

10.6: Scenario Planning and Analysis

Learning Objectives

1. Understand the history and role of scenario planning and analysis.
2. Know the six steps of scenario planning and analysis.
3. Be able to map scenarios in a two-by-two matrix.

The History and Role of Scenario Planning and Analysis

Strategic leaders use the information revealed by the application of PESTEL analysis, global dimensions, and CAGE analysis to uncover what the traditional SWOT framework calls *opportunities* and *threats*. A **SWOT (strengths, weaknesses, opportunities, and threats)** assessment is a strategic-management tool that helps you take stock of an organization's internal characteristics, or its strengths and weaknesses, such that any action plan builds on what it does well while overcoming or working around weaknesses; the SWOT assessment also helps a company assess external environmental conditions, or opportunities and threats, that favor or threaten an organization's strategy. In particular, you can use it to evaluate the implications of your industry analysis, both for your focal firm specifically and for the industry in general. However, a SWOT assessment works best with one situation or scenario and provides little direction when you're uncertain about potential changes to critical features of the scenario. Scenario planning can help in these cases.

Scenario Planning

Scenario planning helps leaders develop a detailed, internally consistent picture of a range of plausible outcomes as an industry evolves over time. You can also incorporate the results of scenario planning into your strategy formulation and implementation. Understanding the PESTEL conditions—as well as the level, pace, and drivers of industry globalization and the CAGE framework—will probably equip you with some insight into the outcomes of certain scenarios. The purpose of scenario planning, however, is to provide a bigger picture—one in which you can see specific trends and uncertainties. Developed in the 1950s at the global petroleum giant Shell, the technique is now regarded as a valuable tool for integrating changes and uncertainties in the external context into overall strategy. Paul J. H. Schoemaker, "When and How to Use Scenario Planning: A Heuristic Approach with Illustration," *Journal of Forecasting* 10, no. 6 (November 1991): 549–64; Paul J. H. Schoemaker and Cornelius A. J. M. van der Heijden, "Integrating Scenarios into Strategic Planning at Royal Dutch/Shell," *Planning Review* 20, no. 3 (1992): 41–46; Paul J. H. Schoemaker, "Multiple Scenario Development: Its Conceptual and Behavioral Foundation," *Strategic Management Journal* 14, no. 3 (March 1993): 193–213. Since September 11, 2001, the use of scenario planning has increased in businesses. Analysis of Bain & Company's *Management Tools and Trends Survey* shows that in the post-9/11 period, approximately 70 percent of 8,500 global executives reported that their firms used scenarios, in contrast to a usage rate of less than 50 percent in most of the 1990s. Darrell Rigby and Barbara Bilodeau, "A Growing Focus on Preparedness," *Harvard Business Review* 85 (July–August 2007). In addition, scenarios ranked fifteenth in satisfaction levels among the twenty-five management tools that Bain examined in 1993, while it ranked eighth in 2006. Darrell Rigby and Barbara Bilodeau, "A Growing Focus on Preparedness," *Harvard Business Review* 85 (July–August 2007): 21–22.

Unlike forecasts, scenarios are not straight-line, one-factor projections from present to future. Rather, they are complex, dynamic, interactive stories told from a future perspective. To develop useful scenarios, executives need a rich understanding of their industry along with broad knowledge of the diverse PESTEL and global conditions that are most likely to affect them. The six basic steps in scenario planning are detailed below.

Six Basic Steps of Scenario Planning

- **Step 1.** Choose the target issue, scope and time frame that the scenario will explore. The scope will depend on your level of analysis (i.e., industry, subindustry, or strategic group), the stage of planning, and the nature and degree of uncertainty and the rate of change. Generally, four scenarios are developed and summarized in a grid. The four scenarios reflect the extremes of possible worlds. To fully capture critical possibilities and contingencies, it may be desirable to develop a series of scenario sets.
- **Step 2.** Brainstorm a set of key drivers and decision factors that influence the scenario. This could include social unrest, shifts in power, regulatory change, market or competitive change, and technology or infrastructure change. Other significant changes in external contexts, like natural disasters, might also be considered.

- **Step 3.** Define the two dimensions of greatest uncertainty. (For an example, see Table 8.4.) These two dimensions form the axes of the scenario framework. These axes should represent two dimensions that provide the greatest uncertainty for the industry. For instance, the example on the global credit-union industry identifies changes in the playing field and technology as the two greatest areas of uncertainty up through the year 2005.
- **Step 4.** Detail the four quadrants of the scenarios with stories. Describe how the four worlds would look in each scenario. It's often useful to develop a catchy name for each world as a way to further develop its distinctive character. One of the worlds will likely represent a slightly future version of the status quo, while the others will be significant departures from it. As shown in the credit-union scenarios, *Chameleon* describes a world in which both the competitive playing field and technology undergo radical change, while *Wallet Wars* is an environment of intense competition but milder technological change. In contrast, in *Technocracy*, the radical changes are in technology, whereas in *Credit Union Power*, credit unions encounter only minor changes on either front. Adapted from "Scenarios for Credit Unions 2010: An Executive Report," Credit Union Executives Society, 2004, accessed May 10, 2011, www.dsicu.com/pdfs/2010_Scenarios.pdf.
- **Step 5.** Identify indicators that could signal which scenario is unfolding. These can either be trigger points that signal the change is taking place or milestones that mean the change is more likely. An indicator may be a large industry supplier like Microsoft picking up a particular but little-known technological standard.
- **Step 6.** Assess the strategic implications of each scenario. Microscenarios may be developed to highlight and address business-unit-specific or industry-segment-specific issues. Consider needed variations in strategies, key success factors, and the development of a flexible, robust strategy that might work across several scenarios.

The process of developing scenarios and then conducting business according to the information that the scenarios reveal makes it easier to identify and challenge questionable assumptions. It also exposes areas of vulnerability (e.g., in a country, an industry, or a company), underscores the interplay of environmental factors and the impact of change, allows for robust planning and contingency preparation, and makes it possible to test and compare strategic options. Scenarios also help firms focus their attention on the trends and uncertainties that are likely to have the greatest potential impact on their future.

Once you've determined your target issue, scope, and time frame, you can draw up a list of driving forces that is as complete as possible and is organized into relevant categories (e.g., science-technology, political-economic, regulatory, consumer-social, or industry-market). As you proceed, be sure to identify *key* driving forces—the ones with the greatest potential to affect the industry, subindustry, or strategic group in which you're interested.

Trends and Uncertainties

Among the driving forces for change, be sure to distinguish between *trends* and *uncertainties*. **Trends** are forces for change whose direction—and sometimes timing—can be predicted. For example, experts can be reasonably confident in projecting the number of consumers in North America, Europe, and Japan who will be over sixty-five years old in the year 2020 because those people are alive now. If your firm targets these consumers, then the impact of this population growth will be significant to you; you may view it as a key trend. For other trends, you may know the direction but not the pace. China and India, for example, are experiencing a trend of economic growth, and many foreign investments depend on the course of infrastructure development and consumer-spending power in this enormous market. Unfortunately, the future pace of these changes is uncertain.

Did You Know?

In his book *Africa Rising*, Vijay Mahajan documents how trends surrounding the 900 million African consumers may offer businesses more opportunities than they're currently taking advantage of:

Many tourists come to Africa every year to see the big game there—the elephants, lions, and rhinos. But I came for a different type of big game. I was seeking out the successful enterprises that are identifying and capitalizing on the market opportunities, and seeking lessons from those that are not so successful, too. In Nairobi, Maserame Mouyeme of The Coca-Cola Company told me how important it is 'to walk the market.' Then, in Harare, I first heard the term 'consumer safari' in a meeting with Unilever executives. This is what they call their initiatives to spend a day with consumers in their homes to understand how they use products. Years after I started on this journey, I now had a term to describe the quest I was on. I was on a consumer safari. The market landscape that is Africa is every bit as marvelous and surprising as its geographic landscape. It presents as big an opportunity as China and India. Vijay Mahajan, *Africa Rising: How 900 Million African Consumers Offer More Than You Think* (Upper Saddle River, NJ: Pearson Prentice Hall, 2008), xii.

In contrast, **uncertainties**—forces for change whose direction and pace are largely unknown—are more important for your scenario. European consumers, for example, tend to distrust the biotechnology industry, and given the number of competing forces

at work—industries, academia, consumer groups, regulators, and so on—it is difficult to predict whether the consumers will be more or less receptive to biotechnology products in the future. Labeling regulations, for instance, may be either strengthened or relaxed in response to changing consumer opinion.

You might also want to consider the possibility of significant disruptions—that is, steep changes that have an important and unalterable impact on the business environment. A major disaster—such as the September 11 terrorist attacks—can spur regulatory and other legal reforms with major and lasting impact on certain technologies and competitive practices. Table 8.4 provides sample scenarios created for the credit-union industry, providing an idea of how you would do this if asked to apply scenario analysis to another industry setting. As you can see, identifying the entry of new competitors and the impact of technology are the two primary sources of uncertainty about the future.

Table 8.4 Developing Scenarios for the Global Credit-Union Industry

CHANGES IN THE PLAYING FIELD			
TECHNOLOGICAL CHANGE		Minor	Major
		Gradual	Credit Union Power: Both technology and the playing field have changed at a moderate pace, making this the most stable scenario. Even with moderate change in these areas, however, the changing basis of competition, new business models, human resources challenges, and industry dynamics are different enough to pose significant challenges for many financial-services companies.
		Radical	Technocracy: The wide-scale adoption of the Internet by US consumers has led to massive technological innovation for financial-services companies, increasing the range of distribution channels as well as the products, services, and geographic scope of financial-services organizations. Regulations and other changes in the playing field, however, have been slow to follow.
Note: After considering a PESTEL analysis, experts in the credit-union industry would identify the two most significant macroeconomic factors as (1) regulatory factors affecting both the types of businesses that credit unions can compete in and the entry of new players and consolidation of existing ones, and (2) technological factors, or the speed with which new technologies related to banking are both developed and adopted by consumers. These two dimensions define the major areas of uncertainty facing credit union executives in the next decade. Considering those dimensions and following the six basic steps in scenario planning, you might then develop the following four scenarios.			

Source: Adapted from “Scenarios for Credit Unions 2010: An Executive Report,” Credit Union Executives Society, 2004, accessed May 10, 2011, www.dsicu.com/pdfs/2010_Scenarios.pdf.

KEY TAKEAWAYS

- Scenario planning was developed in the 1950s by Shell as a tool for integrating changes and uncertainties in the external context into overall strategy. Today it ranks among the top ten management tools in the world in terms of usage. Scenarios are complex, dynamic, interactive stories told from a future perspective. To develop useful scenarios, you need a rich understanding of your industry along with broad knowledge of the diverse PESTEL and global conditions that are most likely to affect them.
- The six steps in formulating a scenario plan are the following: (1) choose the target issue, scope, and time frame that the scenario will explore; (2) brainstorm a set of key drivers and decision factors that influence the scenario; (3) define the two dimensions of greatest uncertainty; (4) detail the four quadrants of the scenarios with stories about that future; (5) identify indicators that could signal which scenario is unfolding; and (6) assess the strategic implications of each scenario.
- Considering the distillation of issues and drivers, select two dimensions of change that will serve as the two dimensions of your scenario-planning matrix. You must be able to describe the dimensions as high and low at each extreme.

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. What is scenario planning and analysis?
2. What is the history of scenario planning and analysis?
3. What is the advantage of scenario planning and analysis over SWOT analysis?
4. What are the six steps involved in scenario planning and analysis?
5. What is the difference between uncertainties and trends in scenario planning and analysis?

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