“Business Wargaming“

A New Approach to Strategy Development and Learning?

Kuala Lumpur, January 2009

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One thought to start off…

Impossibility Theorem

"One thing a person cannot do, no matter how rigorous his analysis or heroic his imagination, is to draw up a list of things that would never occur to him."

Thomas Schelling
Over the last months, we saw massive and little anticipated changes in the business environment!

Selection of Symptoms

- Major shifts in the banking, insurance and pension-plan landscape
- Increasing national debts and influence
- Liquidity constraints paired with higher risk premiums
- Roller-coasting raw material prices
- Capital expenditures are either moved back or cancelled all together
- Smaller budgets and degrees of freedom
- General insecurity – consumption is on the decline
- Recession in several economies – increasing unemployment

Higher factor volatility + unexpected events → Higher Insecurity
While most companies see the value of strategic planning, 28% consider the current tools as insufficient.

Assessment of relevance and efficiency of strategic planning (in %)

- Strategic Planning is Critical for Company’s Success
  - 5% Do not agree
  - 40% Do less agree
  - 55% Do agree
  - Fully agree

- Current Strategic Planning Tools are Sufficient
  - 2% Do not agree
  - 26% Do less agree
  - 52% Do agree
  - 19% Fully agree

Quelle: A.T. Kearney Swiss Strategic Planning Benchmark Studie 2008
40% of companies integrate future-focused methodologies into their strategic planning process.

Integration of future-focused methodologies

Not used: 5%
Fully Integrated: 40%
Integrated: 55%
Applied on an ad hoc basis: 17%
Not used: 5%
But even when using scenarios, some major deficits still remain.

<table>
<thead>
<tr>
<th>Classic Analysis</th>
<th>Advantages</th>
<th>Shortfalls</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Helps understand past trends and developments</td>
<td>• The data lies in the past and do not offer insights into the future</td>
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<td></td>
<td>• Helps reach assumptions about the future based on the past (Extrapolation)</td>
<td>• Disruptive changes (e.g. new business models) can not be captured</td>
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<table>
<thead>
<tr>
<th>Scenario Planning</th>
<th>Advantages</th>
<th>Shortfalls</th>
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<tr>
<td></td>
<td>• Helps to think in alternatives and assign them probabilities</td>
<td>• Scenarios are rational and safe expansions of the past</td>
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<td></td>
<td>• Helps to develop a comprehensive and interlinked strategy</td>
<td>• Scenarios are „black and white” – the reality includes many gray tones</td>
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<td></td>
<td></td>
<td>• Scenarios are biased by the people, who develop them</td>
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**Deficits**

- Lack of future-orientation
- Confined by the boundaries of the scenarios
- Limited contingency planning in the case of abrupt or disruptive changes
- Lack of buy in and support of management (only limited involvement during development)
Let aside that many companies do not use the full potential of working with scenarios.

Use of Entry Probabilities (in %)

- Not used: 21%
- Used on ad hoc basis: 48%
- Fully integrated: 31%

Quelle: Swiss Strategic Planning Benchmark Studie, A.T. Kearney
Business Wargaming leverages traditional strategic planning process by adding one important step.

1. **Assessment of Strategic Variables**
   - Potential Discontinuities
   - History & Trends
   - Foreseeable Developments
   - Critical Uncertainties

2. **Strategy Development**
   - Formulation of Strategic Objectives
   - Analysis/Scenario Development
   - Developing Strategic Options
   - Development of Strategic Plans

3. **Choosing a Strategy**
   - Traditional Strategic Planning Stops here!

4. **Testing the Selected Strategy**
   - Business Wargaming (Test)
     - (Re-)Actions of Competitors
     - Discontinuities & Frictions
     - Surprises
     - Regulatory Actions

5. **Lessons Learned (Basis for Adjustments)**

Choice of a Plan

A.T. Kearney 16/05.2008/2014
Business Wargaming – also called dynamic strategy simulations – originated in the military
Why Business Wargaming?

- Better understand the forces at work in the marketplace and how they affect the business
- Provide top managers with experience competitors lack
- Gain the buy-in from top managers to act on this understanding and experience
  - Buy-in comes from confidence in assumptions and potential outcomes
  - Confidence comes from looking forward and responding to the potential discontinuities and surprises a company might face in the future marketplace
Basic assumption is that the old rules don’t apply any more

Hey they’re lighting their arrows! Can they do that?

© 1997 Gary Larson
Business Wargaming allows to anticipate the dynamics in the corporate environment and to prepare accordingly...

<table>
<thead>
<tr>
<th>Business Wargaming is not ...</th>
<th>Business Wargaming ...</th>
</tr>
</thead>
<tbody>
<tr>
<td>• A business school game with a finite number of lessons to be learned</td>
<td>• Starts on a blank sheet of paper</td>
</tr>
<tr>
<td>• A computer simulation with answers built into the system</td>
<td>• Is designed for each client anew</td>
</tr>
<tr>
<td>• An off-the-shelf product, which is modified for each client and sold over and over again</td>
<td>• Answers specific questions</td>
</tr>
<tr>
<td></td>
<td>• Combines human decision making with quantitative measures</td>
</tr>
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<td></td>
<td>• Allows managers to test strategies in a dynamic environment and see what happens</td>
</tr>
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<td></td>
<td>• Saves time, money and grief as it allows to prepare for the “unforeseen”</td>
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Wargaming is a powerful, risk-free process for thinking about the future

- Players are likely to detect weaknesses or gaps in their own strategy
- New insights are derived concerning already known and not totally assessed issues
- Players understand possible competitor (re-)actions
- Players can prepare for unexpected events
- Players think creative about the future
- Players gain trust into the strategic plan
- Players Reduce risk
- Include management buy-in for future strategic plans
During a Wargame, managers take the role of their firm, their competitors, their customers and even the regulator.

**Team „Company“**
- Executes original strategy
- Makes adjustments based on reactions of market and competition

**Competitor Teams**
- Create offerings in the market
- Forge or dissolve alliances
- Manage profitability
- Take preemptive of reactive actions

**Market Team**
- Reacts to the strategies of the different competitors
- Drives market dynamic
- Judges attractiveness of offerings

**Control Team**
- Structures/runs the game
- Introduces external shocks
- Monitoring and arbitration
- Keeps track of model and quantitative variables
- Plays all other market participants
Wargames are typically played out over 3 "Moves“, simulating a certain period in time.
Typical questions that you can address using a wargaming approach:

- **Industry Consolidation** – No attractive partner left? What can I do?
  - Examples: Media, Telco, Automotive, Airlines

- **Changes of Business Model** – Loss of control over my market?
  - Examples: Pharma, PCs, Mobile Phones, Market Liberalization

- **How can I win?**
  - Examples: Technology Jumps, Product Introductions, Market Liberalization

- **How well am I prepared?**
  - Examples: Different Events, (Financial-) Crisis Planning

- **How do I make money in a commodity business?**
  - Examples: Music distribution, Automotive, PCs, Mobile Phones, Energy, Chemicals

- **How much is really necessary?**
  - Examples: Weapon Systems, Star Wars/SDI

- **Where is the next threat coming from?**
  - Example: Low-Cots Competitors, Global Shifts in Power, Terrorism
Business Wargaming can be applied for several different purposes and at different levels

- Testing strategies (Corporate, Business Unit, M&A)
- Crisis preparation
- Developing foresight
- Change Management
- Education and Recruiting
- Other possible fields are:
  - Reputation management (Corporate/National)
  - Strategic Early Warning Systems
  - Innovation-impulses (primarily on the product-level)
Case Examples
### Changing Market Conditions

#### Several Major Airlines

<table>
<thead>
<tr>
<th>Key questions</th>
<th>Key Learnings</th>
</tr>
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</table>
| • How strong can an airline be outside the major alliances? | • The business model for air travel has fundamentally changed  
  • Past – national airlines have been in partnership with national governments  
  • Today – cheap air travel is a basic fight; the public asks for low priced, reliable services and frequent connections to major hubs |
| • What is the value of any secondary carrier? Can a secondary carrier operate without integration into a major alliance system? | • An existence outside powerful alliances is difficult |
| • How much control are you willing to give up in order to gain access to the routes and landing slots which are critical for your survival? | • There is no apparent solution to combine of customers demand for low-priced air travel with the ambition to remain as an independent national carrier |
| • Where are conditions taking the airline industry? Is the “hub and spoke” system the future, or will some other business model emerge? | • No other routes have more travelers, more growth and profit than the transatlantic routes |
| | • The control of the home market depends primarily on the ability to feed enough passengers to the north Atlantic routes |
## Market launch new technology

### Large European mobile operator

### Key questions

- What are the opportunities in mobile data?
- What are the success factors for a successful positioning and how can this position be defended?

### Key Learnings

- It is not so much about technology, but rather what technology allows you to do
- The handset is a key success factor
- Less is more. Rather the right features as everything in one device. The market is limited in its capacity to absorb new features
- There was no “killer-application” like SMS for 3G mobile
- The right combination of hardware, software, and access to content will bring success
- Content partnerships are very important
- Mobile network operators are at a danger of becoming pure commodity providers
- A simplification of the price structure was urgently needed (flat rate model)

### Results

- The company had a solid strategy for the consumer segment, while the potential in the business segment was underestimated and not sufficiently addressed
- The company addressed the threat though commoditization by executing targeted content and portal strategies
Key Account Management

Fast Moving Consumer Goods Company (White-Label)

Key Questions
- What are the key success factors to break into new key accounts?
- How do I defend my position vs. aggressive competitors?
- How can I reach sustained product leadership by integrating suppliers and customers in my innovation process?

Key Learnings
- Success goes beyond the development and procurement of goods.
- Competence and advice in category management are important differentiators, which help to establish entry barriers.
- Other services such as labeling, legal clearance, logistics etc. are part of the value equation.
- Integrated innovation processes help secure long-term product leadership.
- The LOHAs movement is an important driver in the market going forward.

Special Point:
- A relatively young „Account Team“ had to compete against its predecessors, which had penetrated the account originally and since all have been promoted. They now played a formidable and experienced adversary trying to win the account back.
### Development of the Portable Audio Market

#### Recruiting Game at top business schools (The CEO Challenge)

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<td>• How will the market for portable audio devices develop?</td>
</tr>
<tr>
<td>• Can Apple defend, expand its dominant market position?</td>
</tr>
<tr>
<td>• What will the devices of the future look like?</td>
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<table>
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<tr>
<td>• Apple will be able to successfully and profitably defend its position.</td>
</tr>
<tr>
<td>• The biggest threat for Apple is not coming from portable audio device manufacturers, but mobile phone manufacturers.</td>
</tr>
<tr>
<td>• Trend towards simple user interfaces (software GUI instead of many buttons)</td>
</tr>
<tr>
<td>• Trend towards hybrid devices (phone and audio players) (\rightarrow) Prediction of iPhone</td>
</tr>
<tr>
<td>• Believed-to-be-dead brands will be reactivated; e.g. Sony Ericsson with the new-old &quot;Walkman&quot; logo</td>
</tr>
<tr>
<td>• The right combination of hardware, software, and access to content will bring success</td>
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What happens at a CEO Challenge?

- 30 students, from top business schools – come together to participate in a unique three day event

- They receive a crash course in strategy development and business wargaming, the industry to be simulated as well the specifics of the simulation

- The participants are broken into 5-6 smaller teams and they are lead by a team of 5-6 staff

- In these teams they create a vision and strategy for real companies reacting to ever changing market conditions or simulate the market

- Students also have the opportunity to interact with staff in casual settings
pictures from various events
Applications have risen sharply since the first event

Number of applicants

- October 2004: 45 (one event only)
- January 2005: 160 (two events)
- September 2005: 240 (two events)
- January 2006: 450 (two events)
The major learning for participants came from the simulation itself

Which activity helped you best understand what a consultant does?

Source: Participant Survey
All participants agree that the CEO challenge is a truly unique event

**Testimonials**

- “Fantastic - it really was an unforgettable experience.”
- “One of its kind”
- “The methodology is as close to real life as it gets”
- “It is very unique - especially in terms of exclusivity”
- “More creative and informational. A genius idea really”

**Testimonials**

- “This is definitely unique.”
- “Very Unique. I have never even heard of an event like this. Very cool”
- “Very original - way to lead the pack!”
- “No other company has a similar event. Most of them are competitive.”
- “I haven’t seen wargaming before, so it is a unique and cool proposition. This is much better than a case study”
- “Awesome! Nobody else does anything like this.”

*Source: Participant Survey*
Feedback of participants

“We looked at us and the industry through the eyes of our competitors and the marketplace. The world was really different and we began to understand why they sometimes didn’t do what we thought they might do.”

"I have never understood why they never acted the way as we thought they would."

“We are now making our decisions quicker, better coordinated and a whole lot smarter”.

"We were shocked... We learned a lot."

"One sale - which would have been lost previously - played for this simulation." (CEO)
If you would like to know more about this topic, please have a look at our new book...

Business Wargaming
Securing Corporate Value

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Questions?
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