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**Creating a Risk Intelligent Enterprise:
Scenario planning and war-gaming**

Scenario planning and war-gaming: Sizing up the future

The Risk Intelligent Enterprise seeks to proactively address risks, leverage opportunities, and position the organization to respond rapidly as the risk landscape evolves.¹ These behaviors exemplify the strategic flexibility and organizational agility that organizations seek, but often have trouble actualizing.

Scenario planning and war-gaming can help. Scenario planning helps organizations see risks and opportunities more broadly, to imagine potential futures and alternative scenarios that might challenge their assumptions, and to spot sources of risk that may otherwise go undetected. War-gaming enables organizations to create, test, rehearse, and refine strategies and enhance decision making amid uncertainty. Both of these essentials in the risk management toolkit allow organizations to think outside of conventional mental models and see the threats and opportunities around strategic choices, as well as the potential second- and third-order effects of decisions.

These capabilities stand among the key enablers of the Risk Intelligent Enterprise, together with risk governance, risk sensing, and portfolio optimization (also covered in this series on *Creating the Risk Intelligent Enterprise*). Scenario planning and war-gaming bring the future into the present in vivid ways that illuminate not only the risk landscape, but also the potential impacts of specific risks and responses.

¹ "Reimagining the Risk Intelligent Enterprise," Deloitte Development LLC, 2018.



Three specific questions

Being prepared for future risks and upside opportunities is the intention of risk management programs, however reaching that end-state can be elusive. Common limitations include untested assumptions about the impact of potential future conditions and events, and failure to identify the full range of organizational responses and their potential effects.

This situation raises the following three questions:

- 1 **How can we embrace uncertainty and avoid making untested assumptions about the future?**
- 2 **How can we test the impacts of future conditions and events on our strategies and responses?**
- 3 **What could strengthen the chances of success of specific strategic initiatives, such as product launches and price changes?**

Scenario planning and war-gaming can assist in answering these questions.

First, scenario planning helps you embrace uncertainty by developing data-driven stories about the future that can generate better decisions. Scenarios incorporate management's assumptions about the external environment in which the organization will operate.

Second, the outcome of scenarios will point to potentially useful strategies and risk mitigation tools. Then, testing enables management to gauge the effectiveness of these strategies and tools and to explore other options, based upon projected results.

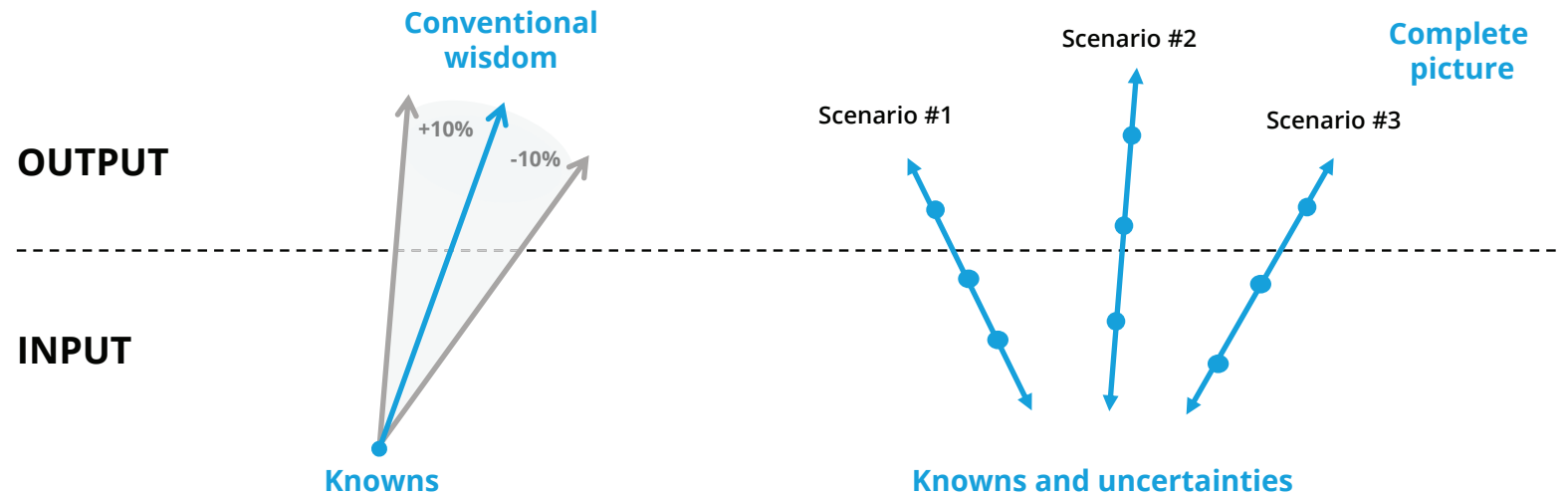
Third, war-gaming helps in gauging the potential outcomes of initiatives such as product launches, price changes, and other externally facing efforts where the responses of customers, competitors, and other parties can affect results. Many organizations mistakenly limit war-gaming to cyber security exercises.

Scenario planning and war-gaming enable management to become more comfortable amid uncertainty. Scenario planning accounts for visible trends that are shaping the future, as well as for forces that cannot be predicted or influenced. This approach also allows for wildcards or black swan events—low-probability, high-impact occurrences that could dramatically change the business environment. Scenario planning and war-gaming enhance decision making by relating specific uncertainties to the strategies, decisions, and initiatives under consideration.

How scenario planning works

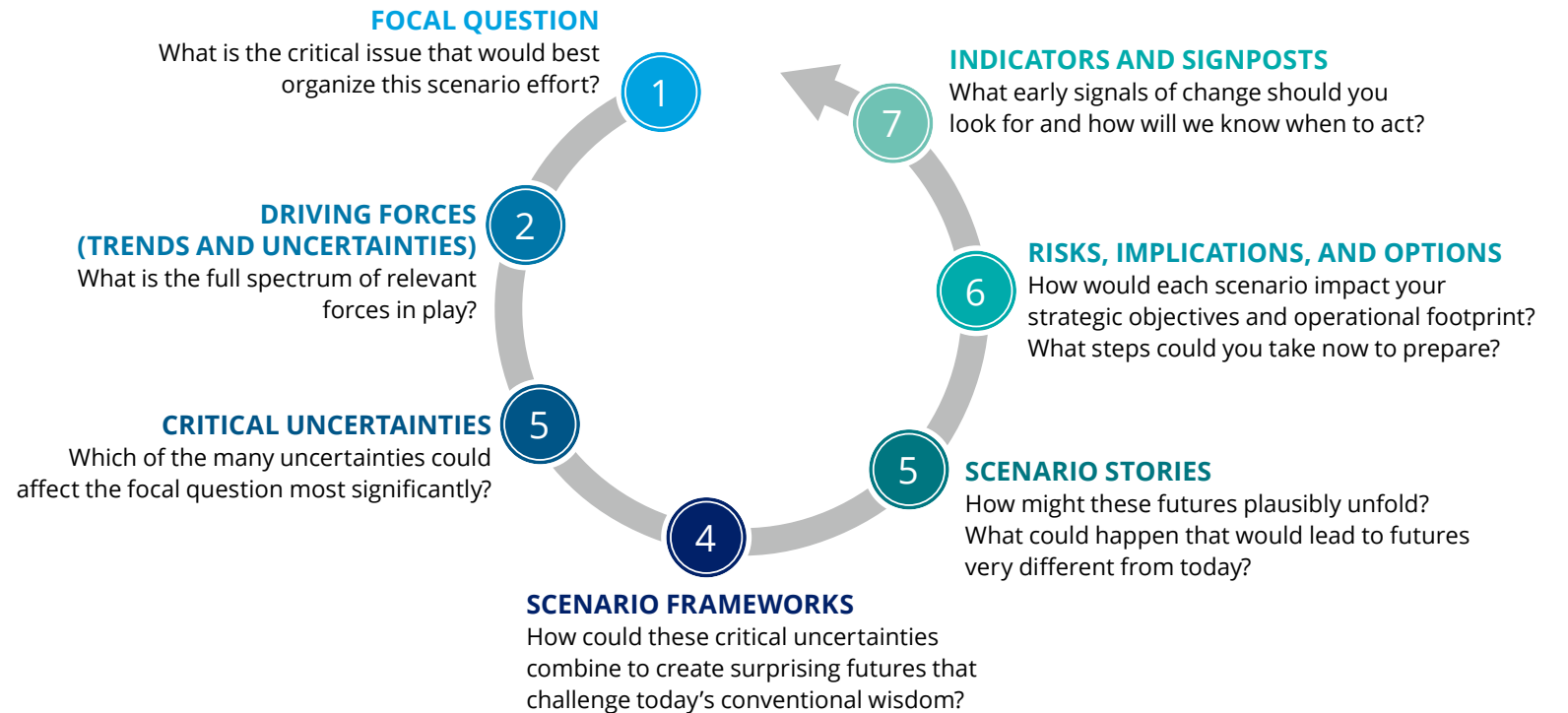
Many planning approaches assume that future conditions will resemble an upward or downward extension of current conditions. They prepare management to make decisions on that basis, usually by suggesting incremental adjustments to current factors, such as budgets, headcounts, and other resource allocations or, by presenting a limited choice-set of responses. These approaches, based on conventional wisdom and known inputs, tend to underestimate and mischaracterize risks to strategies and initiatives.

Scenario planning versus conventional approaches



The scenario planning process poses successive questions to generate an environment in which a full range of uncertainties can be identified and considered. It illustrates how the future might unfold and the impacts on strategy, operations, and other success factors.

Scenario development process



Scenario planning also identifies warning signs that can trigger strategic pivots or risk mitigation tactics. In this way, both opportunities and risks are more fully considered in planning and decision making.

Scenario planning should not be mistaken for making predictions that can be proven right or wrong. Predictions are not the goal. The goal is to visualize various futures, any of which may or may not come to pass, but all of which enable management to better prepare the organization for whatever the future brings. By considering various futures in a creative yet rigorous way, management can not only feel more confident, but may emerge better prepared for the uncertainties and risks that lay ahead.

To get the most out of scenario planning, consider the following:

• **THINK OPENLY ABOUT OPPORTUNITIES AND RISKS**

Don't mistake scenario planning for simple sensitivity analysis or linear planning processes; instead, start with expansive views about how the world could possibly look, given current external trends and potential events.

• **USE NARRATIVES AND STORYTELLING**

Data-driven stories enable a team to picture the alternate futures the organization might face; good narratives challenge conventional wisdom and management's assumptions, but are always logical and plausible.

• **INVOLVE SENIOR MANAGEMENT**

Scenario planning often occurs in a planning function sequestered from senior executives; organizations that engage senior executives in the process typically generate more useful results that more often influence strategy and decision making.

• **UNDERSTANDING ITS PURPOSE**

Scenarios structure contingencies so you can understand drivers of change, consider the resiliency and flexibility of a strategy, and increase clarity and comfort in ways that drive commitment and action.



Scenario planning in action

A commercial bank was concerned that FinTech companies—those using new technologies to automate financial services activities—presented risks to certain areas of their business. Scenario planning identified specific trends and uncertainties and incorporated them into the modeling environment.

- **A trend is a known, currently visible phenomenon.** In this case the trend of FinTech making advances in the financial services marketplace is visible, although where it is going and how quickly remains unclear.
- **An uncertainty is a factor that cannot be currently known or reliably predicted,** but which presents risks (and usually opportunities) to the organization. In this case, the key uncertainty was when FinTech companies will be regulated.

Broadly, our analysis focused on FinTechs being regulated in one to two years or in seven to 10. The first set of scenarios presented limited risks as FinTechs would soon inhabit a similar regulatory environment; the second set held higher risks in that FinTechs could advance into banking activities unencumbered by regulatory demands or their costs for a longer period. This prompted the bank to consider contingency plans, acquisition plans, and other strategic steps.

How war-gaming works

Similar to scenario planning, war-gaming and related simulations enable management to think outside of conventional mental models to discover threats and opportunities of strategic choices. It can be particularly valuable in situations in which the actions of external parties will affect outcomes and generate second- and third-order effects.

To improve decision-making under uncertainty, organizations can employ war-gaming and simulations to identify marketplace dynamics and rehearse, refine, and test strategies and responses in a realistic environment.

For example, war-gaming and simulations can help organizations think through strategic questions such as:

- **How will our competitors, regulators, and consumers react if we launch our strategy?**
- **What would happen to our market position if we launch this product? What other outcomes might occur?**
- **What is the likely response of our employees if we make changes to our culture and incentives?**
- **What data do we have—or need to obtain—to successfully execute this strategy?**

War-gaming tends to be most applicable when the “game” is more or less understood and the goal—or “winning”—is fairly well defined, such as a successful product launch, price change, or crisis response.



War-gaming in action

A global investment bank used simulations to test its ability to execute a coordinated response to a major global counterparty and liquidity crisis. Specifically, the bank sought to test its ability to satisfy regulatory requirements and the needs of counterparties in a real-time, crisis-simulated situation. The simulation occurred over 48-hours with stakeholders from treasury, operations, data management, public relations, and the C-suite playing their roles. External subject matter experts played the roles of regulators and counterparties.

The exercise tested the capacity of the organization to aggregate exposures within four hours, and to execute a sequence of critical tasks and decisions needed to manage a crisis over a 48-hour period.

This simulation exercise:

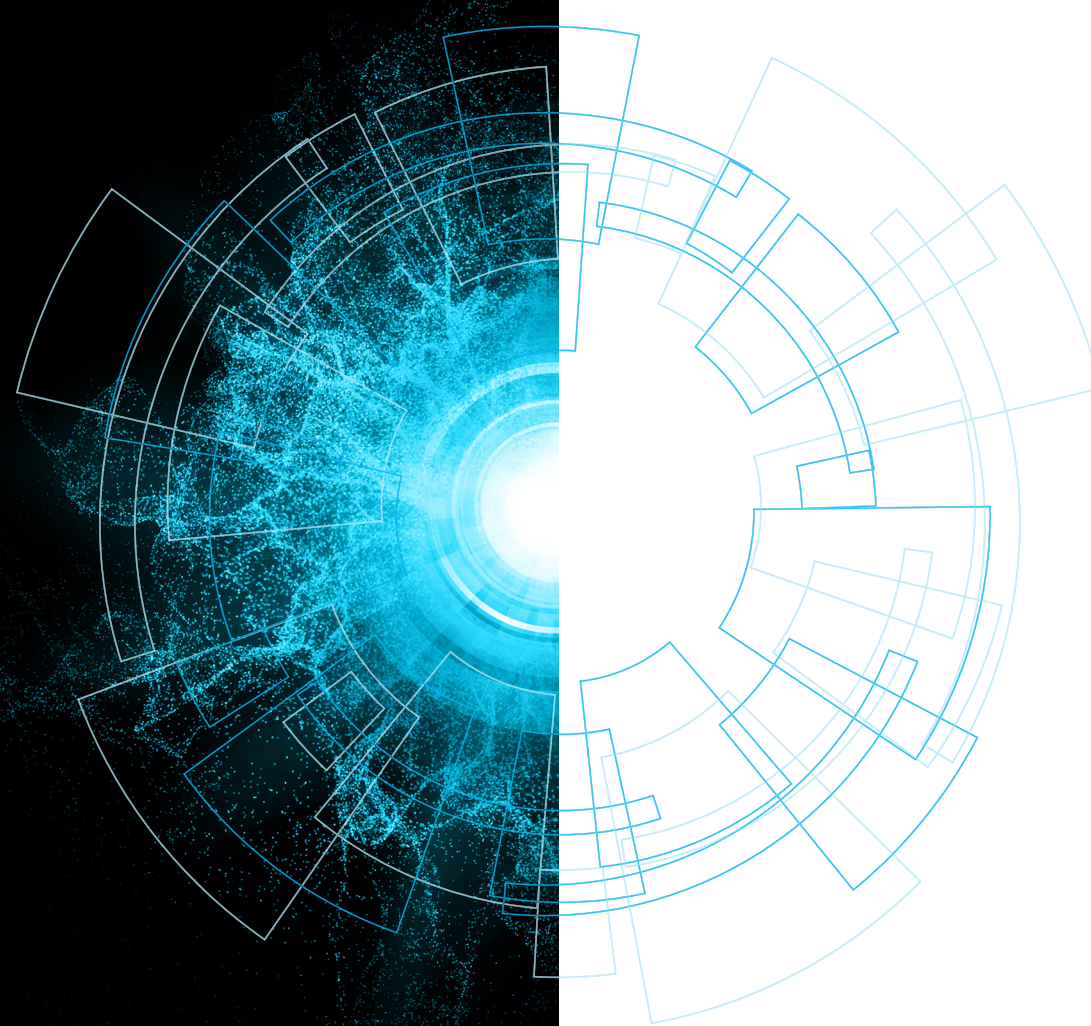
- **Generated greater understanding** of the bank's ability to manage client-related asset movements and crisis communications during a counterparty failure
- **Improved the standardization of the process and reporting template** for divisional exposures, resulting in a better understanding of aggregated risk exposure
- **Contributed to the development** of the institution's crisis management playbook

Seeing the future more clearly

Structured ways of exploring the future can enhance decision making, yet are often too limited to prepare the organization for the disruption of today's business environment. In addition, while strategic planning functions often use these tools, risk management functions tend not to, despite the potential benefits.

Scenario planning and war-gaming is designed to enhance risk management by combining creativity and rigor to chart pathways that would otherwise be undiscoverable. Our approach contributes a strong outside-in point of view, which corrects for the natural tendency of every organization to see itself and its world essentially in terms of itself.

Risk Intelligent Enterprises aim for readiness and resilience in the face of an uncertain future. Scenario planning and war-gaming are two tools for enabling that readiness and resilience and for positioning the organization to respond effectively, even if the future turns out quite differently than imagined.



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Please share this perspective with your teams and contact us when you're ready to start your Risk Intelligence journey.

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