Ashridge Strategic Management Centre
Members Meeting

21st November 2019

Minutes of Meeting

In attendance

Paul Barrett	Babcock
Chiara Covone	D S Smith
Paul Griffith	Ashridge
Richard Horstmann	SBM Offshore
Belinda Littleton	National Grid
Paul Titcombe	Atkins Group

From Ashridge Strategic Management Centre

Stephen Bungay
Neil Monnery
Jo Whitehead

A Tale of Two Economies

Before starting the main proceedings, Stephen drew attention to the publication of a new book by Neil Monnery's called 'A Tale of Two Economies', which builds on his previous work on Hong Kong's 'architect of prosperity' John Cowperthwaite, by comparing the Hong Kong economy to Cuba's and the role of Cowperthwaite to that of Che Guevara. Starting with very similar levels of GDP per capita in 1960, Cuba has since managed to multiply it by two and Hong Kong to multiply it by fourteen. His findings form a basis for the next Members' Meeting of 2020.

Neil's book can be found at https://www.amazon.co.uk/Tale-Two-Economies-Hong-Shaped/dp/1913377008/ref=sr_1_1?keywords=monnery&qid=1575396357&sr=8-1

Neil Monnery and Jo Whitehead: Avoiding Corporate Stumbles

Research carried out by Felix and Jo of 268 companies in the top 100 of US and European indices over a 10-year period showed that 55 of them - about 20% - suffered a 'stumble' leading to their value dropping to 25% below the local index and the loss of the CEO. The frequency was surprising and worrying, and since then Jo and Neil have been analysing the causes of ‘stumbles’ and thinking through some possible remedies. They took us through a number of features of the dataset that were surprising.

They began with the frequency. 20% is conservative, as the criteria employed excluded some companies (like Yahoo) protected by investments that appreciated enough to cover up value destruction in the base business (in their case Alibaba), and some near misses (like Vestas). A ‘stumble’ also involves the departure of the CEO under a cloud, indicating culpability on their part, and over the 10-year period the 55 companies were led by 476 CEO’s meaning that 7.5% of CEO’s were involved in a stumble.

In light of this it is perhaps surprising that there is little explicit focus on avoiding stumbles. There is no clear pattern enabling us to predict that one is likely to occur, and they are spread across a wide range of industries.

The overall findings suggest that although there were usually multiple compounding immediate causes, they were rarely the result of a failure in business as usual, but a consequence of taking on a major strategic challenge. A failed growth strategy was the prime or a major contributory cause in 84% of cases, and the majority were self-induced, the result of deliberate choices made by senior executives.

They usually involved a company finding itself under pressure to take on a difficult, complex challenge, which led it to choose an ambitious strategy with a bias to growth which involved taking on significant unfamiliar risks. The organisation lacked the capability to deal with them, making it overstretched and vulnerable, and subsequent events exposed its weaknesses, resulting in failure.

About a quarter of the challenges were unavoidable. Nokia, for example, had no choice but to respond to Apple. Some, like VW, appeared to be a result of a failure in executing business as usual, but on closer inspection the pressures which led to the emissions scandal were the result of self-imposed ambitions to grow in the US.

The majority of the failures, about 70%, were driven by challenges that did not have to be taken on – all were growth challenges. Tesco was cited as a classic example of this pattern. The critical decisions were taken by the leadership team, with the CEO in particular playing a major role.

The common factor behind these decisions was a bias to growth, resulting in aggressive growth targets, risky M&A or diversification. The resulting challenge was often amplified by predictable factors, such as not taking into account the cyclical nature of some businesses, ignoring the effects of the decision on the balance-sheet, taking on several challenges at the same time, ignoring the execution difficulties posed by organisational complexity or trying to take on an established and competent competitor in a winner-take-all environment.

In all cases of avoidable stumbles, these factors created a gap between the ambition and the capabilities of the organisation which could not be closed. And in most cases, both the gap and what needed to be done to close it were readily apparent but not addressed.

Jo asked Members whether the pattern laid out above describes any stumbles they might have experienced.

In 2001, one member company experienced a loss in value of 70% in just a single day, due to the interruption of cash flow. They had been growing very fast at low profitability and had spent £50-60m on a new IT system. After it was launched, they were unable to bill clients for three months. The resulting cash crisis was eventually resolved, but the CEO left. At the time it felt sudden, but the balance sheet risk had been identifiable. Neil commented that working capital issues should be added to the list of things that lead to stumbles. Thomas Cook (not included in the database) collapsed for a similar reason. Senior executives do not pay enough attention to the balance sheet as opposed to the P&L.

Another member company whose main business is floating oil production and storage units stumbled when it decided to move into drilling ships, which looked similar but turned out not to be. The difficulties created by this move were then compounded by a fall in the oil price and then topped by the unveiling of serious corruption at senior levels. Not only did the CEO leave, the company lost its business in Brazil which had made up 70% of its revenue.

The effects of unexpected amplifying events also played a role when another member company sold its gas distribution business and returned the money to shareholders, confident that it could fund growth in other areas. Then a change in the US tax regime starved it of the cash it needed.

Why do leadership teams fall prey to the risks leading to stumbles?

Jo and Neil identified four main factors: a lack of information or understanding; a gap in the skills of the team rendering them unable to deal with the challenge; bias in assessing the risk, especially a bias to growth and overconfidence, either in themselves or the company or both; and pressures on the leadership team to take on the challenge.

In the first case above, the move into drilling was pushed by a bias to growth but triggered by ignorance of the business.

Ignorance played a role in a recent event at another member company in which some poorly performing projects were discovered. This, combined with the announcement of prosecution over some corruption charges, led to the departure of the CEO.

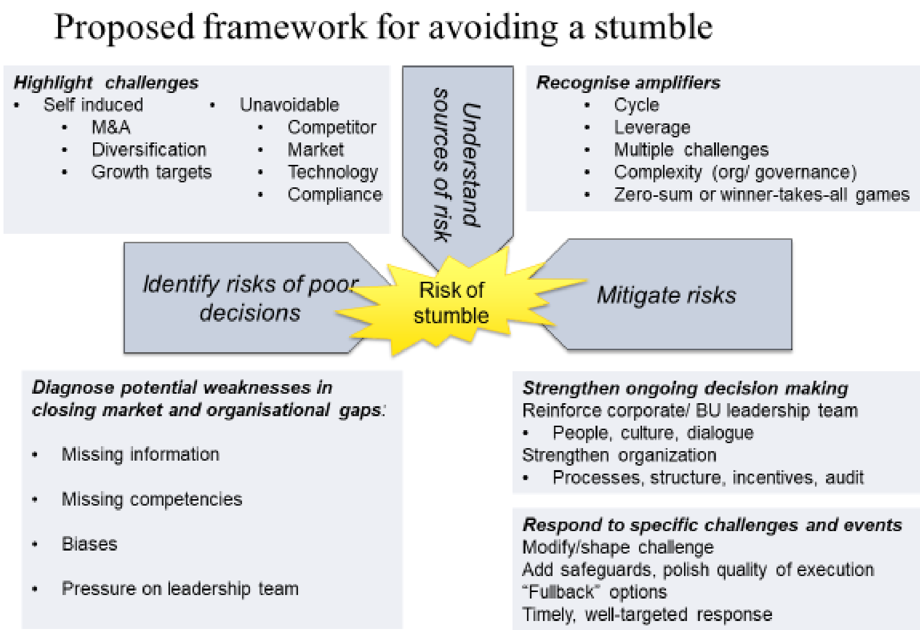
One member observed that many companies have changed their attitude to risk. Deaths on hazardous operations that used to be seen as inevitable are now no longer acceptable.

Ways to Reduce the Risk of Stumbling

To understand how to reduce the risk of stumbling, Jo and Neil compared the approach adopted by other companies in similar situations which avoided doing so, and also the steps taken by new leadership team who took over stumblers. This analysis suggests four ways of mitigating the risk:

1. To reduce the size of the capability gap by taking on a less demanding challenge, lowering the level of ambition or working harder on the execution gaps, such as BHP selling its US shale gas investments or BT reducing its international ambitions;
2. To strengthen the leadership team and/or decision-making processes by making changes at Corporate or BU level, such as replacing senior executives, changing reporting lines or creating mechanisms like Dimon's 'Italian suppers' at J P Morgan Chase designed to 'get the dead cat on the table';
3. To add specific safeguards such as introducing more data or expertise, having further debates, strengthening governance or monitoring progress towards milestones, as suggested in Jo and Andrew's book 'Think Again';
4. If all else fails, to avert a stumble though a timely and well-targeted recovery (such as Exxon's response to the Valdez spill contrasted with BP's response to Bluewater Horizon, or Toyota's recall of vehicles in contrast to VW's cover up of the emissions trickery).

Against this background, Jo and Neil proposed a framework for mitigating the risk of a stumble which is designed to initiate the kind of conversation the senior team need to be having:



A similar function is performed by the tool called 'vulnerability analysis' developed by Stephen and Rebecca in their work on uncertainty.

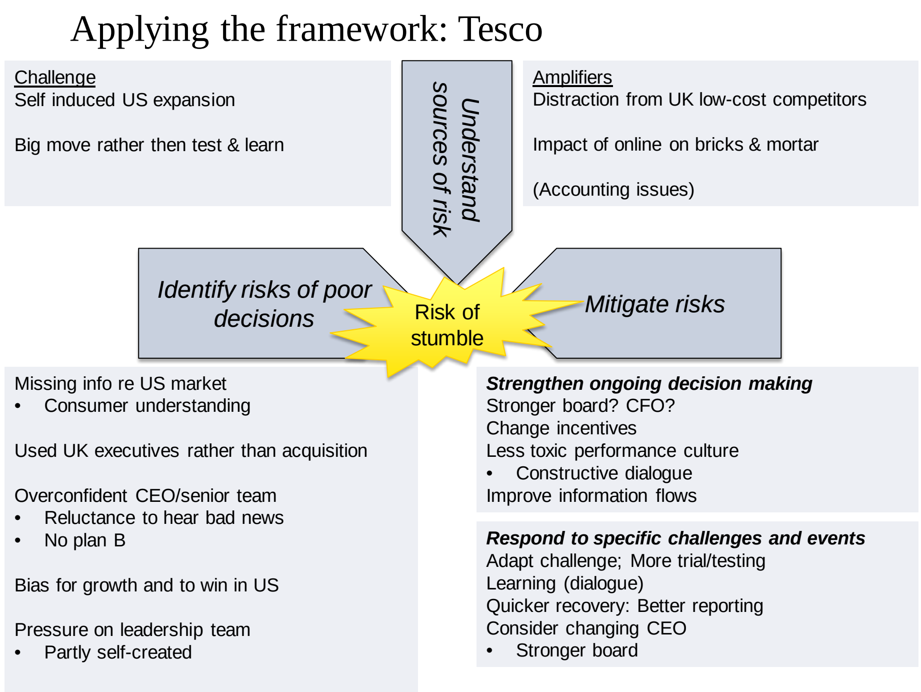
The greatest resilience comes from a combination of:

> continuous work to strengthen general defences through heightening the role of risk management and cultivating constructive dialogue to identify problems early;
>
> and identifying and addressing specific challenges to reduce risk.

They all require work on people, processes and information. Working on people is powerful but slow. Processes can identify challenges and potential triggers, by creating a shortlist of the big ones and adding new ones as they arise.

The final *in extremis* option is to save a deteriorating situation by using a 'fullback'. These include firing the CEO, a sub-group of the board blocking the decision, the intervention of shareholder activists or the actions of a whistle-blower.

How the framework could be applied can be illustrated by the case of Tesco, which began moving towards a stumble under Leahy and completed the process under Clarke:



The company did not understand the habits of the US shopper. Rather than testing and learning Tesco made a big move into the US, driven by the desire – though not the need – to grow. It tried for five years and withdrew in 2012. Clarke was fired in 2014.

One member asked, given the prevalence of people issues, whether HR has a role to play in prevention. There may be something it can do in people evaluation, development and succession planning. However, the hard cases of potentially dangerous personalities at the top, such as Greenbury at M&S or Goodwin at RBS are very hard to mitigate, as they come with highly successful track records and wield a lot of power.

After some discussion Members broke out to discuss a real challenge where there was the risk of a stumble and consider how it might have been mitigated.

As a result of this exercise, it became apparent that almost every member company had in fact experienced a stumble or something very like it. Common themes of the discussions were to improve the quality of information and the timing of information flow, and to push back against the bias to growth. This bias is deeply entrenched and perhaps much of the value of this work is to provide stories that will warn against its perils. Such stories might in fact be more effective than a process or methodology.

We ended the meeting as usual with summary comments around the table:

- It would be good to have a list of stumbles. We are currently deciding what our risk appetite is. In developing scenarios around peak oil, changes in several drivers could mean we would have to adapt fast.

- The list of processes is very stimulating. Maybe we should be making changes to the risk register. The bias to growth is familiar, and there is a need to be able to challenge CEO ambitions.

- We could use vulnerability analysis to challenge the business. Perhaps we could produce an annual stumbles paper – there would be a good readership for that.

- A useful stimulus to thinking about decision making relationships and fostering constructive dialogue.

- This paper in itself provides a useful means of challenging some assumptions about the need for growth. The combination of broad statistics and stories which provide some parallels could be very salutary in changing attitudes.

Future meetings

This meeting took place at a new venue, 11 Cavendish Square. The general view taken by those present was that it was an improvement on our old venue, and we will therefore use it again in 2020.

However, 11 Cavendish Square is not available for our next meeting on 5th March so for that we will return to The Royal Horseguards Hotel, 2 Whitehall Court, Whitehall, London SW1A 2EJ.

This meeting will be led by Neil Monnery and will draw on the themes of his new book and his work on value management. The subject will be economic growth and business value creation.

The meetings scheduled for next year are as follows:

5th March, Royal Horseguards – economic growth and value creation with Neil Monnery;

4th June at 11 Cavendish Square – building an open innovation system and partnering with start-ups with Rebecca Homkes and a guest speaker.

24th September at 11 Cavendish Square – the role of the strategy function in the double portfolio transformation at DSM, with guest presenters Hein Schreuder and Rob van Leen;

10th December at 11 Cavendish Square (provisional date tbc) – strategic agility and growing through uncertainty with Rebecca Homkes and Stephen Bungay.

Members are also reminded about the next Strategy Team Seminar. Each Member has two free places on these seminars. The next one will be held on **Thursday 9th January 2020**, 10.00 – 17.00 at De Vere Venues, Holborn Bars, 138-142 Holborn, London EC1N 2NQ. The subject will be Corporate Strategy and will be led by Jo Whitehead.

The full seminar schedule for next year is as follows:

- **9th January 2020: Corporate Strategy** with Jo Whitehead
- **25th March 2020: International Strategy** with Marcus Alexander
- **9th June 2020: Strategic Planning** with Jo Whitehead, Rebecca Homkes and Hein Schreuder
- **15th July 2020**: **M&A** with Andrew Campbell
- **15th October 2020: Growth Initiatives** with Andrew Campbell
- **December 2020 (tbc): Strategic Decisions** with Jo Whitehead

Please let angela.munro@ashridge.hult.edu know if you would like to reserve a place for members of your team.