

The thoughtful forecaster

[Finance](#), [Investment](#)



Becoming a thoughtful forecaster is important to the development of any company today. Understanding the financial aspects of your company can be the deal-breaking point of whether your company is a successful one or not. In the case, "The Thoughtful Forecaster", we learn that sometimes you are right and sometimes you are wrong, which is partially due to one's bias. We also learn that being a thoughtful forecaster involves trial and error. It isn't easy but throughout the processes you start to understand the financial relationships within your business.

The financial statements provide information needed in order to make a proper analysis and provides you with the historical strengths and weaknesses of your business. The income statement, also known as the "profit-and-loss statement", is utilized to measure the flow of cost, revenue, and profits over a period of time. The balance sheet gives an overview of business investments and the financing in a particular time. Together these two statements can give a thorough outlook of the business's performance and a better understanding of the mechanics that make up the business operations.

Interpreting and utilizing financial ratios is an important way to evolve into a successful financial forecaster. Examining a business's performance includes: growth rates, margins, turnover, and return on investments. Growth rates capture the year-on-year change in percentage of a particular line item. It can be separated into two growth measures: unit growth and price growth. Unit growth is the growth of revenue due to an increase in units sold. Price growth is the growth revenue due to an increase in the price of each unit.

Margin ratios are the percentages of revenue that has not been consumed by any business costs. Margins also measure the cost structure of the business which includes important definitions/ratios. These are: gross margin, operating margin, and net profit margin. Turnover ratios are used to measure productivity, or efficiency, of business assets. It is created by dividing a measure of volume from the income statement by a measure of investment from the balance sheet.

There are several measures of turnover and they include: receivable turnover, inventory turnover, PPE turnover, asset turnover, total capital turnover, and payable turnover. An alternative form of measuring the asset productivity is in “ days”, which takes the investment amount divided by the volume, which is then multiplied by 365 days. The resulting number is the average number of days in a year that an investment item is held by the business. Return on investments (ROI), is the profit generated per dollar of investment and the measure for calculating return on investments.

This measure includes: pretax return on assets, return on capital (ROC), and return on equity (ROE). Financial ratios are useful in forecasting financial statements because they show the relationships across financial-statement line items of the past. The financial models can be helpful in identifying the impact of assumptions on the forecast. Most financial models are composed in excel through a spreadsheet. By doing this it makes it easier to see the assumptions for the different forecast scenarios but it is also used to correct any of the assumptions that were inaccurately made.

The forecasting process should go hand-in-hand with the constant economic changes and you should take into consideration the industry and economy

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wide pressures it endures. These pressures include: inflation, price-growth assumptions, and any economic recessions. Industry reality should also be taken into place and here you should consider business profitability and follow the guidelines that qualify a business to have higher or lower profitability. Having a high profitability does not always mean a high performance.

It is important to recognize that the strategy of competitors do not stand still, and your forecasting should be adjusted when needed according to aggressive competition. Two elements that become a problem in business forecasting are optimism bias and overconfidence bias. Optimism bias is stated as a systematic positive error in the expected value of an unknown quantity. Overconfidence bias is a systematic negative error in the expected variance of an unknown quantity. It is a difficult task but it is important to have an unbiased outlook for the forecast, which is done by having estimated high-side and a low-side scenarios.

When forecasting the financial statements of the Maytag Corporation for the end of 2004, the company's annual report provided me information from the income statement and the balance sheet from the previous two years. On there is calculations and a variety of ratios including the sales growth to return on assets. The ratio analysis gives us a sense of the trends in the business performance. Next it shows that a thoughtful forecaster would need to make assumptions into the future.

Although these aren't completely accurate, they can give us a clearer more centralized view of the analysis. With the qualitative/quantitative research and the historical data that was given we can assume the company will

maintain its position in a declining industry. An increased entry of foreign competition will lead to zero sales growth for Maytag in 2004. Although all the events of 2004 cannot be predicted with the guidance and use of thoughtful analysis, we can conclude a reasonable and unbiased expectation of future performance has been represented.