StrategicThinker™
A publication for business executives presented by the StrategicThinking INSTITUTE

# Scenario Planning: No Crystal Ball Required

By Rich Horwath

There's one question that we are all constantly asked, whether it be by a colleague, boss, investor, spouse, friend or neighbor: "How's business?" A more thoughtful question on the subject would be: "How will your future business be and why?"

The state of our business today is primarily based on what we did in the past weeks, months and years. While today's business has been determined, we have a significant opportunity to impact our future business—as long as we can see where that business will be and the factors that will shape it.

Enter stage left—scenario planning. A survey conducted by the Corporate Strategy Board of senior managers in the year 2000 showed that scenario planning was the No. 1 planning tool used by corporations. Scenario planning is credited with Royal Dutch/ Shell's leap from the eighth largest oil company to the second largest oil company in two years.

## The Basis of Scenario Planning

Scenario planning can be defined as the process of creating vivid mental pictures of the potential but unknowable futures of our business. The process involves identifying the current and emerging factors that will influence those potential future states.

Ultimately, scenario planning allows you to develop strategy with an understanding of the potential future states. Traditional forecasting techniques use historical events and numbers as their planning basis, likening them to driving a car by using the rearview mirror. Scenario planning on the other hand, uses the windshield or future to navigate.

## Scenario Planning's Start

The beginnings of scenario planning can be traced back to defense analyst Herman Kahn in the late 1940s after WWII. Working at the Rand Corporation, Kahn put forth this technique as he described the potential methods that hostile nations could use nuclear weapon technology. *Scientific American* magazine described Kahn as "thinking the unthinkable" and oddly enough, Kahn was used by film maker Stanley Kubrick as the model for Dr. Strangelove in the classic film.

As Kahn's models became more complex and mechanistic, two individuals sought him out: Pierre Wack and Ted Newland, both from Shell. They used the basis of Kahn's scenario planning to develop potential scenarios for Shell, one of which was drastically lower supply and higher prices. This enabled Shell to handle the market challenges of the 1970's OPEC oil embargo better and faster then their competition, driving their move from 8th place in market to 2nd position.

## Benefits of Scenario Planning

Successful strategy is built on being in a state of constant interaction: interaction with customers, interaction with the market; interaction with different functional units within a company and so on. Scenario planning offers the opportunity to project the fruits of this interaction onto potential futures.

Scenario planning provides the following benefits to its practitioners:

- Generates debate about choices that the business faces;
- Facilitates the development of strategy that is effective in several different futures;
- Increases the intensity and frequency of observation in a dynamic business environment;
- Tests business plans against futures;
- Stimulates strategic thinking;
- Maximizes the upside and minimizes the downside of future events;
- Offers a barometer for the group's vision statement;
- Allows you to craft strategy in a relative state of calm versus a fire-drill mentality when one of the worst-case scenarios has just occurred.

Scenario planning also provides the basis for solid contingency planning, which ensures that your business is prepared for almost anything that it faces.

### Steps in Scenario Planning

Looking into the future is not nearly as daunting a task as it first appears when you follow a proven and consistent series of steps.

**1. Identify the participants.** Bring together individuals that can offer keen insights and fresh perspectives. Consider including people outside the company as well, such as select customers, suppliers and thought leaders.

**2. Choose a time frame** (generally from one to five years).

**3. Select the key players that will impact the scenarios** (i.e., competitors, customers, vendors, governmental agencies, etc.).

**4. Identify the key trends shaping the future.** Categorize the trends into groups such as economic, political, social, demographic and technological. Then rate each trend as positive, negative or neutral.

**5. Select the key unknowns for the future** and rate each on two scales: probability of occurrence and potential impact (with 1 being low and 10 being high).

**6. Construct 3-5 scenarios.** Based on the group's compilation and review of the key players, trends and unknowns, develop 3-5 scenarios complete with a situation analysis and outcomes. Then give each scenario a descriptive name.

**7. Strategy development.** Once the scenarios have been created, review your current strategy to determine how well it would work in that scenario. If you don't have a strategy articulated or the current strategy wouldn't fair well in the scenarios, adopt a proces to create a new strategy.

**8. Create contingency plans.** With the 3-5 scenarios in hand, work on creating a contingency plan for each scenario. The contingency plan should describe the situation or scenario, the goals and objectives within that framework, the strategies and tactics to achieve them and corresponding metrics.

### Contingency Plans

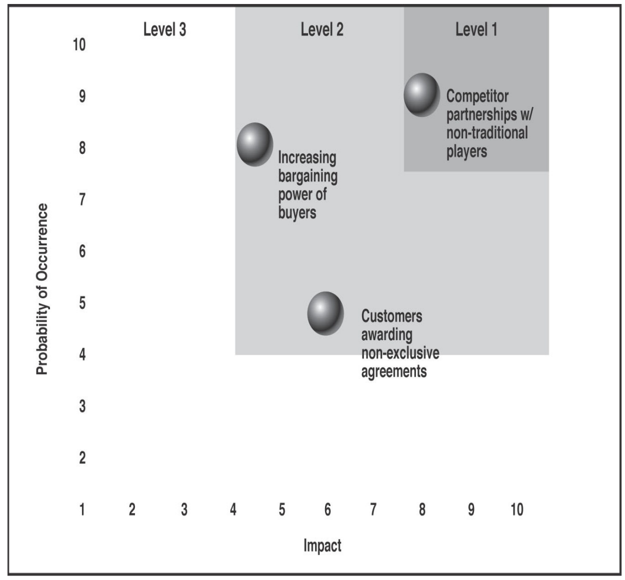
Contingency plans act as insurance policies for your business. While few people are eager to invest the time in developing them, they prove to be priceless when an unexpected situation unfolds.

One example of an industry that would have done well to have contingency plans in place is the airline industry. While hindsight is always 20/ 20, it's not a stretch to describe several scenarios and their contingency plans that a smart airline would have developed in the late 1990s. Business people no longer willing to pay absurdly high ticket prices (lower demand for premium service) and a terrorist attack in the U.S. (lower demand for airline travel) were certainly two plausible scenarios. When these scenarios combined, they were especially formidable, but not insurmountable with the proper preparation. With no contingency plans in place, the majority of airlines ran screaming to the government to bail them out, never mind that the majority of them had outdated business strategies that were hemorrhaging cash to begin with.

## Threat Matrix

A threat matrix can be a useful tool in prioritizing the contingency planning process. A threat matrix allows you to visually capture the threats to the business and assess them on the two parameters we discussed earlier: probability of occurrence and impact. After rating each threat or unknown on a scale of 1 (low) to 10 (high), plot the threat on the matrix.

As we can see in the example of a threat matrix for a midsize medical device company, there are three levels of threat. Those threats residing in Level 1 have the greatest probability of occurring and the highest impact. Any threats residing in Level 1 should be the first to be addressed in contingency planning. For those threats residing in Level 2, a person or group should be assigned to do further research on the threat and report back to the team on its status. Those threats in Level 3 should be monitored for changing conditions.




## "I see a dancing bear in your future…"

Scenario planning doesn't involve crystal balls, tarot cards or frightening mystics. It does involve a proven and rigorous technique to augment your chances of utilizing solid strategy for achieving business success. While we can't know the future with certainty, we can know the potential futures and plan for them accordingly.□

Rich Horwath helps managers develop the skills and expertise to create great strategy and fulfill their leadership potential. He is the president of the Strategic Thinking Institute, a former Chief Strategy Officer and professor of strategy at the Lake Forest Graduate School of Management. Rich is the author of *Sculpting Air: The Executive's Guide to Shaping Strategy* and *Storm Rider: Becoming a Strategic Thinker*. Please contact Rich at (847) 756-4707, email rich@strategyskills.com or visit www.strategyskills.com