Insights

Welcome to the May 2009 INSIGHTS published by acumen7.

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The purpose of this newsletter is to bring you new perspectives on key subjects to stimulate your own thoughts and ideas. In each edition (which will be published bi-monthly), we look at an aspect of business we hope will be of interest to you as an industry leader.

CONTINGENCY PLANNING: THE ART OF MANAGING THE FUTURE IN UNCERTAIN TIMES

Harold MacMillan was once asked what represented the greatest challenge for a statesman. He famously replied "Events dear boy, events". In a commercial enterprise it's a similar problem. We are all trying to engineer advantage for our organisation in an uncertain environment. Our elegant plans are however invariably thrown off-track from the start. So the question often raised is: "Is it worthwhile planning at all? " acumen7 member Peter Dixon examines the answer.

There is a case to answer here. Five-year Plans demonstrably didn't work in the Soviet-era Eastern Bloc. While in contrast free markets can be shown to be generally efficient, current economic circumstances not withstanding. They are made up of many buyers and sellers making independent, de-centralised decisions. They make allocation decisions based on the information contained in those challenging 'events'. So by analogy, in a company, the decentralised structure has intrinsic worth. The talented individuals who make up the company can make local decisions in response to local circumstances.

Prepare for battle

So what should be the role of planning? General Eisenhower – who was involved in preparing a few plans in his time – was clear. His view was that "In preparing for battle I have always found plans are useless, but planning is indispensable". There are two points here. First, it is important to go through the mental discipline. Systematic thinking is required to ensure that the complex entity that is a business works. Co-ordination is the minimum; but dynamic organisations stretch and leverage their limited resources to provide something above the norm. Second, it is important to have your organisation positioned to react to events. The causal chain of events on and after D-Day was intrinsically unpredictable. The essence of success was to be able to react quickly: to counter setbacks and ruthlessly exploit advantages.

Historically commercial strategic thinking has reflected this idea. The detailed plans of organisations such as ITT in the 1960s gave way, in the world of oil shocks and greater economic uncertainty of the 1970s, to the strategic positioning school. The approach is to identify what your chosen clients or customers want, what others offer, and position your organisation in the marketplace to be able to offer something valuable and distinctive. Around the core positioning idea the organisation needs to remain agile and able to react to events.

Know your enemy

Reaction times and the quality of your response are inevitably better if an event has been at least partially anticipated. The mental exercise of thinking through where the risks in your organisation are, and what to do, has huge value. Even better is if you have a rough sketch of how to react.

The first challenge is to identify where the risks are. As all companies are subject to risk – both upside as well as downside – some risk management is required in every company. There is a tendency to think "it's not my job" and for it not to happen. To focus on the important risks requires some initial classification and then some evaluation. When it came to classification Donald Rumsfeld actually had it right in that famously obscure sound bite. As he put it: "There are known knowns. These are things we know that we know. There are known unknowns. That is to say, there are things that we now know we don't know. But there are also unknown unknowns. There are things we don't know we don't know. And each year we discover a few more of those unknown unknowns." This awareness classification of risk is more digestible when it is put into a two by two matrix (see Exhibit 1 below). Against each type of uncertainty there is a different type of action to take, to get a better handle on the risk you need to manage.

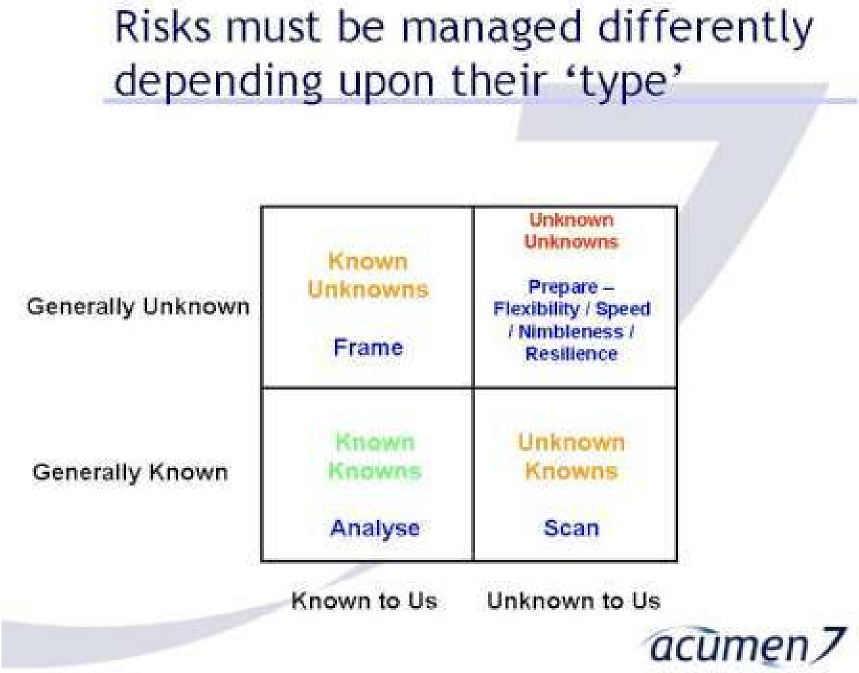

Exhibit 1

Assessing and managing events

Inevitably identifying the sources of potential risk leads to a long list of potential exposures. They need to be prioritised. There are two dimensions for prioritising events – impact and likelihood. Impact is the maximum money value of the effect that the event might have on the company. Likelihood brings in the probability of the event. Likelihood, when multiplied by the 'value' of the event, gives the 'expected value'. We recommend looking at both the expected value of events and at the high impact/low probability events as these can be the 'killers'. It is important to remember that events can be both 'good' and 'bad'.

The next step is to assess the 'manageability' of each event and prioritise those that are both significant and controllable. For those risks where there are things you can do to mitigate the risk, Action Plans need to be set up to do so. For those events that are outside your control, this is where you need Contingency Plans. Finally, ensure decision-making in your company is sufficiently agile and swift so that when an 'Unknown Unknown' occurs you are able to respond to these so-called Black Swans (For more on this, read 'The Black Swan' by Nassim Nicholas Taleb).

To plan or not to plan

So, should you engage in Contingency Planning? Contingency Planning comes in different varieties. At one extreme is Scenario Planning that has been strongly advocated in the commercial world by Shell. The German General Staff first developed scenario plans in the 19th century – hence the famous Schlieffen Plan in 1905. Defence planners now use scenario planning extensively and armies use the related field of war-gaming as an effective training technique. Shell has used business scenario planning to plan for major changes in the oil price, political risk etc. With huge capital investments it is seen as a valuable tool.

However, unlike defence organisations, which are about preparedness for contingent events, in the commercial world few organisations can justify expenditure in examining possible events on the scale seen in Shell. However, every company is faced by risk. As we have seen, a successful company can turn from success to disaster in a matter months. Having plans to handle those risks therefore has a compelling logic, albeit plans of a scale appropriate to your company.

Maximum value, minimum risk

Value is a function of the stream of future cash flows and their likely volatility. So to increase the value of your company you should identify where the company is at risk. You should develop action plans to mitigate the risks you can control. For the high impact risks that you cannot directly manage, you should have at least an outline Contingency Plan in place. And make sure that your decision-making is swift and effective to deal with those all-too-frequent Black Swans.

This article was first published in modified form in Professional Marketing magazine. For further details go to www.pmforum.co.uk

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