Commentary: Why Should I Trust Your Forecasts?

Sinan, Dilek, and Paul make an excellent point – that "trust" is earned by open and honest communication between the forecast provider and the user. Their informative article makes an implicit assumption that both the forecast provider and the user are part of the same organization. When we expand our view to include different organizations in a product's supply chain, the issue of trust becomes more complex, often arising from differing goals and objectives of the diverse organizations that make up the supply chain. I will illustrate using two brief scenarios how open communication (or the lack thereof) can impact performance in the supply chain.

For fast moving consumer goods like toothpaste or soup, retail demand can be predicted fairly accurately, even with simple techniques such as the moving average. In most industries, however, it is common to find multiple levels in the supply chain before the product reaches the customer. For example, distributors or resellers buy from the manufacturer and then sell to the retailer – so it is common for the distributor to "stock up" when the manufacturer offers a promotion (such as price cuts or volume discounts) giving them the opportunity to increase margins when they resell the product to the retailer. Such practices are common all along the supply chain. So even for a product with fairly stable customer demand, incentives and financial goals (margins for our example distributor) often distort the demand signals and amplify uncertainty – commonly called the "bullwhip" effect -- making forecasting difficult.

The solution hinges on trust — if all players in the supply can communicate and agree on a forecast they can work in concert and improve forecast and consequently financial performance. This idea is simple in theory but hard to execute. This were Sinan, Dilek, and Paul's suggestions on "Working to Earn Trust" play an important role. To achieve good forecasting performance in our example, the manufacturer should eliminate promotions (remove the incentive to stock up) and in return give the distributor a low cost (“Everyday Low Pricing”) throughout the year. This will smooth out the orders. They should also agree to a collaborative forecast process that includes the retailer to manage the rather stable customer demand. Any operational savings should also be equitably split between the partners. Large companies in the FCMG sector are now automating this process. Both partners (manufacturer and distributor, say) forecast demand and share it typically “on the cloud” – if the forecasts are close enough the computer automatically picks one (which one is picked is agreed prior). However, if there is a variance in forecast between parties, the people involved in the process resolve such issues (yes, even in supply chain scenarios people trump computers). For example, a potential new store opening may trigger a larger forecast for the retailer – if the manufacturer or distributor knows this they can make allocations for it. This is not a long-term change in demand but a one-off event. For such a collaborative system to work, both parties must trust each other to do what is good for the “system” not just themselves.

The issue of trust in the supply chain takes on an extra dimension when predicting the demand for highly uncertain and seasonal items such as fashion. Forecast errors on some products can run 100% or higher so it is important the supply chain be designed to respond to such wide swings in demand. This is exacerbated because many such product categories are supplied by low-cost producers who are often located far from the primary market. A typical response would be to make a “base” forecast from the low cost supplier but have a local, fast, but often more expensive supplier who can quickly make the product when demand is higher than anticipated. If the demand is lower the local supplier makes less or in some cases is unused. For such a relationship to succeed the manufacturer needs to keep everybody “in the loop” – share forecast information and reserve only the capacity that both parties think is optimal with the local supplier. This would mean an open and honest line of communication where suppliers are constantly updated on sales so they can be prepared for or suggest a “change order” or an “expedited order.” This way all parties in the supply chain can optimize their operations.

Most of Sinan, Dilek, and Paul’s prescriptions are relevant for the supply chain. Only, the parties in this case are different companies who work to improve their bottom line. The challenge is to see that trust and open communication will improve everybody’s bottom line.

That production plans you were designing sipping your morning coffee – your Chinese supplier is having dinner wondering if she can trust your decisions. Perhaps you should pick up the phone, share your plans, and see what she thinks.