

UNIT4

# In Business for You

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HOW FP&A MUST HARNESS SCENARIO  
PLANNING TO AID DECISION MAKING





Modern-day business environments are complex, dynamic and highly dependent on a multitude of external factors, ranging from advances in technology to trade wars between economic superpowers. And then, there is the rare black swan event that disrupts the entire world order. Today, the COVID-19 pandemic has brought the global economic machine to a grinding halt and threatens to contract the world economy during 2020.

At times like these the irrelevance of elaborate long-term planning is reinforced and the need for short-term, dynamic scenario-based planning becomes clear. However, many organisations remain stuck in the traditional planning process, those that take months to prepare and become outdated the moment they are finalised. While humans physically progress into a rapidly changed world, our minds do not adapt as fast to the uncertainty. We prefer to operate with an incorrect map than with no map at all which psychologists call availability bias.

In such a context, it is the responsibility of the FP&A team to guide business leaders towards making informed decisions that ensure optimal performance during these difficult times. In doing so, we must harness the power of scenario-based planning. Next are the critical factors and steps in this process.

## 1. Identify the key business drivers and critical uncertainties

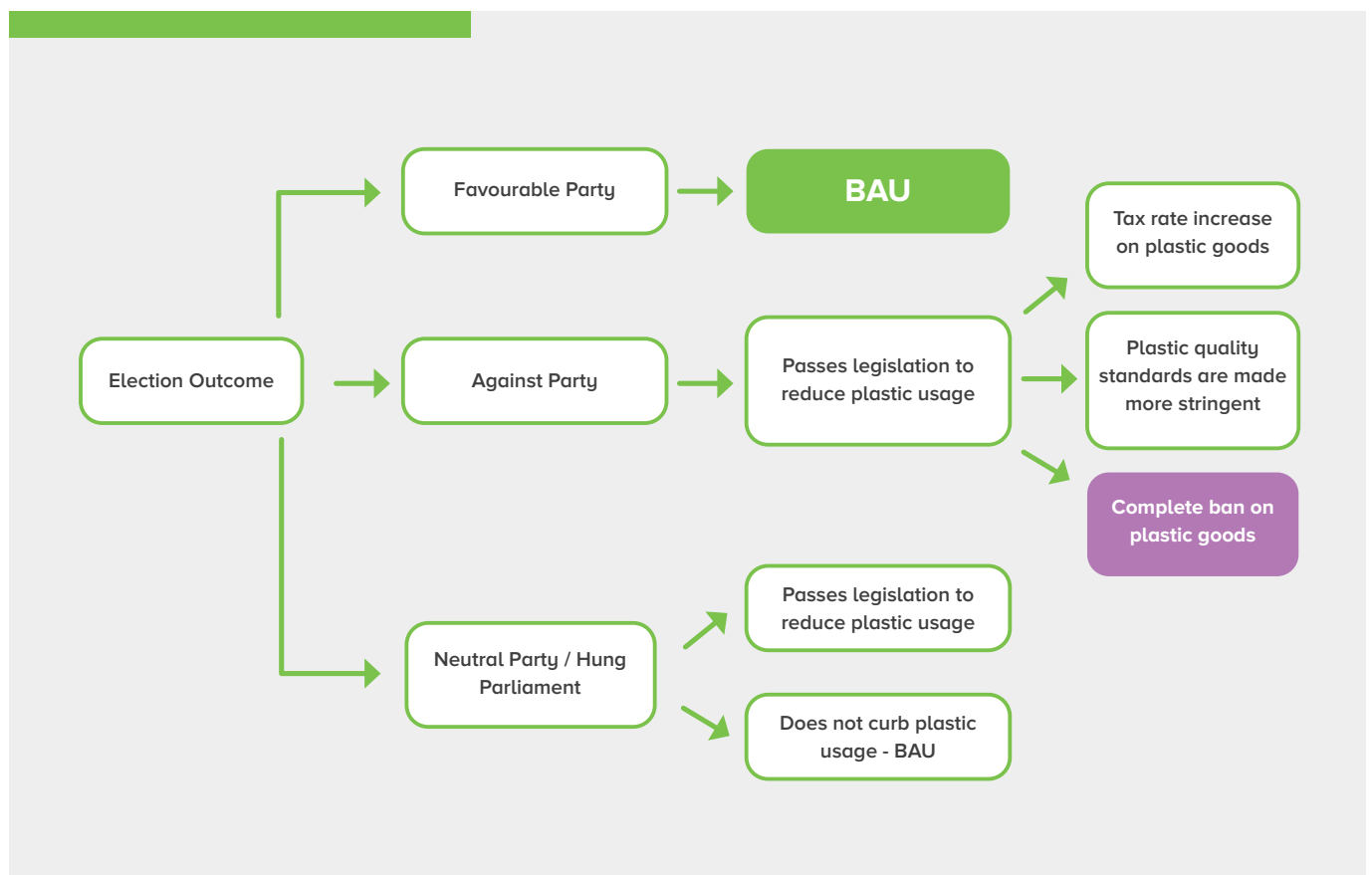
Businesses are affected by a myriad of internal and external factors, for example, competitor actions, technological changes, tax and interest rates and natural calamities. However, there are a handful of key factors that influence an organisation's results more than most. The first step is to identify these. For instance, for a plastic product manufacturer, the most critical external factors may be oil prices, government regulations and research and development (R&D) work that focusses on plastic alternatives.

The next step is to identify the factors that hold the most uncertainty. For example, in an election year where a prominent political party proposes strict measures for plastic reduction, the outcome of the election becomes a significant driving factor to the business. It is a factor that holds high critical uncertainty for the business and can impact results significantly.



## 2. Generate multiple scenarios through decision tree thinking

Due to the uncertainties that exist around key business drivers, multiple scenarios of outcomes need to be built. To bring structure to this, decision tree thinking can be used since it ensures a mutually exclusive collectively exhaustive (MECE) framework. In a continuation of our plastic manufacturer example, a decision tree has been illustrated below. The best-case scenario for the manufacturer would be “business as usual (BAU)” and the worst case would be a complete ban on plastic goods.



### 3. Be mindful of possible cognitive errors and be receptive to the external environment

Our minds are susceptible to multiple cognitive errors. The desire for a certain outcome or a discomfort with uncertainty can make leaders prone to resisting scenario planning. While thinking in an uncertain environment, our minds are likely to disregard negative outcomes with a low probability and over-estimate the likelihood of the best-case scenario. Organisations may become overconfident and fail to prepare themselves for unfavourable outcomes. When Nokia famously ignored the potential of Android's scalability, they overestimated the value of their brand and the probability of their success without Android. They also neglected the probability that other cell phone manufacturers would use Android to scale rapidly. This led to Nokia's downfall.

FP&A teams must play devil's advocate and challenge assumptions of business leaders instead of simply creating 'ideal' scenarios on spreadsheets. Just because a certain outcome has not occurred in the past does not mean it will not happen in the future. Being aware and receptive to the external environment is essential to be able to bring all possible scenarios to the table.

### 4. Harness the technological tools available to enable real-time planning solutions

While all the above factors are certainly valuable for better planning and decision making, it is practically impossible to capture every potential outcome driven by each combination of critical factors. The reality is, circumstances will change rapidly and this requires an ability to update plans in real-time. In the past, FP&A would build 3 scenarios: the base case; the best case and the worst case. Any significant change in circumstance or a request from a senior executive that required a new scenario would trigger all-nighters by the FP&A team and a significant amount of time to calculate and present.

Today, by harnessing the available technology and tools, FP&A teams can quickly build and iterate infinite scenarios instantly. This enables real-time plans to be discussed, which drives more informed decisions to be made.

For instance, in the current cloud of COVID-19 uncertainty, many sudden decisions are being taken by governments, including lockdowns, visa extensions and flight cancellations. In addition, projections on the pandemic's timeline are effectively scenarios that illustrate extreme variety in their results since there is no definite cure to the virus. In such circumstances, no finite number of plans can cover all the possibilities. As a result, it would serve businesses well to have a dynamic planning process ready that can adapt to quick changes.

Overall, the COVID-19 crisis offers FP&A teams and businesses worldwide an opportunity to refine their scenario-based planning processes to help them steer through this tunnel and emerge stronger at the end.

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