

BUSINESS GUIDE

The Ultimate Guide to Scenario Planning

Strategy, steps, and practical examples to de-risk your organization.





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Strategy, steps, and practical examples
to de-risk your organization.

COVID-19 brought scenario planning to the top of mind for organizations. Continuing uncertainty is keeping it there. Facing a challenging collision of macroeconomic risk factors — looming recession, elevated inflation, rising interest rates, geopolitical uncertainty — companies are doubling down on scenario planning to increase resilience.

By building organizational awareness of what could happen, leaders may spot warning signs of brewing challenges so they can respond proactively. When a worst-case event arises, scenario planning documents add tremendous value by playing out multiple outcomes and listing immediate steps to contain damage.

Plans are also valuable for best-case scenarios — say a product goes viral and demand spikes 300% overnight. What if an acquisition opportunity lands unexpectedly? Are you prepared?

In this guide, we will examine the importance of scenario planning, different types of scenarios, and how to use scenario planning to benefit your business. We'll also delve into examples of scenario planning to illustrate the process.

The diagram illustrates the structure of a report, organized into seven sections arranged in three rows. Each section is represented by a box containing a number, a title, and a page number.

- Row 1:**
 - Section 1: **Overview** (Page 2)
 - Section 2: **1 What Is Scenario Planning and Why Is It Important?** (Page 4)
 - Section 3: **2 How to Scenario Plan** (Page 5)
- Row 2:**
 - Section 4: **3 Scenario Planning Work Approach** (Page 7)
 - Section 5: **4 Types of Scenario Planning** (Page 8)
 - Section 6: **5 Scenario Planning in Action** (Page 9)
- Row 3:**
 - Section 7: **5 Best Practices for Scenario Planning and Modeling** (Page 11)
 - Section 8: **The Bottom Line** (Page 12)

CHAPTER 1

What Is Scenario Planning and Why Is It Important?

Scenario planning is an exercise where business leaders make plans for possible futures by identifying ranges of potential outcomes and estimated impacts, evaluating responses, and managing for both positive and negative possibilities.

As an integrated approach to dealing with uncertainty, scenario planning can include everything from projecting financial earnings and estimating cash flow to developing mitigating actions. It's also a valuable way to visualize different representations of an organization's future based on assumptions about the forces driving the market — some good, some bad.

Scenario planning can provide a competitive advantage by enabling leaders to react quickly and decisively. Because a situation has been thought through and actions documented, no one has to scramble when in the midst of a crisis.

Scenario planning also gives executives and boards of directors a framework to make non-emergency decisions more effectively by providing insight into plans, budgets, and forecasts and painting a clearer picture of key drivers for business growth and the potential impact of future events.

It is important to note that scenario planning is not the same as business continuity planning. While both are structured processes for helping a company navigate the future, scenario planning plays a longer game that considers revenue over time. Business continuity planning is about how your business will react to a disaster, such as a warehouse fire or earthquake.

We recommend that all companies perform at least rudimentary scenario planning, even if it's in the context of a business continuity exercise. The process itself has real value.

Scenario Planning Advantages and Disadvantages

A comprehensive scenario planning exercise takes time, effort, and money. Should you commit?

Advantages:

- Scenario planning will help executives understand the effects of various plausible events.
- Finance, operations, and other teams can prepare initial responses.
- There's an element of knowledge management: By having key personnel take part, you capture their insights and recommendations.
- If these stakeholders are unavailable during an actual extreme event, the company has documentation to fall back on.

Disadvantages:

- Scenario planning is a potentially enormous undertaking. It can be a lengthy process to collect data and driving factors; for large enterprises, plans can take months to create.
- Factors that impact plans change, sometimes quickly. That means scenario planning must be a living process, with constant updates as conditions and assumptions evolve.

How to Scenario Plan

A comprehensive scenario planning exercise typically consists of evaluating seven factors:

1. Key issue

In this preliminary stage of the scenario planning process, it's critical to define the issue that you're seeking to address. Essentially, what question are you trying to answer?

2. Time

Designate a time horizon to avoid going too broad. Choose a horizon that's not so short that it is quickly rendered outdated nor so long that it produces vague, unrelatable scenarios.

3. External factors

What are the major external factors likely to impact our business? These are drivers that could influence the future environment and materially impact key internal variables. Consider any relevant external political, economic, social, and technological forces.

4. Internal factors

What are the key internal variables that could be impacted by the external drivers listed? For instance, say you open an office in a country where you have not previously done business, and there's suddenly significant political unrest. How would that impact the mission, vision, and HR strategy for that location?

5. Define assumptions

Drivers fall into two categories. Predetermined elements are considered relatively stable and predictable. Critical uncertainties are the opposite and what we are focused on in scenario planning. Examine the drivers listed and the relationships between them. Determine which ones will have the biggest impact on your business and have the most uncertainty around them.

It's easy to feel overwhelmed by the range of potential outcomes. How can anyone properly plan for so many possibilities? Simply put, you can't. That's why it's best to keep it simple. Focus on two to three major uncertainties and build scenarios around those. One way to do this is by creating a scenario matrix with your top two uncertainties making up each axis.

6. Develop perspective

Construct a series of cohesive and logical scenarios and develop a narrative description for each. Each scenario should be taken to its logical end. Remember, they should be plausible and cover a wide range of possible futures. Finance leaders need to prioritize and develop perspectives about each of the scenarios to help the company navigate.

If this event happens, how will we mitigate its impact on our business? If these circumstances occur, what is our path forward? Establish clear guidelines on how your organization should respond.

At this point, you should also establish early indicators. Each scenario should be assigned a critical trigger point in which the plan of action will be enacted. By recognizing the early signs that you're following in each outlined scenario, you'll be able to pivot quickly to mitigate the impact on your business.

7. Maintenance

Ensure that your company has the right data, technology, bandwidth, and skills to continue developing and maintaining scenarios. It's worthwhile to check in on scenarios every 1-2 months to ensure they are up-to-date with any market trends or company developments.

Scenario Planning Matrix		Scenario #1	Scenario #2
Key Issue	What is the issue we are trying to address?		
Time	Over what time horizon?		
External Factors	What are the major external factors likely to impact our scenarios?		
Internal Factors	What are the key internal drivers that need to be addressed?		
Define Assumptions	Define assumptions clearly, establish relationships among drivers, and limit the number of scenarios created.		
Develop Perspective	Based on the scenario, what perspective must the organization take? How does this perspective feed into strategy?		
Maintenance	Do we have the right data, technology, bandwidth, and skills to develop and maintain scenarios?		

Source: Oracle NetSuite

Scenario Planning Work Approach



There are some best practices, and things to avoid, when launching a scenario planning exercise.

5 actions to take:

1. Secure commitments from senior management, select team members, and organize scenarios around key issues to be addressed and evaluated.
2. Define assumptions clearly, establish relationships between drivers, and limit the number of scenarios created.
3. Make sure each scenario presents a logical view of the future.
4. Focus on material differences between scenarios.
5. Indicate KPIs, and refresh scenarios and update assumptions on a regular basis.

5 actions to avoid:

1. Avoid developing scenarios without defining the issues first.
2. Don't develop too many scenarios — three is a good starting point. Beginning with your best guess at how business will go, add one scenario for things going better, and another for things going worse. A good starting point is 50% for best guess, then 25% for things going better and 25% for things going worse.
3. Do not attempt to develop the perfect scenario; more detail does not mean more accuracy.
4. Avoid becoming fixated on any one scenario.
5. Don't hold on to a scenario after it has ceased to be relevant.

Types of Scenario Planning

There are four main types of scenario planning. Most organizations will want to use a combination.

1. Quantitative scenarios

Financial models that allow for the presentation of best- and worst-case versions of the model outputs. These models can be quickly changed by altering a limited number of variables/factors. Quantitative scenarios are also used to develop annual business forecasts. These models assume key variables are known and that relationships among them are fixed.

2. Operational scenarios

One of the most common types of scenario planning an organization will undertake internally. Operational scenarios specifically explore the immediate impact of an event. The scenario then provides short-term strategic implications.

3. Normative scenarios

These describe a preferred or achievable end state. These scenarios are less objective planning and more geared toward statements of goals. These goals are not necessarily about an organizational vision, but more about how the company would like to operate in the future. Normative scenarios are often combined with other types of scenario planning as they provide a summation of changes and a targeted list of activities.

4. Strategic management scenarios

Essentially stories that say little about the company or industry, but more about the environment in which products and services are consumed. These are often the most challenging scenarios for company leaders to put together because they require a broad industry, economic, and world view. On the plus side, they give planners freedom to brainstorm decisions and a broad storytelling mandate. In some cases, companies bring in analysts or even so-called futurists.



Scenario Planning in Action

Typically, macroeconomic expectations are used in conjunction with scenario planning to help the CFO frame near-term expectations for the company and to level-set expectations in departments.

The fundamentals of scenario planning are the same, even if the particulars across industries and within businesses vary. To illustrate this, consider how two fictional companies, a software provider and a wholesale distributor, would approach scenario planning.

Zenveus Software is a young business software company that had been experiencing steady growth post-COVID until inflation and interest rates started rising. The leadership team hadn't undertaken any scenario planning, but its CFO had lived through both the dot-com bubble and the Great Recession and was ready to act quickly to protect Zenveus' runway. Zenveus decided to create two scenarios: one for an inflationary environment and one for a recessionary environment occurring within the next year.

In the inflationary scenario, the software company imagines that prices for goods and services are rising rapidly. This might lead to a decrease in demand for its productivity tools, as businesses prioritize spending on more essential items. To counteract this, the software company decides to focus on offering cost-saving tools that help businesses be more efficient and save money.

In the recessionary scenario, the software company imagines that the economy is in a downturn and businesses are struggling. In this scenario, the company decides to focus on providing tools that can help

Get Our Free Scenario Planning Template

This scenario worksheet is designed to be used as a guide through the planning project and should help teams avoid common problems.

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businesses streamline their operations and reduce costs. It also considers offering a more flexible pricing model to help businesses manage their cash flow.

For the second company, Vendere Wholesale is an established wholesale distributor with over 50 years in the industry. The company primarily supplies apparel, accessories, and beauty products to US retailers. Vendere is worried about the impact of the economy on its business.

With inflation and the overall economic uncertainty, Vendere Wholesale is already facing a decline in demand and order volume, resulting in a recessionary environment. The finance team at the wholesaler analyzes the key drivers of the recession: inflation, interest rates, rising commodity prices, regulatory actions, and customer confidence and spending. They then examine how those external factors impact the business, like customer attraction and retention, cash flow, capex plans, workforce, cost structure, and access to capital. The team then creates three different scenarios based on these circumstances:

1. **Base case:** This is their baseline scenario based on current, commonly accepted assumptions. For Vendere, they determine this to be an extended, yet mild recession where demand eventually stabilizes.
2. **Worst case:** The most negative set of assumptions. Vedere describes this case as the recession for their business deepening and their demand continuing to decline.
3. **Best case:** The ideal projected scenario. In this case for Vedere, the recession is short-lived and demand for products quickly rebounds.

In each scenario, order volume is used as a metric to trigger when it is time to enact each action sequence. In the base case scenario, the business might consider implementing a hiring freeze and delaying all capex investments until demand stabilizes. For the worst case, Vendere cuts costs, reduces inventory, and continues the hiring freeze to stay afloat. And for the best case, the company builds up inventory and increases marketing efforts to capture as much demand as possible. The organization also lifts the hiring freeze.

By leveraging scenario planning, Vendere Wholesale can develop a more adaptable approach to navigating the recessionary environment. This allows leaders to better manage risk, minimize losses, and position themselves for growth once the recession ends.



Best Practices for Scenario Planning and Modeling

As with many efforts, solid scenario planning starts with people and data.

Assemble the right team

In large companies, financial planning and analysis groups should be included. But while finance professionals can certainly lead the scenario planning process, they won't be successful alone. This effort needs to connect leaders from across the organization, including business units and HR.

Get the right data

For finance teams to execute with confidence, they need the right data, going well beyond the general ledger. To create accurate models, finance needs historical and comparative sales data, headcount, and expected growth, and of course actuals from the general ledger. They'll also need to understand the costs of producing products and services, which products are foundational and which are additive.

Model with basic scenarios

Finance teams should consider developing basic low, medium, and high models. A low scenario is where costs and revenues are challenging. The goal here will be finding cost savings while still delivering quality products in a timely manner. A medium scenario assumes that sales will continue to grow based on last period actuals. This scenario will show how the last period's sales figures compare with forecasts, and what adjustments you need to make on headcount and other

departmental spending to maintain trajectory. The high scenario is usually based on demand increasing and sales accelerating due to big changes in the market. The goal is to ramp up capacity without incurring costs that eat into margins.

Provide break-even analysis

This analysis will support, with data, decision-making regarding your cash-flow break-even level. It looks at the minimum sales volume your company needs to keep operating normally and sales compensation plans to see if you need to adjust commissions or bonuses.

Manage scope creep

The scope of scenario planning is limited only by leaders' time and imaginations. There must be guardrails on the project to keep the time investment in line with expectations. To prevent scope creep, make sure that you:

- Recognize the importance of the team's time.
- Spend more time on creation and analysis of problems/questions, less on "what if" tangents.
- Define important outcomes.
- Decide how you will put your scenarios to use.
- Ask how you will measure success.
- Recognize an evolving context and narrative.

The Bottom Line

To paraphrase Ferris Bueller, “Life moves pretty fast. If you don’t stop and look around once in a while, you could have some outdated scenario plans on your hands.”

Considering how quickly circumstances can change, those using manual processes to conduct their scenario planning will quickly find that they are not getting the full potential from it. Instead, every time an assumption shifts, businesses will be stuck with the time-consuming task of calculating its respective impact.

Instead, adopting a software solution like NetSuite can facilitate and improve the scenario planning process.

In addition to being able to store the data required, [NetSuite Planning and Budgeting](#) is able to easily and quickly model complex calculations including projected revenue, operating and capital expenditures, headcount costs, cash flow, and sales.

The future is never certain. But with effective scenario planning, how your business reacts to it is certainly more clear.





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