

When Scenario Planning Fails

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Summary. How can organizations perform scenario planning when they are hit by shocks outside of leaders' field of vision? Interviews with Nordic executives, who experienced both the Covid-19 pandemic and were in close proximity to Russia as the country invaded Ukraine, can provide clues. Instead of abandoning the typical “base case / best case / worst case” planning, they adapted their planning to encompass four main strategies other companies can try: stretching the types of scenarios under consideration, using vulnerabilities as a prism, building strong action guidelines an internal communication, and building crisis management into the organizational structure.

Over the past several decades, leaders have turned to scenario planning to identify future risks to their businesses. By analyzing things like revenues or margins across locations globally, this method allows leadership teams to design flexible long-term plans against a defined set of alternative external events and outcomes. The outputs can often include short-term financial forecasting and business planning in a “base case / best case / worst case” fashion.

But this method works best for foreseen risks and stable uncertainties like inflation rate forecasts, the likelihood of a new competitor, or a substitute product entering the market. It often fails spectacularly when firms are hit by shocks outside of leaders’ field of vision. And today, leaders are increasingly confronted with significant, and sometimes existential, events that they would not have contemplated even six months earlier. As an executive lamented to us, “There is great reason to be humble. ... The pandemic and the war were not on the risk map at all before they happened.”

Can scenario planning be updated for these new realities? What else must organizations do to prepare for the unexpected?

Scenario Planning Meets Novel Risks

Our research team — which includes a former public company CEO and current chair of several boards, strategy consultants, and a professor at Harvard Business School — wanted to gain insight into how Nordic companies in particular were evolving decision-making and scenario models in the face of novel risks. Nordic leaderships teams provided an interesting benchmark globally for two reasons.

First, because scenario planning is quite effective for foreseeable risks and stable, smaller uncertainties, the method was long well-matched to decades of relatively smooth globalization for Nordic businesses. Leaders learned along the way to watch out for rare “Black Swan” events, but organizations did pretty well by considering in their planning processes a set of scenarios that covered most outcomes. Second, Nordic businesses have also had exceptionally large exposures to both recent seismic events: the pandemic and, due to their geographic proximity, the Russian invasion of Ukraine.

We interviewed and surveyed more than 40 top leaders at 14 global businesses in multiple Nordic countries, spanning air travel to industrial manufacturing to consumer-facing sectors. Our survey and many of the interviews fell during the first quarter of 2022, when the Omicron variant was causing renewed lockdowns and Russia invaded Ukraine. Most of these Nordic companies had major operations in Russia, and all of them were materially affected through factors like energy prices. Further follow-ups happened through 2022 as leaders adapted and pushed their organizations forward.

Our interviewees suggested the last few years presented unique challenges rather than just more severe conditions. They frequently used words like “ambiguous” and “unclear” when discussing what professors Robert S. Kaplan, Herman B. “Dutch” Leonard, and Anette Mikes call novel risks: risks that “arise from unforeseen events, from complex combinations of apparently routine events, and from apparently familiar events occurring at unprecedented scale and speed.” This lack of clarity left the executives at a loss for defining key parameters to place into scenarios; they further found it impossible to parse the future into discrete scenarios per the traditional method.

Organizations and leaders struggled, with one leader decrying, “Plan B ideology has become a permanent state of being.” Yet, leaders did not want to abandon scenario planning (and neither do we). The good news is that, as much as the leaders we studied struggled, we also saw lots of progress in how they adapted scenario planning to fit their new reality.

We’ve organized it into four levels of responses.

Level 1: Stretch the scenarios under consideration.

Not surprisingly, most leaders reported increasing the number of scenarios under study to cover a larger and more diverse set of situations. Discussions now cover events once deemed unthinkable, like an invasion of their own country or a war between the U.S. and China over Taiwan. This expanded view was the most common step taken and the one that all companies should do. Pandemics and wars have happened before, and they will happen again.

There was a notable twist, however. Executives reported that decision-making following the Ukraine invasion was more complex than the pandemic due to the heightened role of moral values of the company, shareholders, and customers in the decisions. Boards became more involved. While some leaders appeared at ease with this — and perhaps even relieved — others were frustrated. “Sensible business decisions could not be made,” said one leader. Thus, the practice of stretching the scenarios under consideration needs to be accompanied by a conversation regarding which criteria will be crucial should a similar type of scenario arise.

Level 2: Use vulnerabilities as prism for looking at scenarios.

One level higher, leaders sought to undergird scenario planning by better studying impacts on key parts the business — especially vulnerabilities.

For example, one leader noted, “In strategy work, crises are not a big thing in themselves; the major impact comes through their consequences like shortages of raw materials.” Following this example, leaders can develop (and maintain) a rigorous working list of their leading vulnerabilities. Some, like single-source supply chains, can be mitigated. Other vulnerabilities are irreducible: two of the companies we interviewed were designed around operations in Russia that could not be repositioned without blowing up the businesses’ cost structure. A company will be better grounded for the next shock, regardless of its origin, by knowing which type of vulnerability will be exposed and how it will propagate into the organization.

Similarly, executives we interviewed often lamented or applauded the financial capacity of their organization to act aggressively during the pandemic and war. While novel shocks can come from unexpected places, companies should be able to readily calculate the financial reserves needed to survive three months with a 50% revenue decline. Accordingly, some leaders we interviewed moved to requiring worst-case scenarios be included in all divisional plans and budgets. One company screened events through a lens of whether they anticipated the shock and its recovery to follow a “V, U, Y, or L” shape.

Executives should also be open-eyed about potential vulnerabilities they may not want to admit. For instance, the departures of key talent can compound a crisis in a devastating way, and organizations with weak bonds with employees may trigger an exodus. One leader lamented, “workers didn’t care at all what was happening” about a past crisis. In another example, the greatest vulnerability was also the company’s key strategic advantage. This organization saw its competitive edge in logistics swiped away as a result of Russia’s retaliation to Western sanctions, forcing a comprehensive revision of the company’s strategy entirely.

Level 3: Building strong action guidelines and internal communication.

The leaders we interviewed frequently noted how pre-defined actions and roles were becoming more important than tidy scenario descriptions. Instead of trying to define detailed scenarios and corresponding action sets, many companies had moved to using “general guidelines in how to handle all kinds of scenarios,” as one executive explained. Another noted: “The key is to find out what actions to do ... rather than to specifically determine what the scenario is. Our goal is such that implications are already painted in, and that the implementation phase can then be started quickly.”

In many of these action guidelines, the pandemic favored speed at the local level as opposed to centralized decision-making pushed outward. For example, while boards were initially heavily involved in operating decisions in 2020, our interviewees recommend engaging the board less frequently and with a focus on updates in order to make faster decisions should similar events happen again. “It’s better to make 10 decisions quickly and let a few go bad than

not make any decisions at all,” reflected one leader. Top leadership still need to communicate “the general direction of actions to be taken,” but the action guidelines could otherwise guide behavior. Importantly, this approach requires clearly defined responsibilities of all parties ahead of time to be successful.

The Russian invasion of Ukraine was viewed differently, however. Leaders emphasized that the reputation of the company was at stake, and that required all parts of the organization to stay on a consistent, common message. The board’s role was to guide decisions and be deliberate in the process, and the key first action of the management team was to provide it with the necessary information. “Demand a deep understanding,” one leader recommended for these types of situations before they turn into actions. Thus, when developing action plans, leaders must define the characteristics of a crisis that requires this more deliberative mode.

Level 4: Build crisis management into the organization structure.

Moving away from traditional, centralized scenario planning, most companies we studied had delegated decision-making power to local geographies as part of the pandemic response. These policies stuck, with a leader commenting, “There has been a shift from a management hierarchy-based mindset to a more location-based approach.” Other executives said that decentralized operations provided their companies with information advantages, less exposure to idiosyncratic risks, and faster exists from Russia when needed. Internally, most executives felt the company was more meritocratic and less political than in 2019 as a result of these changes.

Beyond localization, companies were quite varied in terms of additional organizational alignment for crisis management. About half handled these events within the pre-existing organizational structures and processes, usually by assigning an executive team member to be responsible for pandemic or war measures. Most of the other companies developed a new task force around these events. Frequently, temporary task forces for the pandemic became permanent after the second crisis hit.

Interestingly, some companies built their response on structures and processes that already existed before the shocks and then tailored them in creative ways. A good example was a company that had an already-existing, dedicated business planning and forecasting team devoted to handling the large volatility in their industry. The unit consisted of experts on route planning and capacity management, and also had a robust set of guidelines and processes on how to deal with emergencies. As a result, upper management did not need to be involved in operational decisions. “Emergencies are business as usual to us,” noted the executive we interviewed.

When pandemic hit, the chief operating officer and his team began to oversee the unit, and its processes and practices became a basis for a wider company response. The unit grew and was re-purposed to further handle the effects of the war in Ukraine. Should some unexpected event happen again, this team is on standby. Arrangements like this may be a promising way for companies in managing novel risks going forward.

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Scenario planning is not dead, but leaders must be thoughtful about its usefulness. Global companies face an ever-wider range of external shocks, coming one after another. These conditions require a larger toolkit, one that complements bespoke plans with a more generalized capacity to recognize how features of a novel risk/shock will interact with the company's vulnerabilities and strengths. Leading organizations will further develop the internal communications and structures to guide responses across all outcomes. Plan B shouldn't be a permanent state of being, but the answer isn't to better predict the unknowable future. Instead, the answer lies in being better prepared to deal with the shock.

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