Step 2: Relate Scenarios to Strategies

After scenarios have been identified, the next step is to relate them to strategy—both existing strategies and new options. If an existing strategy is in place, it can be tested with respect to each scenario. In which scenario does the strategy do best? How bad will the strategy perform if the wrong scenario emerges? What will its prospects be with respect to customer acceptance, competitor reactions, and sales and profits? Could it be modified to enhance its prospects?

Even if the scenario analysis is not motivated by a desire to generate new strategy options, it is always useful to consider what strategies would be optimal for each scenario. A scenario by its nature will provide a different perspective than the status quo. Any strategy that is optimal for a given scenario should become a viable option. Strong parts of suboptimal or infeasible strategies can also be harvested for use in future strategies.

Step 3: Estimate Scenario Probabilities

To evaluate the effectiveness of different alternative strategies, it is useful to determine the scenario probabilities. What is the probability of a scenario emerging? Experts could be asked to assess probabilities directly. A deeper understanding will often emerge, however, if causal factors underlying each scenario can be determined. For example, the construction equipment industry might develop scenarios based on three alternative levels of construction activity. These levels would have several contributing causes—interest rates, availability of funds to customers in the home building sector (which, in turn, would depend on the emerging structure of financial institutions and markets), and level of government spending on roads, energy, and other infrastructure areas.

SWOT Analysis

Environmental analysis identifies a host of many potential threats and opportunities. The challenge is to determine which are most relevant for the firm's business and to prioritize them. Both impact and scenario analyses can help the firm develop initial answers. However, even with similar answers from these analyses, not all companies should respond to all environmental events. Whether and how a company responds will be a function of the nature of the environmental activities and the company's own strengths and weaknesses. A SWOT analysis is a framework that guides such decisions. SWOT analysis examines a set of environmental trends classified company strengths (S) and weaknesses (W) and external opportunities (O) and threats (T).

Firm Strengths and Weaknesses

In developing or implementing a strategy, it is important to perform an internal analysis of the firm. This analysis follows the same checklist of strengths and weaknesses used to examine competitors in Chapter 3 (see Figure 3.4) and will not be reviewed in depth again here. There are more than three dozen organized under the categories of innovation, manufacturing, financial, management, marketing, brand equity, and customer base. This checklist is a good place to start when analyzing whether the company can respond to a threat or opportunity or whether it needs to build new assets and competencies to do so. In addition, the Appendix A contains other financial and nonfinancial criteria important to an internal analysis of the firm that should be used in this assessment.

Each asset or competence relevant to the business should be evaluated as to its strength and impact. Is it dominant in that it provides a point of advantage that has endured and is likely to remain so in the future? The service delivery capability of Disney theme parks, for example, is so superior that other firms study its operation. Is the organization willing to invest to make the asset or competence dominant into the future? Certainly, Disney has shown this willingness over many decades. The investment commitment needs to be factored into the financial resource picture. It may mean that resources for new ventures will be limited.

Is it strong but vulnerable? Are others catching up? Should the firm invest to attempt to regain a dominant position so that it is a point of advantage? If so, what program at what cost is implied? Or should the firm retreat so that the asset or competence is simply a modest advantage over some competitors and a point of parity with respect to others? Is the asset or competence adequate, a point of parity? Is it strong enough so that customers do not avoid the firm because of it? If so, is that a satisfactory long-term position? Can advantage be achieved on other dimensions? What investment is implied to maintain the current strength so that it does not become a point of disadvantage? If Target, for example, can deliver quality adequate enough so that customers do not use a quality judgment as a reason to exclude Target from their consideration set, the battle will shift to other dimensions on which Target is likely to excel. Is the asset or competence a liability? Is it holding back the firm from gaining and retaining customers?

External Threats and Opportunities

Imminent threats with high impact should drive a strategic imperative, a program that has the highest priority. If there is a visible quality problem (such as contaminated Perrier water or defective Bridgestone tires on Ford Explorers), fixing it and thus addressing the associated threat needs to be a high priority. When the threat is of low impact or is not immediate, a more measured response is possible. The most extreme threat is one that potentially makes the business model obsolete. Because of the decline in the use of printers, HP has seen its cash cow, printer supplies, declined with rather troubling strategic implications. AOL, with its "You've got mail" greeting and a route to the Internet for newbies and the intimidated, had a dominant business model with some 35 million subscribers. However, it failed to respond to the fact that its customers eventually obtained more sophistication and better equipment. AOL was in a position to be a successful social network Internet company but instead watched others such as Facebook assume that role and allowed its value proposition to erode. Recognizing the threat to the business model in a timely fashion and making the organization responsive might have led to a very different outcome for AOL.

Threats can come in the form of a strategic problem or a liability. Strategic problems, events, or trends adversely affecting strategy generally need to be addressed aggressively and corrected even if the fix is difficult and expensive. Strategic liabilities—the absence of an asset (such as good location) or competence (for example, new product skills)—usually require a different response. A business often copes over time with a liability by adjusting strategies in a way that neutralizes that liability. A firm that lacks new product competencies might engage in a systematic product acquisition strategy.

An opportunity similarly can be evaluated as to whether its impact will be immediate and major. If so, the organization should be set up to move quickly and decisively. One study found