Market Changes – Dealing with Uncertainty Using Scenario Planning

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In the turbulent business environment faced by modern law firms it is imperative that any strategy is robust. By this I mean that it has inbuilt flexibility, enabling it to respond appropriately and quickly to changing circumstances, as well as having sufficient resilience to allow firms to cope with more transient market fluctuations.

It is incumbent on the management team to put in place systems and measures to mitigate any potentially adverse developments (as well, of course, to maximise any opportunities which may arise). This can be achieved by ensuring that the firm has good 'horizon gazing' capabilities and through the use of scenario planning techniques.

By highlighting some of the key drivers which will affect law firms, together with the uncertainties which surround them, the highest impact events facing firms can be identified. We shall consider the principles of scenario planning and set out a practical framework, which allows the impact of unfolding events to be evaluated and incorporated into a firm's strategy process.

What do we mean by scenario planning?

The term scenario planning refers to a range of approaches which allow decision makers to paint a picture of what the future might look like based on their analysis of the major drivers of change in their business environments.

In some respects scenario planning is a creative process (rather like writing a novel) in which a set of known facts – about the firm, its markets, competition and wider economy – are used to create a number of 'plausible futures'. This enables the firm to understand how it would cope with each future, where weakness lies and which changes should be considered now to manage risk and capitalise on opportunity.

Consequently, in addition to strategy development, scenario planning is often also used to better understand the risks associated with a key decision which is being considered.
A flow chart of the overall process is shown in Figure 1.

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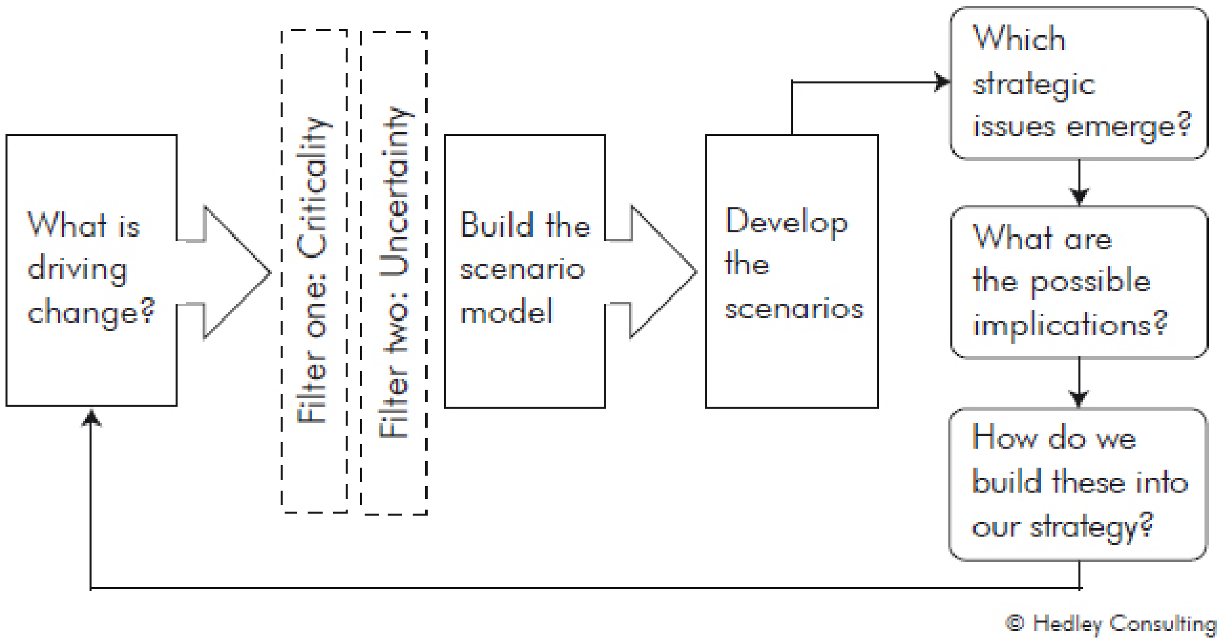

Figure 1: A process for scenario planning

Scenarios may emerge as a result of a number of factors (acting independently or collectively) to shape the business environment faced by firms. The challenge is for the strategist to develop a good understanding of each together with the firm's available options, allowing choices to be made across the range of high-impact situations identified.

From this analysis a range of preferred actions can be developed and a number of outline 'what if' plans created. This is far preferable to decision making, planning and implementation being undertaken on the hoof in the pressure-cooker environment of a fast-developing situation.

Identifying the drivers of change

In scenario planning it is fundamental that a good understanding of the possible drivers of change is gained. It is these which create the uncertainties around which judgments need to be made. These change drivers can be analysed within a framework that considers longer term macro-trends, more immediate competitive pressures and the firm's own capabilities and competencies.

The longer term view

An analysis of the longer term environment facing any organisation will potentially allow a number of drivers of change to be identified.

These will be the political, social, economic, technological, environmental and legislative developments which are shaping the future competitive environment. Taken collectively they comprise the 'PESTEL' acronym beloved of the strategist. By their very nature such changes are longer term and, as such, run the risk of being ignored for too long, while those tasked with devising business strategies focus on 'three-year survival plans' and dealing with immediate, rather than longer term, factors. This is wholly understandable but these cannot be discounted. Scenario techniques provide a means by which their possible impact can be considered and prepared for.

Today and tomorrow – The competitive analysis

As well as a macro-view, a competitive analysis should also be undertaken. This is conducted on a closer time horizon and so is likely to be seen as being of much more immediate relevance by partners in the firm. Such analyses are most often undertaken using models based on the Five Force framework first suggested by Michael Porter of Harvard Business School.

This analysis aims to explore the competitive pressures that a firm will face from five different perspectives.

Existing firms with whom one already competes present an obvious starting point for any scenario planning exercise. What would the impact be of significant changes – perhaps two rivals merging or one going out of business, for example? What would the firm's response be and how quickly could any strategic realignment be implemented?

Client power is higher now than at any point in history and all the indicators suggest that this trend will continue in the future. Moreover, the demands of the client are not simply being felt in pressures for lower fees but also in requirements for increased speed of action, higher levels of service and more commercially focused advice.

Larger clients now have the ability to access knowledge and compare competitive offerings through the use of expert systems, in-house databases and knowledge management tools. The pervasive powers of the internet and social media are excellent routes to information for those who are less frequent users of legal services.

What will the firm's response be to continued downwards pressure on price? How can any service differentiation strategy be made meaningful or will it simply incur incremental costs without any revenue benefit? How will client demands rise further when increased choice and more sophisticated marketing created by a deregulated profession affects the legal market?

Pressures affecting the cost base will have a significant impact on a firm's ability to eke a profit from its pressurised revenue streams. The cost base needs to be considered both in absolute terms – the relative price and affordability of staff, IT, PI insurance and the like. And, more importantly in the longer term, the firm's ability to reengineer itself to adopt a more appropriate operating model to create a step-change reduction in costs. In simple terms, ensuring that staff are being paid at market rates for their level of seniority is important but having the wrong staff doing work for which they are over-qualified will trump any salary benchmarking exercise. It is in this remodelling of the cost base that many firms will founder. What are the scenarios that will drive business model reengineering? What options does the firm have to engender change? What are the possible implications of following any particular route?

The actions of new entrants have been a significant factor for many firms over the past decade or more as expansionist firms from ‘out of area’ have set up camp either on a geographic, sector or practice area basis in order to compete for a share of historic client revenues. View the impact of US firms in London’s traditional financial markets or the UK’s expansionist national firms on historically stable (some might say inert) local markets and the impact of the new entrant firm is clear. Deregulation and the availability of external capital is likely to increase the activities of new entrants whether through start-up operations or the actions of a small number of consolidator brands. There are a number of potential scenarios which a prudent management team should consider and have actions plans sketched out to cope with, covering both the threat of existing law firms as well as the impact of ABS and third-party businesses.

The rise of substitute services will present a further series of challenges which need to be considered in scenario planning.

It appears certain that the lower-end, less complex and more process rich areas of legal services (many of which have been the traditional bread-and-butter work of small or mid-sized firms) will be particularly susceptible to attack from organisations, which are not law firms in the traditional sense, offering improved efficiencies and service levels at a lower cost. It should also be anticipated that the same organisations, having ‘cut their teeth’ on this initial tranche of work will seek to undertake those matters of a more complex nature which are regarded as being of low added-value by clients. Such actions will impact still further on the competition faced by firms.

The in-house legal community has grown at the fastest rate of any segment of the legal service industry in the UK over the past 15 years. In-house lawyers, backed by corporate brands and financial muscle, now have an opportunity to create legal service offers which were previously the sole domain of the private practitioner. They now have a route to market which, should they choose to exercise it, will create direct competition.

For those firms operating in the corporate and commercial spheres, there is the probability that the smart head of legal will disaggregate their purchasing ever more finely. With work being placed with providers using a ‘horses for courses’ matrix, it is likely that price competition in the mid-market will increase further. Some in-house departments will increasingly take the view that it is more efficient and cost effective to resource parts of their work internally to a much larger extent than ever before.

It is also important not to pigeon hole these forces as discrete events. In reality, it is most likely that they will combine; with one driving the other or providing a catalyst for wider change. It is clear, for example, that increased client pressure on fees will be exacerbated by market oversupply and the disruptive effects of new entrants.

Reality check – Internal analysis

Many firms face futures in which their own organisation itself presents some of the most significant challenges. These will commonly include constitutional, governance, succession, culture and management time bombs which are ticking but are either ignored or tampered with superficially on an infrequent basis.

Mired in the belief that normal service will be resumed at some point in the future, firms ignore the mismatch between the way in which they organise and manage themselves when compared to the evolving requirements of the market.

Internal analysis should inform scenarios centred on the requirements of future clients and markets in terms of the core competencies, skills and attitudes that will be required to succeed. Without the building of these competencies, what will the impact be? How will the competencies be acquired and over what timescale? What are the key drivers of change inside the firm and without?

The wake-up call of criticality and uncertainty

It should be clear that the identification of these possible drivers of change is only the starting point of scenario planning. Once identified, judgments need to be made as to the nature of these drivers (are they in themselves critical or, in combination, may they lead to critical events) together with the levels of uncertainty which surround them.

In developing a deep understanding of issues which are both critical and uncertain one gets to the nub of scenario planning.

This is because potential future changes which are both critical and uncertain may result in high impact situations for the firm. They provide the starting point for the creation of a range of alternative scenario models and their development into actionable plans.

Planning for the unexpected

Once these have been articulated and explored, issues which flow from then need to be considered and any implications built into strategic plans. The key questions centre on:

- What potential significant risks and opportunities are latent in the business environment and how can the firm mitigate the former and capitalise on the latter?

- What are the implications for the firm and how will they affect the current strategy and plan?

- How would the firm respond should one or more of these high-impact ‘what if’ scenarios were to unfold and over what timescale?

- Can the risk be managed adequately from within the framework of the existing strategy or is an addendum or alternative plan required?

- How often do we need to formally review the development of these scenarios? Who will have responsibility for ongoing background monitoring and access to the corporate 'alert button' should fast moving developments occur?

To be clear, the scenario approach is not about fundamental alterations to a firm's current strategic path per se. It is not a strategy review by another name but rather a stress testing of the current strategy and how it might be affected by change.

Nonetheless, there is a possibility that the firm's strategy is found to be wanting in some fundamental way. This is unlikely unless the process by which it was developed in the first place was fundamentally flawed. It is most likely that scenario plans will sit alongside the current strategy and inform its ongoing development.

Sourcing the intelligence needed for effective scenario planning

Many of the questions that I am asked by firms embarking on the development of a scenario planning approach are around the apparent difficulties in sourcing the forecasts and horizon-gazing information needed to generate the insights that are required to decide on key drivers, their impact and the levels of uncertainty surrounding them.

In truth, much of the necessary information already exists in the form of internal and readily accessible external knowledge sources.

Its unearthing should be regarded as a systematic process which moves the strategist from gathering and assessing data and information (whether internal or external) through to an evaluation of its impact.

As we have seen, the evaluation can be conducted using a number of the analytical frameworks commonly deployed in strategy development. Its purpose is to provide the insights and intelligence needed to build each of the scenarios on which the organisation will develop its anticipatory plans.

Importantly, it should be a continuous process that monitors leading indicators of potentially significant change on an ongoing basis. It is oft said, but always worth repeating, that the days of static three or five-year strategic plans are over (if they ever existed in the first place). Good strategies in the 21st century are defined by adaptability, nimbleness and the ability to deploy (and redeploy) assets in new configurations at pace, together with a willingness to embrace uncertainty as part of the planning process.

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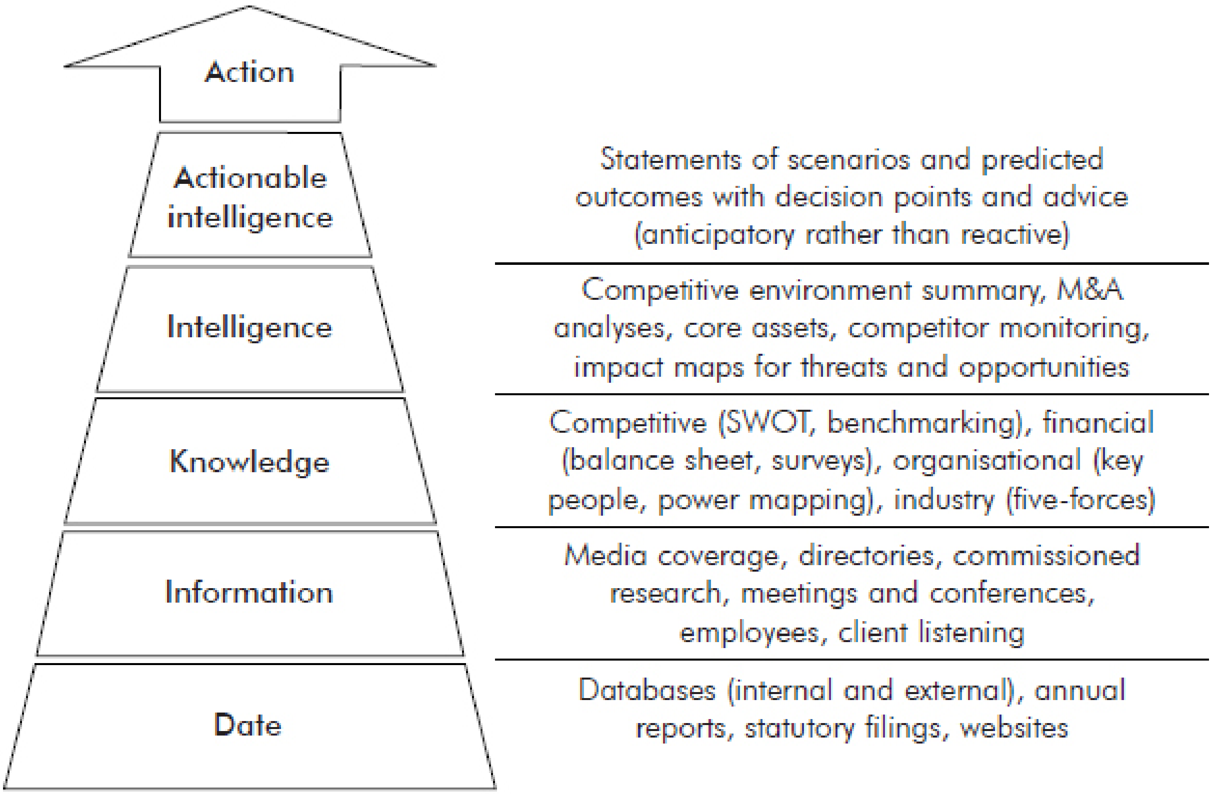

Figure 2: Intelligence evaluation

The implications of the ripple pattern

Any market development should be viewed from a number of important perspectives. For example, what will be the impact of any event be on each of the following?

- The firm directly and its immediate stakeholders – staff, suppliers, financiers and professional networks;
- More specifically, the partners and owners of the business;
- Current and future clients who will need our services – but which services and in what volumes;
- Looking further afield, the customers and clients of our clients – since they will drive the activity which ultimately will provide our workload; and
- How the world might look over the next few years and the implications for marketing strategy. In particular, how increasing levels of deregulation will affect firms in all parts of the market.

The pace and diversity of change in both society and business is such that having a rigid strategic plan is less viable and desirable. This will mean that an approach which embraces scenario planning will be increasingly important, both in articulating and quantifying the potential risks which exist in the business as well as providing confidence these have been fully considered in the firm’s strategy planning process.

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