**Mathematics for Forecasting**

# INTRODUCTION

⏺ Forecasting is the Process of predicting the future trends.

⏺ It allows organizations to be more proactive than receptive.

⏺ The process of forecasting may affect every area or department of organization in many ways.

⏺ A major purpose of forecasting is to give us choice of alternative plan, design, and backup resources.

⏺ It tries to find out how much the service or the products the customers will buy.

⏺ It involves different tools, techniques and methods which may be quantitative or qualitative in nature.

⏺ Organization may use forecasting to make decisions regarding price, or should the company entre into a new market zone or not.

⏺ Predicting how much of a product the customer will purchase is the essential to demand management

⏺ Dedicated to short term production scheduling, logistics coordinates product demand with production input availability and timing in order to meet customer delight.

# REASONS FOR FORECASTING

1. Increasing the delight of customer.

2. Taking steps to decrease stock outs.

3. Decreasing the levels of Buffer stock which organization may need.

4. Proper Scheduling operations efficiency.

5. Decreasing service or product cost of obsolescence.

6. To Manage the policy of pricing as well as promotion in a optimum way

7. Improving logistics and other activities of the firm.

|  |
| --- |
| **Quantitative Methods** |

A statistical technique projection about the future which uses numerical facts is known as the quantitative method.

**a) Graphical Method**

⏺ It is the method which include the plotting of graph from the given information which signifies that the given information can be seen in a visual manner.

⏺ The patterns of the graph and the trends are very easy to locate thus demand can be extrapolated so that it can be used for the future purposes.

**b) Modelling using Econometrics**

⏺ It signifies the different sets of equations which are intended to use for a specific purpose by solving those simultaneously. This can be studied using independent and dependent variables which may be related among themselves.

**c)** **Method of Moving Average**

⏺ Method of Moving average uses the mean of the recent years/month/week parameter.

⏺ The mean may be calculated by two, three, four, five etc. period which are taken into consideration.

⏺ It uses the arithmetic mean to find the forecasted value for the next year.

⏺ A three yearly or monthly moving average uses the average of the last three years or months.

⏺ Every time a new year of factual data is made available, it replaces the oldest time year’s data.

Example of method of moving average:

|  |  |  |
| --- | --- | --- |
| Year(s) | Demand (Units) | **3 yearly moving average** |
| 1 | 120 | - |
| 2 | 90 | - |
| 3 | 150 | - |
| 4 | 180 | 120 |
| 5 | 210 | 140 |
| 6 | ? | 180 |

Thus, the forecasting value for the 4th year is calculated as follows:

The forecasting value of 4th year = (120+90+150)/3 = 120 units

**d)Analysis of Exponential Smoothing:**

This is some other time collection forecasting method the place the forecast for the subsequent length is calculated as 'weighted average method' of all preceding values. It is based totally on the precept that the latest values are the most vital for predicting the future value. Also, it presumes that values prior to the cutting-edge fee are additionally applicable however in a declining significance as we go again in time. the equation is given as follows:

Y1t+1= ayt + (1 - a) Y1t

Where,

Y1t+1=Represents the new demand to be forecasted

Y1t=It represent the old demand which is based on weighted

average

yt=Previous actual value

a = Smoothing value, such that 0 < a < 1

If the value of a is not given it is assumed to be 0.2

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
| Demand (Units) | 213 | 201 | 198 | 207 | 220 | 232 | ? |

With the help of exponential smoothing analysis,

t + 1 = 7 ( as we need to forecast for the 7th Year)

Thus, t = 6

Putting the values in the above formula we have,

Y17=ay6+ (1 - a) Y16

= 0.2 232 + (1 - 0.2) 212

= 46.4 + 0.8 ` 212

= 46.4 + 169.6

= 216 units

Calculation of Y16= = 212 units

**e) Regression Analysis:** Regression means 'to regress', which indicates that one has to collect the past data. The meaning of regression analysis in statistics is the collection of the past data which can be analyze for the strategies of organization. The typical model is represented by the following equation.

Y1 = a1 + b1x + c

###### Where,

Y1 = dependent variable

x = independent variable

c = un-explanatory terms

The above equation becomes simple regression if c = 0

Thus, we have;

Y1 = a1 + b1x; r2

###### Where,

r2= represents the power of the given model. It represents if the given model is bad or good.

The Significance of the given equation Y1=a1 + b1x; r2

⏺ If b sign is positive, that indicates that y1 is directly proportional to x

⏺ If b has negative sign then y1 is indirectly related to x

⏺ r2has value between 1 and 0 ( 0 < r2< 1 )

For example

If r2= 0.8 = 80% which means that 80% of fluctuations in Y1 is reflected by x and the 20% may be due to c

**Note:**

⏺ If 0.8 ≤ r2 model is a good

⏺ If 0.6 ≤ r2 < 0.8 model is said to be average.

⏺ If r2≤ 0.6 model is said to be poor.

**Analysis of Multiple regression:** The multiple regression model is represented by

**Y1 = a1 + b1x1 + b2x2 + ……….bn-1 xn-1**

###### Where,

a1 = represents constant

b1, b2……bn-1= represents co-efficients of regression

x1, x2……xn-1= represents independent variables

Y = dependent variable.

# SOLVED PROBLEMS

1. Find 3 and 5 period moving average?

Hence Forecast value for 11th period

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Period | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| Demand (Units) | 110 | 120 | 135 | 142 | 154 | 160 | 173 | 180 | 190 | 210 | ? |

**Solution:**

|  |  |  |  |
| --- | --- | --- | --- |
| Period | Demand (limits) | 3 period average | 5 period average |
| 1 | 110 | – | – |
| 2 | 120 | – | – |
| 3 | 135 | – | – |
| 4 | 142 | 121.67 | – |
| 5 | 154 | 132.33 | – |
| 6 | 160 | 143.67 | 132.2 |
| 7 | 173 | 152 | 142.2 |
| 8 | 180 | 162.33 | 152.8 |
| 9 | 190 | 171 | 161.8 |
| 10 | 210 | 181 | 171.4 |
| 11 | ? | 193.33 | 182.6 |

∴ As 3 period moving average forecasted value for 11th period is 193.33 units and as per 5 period moving average forecasted value is 182.60 units.

2. For the following data calculate 3 and 5 monthly moving averages:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Month | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| Demand  (units) | 220 | 228 | 217 | 219 | 258 | 241 | 239 | 244 | 256 | 260 | 265 |

**Solution:**

**Table 1 : Calculation of Forecasted Demand**

|  |  |  |  |
| --- | --- | --- | --- |
| **Month** | **Demand Y** | **3 – monthly**  **Moving Average** | **5 – monthly**  **Moving Average** |
| 1 | 220 |  |  |
| 2 | 228 |  |  |
| 3 | 217 |  |  |
| 4 | 219 | 221.67 |  |
| 5 | 258 | 221.33 |  |
| 6 | 241 | 231.33 | 228.40 |
| 7 | 239 | 239.33 | 232.60 |
| 8 | 244 | 246.00 | 234.80 |
| 9 | 256 | 241.33 | 240.20 |
| 10 | 260 | 246.33 | 247.60 |
| 11 | 265 | 253.33 | 248.00 |
| 12 |  | 260.33 | 252.80 |

3. Find the forecasts by 4–yearly and 5-yearly moving averages, from the following data of sales (‘000’)

Year 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015

Sales(`) 48 53 55 56 58 63 68 60 61 68 58 63 70 76 83 88

**Solution:**

Table 2

|  |  |  |  |
| --- | --- | --- | --- |
| **Year** | **Sales** | **4 – Yearly**  **Moving Average** | **5 – Yearly**  **Moving Average** |
| 2000 | 48 |  |  |
| 2001 | 53 |  |  |
| 2002 | 55 |  |  |
| 2003 | 56 |  |  |
| 2004 | 58 | 53.00 |  |
| 2005 | 63 | 55.50 | 54.00 |
| 2006 | 68 | 58.00 | 57.00 |
| 2007 | 60 | 61.25 | 60.00 |
| 2008 | 61 | 62.25 | 61.00 |
| 2009 | 68 | 63.00 | 62.00 |
| 2010 | 58 | 64.25 | 64.00 |
| 2011 | 63 | 61.75 | 63.00 |
| 2012 | 70 | 62.50 | 62.00 |
| 2013 | 76 | 64.75 | 64.00 |
| 2014 | 83 | 66.75 | 67.00 |
| 2015 | 88 | 73.00 | 70.00 |
| 2016 |  | 79.25 | 76.00 |

4. Find the “forecast” for year 7th using weighted “Three years” Moving Average.

|  |  |  |  |
| --- | --- | --- | --- |
| Year **(`)** | Sales (1000 `) | Weighted | Weighted moving Averages |
| 1 | 10 | 2 | - |
| 2 | 15 | 3 | - |
| 3 | 12 | 4 | - |
| 4 | 14 | 5 | [2(10)+3(15)+4(12)] / 2+3+4 = 12.56 |
| 5 | 16 | 6 | [3(15)+4(12)+5(14)] / 3+4+5 =13.58 |
| 6 | 18 | 7 | [4(12)+5(14)+6(16)] / 4+5+6 =14.27 |

Thus for 7th year for casted value = = 16.22

5. Calculate weighted 5 period moving average for the following data. Also find forecasted value for 10th period.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Period | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 |
| Demand (Units) | 10 | 15 | 5 | 25 | 40 | 30 | 50 | 45 | 60 |

**Solution**

|  |  |  |
| --- | --- | --- |
| Period | Demand (Units) | 5-period moving weighted average |
| 1 | 10 | – |
| 2 | 15 | – |
| 3 | 5 | – |
| 4 | 25 | – |
| 5 | 40 | – |
| 6 | 30 | = 23.67 |
| 7 | 50 | = 27.34 |
| 8 | 45 | = 36.34 |
| 9 | 60 | = 41.34 |
| 10 | ? | = 48.67 |

**Practice Questions**

1. Find weighted 3 and 5 monthly averages

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Monthly | 1 | 2 | 3 | 4 | 5 | 6 |
| NAV (Cr) | 12 | 15 | 21 | 30 | 33 | 36 |

# Weightage are considered in order of increasing order, 3(2)13

# Hint: 3(2)13 means weights start from 3 till 13 with difference of 2 in weights.

2. For the following data find 5 period and 3 period average, Also, Forecast demand for the 11th year.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Year | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
| Demand in units | 110 | 120 | 135 | 142 | 154 | 160 | 173 | 180 | 190 | 210 | ? |