

## **Contingency Planning vs. Scenario Planning<sup>1</sup>**

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The purpose of this paper is to provide a brief overview of contingency planning and how it fits into the overall scenario planning process. Furthermore, this paper will illuminate the significant steps of the scenario planning process and the importance of scenario planning in the modern marketplace.

### **Contingency Planning**

Contingency planning is a component of risk management (PMI, 2017). The purpose of contingency planning is to proactively establish which project risks (both positive and negative) can be moderated against using various methods of mitigation. One form of contingency response is the strategic reserve. These reserves may take on several different forms. Schedule contingency, for example, is a duration estimate that accounts for possible schedule overruns and provides a time contingency. Budgetary contingency, such as a management reserve fund, protects against cost overruns by having a ready reserve of allocated funds available in the event a task or subroutine goes overbudget (PMI, 2017; Kerzner, 2018). Other contingency strategies include insurance tactics, hardware redundancies, software backup, alternate physical locations, legal strategies, human resource substitutions, and even comprehensive strategic alternatives regarding changes in the sociopolitical environment.

A contingency for a positive risk, such as a sudden and unexpected influx of resources, could be to initiate an internal effort to innovate or perhaps acquire additional human resources. In any case, all quantified risks are listed in the risk register. The risk register includes the action to take, resources required, decision-maker, risk owner, contingency plan, trigger conditions, contingency plan if the response fails, and residual and secondary risks that may trigger from the primary risk (PMI, 2017). Risk quantification and the risk register directly impact the decision-making matrix in that one can effectively categorize the level of decision-making authority needed to respond to the risk (PMI, 2017). Risk quantification is also used to establish cost and schedule contingency plans (PMI, 2017). For instance, a realized risk with high impact and high-resource mitigation may require a high-level authority to implement the corresponding mitigation strategy. In contrast, a

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risk with low impact and low-resource contingency utilization may only require low-level authority to implement a mitigation strategy (Kerzner, 2018).

## **Contingency Planning vs. Scenario Planning**

Scenario planning is a strategic planning and risk management methodology to develop multiple, holistic, plausible scenarios for the future in order to gain insight and create strategic alternatives (Wilkinson & Kupers, 2013). Scenario planning was simultaneously developed by Herman Kahn (a member of the RAND corporation) in the United States and Gaston Berger in France in the 1950s (Wilkinson & Kupers, 2013). Scenario planning seemed to catch on and continued on a small scale until the 1970s when Shell oil publicly championed the process as part of its strategic planning and risk management operations. Immediately afterward, scenario planning came into vogue (Wilkinson & Kupers, 2013).

Scenario planning is elemental due to multiple considerations, the most important of which is related to its holistic and non-mathematically based nature. This nature establishes scenario planning as very different from contingency planning, which is primarily based on a mathematical premise incorporating past data, probability, and previous experience. For instance, scenario planning is not linked to past or present data, nor assigned probabilities based upon the same data. In this way, scenario planning is a unique strategic planning tool that can develop novel and otherwise non-linear plausible scenarios for the future based on storylines. These storylines carry unique circumstantial watermarks that can be used by personnel in the future to identify if the scenario is being realized (Wilkinson & Kupers, 2013). In other words, the scenarios carry internal alarm systems for future identification purposes. In this way, scenario planning provides a unique resource for planning staff, executives, and managers within organizations regarding strategic planning and action plans. While there are similarities between contingency planning and scenario planning, they are two distinct approaches with different goals and disparate processes.

## **Scenario Planning Process**

The process of scenario planning follows six guidelines: frame the challenge, gather information, identify primary forces, define critical characteristics of the future, generate multiple scenarios, and develop scenarios via storylines (Wade & Wagner, 2012). These six guidelines are managed by the scenario planning champion and fulfilled by the ten to thirty participants throughout the exercise. The result of this process is multiple scenarios, each reflecting different futures. Each scenario should be independently validated and assessed for plausibility and applicability. Then, scenario indicators are identified, and a monitoring schedule developed. In this way, organizations

can identify which scenario is playing out in real-time and adjust accordingly (Wade & Wagner, 2012).

One of the unique strengths of a scenario planning process is the possibility of identifying black swan events. A black swan event is one that, according to Wade and Wagner (2012), has three characteristics. First, it is exceedingly rare. Secondly, the event, if it occurs, has a massively disproportionate impact. Thirdly, in hindsight, the event seems to fit in the context of the environment. These black swan events are, therefore, generally high visibility, high impact events that are exceedingly difficult to plan for in a risk management context. Substantial reserves, flexibility, and maneuverability are some of the only ways to mitigate a black swan event (Conerly, 2013). A historical example of a black swan event is the Black Death in the 14th-century medieval world. In this case, the sickness was utterly unexpected and resulted in the death of roughly 50% of the medieval population. Thus, the Black Death was exceedingly unlikely, had a massive impact on the world, but was, in hindsight, seemingly inevitable to historians and epidemiologists (Conerly, 2013). Thus, the Black Death fulfills the three characteristics of a black swan event, according to Wade and Wagner (2012). An oft-cited recent example would be the terrorist attacks of September 11, 2001. In this case, the assessed probability of the event was near zero, the event has a disproportionately massive impact, and the event seems to fit the sociopolitical atmosphere of the time in hindsight (Conerly, 2013; Wade & Wagner, 2012).

Another, more recent example of a black swan event is the COVID-19 pandemic as it relates to the car rental company Hertz. Hertz had, in recent years, taken on more than \$24 billion in debt, primarily due to corporate acquisitions and car purchases. This debt was set against a cash reserve of \$1 billion (Krisher, 2020; Chokshi, 2020). Hertz was nearly entirely corporately geared towards the travel industry rental car sector (Chokshi, 2020). With the onset of COVID-19 in the 4<sup>th</sup> quarter of 2019 and the 1<sup>st</sup> quarter of 2020, Hertz lost all revenue when governments shut travel down as a pandemic mitigation strategy. This loss of income culminated in literally zero revenue for Hertz starting in mid-March of 2020 (Krisher, 2020). Unable to pay its creditors, Hertz filed for Chapter 11 bankruptcy protection on May 22, 2020.

This confluence of factors represents a black swan event for Hertz. The probability of a travel-ending pandemic occurring at such an unfortunate time for Hertz, given the corporate debt ratio, was undoubtedly seen to be near zero. The impact of the event was disproportionately massive. Lastly, the pandemic, according to some analysts, seems to have been somewhat inevitable (Lipton, Sanger, Haberman, Shear, Mazzetti, & Barnes, 2020). In this case, Hertz could have employed scenario planning as a strategy to identify possible black swan events relative to taking on large amounts of debt. No one will ever know, but perhaps a scenario planning event would

have identified a pandemic as a possible black swan event for a travel-based rental car company with an extraordinarily risky debt-to-income ratio.

### **Importance of Scenario Planning**

Strategic planning is different from forecasting, probabilistic extrapolation, and predictive analytics because it is fundamentally different from a mathematically based process (Wade & Wagner, 2012). Whereas forecasting is generally a direct extrapolation of the present, and probabilistic forecasting is a combination of present data and weighted probabilities of extrapolated variables, strategic planning is based in a holistic approach to many plausible futures (Wilkinson & Kupers, 2013). The result of a scenario planning exercise is a series of plausible futures, each with signposts/indicators, mitigation and exploitation strategies, and a monitoring strategy to identify if a future scenario begins to play out. Ideally, if one of the scenarios begins to come to fruition, the company is in a position to employ one of the previously developed mitigation or exploitation strategies (Wade & Wagner, 2012). Thus, scenario planning emerges as a compelling option for both strategic planning and risk management.

As a potential drawback, scenario planning can be prohibitively expensive, as the ten to thirty person teams generally required to develop multiple scenarios are necessarily highly skilled/educated employees or consultants. These experts are correspondingly expensive to employ. Therefore, proponents of scenario planning often must overcome initial corporate resistance at the cost of the exercise. Due to this high expense, the decision to engage in scenario planning is typically made at the C-suite level. Proponents of a scenario planning exercise should, therefore, be prepared to argue the business case for a scenario planning exercise at the very highest corporate level.

### **Conclusion**

This paper provided a working definition of contingency planning and explained how it could arguably become the entry argument into scenario planning. Furthermore, this paper explained how contingency and scenario planning are related but fundamentally dissimilar and how the scenario planning process can lead to critical insights in nearly any modern industry.

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