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SUPPLY CHAIN TRENDS AND ISSUES

Getting Scenario Planning Right

Avoiding Common Traps that Can Lead to Risks and Un-optimal Decisions in the Supply Chain

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"Scenario Planning" has become quite the rage, both in the supply chain and business generally.

Why? In part because it is just a smart way to consider strategic options and how to mitigate risks, and also because the increasing dynamic world and markets companies operate in today makes steady state planning a recipe for disaster.

In the supply chain, scenario planning can be used in many areas, but most commonly is used in supply chain network design, strategic Sales and Operations Planning (S&OP), and planning and procurement strategies for different levels of commodity or raw materials costs.

The smart folks over at McKinsey recent ran a piece on the keys to successful scenario planning that we thought was worth summarizing.

The target audience for the piece is the general business executive rather than supply chain professionals, but we thought some of the recommendations were worth considering in SCM as well.

Below, according to a recent article in The McKinsey Quarterly, are traps to avoid when performing a scenario planning exercise:

Don't become paralyzed: If the range of potential scenarios is too broad, it may lead to paralysis in decision-making, as the level of uncertainty can create a certain inertia against taking action. Instead, pick the scenario whose outcome seems most likely and base a plan upon that scenario, and/or try to find a strategy that produces at least acceptable results or options under all scenarios.

- Don't let scenarios muddy communications: While scenario analysis is powerful, it should not be stressed too much in executive communications, lest the troops become overly confused or anxious about the future state. Key is to communicate how the company (or the supply chain) will thrive under a variety of scenarios.

- Don't rely on an excessively narrow set of outcomes: While too many scenarios can cause paralysis by analysis, too few can leave a company complacent that it has all its bets covered. In today's world, that's very dangerous – just as Wall Street bankers got caught making investments that precipitated the financial crisis based on not considering scenarios where US housing prices would drop more than 20%.

Putting in some extreme scenarios to understand how the supply chain would and could react can be beneficial. For example, how many companies in 2005 considered the possibility of oil prices going near $150 a barrel by 2008? Are you considering how your supply chain could survive if war someday did break out between China and Taiwan, leaving your offshore goods stranded on the mainland?

- Don't chop the tails off the distribution: Similar to the previous trap, when a large number of scenarios are presented, the natural reaction to whittle the number down is to simply chop off the extremes at either end of some curve. That is dangerous, because sometimes the extremes are encountered. Planners and supply chain strategists should include "stretch" scenarios while acknowledging their low probability.

- Don't discard scenarios too quickly: Sometimes the most interesting and insightful scenarios are the ones that initially seem the most unlikely. Don't throw out forever scenarios that don't make the cut right now. In the course of a supply chain network redesign, for example, it is quite possible scenarios that were eliminated from consideration upfront could become useful as is or with modifications during the course of the multi-year project as the world continues to change rapidly.

Remember when to avoid scenarios altogether: McKinsey says that sometimes, uncertainty is so great that scenarios cannot be built reliably at any level of detail. If everyone in an organization thinks the world can be categorized into four boxes on a quadrant, it may convince itself that only four outcomes or kinds of outcomes can happen.

These are some good points to remember when developing supply chain scenarios. Our take is that for supply chain professionals, the most important thing is to remember these traps when doing supply chain analysis and providing recommendations to business executives. For example, in some cases, being very clear to executives about what range of scenarios were provided to the supply chain team to do its planning; or what scenarios were actually considered and what were left out in the set of options being presented to business executives.

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Several years ago a fast growing candle manufacturer needed to build a new distribution center to handle that growth. In sizing the new facility for storage and throughput, relatively conservative projections about future sales volumes were forecast – no one thought (or was willing to predict) that the current rate of 20% or more annual growth would continue. But it did, for several additional years than planned.

So, within just a few years, a second distribution center had to be built – at much higher cost than if the original building had had more flexibility to be expanded if the high growth scenario proved true.