

SCENARIO PLANNING

Introduction

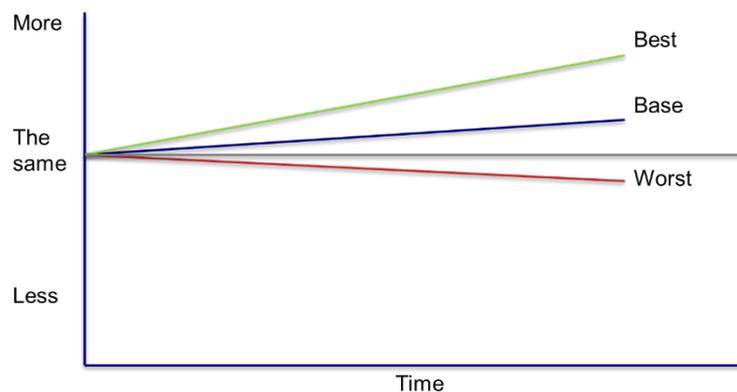
This paper explains how to make use of scenarios to help plan for an unknown future.

Scenarios are possible future worlds. The US military used them in the Cold War to imagine possible Soviet actions. Royal Dutch Shell picked up the idea before the 1970s oil price shock and was the only oil major ready for it.

Scenarios are a routine part of business planning today but our view is that the typical approach is poor and in times like this will not deliver. Here we explain why and how to use scenarios well.

Scenarios are more than this

In normal times, organisations typically limit what they call scenarios to an upside and a downside around an expected future.



While the cliched terms best case and worst case come from scenario planning, they focus on one metric. We don't think these are scenarios. They are sensitivity analyses.

So we're not going to take that approach here, though it is good for exploring whether a plan will stand up to a poor forecast. Importantly, if the change is not linear or where more than one thing is uncertain, best case, worst case and so on falls over.

If you are a toll road operator and a disruptive new technology comes along, or a big change in the price of fuel leads to a mode shift, simple projections don't cut it.

How to deal with complexity

The scenario theorists realised, though, that we quickly become daunted by too much complexity. The solution is to identify the greatest uncertainties and then map them against each other. Each junction becomes a possible future. We think through what each possible future might mean, together with the key metrics, and work out a plan to deal with each one.

Each plan is called a playbook, like those used by sports teams that need different plans for different on field events and can't stop the game to get organised. From here comes a final plan that is resilient enough to deal with all of the future worlds.

Let's make sense of this with a worked example.

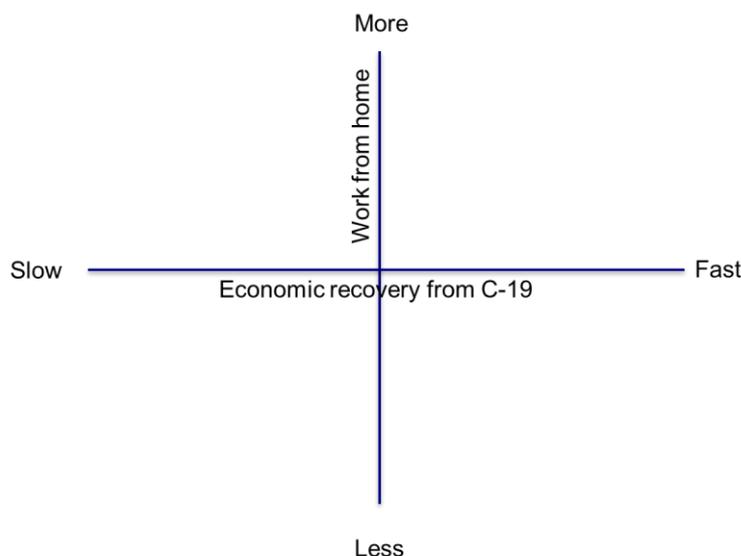
An example

We're going to identify just two uncertainties. You may want more, but be aware that every extra uncertainty increases the number of possible worlds exponentially.

We're going to use the example of a toll road operation. With a massive fixed investment in the road, big revenues from drivers who make decisions about whether to use the road on a day by day basis, and all sorts of economic uncertainties, this is a complex business.

It clearly won't be enough to run a simple base, best and worst case scenario model.

Here you see our two chosen uncertainties which, for illustration, we're proposing are the most significant.



On the X axis we have the uncertainty about how quickly the economy will recover from COVID-19. Will it be a long drawn out recession on the left, or a rapid bounce back on the right?

On the Y axis we're looking forward to the extent to which people will go back into offices once the virus is beaten. We know that many people have enjoyed the experience of working at home and many organisations report efficiency gains. But how many commuters will this take off our toll road?

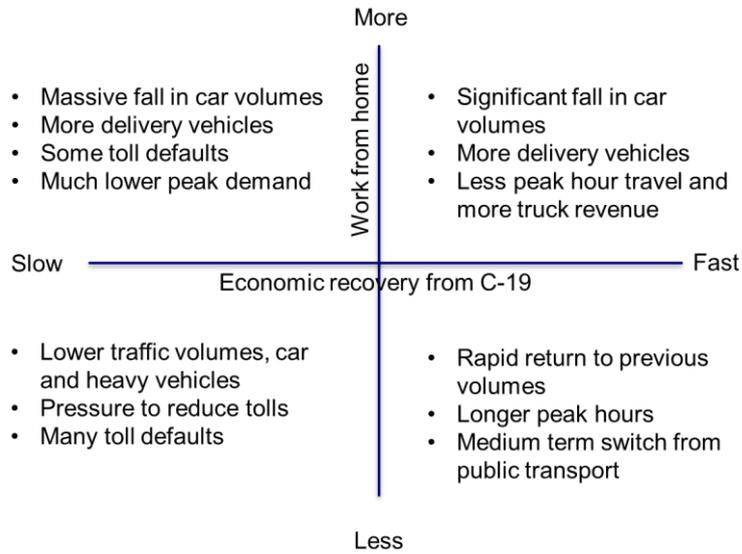
We now need to think about what the impact of each change will be. Ours is a very superficial analysis for the purpose of our illustration, but if recovery is slow and more people work from home, there'll be a lot less commuting.

There'll probably be a lot more home delivery and movement of goods between locations by truck.

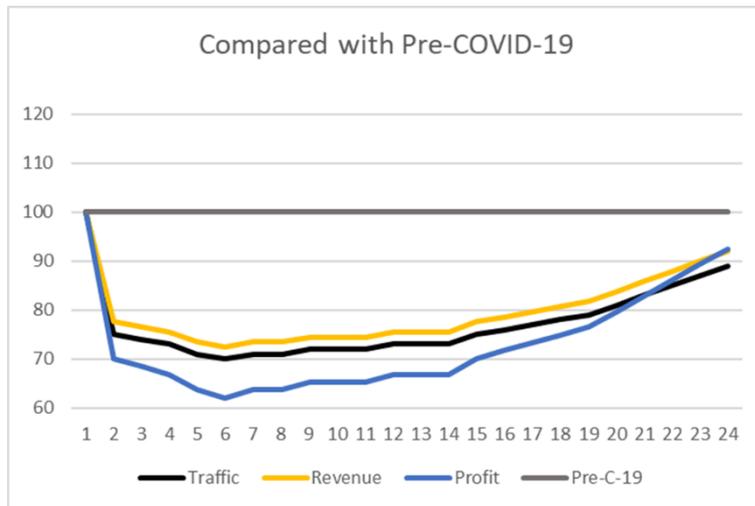
A recession means some motorists will fail to pay our tolls while the peak hour gridlock will be replaced by more even traffic through the day.

Our four scenarios

Our toll road operator cares about revenue and profit. Both are driven by traffic volumes and the mix of traffic, as well as other factors. Scenario thinking lets us think about ALL of these. When we put some likely numbers in based on each of the four scenarios, we get a much richer view of alternative futures.

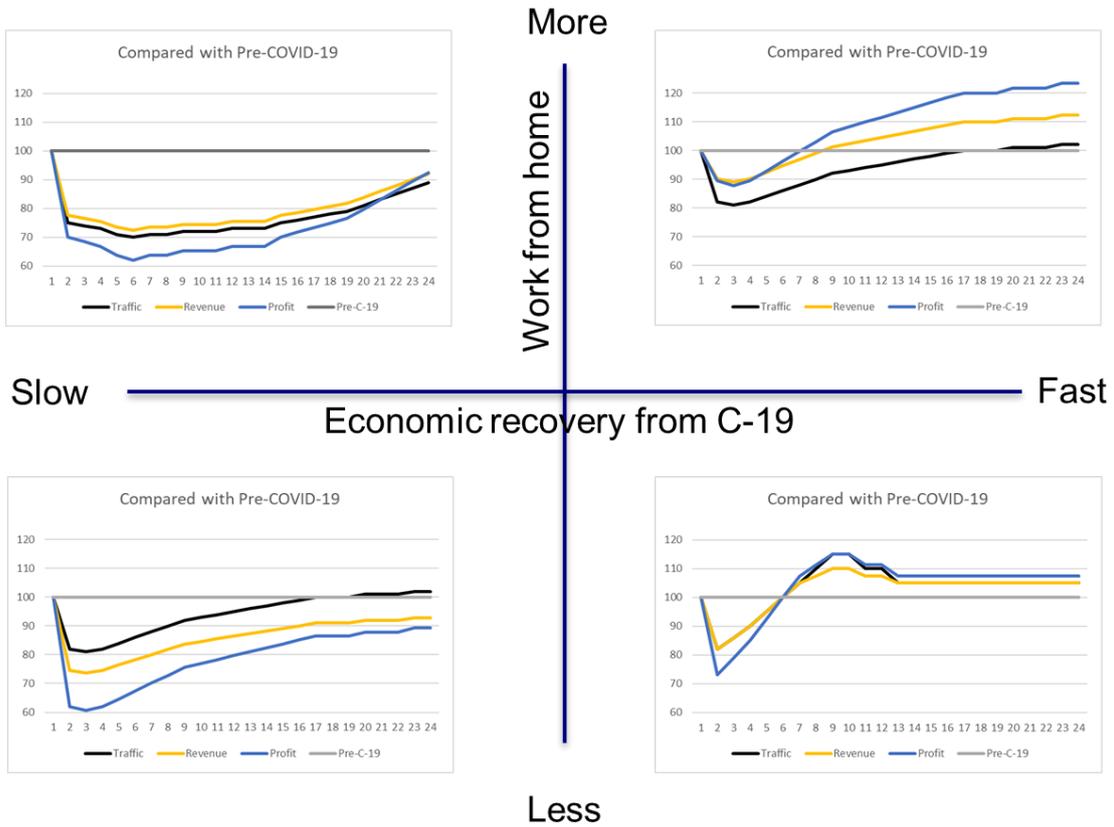


This is the “more working from home and a slow recovery” scenario:



Here we first model traffic, which is sharply down for an extended period, then revenue arising, which is down, but not by quite as much.

Then resulting profit which declines even more than traffic. Now we look at equivalent graphs for each of the four scenarios:

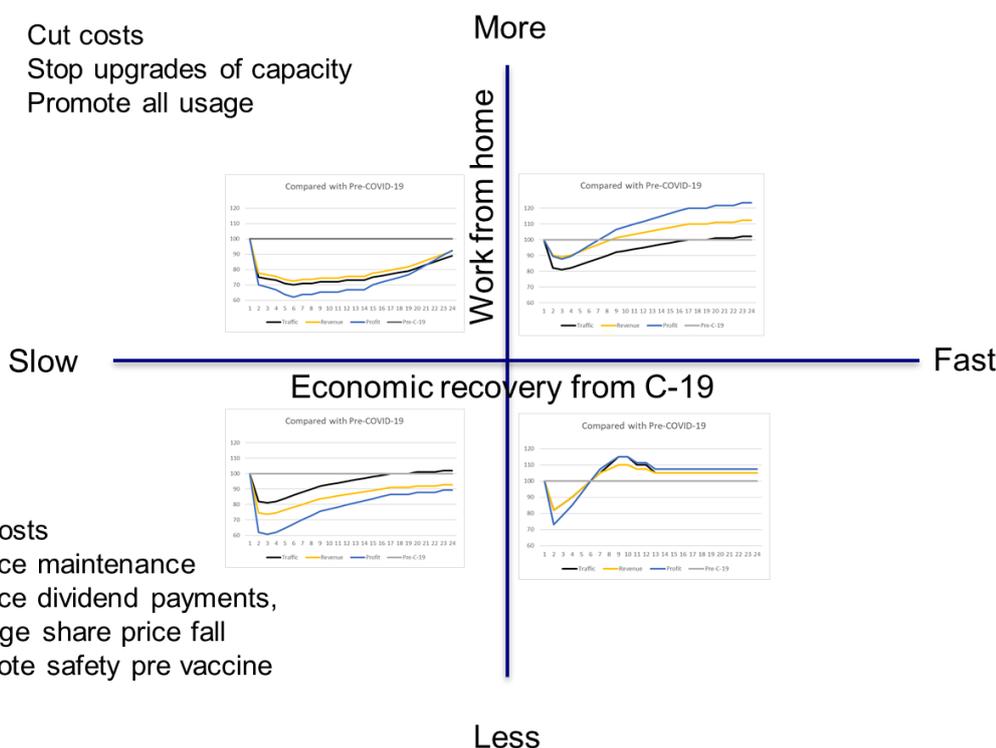


Look at the difference in the shape of the curves. And the different gaps between, say, traffic and profit. Clearly, plans based on ‘a little bit more’ or ‘a little bit less’ are not enough. Indeed, we will need a different response to each of these situations and the differences will cover a number of dimensions.

Four playbooks

Now, let’s hypothesise a plan, or playbook, for each scenario. To pick a couple of elements, the scenarios highlight things like a decline in profit leading to a decline in business value and a likely decline in share price. They also highlight that borrowing may be needed to fund faster (not slower) recovery, though with very different borrowing terms and therefore mechanisms.

- Cut costs
- Stop upgrades of capacity
- Promote all usage



- Cut costs
- Reduce maintenance
- Reduce dividend payments, manage share price fall
- Promote safety pre vaccine

We have four playbooks, but we only want one plan. So what happens now?

Towards one plan

Well, there are some key elements that we can draw out - things that are critical across one or more plans, although they may lead in different directions. Road capacity growth is a great example, some scenarios see traffic jams, others see underutilisation. The plan needs to be flexible, too. The marketing plans will need appropriate messages ready to roll at short notice. And we need to prepare for investment without starting big spending until the picture becomes clearer.

Here are some things that might be in a resilient, consolidated plan:

- Do thorough assessment of costs through business
- Assess capacity growth options
- Commit to preliminary work on short term capacity growth
- Prepare marketing plan with off peak focus plus optional all-times focus and safety focus
- Set up short term borrowing facility
- Educate market analysts on scenario possibilities

Making it happen

But, what does this mean for you? The earlier methodology leads to a series of questions which we revisit here:

- What are your top uncertainties?
- What impact would each combination have on the business?
- How would each combination play out in your key metrics?

- What playbooks would you need to develop for each combination?
- What single plan will you put in place?

But it is not a simple or quick process and it needs to be managed carefully.

You need to involve a variety of people in your organisation, covering your whole operation. You need to allow plenty of time, which is an expensive investment. And you need to get people to overcome the many, well researched mental biases that steer our unconscious thinking towards, in particular, more of the same.

Few organisations claim to have been well prepared for COVID-19, even though the high likelihood, dangers, impacts and outworkings were accurately predicted. Although the probability was high, organisations chose to act as if it was incredibly low.

The good news here, though, is that organisations which plunge small teams into scenario thinking find that, after only a few hours, people become immersed and start to internalise different futures.

Instead of saying ‘it won’t happen so I can’t think about a plan’, they actually do some deep thinking about what each alternative future would look like and how they can be ready for it.

Conclusion

We believe a proper understanding of scenario planning is important for any manager or planner because it provides an essential tool to deal with uncertainty.

For more information

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