

THE FUTURE, TODAY:

The strategic imperative of better forecasting



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Data-driven strategies

For procurement organisations, effective forecasting is a necessity. Getting it right – or wrong – has implications for functions throughout the business

EXECUTIVE SUMMARY

- Forecasting input prices is not an end in itself: the goal is appropriate strategies that are informed by that forecast. But too many procurement organisations never get that far.
- Better forecasts confer strategic advantage: you know more than your suppliers. But many procurement organisations instead rely on their suppliers for their forecasts – handing the advantage to the suppliers.
- Third-party forecast providers combine commodity expertise with rigour and statistical models. Market gossip is a poor substitute – and very arguably, an expensive one.

US writer HL Mencken was in no doubt. “I never make predictions,” he insisted. “Especially about the future.” But, today, being able to take a view of future input prices – for raw materials, transportation costs, and energy prices – is vital if procurement organisations are to make sensible decisions regarding the best time to buy, the best price to pay, and what might be a suitable contract length.

And without such a view of future input prices, procurement organisations will struggle to identify optimal hedging strategies, understand when buying forward makes sense or stockpile raw materials to mitigate against price rises.

Just as compellingly, procurement organisations’ views on future input prices are no longer solely an internal affair, of interest only to buyers, category managers and senior procurement executives.

“Increasingly, the procurement organisation’s view on what is happening in sourcing markets is being sought by other functions within businesses,” says Søren Vammen, product director for forecasting at Mintec, the world’s leading independent provider of global food pricing data and analysis. “Functions such as finance and risk management



Input prices have a major bearing on profitability projections – and procurement is seen as being the function closest to that perspective

Søren Vammen, Mintec

want to know not only what is happening in sourcing markets, but also what will happen – and for how long might it last. Input prices have a major bearing on profitability projections – and procurement is seen as being the function closest to that perspective.”

GETTING FORECASTS RIGHT

Yet forecasting is difficult, and often poorly performed. Typically, procurement organisations spend too much time obtaining and validating data sources, and too little time developing actual forecasts – and even less time on developing and executing appropriate strategies based on those forecasts. Yet it is those strategies that deliver the value from forecasting, rather than the data or the forecasts themselves.

“Forecasting is part art and part science,” says Steven Carnovale, assistant professor of supply chain management at Rochester Institute of Technology’s Saunders College of Business, and an associate editor of the Journal of Purchasing and Supply Management. “The ‘art’ component brings experience, insights, and interpretation; the ‘science’ component brings statistical rigour, accuracy, and the ability to model the effects of different causal factors. But both aspects are valuable: numeric forecasts alone, without interpretation or context, are not as useful as forecasts that are augmented by insight and experience.”

“On its own, a forecast is just numbers,” says Andrea Sordi, professor of supply chain management at the University of Tennessee’s Haslam College of Business, and a former procurement director with Mondelēz and Kraft Foods. “The value from forecasting comes from translating the forecast into decisions and insights: knowing whether to hedge, buy forward, look for alternate sources or make substitutions.” ■

Fuel for strategies

Accurate and timely forecasts help ensure procurement functions have better-informed conversations with stakeholders, as well as deliver a host of benefits

Suppose that procurement organisations could free themselves from finding and validating the data sources from which to calculate forecasts, and simply subscribe to price forecasts prepared by third-party providers employing skilled and experienced commodity market experts?

Forecasts covering key commodities such as cocoa, cotton, aluminium, polyethylene, rubber, PET, beef, butter, cod, milk powder, rapeseed, rice, soya beans and soya bean oil, palm oil, wheat, coffee more than 50 different commodities, in fact, as well as key trading currencies and container rates?

And forecasts with a 15-year provenance of proven accuracy, and forecasts that stretched over the longer term, as well as the shorter term, and which came coupled with hedging recommendations, price targets, and price trend indicators?

Armed with such forecasts, procurement organisations could instead move beyond finding and validating data, and concentrate on designing and executing value-enhancing strategies based on those forecasts – the very activity that procurement organisations should be doing, in short.

Suppose no longer: such a forecasting service exists, has been in operation since 2007, is used by an extensive range of multinational businesses – and has now been acquired by global food pricing data and analysis provider Mintec.

“As a standalone business, Kairos Commodities enjoyed a global reputation, supplying forecasts to businesses as diverse as Husqvarna, Palfinger, Pernod Ricard, Thyssenkrupp, Novozymes, and Associated British Foods,” explains David Bateman, head of marketing at Mintec. “Many Kairos customers were also Mintec customers: so the logic of combining Mintec’s 35 years’ experience of price discovery with the 15 years of forecasting and hedging expertise developed by Kairos was compelling, delivering the resource required to extend the range of commodities covered, while



bringing Kairos’ team of commodity specialists and its proprietary combination of fundamental, statistical, and technical forecasting analysis to Mintec’s growing customer base.”

KNOWLEDGE IS POWER

And certainly, Kairos customers are more than happy to vouch for the advantages of using Kairos’ forecasting service, now marketed as the Mintec Commodity Price Forecast Service. Frank Thorsen, director of global supply at Scandinavian publishing firm Story House Egmont, for instance, recalls first using Kairos’ forecasts when working for a food manufacturer supplying some of Europe’s most demanding supermarket firms during the 2008 global financial crisis.

“Price inflation was horrendous: every month we would plug in the worst-case scenarios foreseen by both the buying team and their suppliers, and we would still get it wrong. The impact on EBITDA was significant, and we were struggling for credibility. Using demonstrably rigorous external forecasts significantly transformed our performance: every month, we would



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Frank Thorsen, Story House Egmont

put the buyers' views, the suppliers' views, and the Kairos forecasts side-by-side, and compare and contrast. Then we could go to senior management, and conduct informed discussions in which we would be seen as credible, armed with what was seen as proper data, and which had been sourced through a structured process. So the dialogue changed: it was no longer around the validity of suppliers' views, it was instead about a formal, statistically derived regression model, and the specifics of what it was showing."

Today, he adds, Story House Egmont is also benefiting from the Mintec Commodity Price Forecast Service, relying on forecasts of future prices for both paper and container freight from China to develop appropriate strategies – something that is especially valuable post-Covid, as significant price inflation again features in global sourcing markets.

And typically, notes Søren Vammen, product director for forecasting at Mintec, the benefits of the Mintec Commodity Price Forecast Service are seen at both the category level, and at the level of the overall business.

BUSINESS-WIDE BENEFITS

In a category context, the ability to understand the factors that driven the price of a specific commodity do more than just enable appropriate price mitigation strategies, he explains. Commodity purchase decisions become more fact-based, and help to empower fact-based negotiations with suppliers. Moreover, understanding a commodity's cost drivers leads to more informed, and more credible, conversations with stakeholders within the business—conversations that require only minimal research and time: the relevant facts are already known and understood.

Which is not to say, says Vammen, that those more appropriate price mitigation strategies are not worthwhile: far from it, he insists.

"The execution of timely advantageous market interactions leads to unparalleled cost savings – often in excess of 10%–30% at a category level," he sums up.

Likewise, at the level of the overall business, improved forecasting delivers benefits that go beyond the obvious.

Forecasts sourced from an external provider, for instance, help to improve the resilience of both the procurement organisation and the broader business: changes within key personnel in the commodity procurement organisation no longer risk losses caused by loss of access to the specific commodity market knowledge embedded in individual employees. Instead, says Vammen, the business has ongoing access to the market knowledge embodied in the broadly-based team of commodity experts who are responsible for delivering the Mintec Commodity Price Forecast Service.

"Investors in a business don't like unpleasant surprises – but that can be exactly what they receive when procurement organisations lose track of market trends, and must respond reactively, rather than proactively: profitability suffers. Reliable forecasts underpin reliable profitability – yet too many businesses still rely on buyers' guesses and market gossip for their input price forecasts." ■



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BETTER KNOWLEDGE, BETTER PRICES

Midsona Group, a European leader within the health food, organic products and food supplement markets with production sites across Europe, subscribes to both Mintec's price discovery service and the original Kairos forecasting service.

"We find the Mintec Commodity Price Forecast Service provides us with a strategic advantage in our sourcing markets," says Per Zenshøj, Midsona's Nordic sourcing director. "The facts speak for themselves: we have been able to avoid price increases that we would otherwise have struggled to avoid."

That said, he notes, it is only possible to accurately forecast events and market trends that are actually capable of being forecasted: in June 2021, for instance, an unexpected cold front moving across Paraguay, Bolivia, and Argentina resulted in frost damage so severe that some farmers lost 50%–60% of their chia seed harvest.

But otherwise, better forecasts have delivered a compelling advantage in supplier negotiations, allowing Midsona's procurement organisation to break down manufactured products into their component parts—including packaging and any associated currency implications in the case of commodities traded in United States dollars—and consequently negotiate from a position of strength with suppliers.

"Often, we're better informed about price trends than many of our suppliers, which gives us a distinct advantage," says Zenshøj. "Mintec's plans, we're told, are to widen the range of commodities covered by the forecasting service. We very much welcome that: it's very good news indeed."

Improve your forecasts: insights from experts

- Measure and monitor ongoing forecast accuracy, and try to assess the costs of poor forecast accuracy in terms of flawed decisions, tactical mis-steps, and missed opportunities. “It all helps to build the business case for change,” says Søren Vammen, Mintec product director for forecasting.
- Forecasting is the start of a process, not the end point or a goal in itself. What really matters are the strategies and decisions that stem from those forecasts: this is where the procurement organisation should be spending its time, and where it can add the most value.
- Sophisticated forecasting tools are best leveraged by sophisticated analysis, capable of interpreting the full statistical rigour provided: consider investing in upskilling the procurement organisation to take advantage of the insights provided.
- Don’t underestimate the impact on the procurement organisation’s credibility through following a disciplined and structured approach to forecasting and decision-making.



ABOUT OUR PARTNER

Mintec enables the world's largest food and CPG brands to implement more efficient and sustainable procurement strategies. We do this through our cutting-edge SaaS platform, Mintec Analytics, which delivers market prices and analysis for more than 14,000 food ingredients and associated materials. Our data and tools empower our customers to understand supplier prices better, analyse their spend and negotiate with confidence. Ensuring they are best placed to reduce costs, manage risk and increase their efficiency, helping to maximise their margins. Contact us to find out how your business could benefit.

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