



National Executive Development Webinar Series

Scenario Planning: Plotting a Course Through an Uncertain World

By David Axson

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Presented in partnership with:



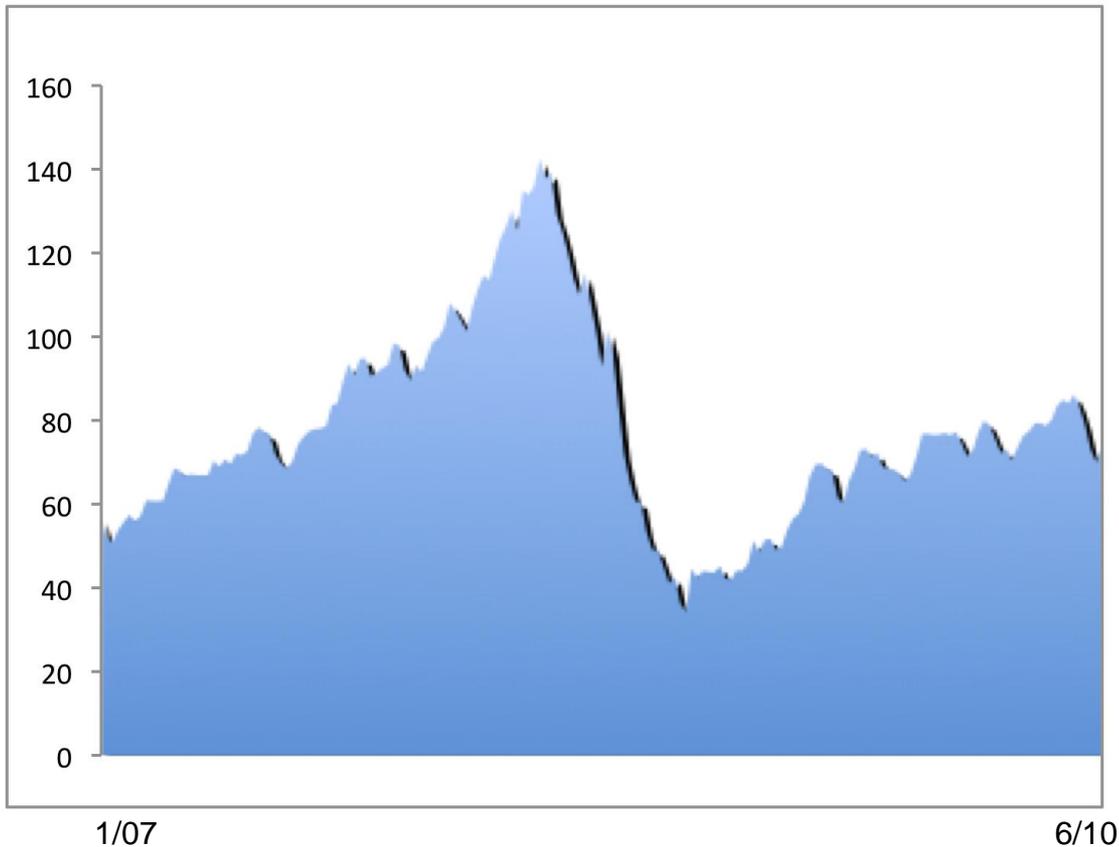
**Certified
Management
Accountants**



Its been an interesting few years!



Oil Prices 2007-2010
(Brent Crude)



- Commodity prices
- Investment returns
- Real estate values
- Consumer spending
- Exchange rates
- Share prices
- Employment
- Inflation

Source: U.S. Energy Information Administration, June 2010



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The extraordinary is now ordinary



Trends

- Regional economic upheavals
- Rise of new economies
- Commodity booms (& busts)
- Population growth/demographic change
- Environmental concerns
- Global interdependence
- Technological innovation

Events

- Dot.com bubble bursts
- 9/11
- Sarbanes-Oxley
- SARS
- Asian Tsunami
- Hurricanes Katrina/Rita
- H1N1
- Terrorist attacks
- Global credit crisis
- Volcanic ash closes Europe!



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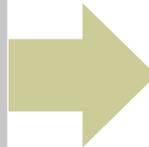


Traditional planning & budgeting practices

Single Set of Assumptions

Detailed plans & budgets

| | |
|--------------|------|
| Inflation | 2.5% |
| Oil | \$75 |
| \$/€ | 1.20 |
| GDP | 2.7% |
| Unemployment | 7% |



| | January | February | March | April | May | June | TOTAL | YTD Actuals Variance | YTD Act Var % | Total Variance | Total Var % |
|----------------------|---------|----------|-------|-------|-------|-------|--------|----------------------|---------------|----------------|-------------|
| Salaries | 19.00 | 19.00 | 19.00 | 19.00 | 19.00 | 19.00 | 243.00 | -1.00 | -1% | -3.00 | -1% |
| Bonus | 1.43 | 1.50 | 1.76 | 1.66 | 2.00 | 1.80 | 22.56 | -2.35 | -39% | -2.56 | -13% |
| Benefits | 0.19 | 0.19 | 0.19 | 0.19 | 0.19 | 0.19 | 2.43 | 1.35 | 59% | -0.07 | -3% |
| Insurance | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 0.15 | 1.00 | 0.00 | 0% | -0.10 | -5% |
| Rent | 2.90 | 2.90 | 2.90 | 2.90 | 2.90 | 2.90 | 34.80 | 0.00 | 0% | -1.20 | -3% |
| Utilities | 3.00 | 2.00 | 2.50 | 1.50 | 1.00 | 1.00 | 22.77 | 0.92 | 9% | -1.23 | -5% |
| Office Supplies | 0.11 | 0.20 | 0.16 | 0.20 | 0.07 | 0.37 | 3.30 | 0.07 | 9% | 1.00 | 43% |
| Travel - Air | 7.15 | 7.50 | 8.00 | 9.00 | 15.00 | 9.00 | 116.50 | -17.45 | -58% | 13.50 | 13% |
| Travel - Hotels | 1.43 | 1.50 | 1.76 | 1.66 | 2.00 | 1.80 | 22.56 | -3.35 | -49% | -7.44 | -26% |
| Travel - Car | 0.72 | 0.75 | 0.88 | 0.83 | 1.00 | 0.90 | 11.28 | -2.68 | -178% | 6.28 | 126% |
| Travel - Train | 1.90 | 1.00 | 1.50 | 1.00 | 1.20 | 1.00 | 20.00 | -1.50 | -33% | 9.00 | 82% |
| Gifts & Misc | 0.50 | 0.00 | 0.00 | 0.50 | 0.00 | 0.00 | 4.00 | 0.00 | 0% | -1.00 | -14% |
| Maintenance & Repair | 0.35 | 0.14 | 0.06 | 0.43 | 0.30 | 0.36 | 3.04 | 0.02 | 1% | 0.04 | 1% |
| Marketing | 2.00 | 0.00 | 8.00 | 9.00 | 4.00 | 7.00 | 59.00 | -3.00 | -15% | 5.00 | 9% |
| Net Income | 9.83 | 16.17 | 14.35 | 9.90 | 20.18 | 17.53 | 200.01 | 15.43 | 28% | 0.01 | 0% |



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Increased interest in scenario planning

Scenario planning allows organizations to evaluate the efficacy of strategies, tactics, and plans under a range of possible future environments.



In summary...

Place
Your Bets

What if?



*Deep
Recession*

*Zero
Growth*

*Modest
Recovery*



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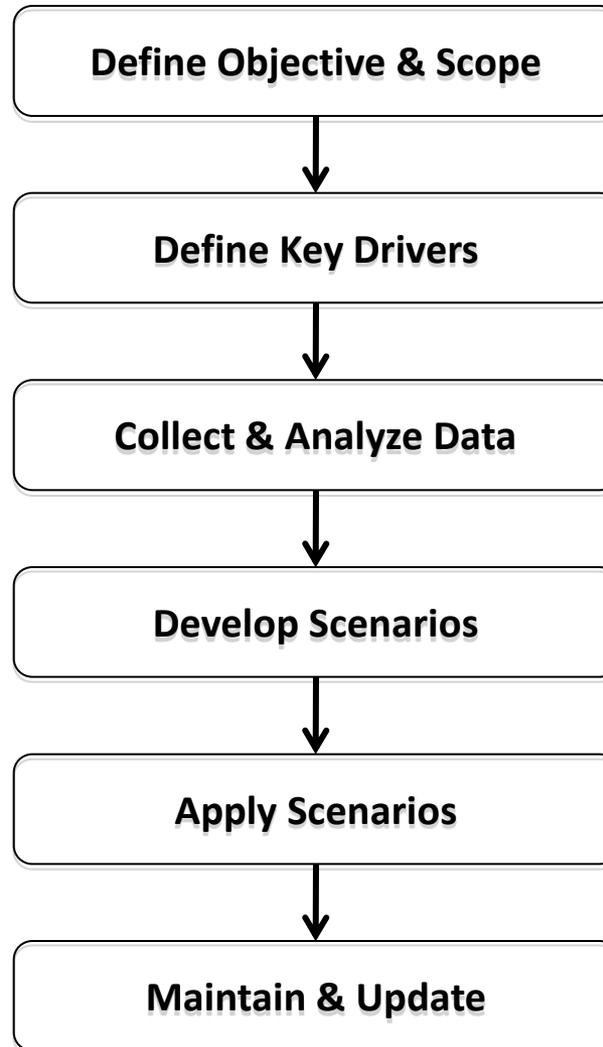


Alternative assumptions

| | Zero Growth | Modest Growth | Recession |
|--------------------------------|---|---|---|
| Description | Stagnant economic growth, low inflation, flat consumer spending | Moderate growth typical of a robust economic recovery | Continued weak economic growth with inflation trending toward zero. Results in the longest period of economic weakness since the 1930's |
| GDP Growth | | | |
| 2010 | 1.0% | 3.5% | -1.0% |
| 2011 | 0.5% | 4.0% | -1.2% |
| 2012 | 1.2% | 4.2% | 0.0% |
| Consumer Spending | 1.0 - 1.5% growth but little real growth as increase is driven by government stimulus | Falling unemployment and rising wages drive growth | Weak and well below the historical trendline |
| Corporate Profitability Growth | 2%-2% growth driven by cost cutting | Faster profit growth generates greater stock price appreciation and improved credit quality | Weak economic profits adversely affects the stock market and credit quality |



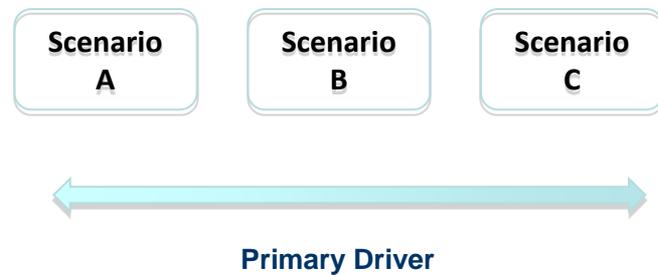
Developing a scenario plan



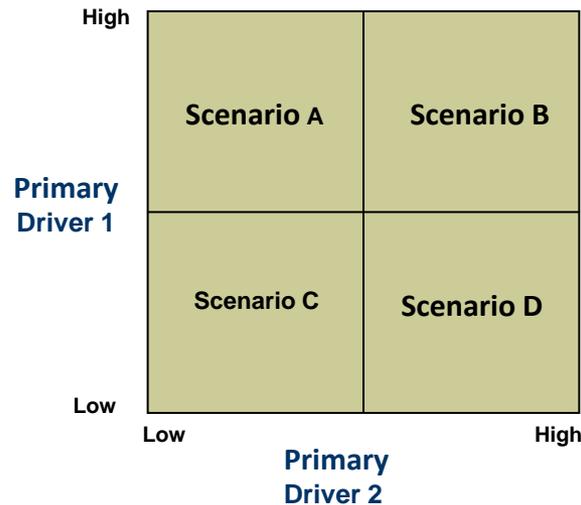


Alternative scenario planning approaches

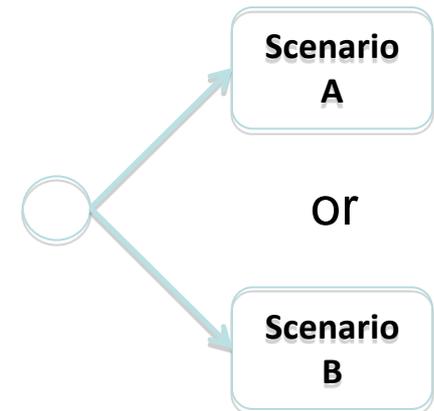
Spectrum



Matrix



Binary





Case study

Electric IQ

- Software company focused on developing smart systems to manage electric usage in factories and office buildings.
- Sales are \$25 million from installing systems in new office buildings in W. Europe.
- Management want to gain insights as to the relative attractiveness/risk of the markets for retrofitting existing infrastructure in W. Europe and N. America versus focusing on new construction in China, India, E. Europe and L. America.



Identify external and internal drivers



External Drivers

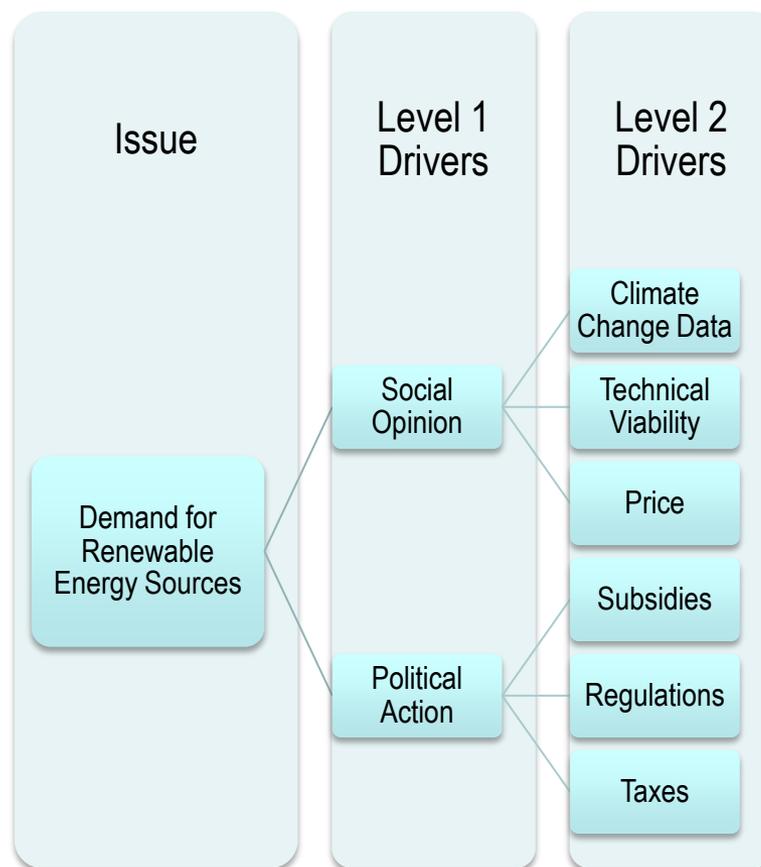
- Economic growth
- Government policy/regulation
- Demographic change
- Market size and growth rate
- Commodity prices
- Consumer spending
- Rate of technological innovation
- Inflation
- Cost of borrowing
- Social attitudes

Internal Drivers

- Mission, vision, strategy
- Business model
- Customer satisfaction/loyalty
- Productivity
- Cost structure
- Quality
- Talent
- Time to market
- Reputation/trust
- Access to capital



Define the relationships between the drivers





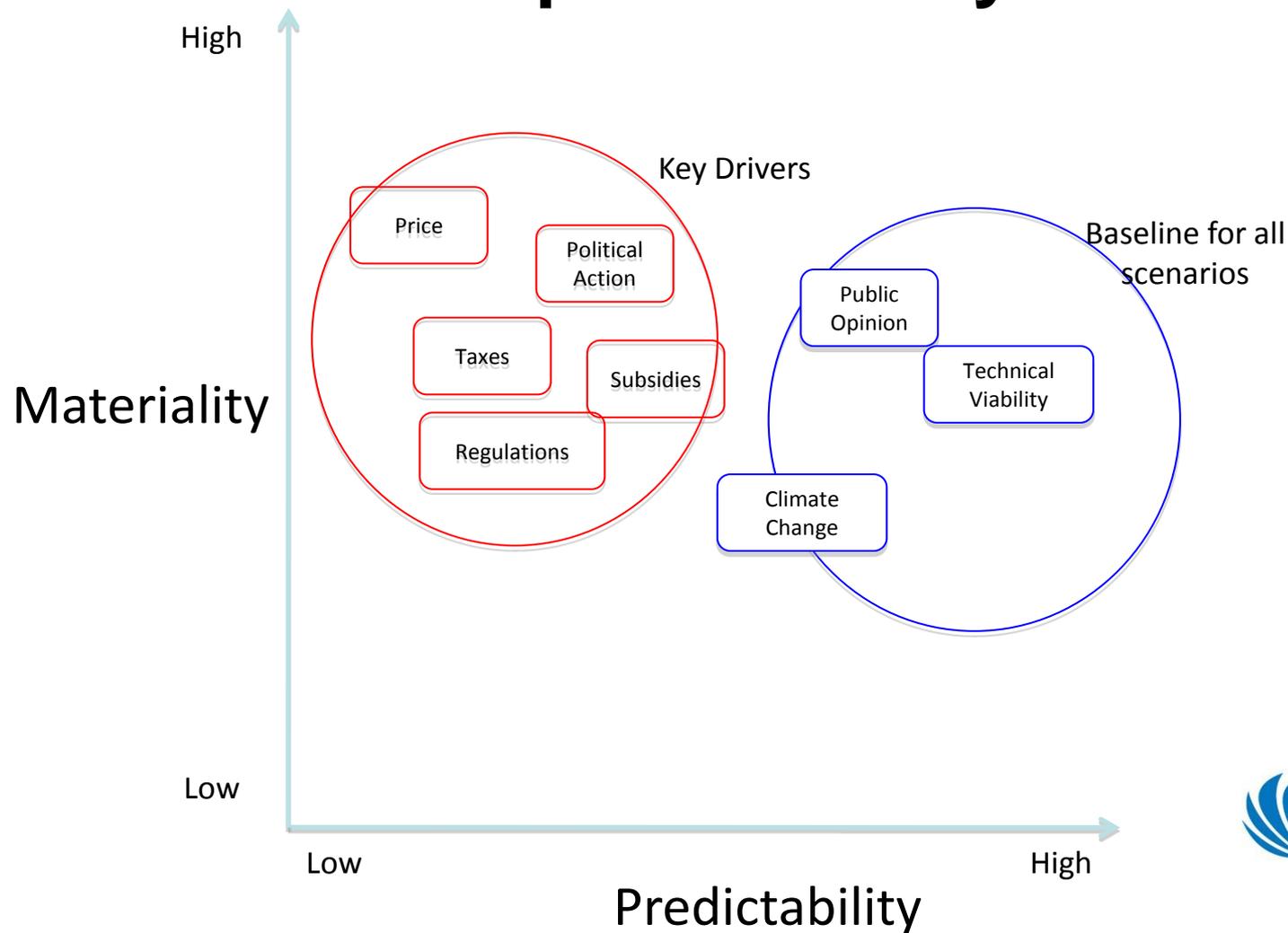
Identify possible data sources



| Driver | Quantitative Data Sources | Expert Opinion | Other Data Sources |
|----------------------------|--|--|--|
| Social Opinion | <ul style="list-style-type: none">○ Polling data | <ul style="list-style-type: none">○ Thought leaders | <ul style="list-style-type: none">○ Press coverage○ Pressure groups |
| Climate change | <ul style="list-style-type: none">○ Climate statistics○ CO² emissions | <ul style="list-style-type: none">○ Futurists○ Climatologists | <ul style="list-style-type: none">○ Environmental impact analyses |
| Technical viability | <ul style="list-style-type: none">○ Adoption rates○ Product availability | <ul style="list-style-type: none">○ Scientific journals | <ul style="list-style-type: none">○ Patents○ New product launches |
| Pricing | <ul style="list-style-type: none">○ Relative pricing○ Economic cost○ Vehicle sales | <ul style="list-style-type: none">○ Demand patterns and forecasts | <ul style="list-style-type: none">○ Consumer willingness to pay |

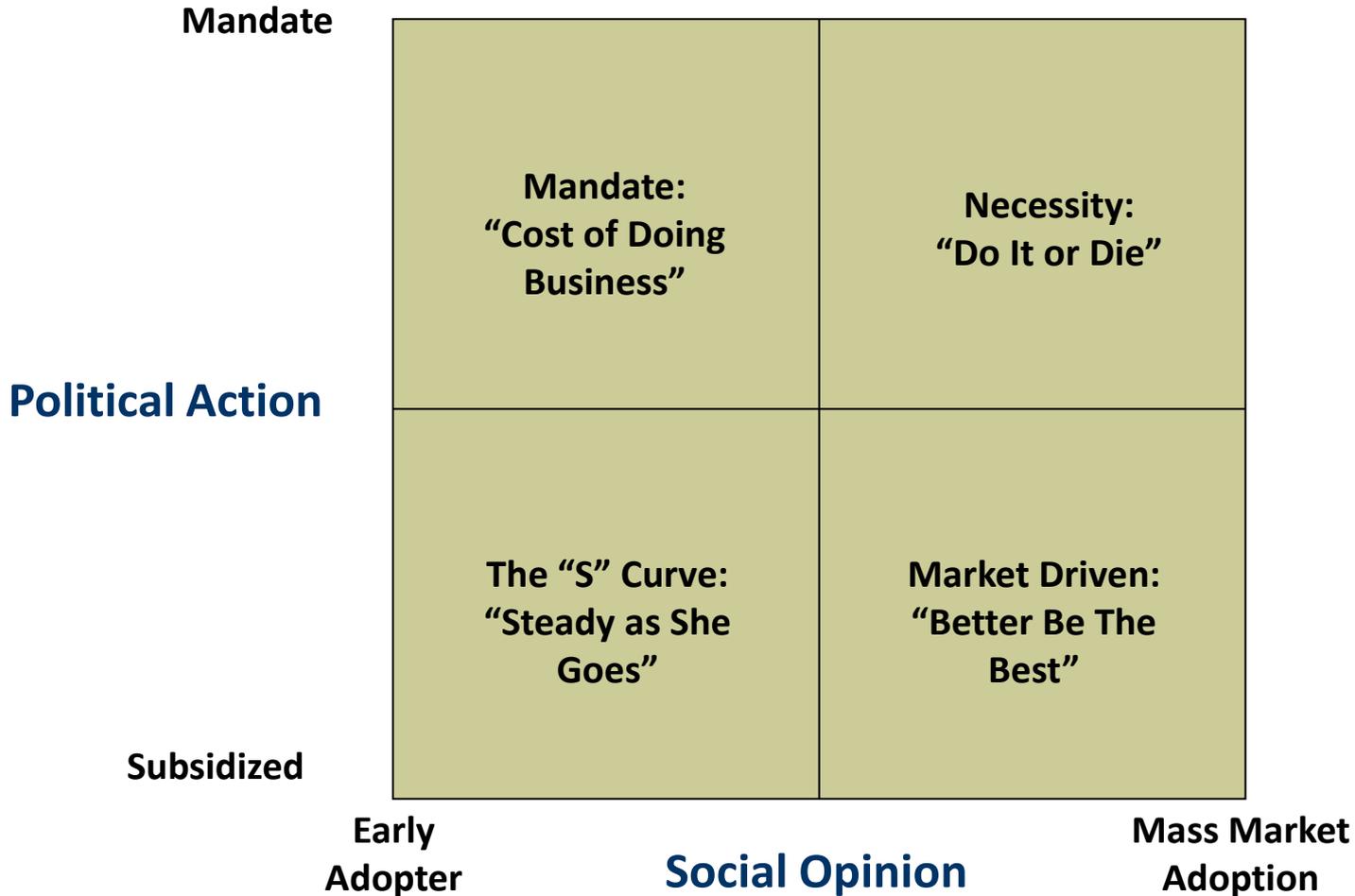


Assess the materiality and predictability





Map to the two primary drivers



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Develop credible scenarios

- **Necessity—“Do It Or Die”**: public opinion swings rapidly to green solutions and dramatically changes customer-buying patterns. Products not seen as being green are shunned in the marketplace. Governments mandate adoption of environmentally friendly technologies.
- **Market driven—“Better be the Best”**: Public opinion moves to green and consumers are willing to pay extra for the best products. Governments offer some incentives. Adoption is balanced between market innovation and a series of tax-based incentives.
- **Mandate—“Cost Of Doing Business”**: Governmental action leads to hard mandates for adoption in the California model. Little support is provided and adoption becomes a “cost of doing business” akin to a tax. Public opinion is not a major driver; consumers will not pay more for green solutions unless forced to do so through taxation or mandate.
- **The “S” Curve—“Steady As She Goes”**: Demand for smart grid systems follows a traditional adoption cycle of early adopters leading the way at high prices; as the market scales and prices drop, mass market adoption takes-off before flattening out as maturity is reached. Little effective public policy or incentives are provided/needed.



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Analyze the planning implications of each scenario

| | Do it or Die | Better Be The Best | Cost of Doing Business | Steady As She Goes |
|-------------------------------|---|--------------------------------------|---|---|
| Approach to Innovation | The minimum is not enough; must be best to win | Innovative leadership has real value | Must meet the standards; little advantage in being ahead of the curve | Focus on select areas where there is strong demand and we have a capability |
| Marketing Strategies | Either be the safe option (compliant) or the best | Must be a leader | Partner with builders and owners to secure share | Be #1 in select niches |
| Market Goals | Own the high end | Acquire share | Be the preferred supplier | Build share in niches |
| Financial Goals | High margins | Focus on size and scale | Low cost producer | Modest growth over time |



Using scenarios

- Recast budgets under each scenario to assess the financial implications on revenues, margins, cash flows and capital expenditures.
- Test the financial impact of alternative approaches under each scenario.
- Identify leading indicators and key performance metrics that can provide the organization with an early warning that the most likely future scenario is changing.
- Model alternative resource allocations under each scenario to test speed of execution and likely results



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How to avoid the pitfalls

| Risks | Mitigation Strategies |
|--|--|
| Poorly defined issues or decisions make it difficult to identify key drivers and therefore construct scenarios. | <ul style="list-style-type: none">• Upfront, ask the question: “Can we define the decisions that will need to be made and who will need to make them as a result of completing this process?” |
| Scenario definition and refinement becomes a never-ending process. | <ul style="list-style-type: none">• Establish a clear timeline.• Remember that more detail does not equal more accuracy. |
| Scenarios are perceived as being too subjective. | <ul style="list-style-type: none">• Describe how each scenario can realistically evolve from the current state. |
| Management becomes fixated on a single scenario or relies on a scenario long after it has ceased to be relevant. | <ul style="list-style-type: none">• Offer real world examples of situations where fixation on a single scenario proved dangerous. |
| Little changes as a result of developing scenario plans. | <ul style="list-style-type: none">• Clearly set expectations upfront and secure senior management commitment through participation in the process.• Illustrate the impact, in both operational and financial terms, on current plans and strategies of different scenarios. |



Benefits of using a scenario approach

- Explicitly addresses uncertainty upfront
- Provides well-defined contingency plans
- Provides a foundation for explaining variations in performance
- Provides an early warning mechanism of potential opportunities and threats
- Increases awareness of the external drivers of performance



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Questions?



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