Managing For Success

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Why Is "5 Scenario Planning" A Key To Revenues And Profits During The Downturn?

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By reacting quickly as economic conditions change, high performing businesses stay successful and grow revenues and profits even in economic times like these. ***How do they do this when their competitors so often are being battered and losing market share?***

High performing businesses know that ***Focused Scenario Strategic Planning*** puts them ahead of the curve. It seems self-evident that if you knew what the economy would look like over the next 12 months and could plan for that, you would be more successful. So what do high performing businesses know that others don't? **And why "5 scenario planning?"** To begin with, not even the top economists can accurately predict what the economy will do over the next 12 months.

To demonstrate this, we always remind our clients that at the beginning of every year, the top 100 economists predict where interest rates will be at the end of the year. Every year one of them is right. But with extremely rare exception (twice in 20 years) none are right two years in a row!

This isn't because they are bad economists, it's because their predictions are based on how a series of economic drivers will behave over the ensuing 12 months. There are many independent factors that can affect these drivers, which no one

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can control or predict. Examples of these, that are currently much discussed, are how much new debt will the United States sell over the next 12 months? How much of the debt will China buy? How will the markets react in setting interest rates if China curtails buying our debt or to the level of oil prices if they begin to rise dramatically, etc?

These are the kind of imponderables that no economist can guess right on every year much less two years in a row. Congress can repeal a lot of things, but it cannot repeal the law of averages. So when we hear leading economist say "things are getting better" or "the economy will hit bottom next month," these are predictions based on that particular economist's guess as to how all the variables will turn out. One out of a 100 may get it right, or none may get it right.

So if ***no one really knows*** what the next 12 months will look like, how can high performing businesses plan to react quickly as economic conditions change? **Enter 5 scenario planning.**

What we do know is that in an economic downturn there are 5 basic economic forms that the downturn can take. As conditions progress the entire economy may experience one, several or even all 5 scenarios. In fact different segments of the economy may experience different scenarios simultaneously.

For example, road construction could, given government stimulus spending, experience very high demand for its products and services. That segment could need to hire a lot of workers and even experience a shortage of qualified people for certain positions. While at the same time, the clothing manufacturing and distribution segment of the economy could experience low demand, layoffs and a poor retail climate with falling revenues further depressing commercial construction.

In this type of downturn what are the 5 applicable scenarios? In layman's terms we often talk about ***Depression, Severe Recession, Mild Recession, Stagflation, and Severe Stagflation***.

In economic planning terms how do these differ? If we experience substantially increasing unemployment, strong deflation, and extremely low interest rates we normally talk of ***Depression***. Increasing unemployment, deflation, but high interest rates, normally describes a ***Severe Recession*** scenario.

If on the other hand we see increasing unemployment with both level cost of living and level interest rates, it normally describes a ***Mild Recession***. ***Stagflation*** occurs when we see increasing unemployment, inflation and low interest rates. By contrast, substantial increasing unemployment coupled with strong inflation and high interest rates we call ***Severe Stagflation***.

To do their planning, high performing business must consider how the economy would look if each of the 5 scenarios occurred. High performing businesses can then see over the next 12 months, what steps are common to each scenario.

Obviously, a business should implement the common steps. By also predetermining the action step that differ depending on the scenario, high performing business can move quickly to implement changes in strategy as the scenarios shift, while competitors are left trying to figure out how now to react to history.

It is because high performing companies keep these concepts top of mind, they can anticipate changing economic conditions and be ahead of the curve. They understand that 5 scenario planning is an essential part of a process they use to outperform their competition and grow profits.

While this process takes time, good team work, and a real commitment to having a learning focused environment, it has paid off for our clients. The time it takes to do it right upfront is gained back many times over as the business cycle progresses.

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