Risky scenarios

By Andrew Hedley, director, Hedley Consulting

An acid test of the efficacy of any strategy is the way in which it is able to accommodate and respond to uncertainty and unforeseen risks as they emerge over time.

While we live in an increasingly non-linear world, many strategies are still constructed using a surprisingly one-dimensional model. They envisage a known start-point and a desired end-state with a series of predetermined steps in between. The underlying assumption (indeed assertion!) is that 'nothing can get in the way of us achieving our goals'. However, when the rules of business are changing on an almost daily basis, how valid is an approach that targets goals that were sensible, stretching and achievable but in a world that is consigned to history? These goals may be wholly inappropriate, unrealistic, or just plain silly when viewed in the context of new rules of competition and economics?

An alternative approach to strategy is found in the theory of logical incrementalism. This views successful strategy in a dynamic environment as being inherently about flexibility and the taking of incremental steps towards a desired 'end state'. This method links strategy and implementation in a continuous improvement cycle. There are a number of advantages for a naturally risk-averse firm to take such an incremental initiative and in proving the good sense of its strategy by adopting a 'toe in the water' philosophy. This is especially true in the turbulent markets that make the veracity of the approach even stronger.

Scenario-planning techniques can assist strategy development in just such fast-changing markets and business environments. Modelling of this nature combines known facts about the market, the firm and the competition with a number of plausible future developments that would change the competitive dynamic. These alternatives will often be developed using macro-analysis tools and competitive frameworks to take as rounded a view as possible of how change might impact on the firm.

The creation of different permutations using these facts, and then turning potential developments into a series of possible futures against which the firm's strategy can be tested, is the basis of the scenario-planning approach. While it is valid to select any scenario, it is often the case that those chosen tick the twin boxes of being acknowledged as plausible and accepted as uncomfortable for the firm. However, plausible should not be confused with predictable or probable! Events in these first two categories should, indeed, already have been factored into strategic thinking at an earlier stage. This is about stress-testing the strategy with a number of 'what ifs'. How will the firm respond to such events and the changed business risk profile that emerges?

Events of the past 12 months have demonstrated to anyone with lingering doubts just how dramatic and far reaching the impact can be when unlikely, but plausible, scenarios come to fruition. With the unravelling of world financial markets and the tsunami-like effect on professional services, many firms find themselves without a Plan B when Plan A is no longer fit for purpose.

A decade of investing in bull-market service lines has led to firms that are no longer balanced and in a position to take advantage of the opportunities presented by the enduring bear economy in which we now find ourselves.

In the wonderful 20:20 vision afforded by hindsight, it is clear that a professional-services business, with no hedge against recession, which has invested in only those practices that flourish in economic boom times, will be hugely exposed when the market reverses. Of course, the speed and depth of the reverse is what has caused particular issues for many firms. The ability to retool and realign the business is limited when faced with changes that move at such unprecedented pace.

The use of scenario planning as part of a rounded strategy process would have provided the opportunity to evaluate these risks in advance and to draw up contingency plans should such events unfold.

It is abundantly clear from the feedback I receive at seminars and conferences that scenario-planning techniques are at best underused in many professional-service firms and, at worst, do not figure at all. Yet they offer leaders an excellent methodology by which to evaluate the relative risks and opportunities of different strategic options. By understanding these better, and developing outline contingency plans to deal with a range of plausible future scenarios, firms put themselves in the best position to manage the unknowns associated with market turbulence.

Whatever the future holds, it appears likely that the pace of change will only increase, and that business paradigms will continue to be redefined. In such a context, the emergence of scenario planning as a core element of strategy formulation should be anticipated as firms work hard to better maximise their potential opportunities and mitigate the business risks they face. ■

Andrew Hedley is the director of Hedley Consulting and a member of the* Managing Partner *editorial board. He can be contacted at: andrew.hedley@hedleyconsulting.com