

TELLUSANT QUICK READS

PRINCIPLES OF STRATEGIC FORECASTING

Strategic forecasting is a new field in management. The strategic forecast makes 3–10-year predictions on demand, consumer groups, and other factors critical to strategic plans.

They are central to resource allocation decisions that are irreversible (e.g., acquisitions, investment in new plants, development of entirely new products) and to strategic planning.

We say new field, because so far global and other companies have not worked with strategic forecasts in a systematic manner. Many have 5 year outlooks, but we have never encountered a systematic and scientific approach. And we have seen many global companies in action.

Strategic forecasting accuracy is paramount to long-term success. Poor strategic forecasts have up to 20% negative impact on share price.

Why is strategic forecasting important? There are two reasons:

First, executives need to understand the "state of nature" as well as possible.¹ This means that if they have perfect knowledge about the future, management becomes an algorithmic problem. Everything is known.

On the other hand, maybe they have no knowledge of the future. Then every action is a random guess.

Reality is in-between. Striving for a better understanding of the state of nature pays off.

Second, managerial problems are always becoming more complex. It is like the car engine: it had a fairly simple engineering solution 150 years ago; today it is incredibly complex.

With complex problems, more data, analyses, insights are needed.² Strategic forecasting provides such new insights.

Given the rising importance of strategic forecasts, we have formulated three principles for how to make them robust. They are based on a review of the literature.

A Base forecasts on science. Most companies make long-term forecasts. But they are invariably based on home-made methods. We have reviewed many such forecasts over the past 20 years, and we have never seen a robust, systematic approach.

B Use one base approach across all units. Currently, methods differ between countries and business units. This cannot remain the state of things. How can a method work in France,

but not in the United States? There has to be commonality in approaches. What differs are the parameters and weights.

Γ Apply the subsidiarity principle. It stipulates that "decision-making authority is best placed (a) where responsibility for outcomes will occur; and (b) in the closest appropriate proximity to where the actions will be taken that will produce the outcomes."³

STRATEGIC FORECASTING PRINCIPLES

A Base forecasts on science

- Use academically robust methods, not homemade solutions.
- Do not use methods from tactical or operational forecasting such as S&OP forecasting methods.
- Do not over-simplify to make the methods used understandable by executives.

B Use one base approach across all units

- Strive for comparability in findings between countries and business units.
- Standardize data definitions with a global taxonomy and harmonize data to ensure consistency.
- Have one version of the truth in one repository. Do not allow circulating spreadsheets.

Γ Apply the subsidiarity principle

- Create the forecasts at the local or BU level, within the global approach.
- Maintain scientific integrity by centralizing methods development and data validation.
- Rely on outside experts. No large company can develop or maintain the required skills in-house.

Source: Tellusant Thought

¹ Blackwell, D. (1953): *Equivalent Comparison of Experiments*. Ann. Math. Statist. (24), pp. 265-272.

² Brynjolfsson, E, et al. (2011): *Strength in Numbers: How Does Data-Driven Decisionmaking Affect Firm Performance?* SSRN Working Paper.

³ ScienceDirect: *Principle of Subsidiarity*