STOP MAKING ASSUMPTIONS!
DEAL WITH UNCERTAINTY

Daniel S. Murad
President

The ChemQuest Group, Inc.
Cincinnati, Ohio

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Does your strategy work in a changing landscape?

The traditional route to strategy development requires precise predictions rooted in assumptions. We all know what happens when one assumes. Not too surprisingly, similar results occur in corporate strategies. At the heart of the traditional approach, executives use assumptions to predict the future and follow it by applying financial analytical tools to choose a strategic direction.

This process often ignores and/or underestimates uncertainty because of time/ resource constraints, lack of training and a myopic field of vision. Firms should not be disappointed therefore, to find themselves reacting to changes, rather than proactively planning for any uncertainty caused by the landscape external to their company. Most organizations revert to "gut feel" when faced with complex decisions that comprise multiple uncertainties.

Assess uncertainty, don't make assumptions. Acknowledging that uncertainties exist is good practice. Because, dealing with all uncertainties will result in more robust decisions and significantly better preparation when action is called for. Why do organizations have emergency response plans for their production units, but lack the same degree of risk assessment for their business planning?

Assessing Uncertainty

1) Identify all uncertainties associated with a strategic decision. It is very important to emphasize internal as well as external uncertainties, with a particular emphasis on the external. Internal uncertainties are within a company's control. A definitive decision can be made once enough data is generated on an uncertainty. However, external uncertainties are an outcome of a changing landscape. Organizations typically have no control over such uncertainties, e.g., economic, environmental, competitive reaction, substitute technologies, etc.

2) Structure the uncertainties[1].
   a) Comprehend how uncertainties relate to each other and to the decision criteria (financial e.g., NPV, DCF or otherwise) to ensure consideration of key risks.
   b) Select sources for assessment of uncertainty. Including sources of contrary opinion enhances decision quality.
3) Assess each uncertainty and its relational influence. There are many analytical tools available on the market today in the form of software packages and/or homegrown Microsoft Excel® add-ons. Some organizations may use a more complex methodology such as "Monte-Carlo" or "10% & 90%" probability modeling.

While it is often possible to reduce the risk of some uncertainties through market research (e.g., market trends, elasticity of demand, importance of technological attributes, etc.) it is the residual uncertainty (e.g., regulatory debate, competitors' plant builds/expansions) that create wide gaps between strategic planning and execution.

Residual uncertainty facing most strategic-decision makers falls into one of four broad levels ascending in complexity.[2]

Level One: A Clear Enough Future
At this level, the residual uncertainty is irrelevant allowing organizations to develop sufficiently precise strategic plans. In practice we found that utilization of traditional methodologies such as market research, value chain analysis and five forces analysis, provide relevant financial results.

Level Two: Alternative Futures
This is perhaps the most common. Here, the future can be described as one of few discrete scenarios. Level Two uncertainty is typically manifested in the form of regulatory uncertainties or competitor's strategies that are difficult to predict, such as an oligopoly market like TiO_2 where the primary uncertainty is competitors' plans to expand or build new capacity.

[1] K.Oppenheimer
[2] Courtney, Kirkland & Viguerie- McKinsey- Harvard Business Review November-December 1997

Analysis at this level should follow that stated above in Assessing Uncertainty, where probabilities are assigned to potential outcomes of each discrete scenario.

Level Three: A Range of Futures

There are no natural discrete scenarios. A limited number of variables describe the future and the outcome may lie somewhere in the range of variables. Level Three uncertainties typify situations where companies are expanding geographically and attempt to predict the rate of market penetration. In another common level three situation, the value of the strategy depends on predicting the implication of new technologies such as nano-particles.

Analysis at Level Three is similar to Level Two. Only organizations should form a few far-reaching alternative scenarios, illustrative of situations that make up a probable range of future outcomes, e.g., 80% probability.

Level Four: True Ambiguity

A number of dimensions of uncertainty interact to create an environment that is virtually impossible to predict. Level Four situations are quite rare, and they tend to migrate toward one of the others over time. Nevertheless, they do exist. Level Four uncertainty typically exists in situations such as investing in a region where there is a high degree of political unrest on a consistent basis, or currency devaluation, or no way of predicting laws governing property rights and transactions. Expanding operations into post communism Russia or present day Afghanistan, or certain countries in Latin America all represent illustrations of multi dimensional uncertainties that are illustrative of Level Four.

Analyses in Level Four situations are highly qualitative yet they must be done. The best approach is to refer to analogous situations that may have existed in another time or region, while adjusting with information relevant to the present situation. Companies can identify patterns that show how the strategy and markets may evolve by benchmarking indicators and determining the key attributes of past winners and losers in analogous situations, and by identifying the strategies they employed.

Regardless of the change in landscape, or complexity of uncertainty, be prepared. Develop your business response plan by identifying uncertainties, structure the relationship of influences, and assess outcomes. Above all, avoid making assumptions.

About The Author

Dan Murad

President
The ChemQuest Group, Inc.,
an international strategic management consulting firm specializing in the Adhesives, Sealants and Coatings industries,
headquartered in Cincinnati, Ohio.

Dan joined The ChemQuest Group, Inc. in 1996 from the Rohm & Haas Company where he was most recently European Director, Industrial Coatings. Prior to R&H, he spent thirteen years with Unocal Polymers where his career took him from technical service positions to Director of Marketing. He directed the sale of the Unocal Polymers Business to Rohm & Haas, working closely with Morgan Stanley, numerous attorneys, as well as the FTC. His entire career has been dedicated to the Coatings and Adhesives Industries. His particular strengths lie in strategic assessment and value creation on behalf of clients. He holds degrees from Wabash College (BS Chemistry) and William & Mary (MBA).
Contact Dan at (513) 469-7555 or dmurad@chemquest.com

Questions or request for additional copies of this paper may be directed to the author at:

The ChemQuest Group, Inc.
8150 Corporate Park Drive
Suite 250
Cincinnati, OH 45242

(513) 469-7555
(513) 469-7779 – FAX

www.chemquest.com