
7.

The benefits of scenario-based planning

How scenario-based planning
fosters flexible strategies

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In the last chapter we saw how scenario-based planning can improve decision processes. We will now turn our attention to decisions at an aggregated or corporate level. We will examine how entire strategies can change and – ideally – be optimized. The key question is how scenario-based planning can help make strategies more flexible. This chapter therefore begins by explaining what exactly is meant by "flexible strategies" and where they belong in the conceptual scheme of things. We will look at factors that impair the flexibility of a company's strategies and suggest ways to overcome these hindrances. Examples drawn from various industries illustrate why and in what areas today's businesses depend more heavily than ever on flexible strategies.

7.1 INTRODUCTION

Realigning a global organization is a major undertaking. Again and again, though, companies find that timely self-reinvention puts fresh wind in their sails. To put that another way: If you can't change, you can't seize opportunities. Why? Because precisely this inability, this *immobility*, incurs opportunity costs and blunts a firm's competitive edge. Flexibility, on the other hand, can increase the value of the company, create competitive advantages and thus contribute to both growth and successful performance.

Take the example of Korea's Samsung Group. Long looked down on as a cheap-and-cheerful electronics producer, it has now evolved into a leading high-tech provider known for its outstanding research and development work (Khanna et al., 2011). Finnish mobile phone vendor Nokia has likewise reinvented its portfolio several times over – moving from rubber products to televisions to mobile handsets – and has successfully established a new market positioning every time. Failure to factor the trend toward smartphones into its strategy quickly enough has now once again brought the company to a turning point in its development. US technology group IBM is another major player that is known for its self-transformation capabilities, having morphed from a maker of mainframe hardware to an integrated provider of software, service and consulting. These examples show that flexibility and long-term strategies go hand in hand. It is no longer enough just to tweak individual

functions if you want to respond to profound changes in the marketplace – you need to see the bigger picture. Flexibility is not a strategy in itself. Regardless, companies do well to strive toward the integrated, strategic planning of enterprise flexibility (Meffert, 1999).

7.2 STRATEGIC FLEXIBILITY – OPENING THE DOOR TO A CHANGE OF STRATEGY

Strategic flexibility addresses the issue of what conditions must be put in place and what must be done to enable a company to apply a change of strategy. The change-over happens when a company formulates and implements a new strategy (in the context of business process reengineering, restructuring, realignment or a turn-around, for example). The process is accompanied by the adaptation of organizational structures, information systems, the corporate culture and staff incentives (Burmam, 2004a). It follows that strategic flexibility is not limited to certain periods or phases of corporate development.

There is no shortage of related concepts. Agility, resilience, transformative and adaptive capacity, dynamic capabilities, flexibility: Literature on the subject uses all these terms to describe the attributes a company must possess if it is to survive in a volatile competitive environment. The definitions, however, are not exactly clear-cut. Some concepts place greater emphasis on resources or processes. Others focus on the cognitive aspect: those factors that concern the behavior of managers and employees. Some of the most important concepts are described in this section.

The extent of a company's "strategic agility" shows how flexible its strategy process is (Doz/Kosonen, 2008). Agility can be seen as a combination of three capabilities:

- ◆ Strategic sensitivity: The ability to open up the strategy process and create a multidimensional organization by involving key internal and external stakeholders
- ◆ Leadership unity: Top management's ability to act as a team. Its job is not to dictate the answers, but to create a context that is conducive to collaborative work

SCENARIO-BASED STRATEGIC PLANNING

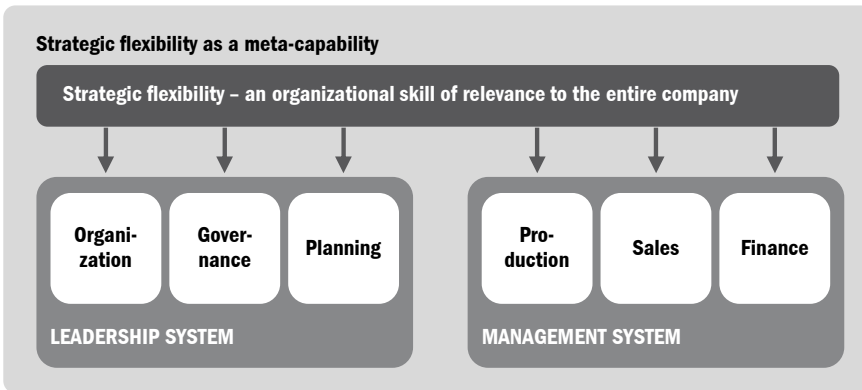
◆ **Resource fluidity:** The ability to quickly make financial and human resources available where they are needed most. This means dismantling bureaucracy, overcoming silo mentalities and introducing modular process structures

"Strategic resilience" is the term used to describe the ability to reinvent business models and strategies when conditions and circumstances change. Companies should be put in a position where they can anticipate any form of change that poses a threat to their most important sources of profitability – and to respond before problems materialize (Hamel/Välilikangas, 2003). In other words, strategic resilience enables a company to launch robust change initiatives in response to specific situations in order to safeguard its long-term survival in the marketplace (Lengnick-Hall/Beck, 2009).

The terms "transformative" and "adaptive capacity" focus on the technology side. They refer to a company's ability to constantly redefine its product portfolio by drawing on technological opportunities both outside (adaptive capacity) and inside the firm (transformative capacity), thereby giving itself a competitive advantage (Garud/Nayyar, 1994).

Most of these approaches share the same conceptual roots: They all highlight a company's strategic agility from the resource and competence angle. From the perspective of the resource based view, strategic agility – and hence a company's lasting success – is linked to the appropriate redistribution of existing resources and the addition of new ones. As far back as the 1950s, resource theorists sought to use the interplay of resource accumulation and reorganization to explain the phenomenon of long-term growth (Penrose, 1959). At the end of the 1990s, the dynamic capabilities theory took over where this idea left off. Scholars no longer looked to growth as the measure of success, but to a firm's ability to carve out different competitive advantages. Teece, Pisano and Shuen defined the term "dynamic capabilities": "... dynamic capabilities [are] ... the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments. Dynamic capabilities thus reflect an organization's ability to achieve new and innovative forms of competitive advantage given path dependencies and market positions" (Teece et al., 1997, p. 516).

FIGURE 7.1: STRATEGIC FLEXIBILITY AS A META-CAPABILITY



Source: Burmann, 2004a

Dynamic capabilities, then, are enterprise-wide competences that link ongoing processes to an organization's historic development and its endowment with resources (Burmann, 2004b). These are the capabilities that keep a company and its strategy flexible. But what exactly does that mean? Let us take a closer look at the term "strategic flexibility".

According to the Latin root, a thing is flexible if it is pliable, supple and adaptable. If they are bent in a given direction, flexible physical objects can often be returned to their original form. Not so the change in an organization, which is permanent. So if strategic flexibility is to be based on dynamic capabilities, it must be seen as a meta-capability that embraces the entire enterprise and all its functional units.

Flexibility depends on the extent to which and the way in which an organization can be guided at all or, conversely, what self-guiding dynamics it develops as a system. It also depends on how agile an organization is. In this context, it is

important to clarify what conditions are in place to enable the company to maintain strategic flexibility, what obstacles might still be in place and how they can be eliminated (Volberda, 1999). Such conditions can include incentive structures for the relevant parties, organizational structures and processes, financial and cost elasticity and criteria relating to the target market.

Strategic options can be exploited to the full only if these factors of influence are fully visible and optimized.

7.3

OBSTACLES TO STRATEGIC FLEXIBILITY

There is always an inherent tension whenever strategic change takes place. The need for order, organization and control on the one hand pulls against the need for rapid response, dynamic learning processes and change on the other. As we saw in chapter 2, forecasting the outcome of profound and ongoing change is not easy to do, which makes it hard to get the strategy process moving in the right direction. The challenge is therefore to design strategic processes that have sufficient built-in flexibility. So what obstacles to strategic flexibility might one encounter?

Let us briefly examine the forces of inertia that prevail in many organizations. The following mechanisms can render strategies inflexible:

Inertia is the inability to set new internal processes in motion in response to changes in external conditions (Miller/Friesen, 1980; Tushman/Romanelli, 1985). The causes of inertia tend to be inflexible social structures, cognitive styles that have become encrusted, rigid behavioral patterns and proven decision heuristics (Volberda/Baden-Fuller, 1998). A company can, for example, become inert if its resources are closely tied to defined strategic initiatives. If the prevailing conditions change, such resources cannot readily be reallocated from one strategic initiative to another. The reasons for the inflexibility of resources may be endogenous (where an extensive resource pool or a large number of direct reports gives rise to power struggles, for example). But they might equally be exogenous and driven, say, by resource markets.

The classic example is capital: It will always be easier to raise capital for a business model that manifestly already works than for risky new ventures.

A company's strong market position can also hinder the reallocation of resources to new business lines. In many cases, there is simply no incentive for management to forfeit a powerful market position in established lines in favor of an alternative that is fraught with uncertainty.

CASE STUDY: EASTMAN KODAK

In retrospect, Eastman Kodak is regarded as the Google of its day (The Economist, 2012). Kodak pioneered both ground-breaking technologies and marketing innovations. In 1976, the company accounted for an astonishing 90% of the US market for film materials and 85% of the US market for cameras. Even in the 1990s, the company was still singled out as one of the five most valuable brands in the world for several years running (The Economist, 2012). Its rival Fuji enjoyed a similar position on the Japanese market.

When the market moved on from analog to digital photography, however, margins slumped, threatening the business models of both Kodak and Fuji.

As early as 1981, when rival Sony launched "Mavica", the first ever digital camera, an internal analysis at Kodak rated the potential of digital photography as very high. The market transition was accelerated by the fact that China's fast-growing middle class quite simply leapfrogged analog photography altogether. However, Kodak's margins on films, chemicals and development were still so fat that it refused to alter its course. The company's lack of adaptability had fatal consequences for its stock price and its ongoing development (Caroll/Mui, 2008). Eventually, in January 2012 Kodak filed for chapter 11 business reorganization.

Rigid routines within the organization also contribute to inertia in decision processes. Routines are reactions that occur automatically or rules that govern decision outcomes, linking different activities to each other. While some are institutionalized, others go largely unnoticed by the members of an organization. Working through defined project phases in a straight line is just one example. Once

established, however, such routine organizational processes are very difficult to change (Gilbert, 2005).

Different types of internal reactionary force can keep a company on a strategic development trajectory for a long time. That is not necessarily a bad thing, because the benefits of experience and organizational learning can improve efficiency and strengthen the firm's competitive position. At the same time, however, what are known as path dependencies can prevent strategic realignment by creating lock-in effects, and it is not unusual for these effects to impair flexibility in the long run. A company that seems to be running on rails can quickly find itself shunted into the sidings. Unquestioning adherence to strategies and processes that have served the company well in the past can be difficult to uproot if and when a change of strategy becomes necessary.

Path dependencies usually begin with a critical incident followed by a series of decisions that are reinforced by positive feedback. This process is often illustrated using the QWERTY keyboard on modern PCs. This keyboard layout was originally selected by the inventor of the typewriter to compensate for mechanical deficiencies. When the computer age dawned, however, it was retained without question. Proposals for a more ergonomic layout made eminent sense, but failed to become established.

7.4 PRACTICAL APPLICATION

This section looks at case studies from a number of industries. Their purpose is to show the points at which various companies needed, adopted or missed out on strategic flexibility. What becomes clear is that flexibility can play a number of widely differing roles in corporate strategy processes.

◆ **Power generation:** In Germany, the government's unexpectedly abrupt withdrawal from nuclear energy is forcing energy producers to alter their strategies. Accelerated in the wake of the Fukushima nuclear disaster, this shift in energy policy drove many utilities into the red. The new situation therefore demands a strategic realignment, as old business models will become non-viable in the medium term. Existing resources cannot be reallocated at the drop of a hat, however: Power

companies have already invested in plants and processes to generate nuclear energy, tying up their capital for decades to come. To make matters worse, there are still no reliable guidelines on which realignment might be based. Decisions have still not been made on political conditions surrounding the promotion of energy from renewable sources, the permanent disposal of radioactive material and the time frame for further expansion of the power grid. New strategies are therefore needed that will work irrespective of these uncertainties.

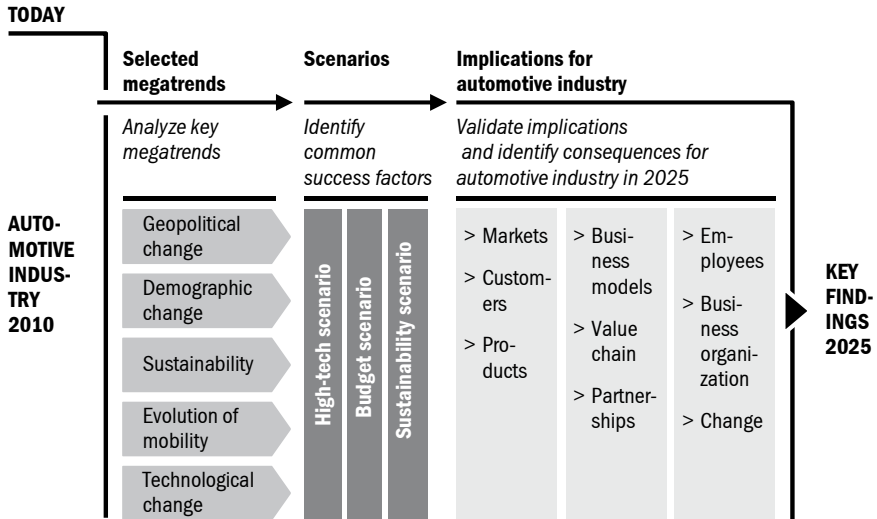
Storage technologies for alternative forms of energy could be one possibility. Hybrid power plants, for example, use electrolysis to generate hydrogen and oxygen from excess electricity from wind turbines. The hydrogen is then separated from the oxygen and stored, transforming volatile electricity into an energy-rich gas that can readily be stored. New cooperative ventures are needed for the project. In one such venture, wind power company Enertrag has teamed up with petroleum company Total, power utility Vattenfall and German rail carrier Deutsche Bahn. The total cost is EUR 21 million (Dambeck, 2011).

◆ **Automotive engineering:** While the political arena is called on to respond at short notice to unforeseen events, megatrends are the driving force behind changes in the strategic environment in the corporate sector. When several such megatrends converge, the resultant transition can be profound indeed. The auto industry is a fine example: The closer attention commanded by sustainability, technological advances (in e-mobility, telematic systems and networking, for example) and scarce resources will radically alter OEMs' business models in the years ahead (Wendt, 2011).

For decades, the automotive industry focused its attention on pumping money into production facilities, dimensioning production to maximize capacity utilization and flooding the market with more and more new variants of cost-optimized standard models, many of them at knock-down prices. This practice still works in the fast-growing Chinese and Indian markets. In the industrialized world, however, auto makers have to morph into mobility service providers. In these traditional markets, the automobile's sheen as a status symbol has become noticeably tarnished.

New mobility models, the integration of IT service providers and energy suppliers, in-car apps and new customer demands in terms of mobility and networking are necessitating huge investments in IT, infrastructure and the development of new, efficient solutions. This kind of model links a new form of automobility (based on

FIGURE 7.2: IMPACT OF FIVE MEGA-TRENDS ON THE AUTOMOTIVE INDUSTRY



Source: Wendt, 2011

use instead of ownership) to seamless, barrier-free transitions between private vehicular traffic, public transportation and non-motorized forms of transportation. The key issue is to organize three scarce resources – energy, space and time – in such a way that urban development can be made livable, functional and sustainable at the same time (Schmidt, 2011a).

◆ **Media:** The media sector has been in structural transition for years. The advance of digital technology, accompanied by new user habits and convergence of the telecommunications, IT and media markets, is having a disruptive effect on the business models of traditional providers. Many traditional media companies have yet to find suitable responses. The US newspaper market, for example, has been languishing in crisis for years. The New York Times – the publication of choice for the global intelligentsia – saw its annual sales slump by 27% from USD 3.3 billion to USD 2.4 billion from 2006 to 2011 (Schmidt, 2011b). Nor is there any sign that the transition is slowing down. The number of Internet users worldwide has now exceeded

two billion, whereas only 250 million people around the globe enjoyed Internet connectivity as recently as the year 2000.

The initial strategy adopted by many media companies – offering free content on digital platform – has failed. On the American dailies market, free and unlimited use of websites and mobile offerings has mostly been abandoned. Access to the third-biggest newspaper in the US (again the New York Times) costs at least USD 15 for four weeks or USD 195 a year (Schmidt, 2011b).

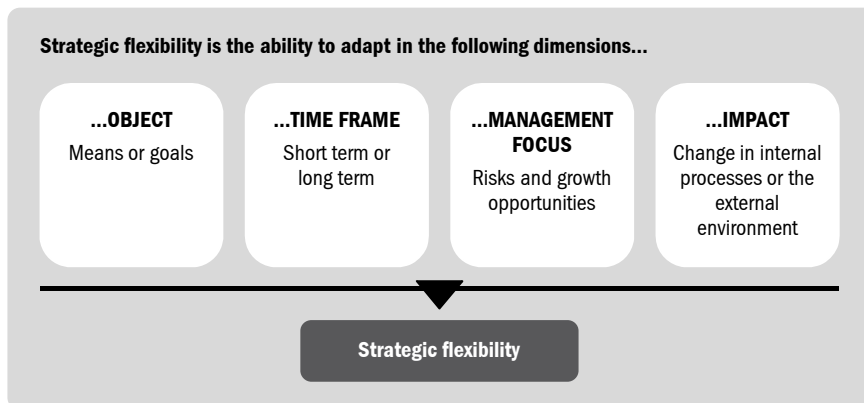
Media companies need ways to diversify if they are to soften their dependency on content business that is funded by advertising as quickly as possible. The Axel Springer media group, for example, generated more than one third of its revenues online in 2011. And most of that was not made with journalistic content, but with the Stepstone online job exchange and the Immonet and Seloger real estate marketplaces, for example. The company is thus evolving from a traditional publisher to an Internet service provider (Bernau, 2012).

7.5 SCENARIO-BASED PLANNING AS A TOOL TO CRAFT STRATEGIC FLEXIBILITY

Strategy research assumes that some aspects of strategy processes evolve without any conscious planning. That, however, can be no excuse for tolerating suboptimal processes. Scenario-based planning can help a company overcome the inertia and lock-in effects that arise from path dependencies. In this context, strategic flexibility is a concept that helps to visualize **potential** courses of action (Burmans, 2004b) and thereby enables managers to make the most of the strategic options at their disposal.

The scenario method is a perfect complement to the strategy process, opening it up both within the company and toward the outside world. First and foremost, this method ensures that representatives of all a company's functional units are involved in the strategy process. It also gives the organization a keener perception of the relevant exogenous influences, by also calling in external stakeholders to identify relevant factors of influence. Asking open questions at the start of the 360° stakeholder feedback stage makes sure that strategic planning does not become too

FIGURE 7.3: DIMENSIONS OF STRATEGIC FLEXIBILITY



Source: Burmann, 2004b

heavily focused on specific dimensions (such as the object, time frame or impact) at too early a stage. Instead, it allows influences to be explored initially with no consideration for any cause-and-effect relationships. Four dimensions outline the potential for action:

The first dimension examines flexibility with regard to the goals the company wants to achieve and the means it intends to employ to do so. The following permutations are possible:

- ◆ A new weighting is given to existing goals
- ◆ New goals (such as sustainability and diversity) are added
- ◆ The deployment of factors of production such as capital and human resources changes (in both qualitative and quantitative terms)

The second dimension describes the time frame that an organization can consider when changing its strategic alignment. The spectrum ranges from

- ◆ The short-term reshuffle of existing resources to

- ◆ The long-term reallocation of the resource portfolio in light of anticipated future demand based on a new delivery program

The third dimension measures how flexible the management is in terms of the options available to it. Management can

- ◆ operate a defensive/passive risk strategy to guard against risks (by monitoring KPIs and comparing to past values, for example)
- ◆ actively and aggressively seek new growth opportunities and be prepared to quickly modify its structures and processes
- ◆ be flexible with regard to speed and readiness to act

The fourth dimension looks at the impact environmental factors have on the flexibility of organizations. In particular:

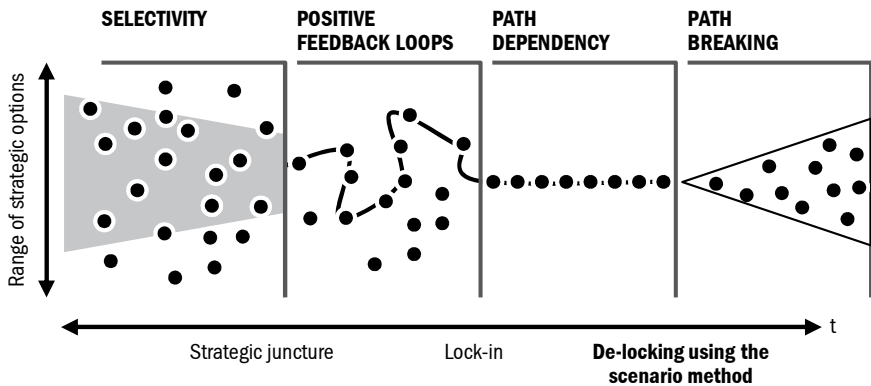
- ◆ The specific influence on market conditions (by launching innovations, for example)
- ◆ The change in internal process variables, optimization and streamlining

Each of these four dimensions can be supported by our method of scenario-based strategic planning. For example, 360° stakeholder feedback contributes to finding new goals and adjusting the weight of existing goals. The impact/uncertainty grid can help assess the influence of market conditions or changes in process variables.

Scenario-based planning can overcome forces of inertia within the organization and break up (or help redirect) well-worn development paths. Via positive feedback loops, the range of strategic actions is narrowed over time. As long as the overall environment is stable, there is no difficulty reducing the options to a single path. But if the environment changes, lock-in effects can occur, placing strategic flexibility and competitiveness at risk. The scenario method can then re-open the strategic planning process and break up existing paths.

These insights can also be mapped onto higher levels of strategic planning, as behavioral patterns take shape on the basis of such decisions. Lock-in effects narrow the frame of reference within which strategic options are analyzed. They also limit the scope of management initiatives and ultimately lead to strategically inefficient outcomes (Schreyögg et al., 2003).

FIGURE 7.4: IMPACT OF THE SCENARIO METHOD ON LOCK-INS IN STRATEGIC PLANNING



Source: Schreyögg et al., 2003

The method can be used to generate momentum that helps alternative courses of action make the breakthrough. Applied consistently, the scenario method will ideally prevent strategic options from ever becoming excessively restricted. It can do this because, irrespective of existing strategic priorities, it explicitly seeks out weak signals and blind spots.

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