process is the analysis of data keeping in view the reasons for changes in

The past. To draw conclusions on the future course of action, forecasting techniques may be used to draw the inferences. In forecasting process the following questions to be answered for reliability of the inferences drawn from forecast:

- What is the purpose of the forecast? How is it to be used?
- What is the age of the dynamics and components of the system for which the forecast will be made?
- How important is the past in estimating the future?

Short-term Forecasts

Short-term forecasts are forecasts of sales, costs or resource requirements and so on for up to about one year ahead. They are usually prepared by extrapolating historical data. On the assumption that future operating trends and characteristics will, in the short-term at least, be a continuation of recent trends and current operating characteristics. Another requirement for short-term forecasting is the need to establish relationship between key quantities, such as the relationship between the following:

- Production quantities and total production costs.
- Production quantities and resource requirements (materials, labour, machine capacity etc.)
- Sales quantities and selling costs, and warehousing capacity and so on.
- Sales quantities and time (trend analysis)

Problems in Business Forecasting

The statistical techniques might suggest accurate forecasts can easily be prepared from an analysis of past data. In practice it is very difficult to forecast future events because of uncertainty about changes that will occur in the future. Such changes may mean that past data is no longer a reliable basis on which to build a forecast of the future. There are a number of changes that may make it difficult to forecast future events *viz.*

- Political and economic changes will create uncertainty. For example changes in interest rates, exchange rates or inflation can mean that future sales and costs are difficult to forecast.
- Environmental changes can also cause forecasting problems. For example, the opening of the channel tunnel might have a considerable impact on some companies' markets.
- Technological changes may mean that the past is not a reliable indication of likely future events. For example the availability of faster machinery may make it difficult to use current output levels as the basis for forecasting future production output.
- Technological advances can also change the nature of production. The advent of advanced manufacturing technology is changing the cost structure of many firms. Direct labour costs are reducing in significance and fixed manufacturing costs are increasing. This causes forecasting difficulties because of the resulting changes in cost behaviour patterns, break-even points and so on.

Selection of Suitable Business Forecasting Technique

In choosing a suitable business forecasting technique the forecaster must consider the following factors:

- Forecast from desired- The forecast form can vary between obtaining a point estimate or a prediction interval. The form of the forecast can influence the choice of forecasting method used.
- Time pattern- The time frame or time horizon is the total period over which forecasts are required. It is a week, a year or perhaps ten years? The longer the time period the more difficult the forecasting becomes, and the more useful qualitative methods become.
- Pattern of data- The important aspect about the pattern of data is whether a time series or some cyclical pattern exists within the data. This will dictate the forecasting techniques to be used.
- Cost of forecasting- The cost of forecasting may vary significantly depending on the cost of collecting and storing the data. The costs of forecasting should be compared with the value of having good accurate forecasts.
- Accuracy required- Perhaps crude forecasts are sufficient in a particular situation. In a different problem a very accurate forecast is required.
- Availability of data – The choice between quantitative and qualitative approaches will depend upon whether suitable data is available or can be collected.
- Case of operation and understanding- The strategies must be able to understand and explain the forecast methodology used. If he does not understand the methodology he will not have confidence in the results. There is also a danger that he will not foresee, the parameter of the model needs to be changed because of underlying changes in the data.

Choosing the forecasting method to be used in a particular situation involves finding a technique that balances all the above factors. The best technique is usually the technique that meets the needs of the situation at the least cost and inconvenience. A general guide to the choice of technique is as follows:

- Quantitative forecasting methods are used when historical data is available.
- Univariate models are used to predict future values when it is believed that the historical pattern will continue.
- Causal models are used when the historical pattern is likely to changes in some other uncontrollable but predictable variable or variables.
- Qualitative forecasting techniques are employed when historical data is scarce or not available at all.

In practice most, forecasting systems involve both quantitative and qualitative methods. Quantitative methods are used when the existing data pattern is expected to persist, while qualitative methods are used to predict when the existing data pattern might change. Thus forecasts generated by quantitative methods are almost subjectively evaluated by management. This evaluation may result in a modification of the forecast based on the Strategist's expert opinion.

Conclusion

The growing competition, rapidity of change in circumstances and the trend towards automation demand that decisions in business are not to be based purely on guess work rather on careful analysis of data concerning the future course of events. Forecasting aims at reducing the areas of uncertainty that surround management decision making with respect to costs, profit, sales, production, pricing, capital investment and so forth. Companies must plan their future with business forecasts otherwise they may become things of past. So far companies

operated within a license and permit regime and a sheltered market forecasting was not considered very useful and liberalization is changing the rules of the game. With liberalization, the Government has less of a role to play. Companies previously relied on hunches, political contacts and sketchy plans, but now has to face stiff competition in the domestic and global markets, and business forecasting is fast gaining importance.

The object of business forecasting is not only to determine the trend of figures that will tell exactly what will happen in future, but also to make analysis based on definite statistical data, which will enable the firm to take advantage of future conditions to a greater extent than it could do without them. In the words of Henry Fayol 'forecasts are not prophecies but their function is to minimize the unknown factors'. While forecasting, one should note that it is impossible to forecast the future precisely. There always must be some range of error allowed for it in the forecast.

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