What is Forecasting?

Forecasting is a technique for making predictions of the direction of future trends based on the analysis of past and present data. Businesses use forecasting to determine how to allocate their budgets or plan for expected expenses for an upcoming period of time.

Basically, it is a decision-making tool that helps businesses cope with the impact of the future's uncertainty by analysing **historical data** and **trends**. It is a planning tool that enables businesses to chart their next moves and create budgets that will hopefully cover whatever uncertainties may occur.

Forecaster uses data for carried out forecasting methods can either get from primary sources or secondary sources.

- **Primary sources:** Primary sources provide first-hand information, gathered directly by the person or organization that is doing the forecasting. They usually collect the data from various questionnaires, focus groups or interviews and, although all the information is difficult to gather and integrate, the direct way of acquiring the data makes primary sources the most trustworthy.
- **Secondary sources:** Secondary sources provide information that already collected and processed by a third-party organization. Receiving the data in an organized and arranged way makes the forecasting process easier.

Features of Forecasting

Here are some features for making a forecast:

1. Involves future events

Forecasts are created to anticipate future possibilities, scope, etc making them important for product planning.

2. Based on past and present events

Forecasts are based on points of view, intuition, guesses, as well as on actual facts, figures, and other related data. All the factors that go into forming a forecast reflect to some extent what happened with the business in the past and what is likely to occur in the future.

3. Uses forecasting techniques

Most organizations use the quantitative method, particularly in the planning and budgeting process.

https://youtu.be/M8Kiwv9gDJU

Methods of Forecasting

Companies choose between two basic techniques when they want to predict what can happen in the future. They are- qualitative methods and quantitative methods.

1. Qualitative method

We have also known the qualitative method as the judgmental method. Qualitative forecasting offers subjective results, as it consists of personal judgments by experts or forecasters. Forecasts are generally biased because they are based on the expert's knowledge, experience, and rarely rely on data.

One example is when a person forecasts the outcome of a football game, which is based more on personal motivation and interest.

2. Quantitative method

The quantitative forecasting method is a numerical process, making it consistent and aim-oriented. It drives away from relying the results on opinion and intuition, instead of utilizing large amounts of data and figures that are interpreted.

There are four main quantitative forecasting methods you can use to determine future sales values, revenues, expenses, costs, trends, and other identical indicators. They are:

- **Straight-line method:** This is the simplest forecasting method, both to learn and to follow. It's typically used by financial accountants to determine future revenues based on past trends and figures.
- **Moving average:** This technique determines the underlying pattern of a dataset to predict future values. The most widely used types are the three-month and the five-month moving average.
- **Simple linear regression:** Simple linear regression is specially useful when analyzing the connection between different variables, to get a more accurate forecast.
- **Multiple linear regression:** we mainly used Multiple linear regression for forecasting revenues, in situations where two or more independent variables are needed for a forecast.

Process of Forecasting

You need to follow a careful process in order to generate accurate results. Let's discuss some steps in the process:

1. Develop the basis of forecasting

The first step in the process is developing the basis of the analysis of the company's condition and determining where the business is currently standing in the market.

2. Estimate the future operations of the business

Depending upon the research organized during the first step, the second part of forecasting concerns with estimating the future conditions of the industry how the business operates and predicting how the company will handle it.

3. Regulate the forecast

This step involves looking at different forecasts data in the **past** and comparing them with the **actual** impact that happened to the business. Then evaluated differences in previous results and current forecasts, and the reasons behind the deviations are recognized.

4. Review the process

They reviewed every step. After that, they made refinements and modifications if needed.

Benefits of forecasting

Helps to Predict the Future

It gives management a broad idea of what to expect. Forecasting gives the company a sense of direction, which will allow the business to function better in the marketplace. **Forecasting** brings out some risks and uncertainties that a new business may face and can offer an entrepreneur the right tools to prepare for elements, such as the strength of the competition, potential demand for a product or service and future industry development.

Good for Customers

If a company can **anticipate demand**, it is more likely to make sure its products are always available within the market. There is a greater chance of meeting customer's orders and delivering the product on time.

Keeps a Company Up-to-date

Businesses that forecast regularly must think ahead all the time. This helps them predict the change in market trends. Forecasting gives managers **required data** that they can use to identify any **weakness** in the organization's processes. By discovering potential shortcomings ahead of time, the company's managers have the suitable tools to rectify any weakness before they affect the profits.

Learn from Past Experience

Most businesses face several possible uncertainties, such as periodic rises and falls in sales, changes in staff and changes in raw material prices, depending on the exact nature and purpose of the organization. **Forecasting** plays a significant role in bringing managers with the information they need to make **wise decisions** regarding the company's future.

Collecting and **analyzing** past data helps people remember what worked previously and what didn't. Learning from experience strengthens us.

Promoting workplace cooperation

Gathering and studying the data required for forecasting typically requires **coordination** and **association** between all the company's department managers, as well as other employees. This makes the entire process a collaboration, enhancing team spirit and cohesion.

Receiving Financing

If the business requires a **loan** for a new project, the bank will ask for information about the future, such as sales, profits, etc. The bank needs that data before it will think of approving the loan.

Terms Related to Forecasting

Demand Forecasting

Demand forecasting is the method of using historical sales data to evaluate future customer demand. It is an important step for businesses to make wise and quick decisions about inventory levels based on purchase trend estimates. Read more>>

Sales Forecasting

Sales Forecasting is basically estimating future revenue by predicting the amount of product or services a sales unit will sell in the next week, month, and year. Read more>>