Scenario Planning

What is it?

Scenario planning is a well-established technique through which a range of possible futures can be explored. It provides a structured process for consciously thinking about future environments within which a company may need to operate.

The basis of scenario planning is that the future is uncertain. It enables executives to fully explore the range of possible futures, or 'scenarios' (see Figure 1) and identify the main drivers of change. The tool uses the interactions between important variables or 'market drivers' to create and explore the potential scenarios.

The scenarios range from probable and plausible scenarios to "wildcards" (things which might have been thought impossible, like the global banking crisis).

The science behind this approach dates back to the 1950s when Hermann Kahn developed scenario planning as a distinct activity at RAND Corporation. He encouraged people to think about nuclear war and its consequences. Kahn's ideas gained momentum among economists and politicians before they emerged in the corporate world, and were adopted by companies such as SRI International and Royal Dutch Shell. Shell subsequently used the tool to predict the Arab-Israeli war and fall of the Berlin Wall using these scenarios to plan responses and grow their market share.

When to use it

Scenario planning has two main applications:
1. To explore all possible futures to identify the **most probable scenario**. The main company business plan can then be developed to address this most probable future.

2. To develop contingency plans for a **range of different scenarios**. This is valuable because it allows companies to respond to changing market dynamics more quickly than their competition, which is key in today's turbulent markets (Lindgren and Bandhold, 2003). As a result of scenario planning, the most probable changes in the market will have been analysed and a plan of action agreed.

How to use it

The leadership of the company needs to assemble a group of people with a broad range of skills and expertise from across all areas of the business.

The scenario planning process starts with identifying all the market drivers that could affect the future. These are called variables. This is done using brainstorming techniques.

Each variable is scored on two axes:

Impact: The level of potential impact that each driver could have on the market is scored from low to high
Uncertainty: The uncertainty of future changes in each variable occurring is scored from low to high.

The variables are then plotted on a chart with Impact on the y axis and Uncertainty on the x axis (see Figure 2). Using the chart, variables can be divided into three categories:

- Monitor
- Important
- Critical

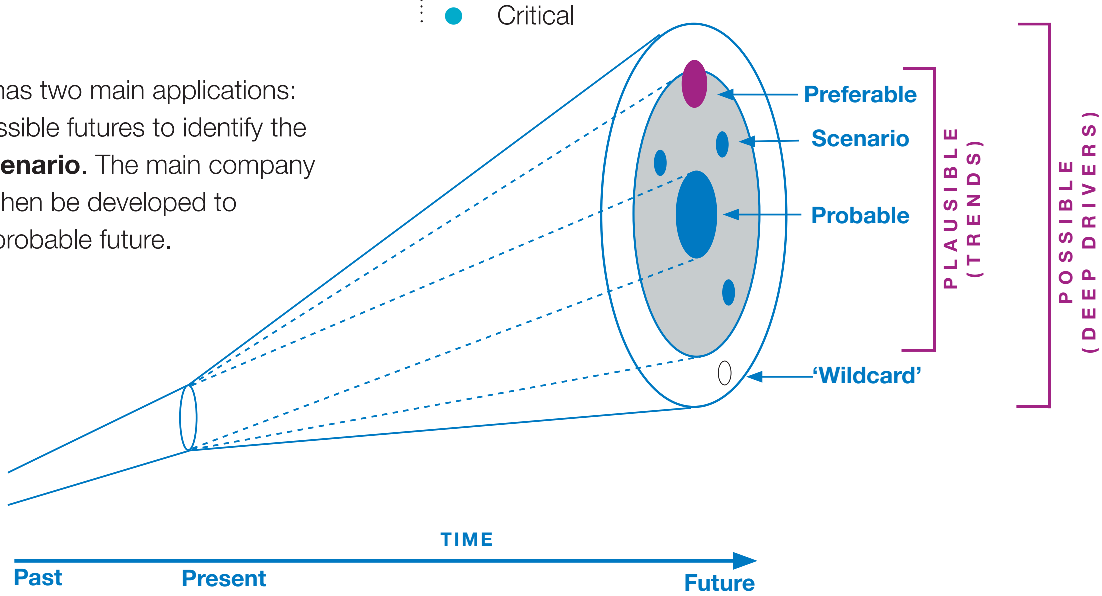

Figure 1 The range of possible scenarios

Variables that fall into the 'monitor' and 'important' categories will either have a low impact on the market, or already be accounted for in strategic planning due to their high certainty. It is the 'critical' variables which need to be explored more deeply to prepare for the most important changes in a company's market.

This is done by exploring how the critical variables could interact with each other, using a four step process:

1. The range of outcomes for each variable is agreed. This creates a scale for each axis of the scenario chart.

2. The interactions between each of the variables are explored, plotting 2 variables against each other (see Figure 3). If there are four critical variables, there will be six different charts to explore. If five critical variables are identified, this increases to 10 charts.

3. A short narrative is written to explain what is happening in each quadrant. Each quadrant is summarised by assigning a nickname. Circles are plotted to identify where the market is now and where it is likely to be in the future.

4. The final step is to understand how each of the most probable scenarios from each of the charts interact simultaneously. This is written as a single narrative telling the 'story' of the future market. Alternatively, a contingency plan can be written for each possible scenario.

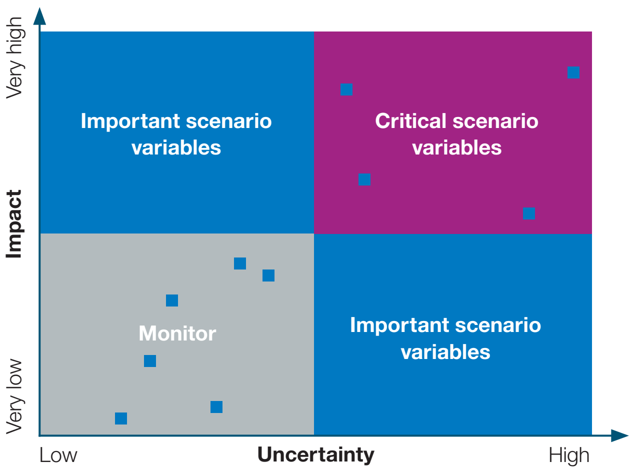

Figure 2 Impact and Uncertainty Analysis Matrix

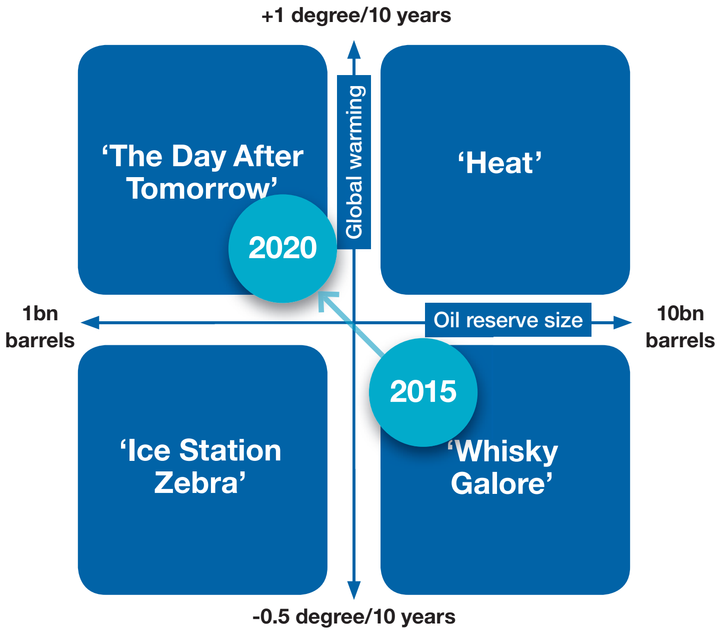

Figure 3 Scenario Chart
Example: Global warming vs Oil reserves

Strengths and weaknesses

Scenario planning opens executives' minds to the range of possibilities before agreeing on what is probable. This is important because standard strategic planning often assumes that the future will be similar to the present, which is not always true.

A further strength of scenario planning is that it is a group exercise. Stakeholders from across the business will have different opinions about the key drivers. The discussion which occurs around market drivers is a very valuable activity. This increases the robustness of the final scenario and ensures buy-in from all business areas.

However, the qualitative narrative used to describe scenarios is subjective, which means it is difficult to identify whether the scenario has been described correctly. The story needs to be combined with quantitative evidence in order to be credible (Wilkinson and Kupers, 2013).

To find out more, contact Jonathan Davenport at **jonathan.davenport@milnerltd.com**.

Further reading

Lindgren, M. and Bandhold, H. (2003) *'Scenario Planning: The Link Between Future and Strategy'* New York: Palgrave Macmillan

Wilkinson, A. and Kupers, R. (2013) *'Living in the Futures'* [online] Available at: https://hbr.org/2013/05/living-in-the-futures [Accessed 23 Jun 2015]