Analyzing Forecasts

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WHAT'S COVERED

In this lesson, you will learn about organizational inputs when analyzing forecasts. Specifically, this lesson will cover:

1. Impacts of Forecasting on a Business

As we mentioned in the earlier lessons, business planning and financial forecasting refer to the set of activities where business operations are planned for advancing the business strategy, and what results may occur from executing those strategies in the next year.

Firms need to take great care in this process because these statements are reviewed by many stakeholders, including creditors, vendors, and regulatory agencies.

Forecasting financial statements start with the estimation of several values, the first of these being sales, and then the cost of goods sold and anticipated expenses. Since actual business activities are planned in relation to these estimates, it is very important that realistic expectations and estimates are used.

With this in mind, it is important to remember to address these specific points:

- Will the company have sufficient cash on hand to meet its regular bills and any non-regular costs or investment opportunities that become available?
- Will the financial position of the business remain sound after this growth is achieved? This is what the balance sheet shows us.
- Is there a logical balance between debt and the amount contributed by the owner, when the business is raising funds through operations in its own right?
- Are short- and long-term obligations matched properly with appropriate funding? Is a short-term borrowing funding short-term asset needs?
- Do key business ratios remain within sensible bounds?

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2. Impacts of Modifying Inputs on Business Operations

Businesses often manage and address these key issues by closely measuring the impacts of modifying the inputs to operations.

2a. Accounts Receivable

Accounts receivable is the money owed to a business by its customers and it is shown on the balance sheet as an asset. To forecast this, a business not only has to anticipate the level of sales that will be made on credit, but it also has to anticipate when payments on these accounts will occur and account for the fact that some of these credit accounts will default and become bad debt.

Accounts receivable has a great impact on a firm's expected cash inflows, so modifying this in the forecast will affect how much cash a company decides to have on hand.

2b. Inventory

Inventory is another key input. It primarily deals with the goods on hand that are required at different locations. The issues of inventory management concern:

- The fine line of lead time for replenishment
- The current cost of keeping the inventory on hand
- Inventory forecasting, valuation, and visibility
- Future inventory prices

Balancing all of these leads to an optimal inventory level. This is an ongoing process as the business needs shift and react to a change in strategy and goals. Companies that rely on the sale of physical goods and have to carry inventory must manage it in such a way as to decrease expenses as much as possible. Since inventory is such a prevalent expense, accurate forecasting is of the utmost importance.

2c. Accounts Payable

Accounts payable is money owed by a business to its suppliers and is shown on its balance sheet as a liability. Usually, a supplier will ship a product, bill the company, and collect payment later. This is all part of the cash conversion cycle. This is the period of time when the supplier has already paid for all materials but hasn't been paid in return by the final customer. These accounts payable influence the current liabilities of the business, which in turn impact the liquidity of the business.

SUMMARY

In this lesson, you learned that it is important to begin the forecasting process with realistic sales goals and expense estimates. The **impacts of forecasting on a business** and its ability to succeed can be significant if the forecasts are unrealistic or poorly conceived. Businesses can measure the **impact of modifying inputs of business operations**, including **accounts receivable**, **inventory**, and **accounts payable**, in order to assess future financial health.

Best of luck in your learning!