

5

Insights on Strategic Predictions

1. Base analysis on theory
2. Strive for parsimony
3. Explain or predict?
4. Use longest history possible
5. Feel the market

Base analysis on theory

- For category / market modeling, start with the theoretical foundation, not with a list of possible independent variables.
- Make sure your theoretical foundation builds on existing data for all markets you are analyzing. Do not use different models for different markets: maintain model integrity.
- Adjust if the theoretical foundation does not work but do this based on another theory.

Strive for parsimony

- A parsimonious model uses as few explanatory variables as possible, but not fewer. 1-2 variables are ideal for predictions, 3-4 is usually maximum.
- Parsimonious models tend to predict better than complex models. Also, in complex models, the unintended biases of the modeler may be incorporated unknowingly.
- Parsimonious models are also possible to understand for non-statistical executives (which are just about all executives).

Explain or predict?

- Many modelers treat prediction and explanation as the same problem. This is wrong. Methods and tests differ for these two goals.
- Explanatory models look at history and finds drivers and their magnitude. It has no predictive intent, although it can inform it.
- Predictive models teases out what will happen. For this, no independent variables may be required, or maybe a few.

Use longest history possible

- If you look 5 years into the future, you need at least 5 years of historical data, and ideally 20 years. Make good use of pooling (between countries / categories).
- Past momentum needs to be incorporated. If economic growth suggests solid category growth, but the category has been flat for 10 years, then future is flattish.
- Always maintain historical data. Definitions may change over time, but it is always possible to adjust for this. Companies need long memories.

Feel the market

- The most important aspect of modeling is that the team making the model must “feel” the market. This means having observed it in real life.
- Developing feel may be costly because the team must visit the places being modeled. This cost is unavoidable.
- Feel is paramount to success. Ivory tower modelers will over time degrade insights.