Avoiding corporate stumbles

ASMC Members Meeting

21 November 2019

Suggested Agenda

Topic	Timing
Introduction	14.00
Who stumbled? Why?	14.10
Discussion	14.30
What can be done?	15.10
Break	15.30
Breakout and reporting back	15.50
Pitfalls to avoid	16.30
Round the table	17.00

Stumblers is an under researched area

- **Prior studies of under-performing companies have limitations**
  - None combine a holistic approach with a representative sample

- **There are open questions on which there are different views e.g.,**
  - How frequent are stumbles? How much should we worry?
  - What are the causes of stumbling? BAU organisational failure, senior management decision making, external events or “other”? If a mixture, what are the typical patterns?
  - How feasible is it to avoid stumbling? Is it generally the result of unavoidable forces such as new competitors or unexpected changes?
  - If feasible to avoid, what are the key changes to make? Organisational? Senior team? Processes? Incentives? …?
  - To what extent can the risk of stumbling be avoided through a programmatic approach?

Members Meeting Update: Stumblers

- **We have done further case study analysis on the 55 stumblers identified**

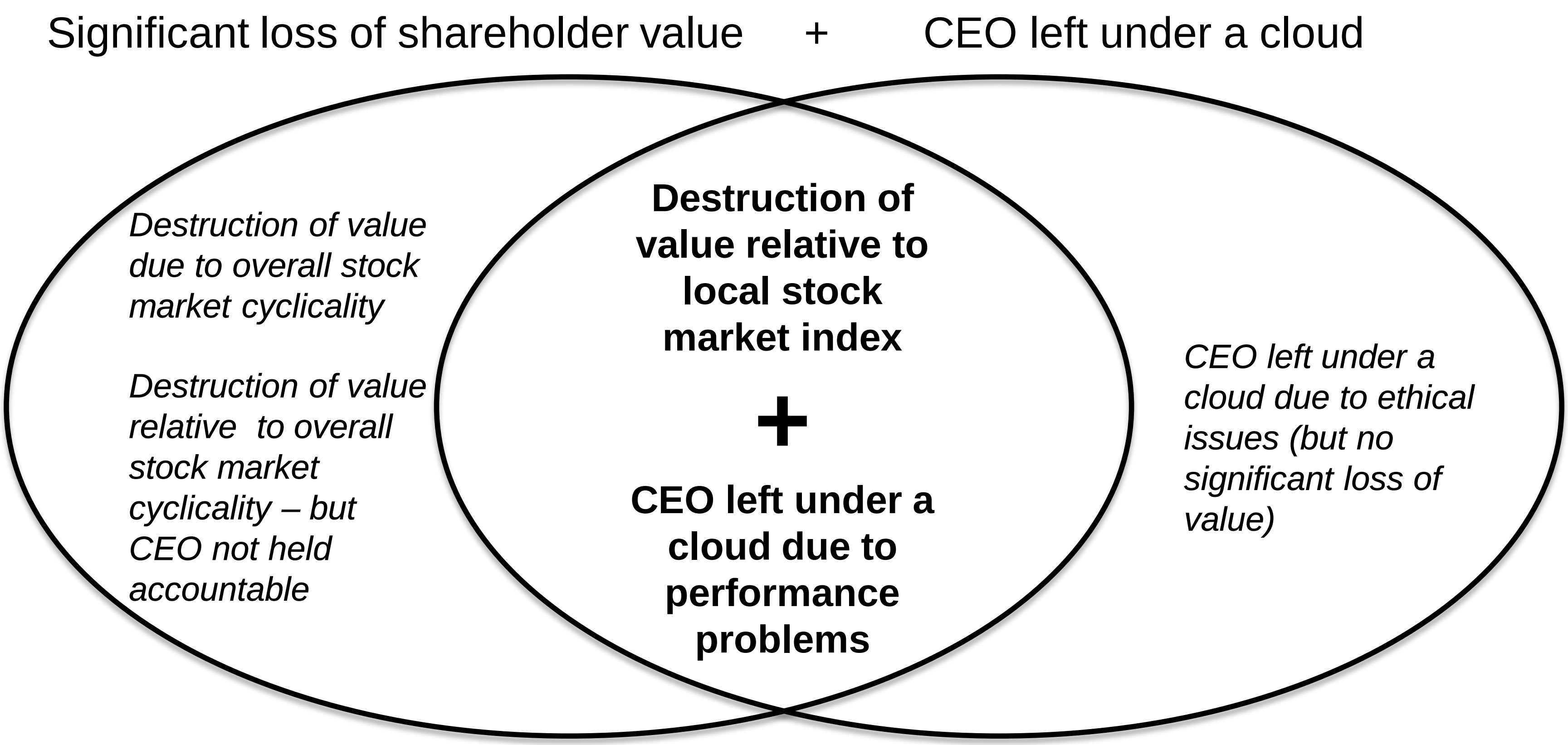
- **Several surprising observations about stumblers**
    1. Stumbling is unexpectedly frequent
    2. There is little explicit focus on avoiding stumbles
    3. Most stumbles are not caused by BAU
    4. Only a minority of stumbles are unavoidable
    5. The majority of challenges were self-induced
    6. The difficulty of the challenge was often amplified by predictable factors
    7. Stumbles mostly caused by the leadership team not doing what they should know needs to get done
    8. The main reasons why leadership teams fall short in reducing the risks of stumbling are information, competence, bias and (resistable) pressures to take on difficult challenges

- **We propose two main types of remedy that could prevent stumbles**
    - Some ongoing work can be done to increase an organizations defences against stumbles
    - And extra mitigation can be deployed when a specific challenge arises

Agenda

- **Who stumbled?**
- **Why did they stumble?**
- **What can be done to reduce the risk of stumbling?**
- **Summary and round-the-table**

We focused our survey on situations in which a significant loss of value might have been avoided



Surprise 1: Stumbling is unexpectedly frequent

- **We evaluated 268 companies over a 10 year period**
  - All those in the top 100 in Europe or the US between 2006 and 2016

- **A stumble was defined as**
  - >25% drop in share price relative to the local index over one or two years, AND..
  - CEO left under a cloud (excl those in post for < 2 years)

- **1 in 5 companies stumbled**
  - 55 stumbles in the 10 year period

- **1 in 8 CEOs stumbled**
  - 55 of 476 CEOs who left their post after serving for at least 2 years

- **20% chance of a major setback is significant**
  - Many issues in risk register with lower probability

N.B. 37 stumbles in Europe versus 18 in US. 21% of CEOs stumbled in Europe versus 15% in US
Shorter CEO period in office in Europe; smaller average company size

Surprise 2: Little explicit focus on avoiding stumbles

- **Stumbling is no fun**
  - CEO departs
  - Shareholders lose out
    - A total cost of about $1 trillion in lost value
    - 40% average TSR underperformance in stumbling CEOs last 2 years in office
  - Business often in turmoil

- **Would expect more senior management focus on avoiding a 20% chance of a very significant setback**
  - Frequency and impact much higher than many risk register or strategic plan items

- **Also relatively limited research on the interaction of factors that lead to stumbling**

- **The objective of the research is to**
  - <u>Understand why stumbles occur</u>
  - <u>Propose what can be done to reduce the risk</u>

Wide range of stumblers

	Consumer	Energy	Financial	Health	Industrial	Technology	Minerals	Utlities
Europe	• Volks-wagen • Carrefour • Tesco	• BG Group • BP	• Ageas (Fortis) * • Assicurazioni Generali • Barclays • Deutsche Bank (2) • KBC Group * • RBS* • Societe Generale • Standard Chartered • Swedbank • Swiss Re* • UBS Group* (2) • Unicredit	• GSK	• AP Moller - Maersk • Rolls-Royce	• Nokia OY (2) • Ericsson	• Anglo American • BHP Billiton • Rio Tinto	• BT • Orange • Telecom Italia • Electricite de France • Veolia Environn-ement
US	• Target • Time warner • CVS	• Apache • Trans-ocean	• AIG* • Bank of America* • Bank of NYMellon • Citigroup* • CME group inc • Fannie Mae* • Morgan Stanley*			• Ebay • Intel • Yahoo (2)	• Newmont	

* = Financial services stumble as a direct result of the financial crisis

N.B. Multiple stumbles are indicated by numbers in brackets

The analysis covers all 55 companies, but we will draw mainly on ten case studies to illustrate the framework (1)

- **Tesco**
  - Failed push into US market with Fresh & Easy
  - Eye off the ball in core UK market
- **RBS**
  - Failed to identify time bombs in the balance sheet at ABM Amro acquisition, even as the financial crisis was hitting
- **Nokia**
  - Inadequate strategy to deal with competitor action (launch of iPhone)
  - Critical software developed in a cumbersome joint venture (Simbian)
- **BP**
  - Failure to prevent or contain Deep Water Horizon, despite awareness of safety issues
  - Safety improvement programme strengthened, but only after the tragedy
- **Carrefour**
  - Inexperienced team chosen to turn around core business

The analysis covers all 55 companies, but we will draw mainly on ten case studies to illustrate the framework (2)

- **CVS**
  - Acquisition of Caremark, a mail-order prescription provider created potential conflicts of interest
  - CVS accused of forcing Caremark customers to switch to travel to CVS stores

- **Barclays**
  - LIBOR crisis forced Bob Diamond out of Barclays
  - Push for ambitious growth prioritized over clear messages over values and behaviour

- **BT**
  - Limits to growth encouraged entry into international markets, providing long term communications outsourcing contracts for large organizations
  - Poor design of contracts exposed by crash; large losses

- **VW**
  - VW pushing for significant growth to build scale versus Toyota and other global auto companies
  - Pressure to produce distinctive cars for US market led to “Dieselgate”

- **AIG**
  - Didn’t realise that (autonomous) Business units had toxic assets on their balance sheets as a way to perk up returns to hit ambitious growth targets

Agenda

- **Who stumbled?**
- **Why did they stumble?**
- **What can be done to reduce the risk of stumbling?**
- **Summary and round-the-table**

Surprise 3: Most stumbles not caused from BAU

- **Of the 55 examples only 2 were due to a failure at executing BAU**
  - A BAU stumble is defined as when an organization stumbles when seeking to address a challenge that is the result of the historic (BAU) strategy
  - Both Societe General under Bouton and UBS under Grubel stumbled due to rogue traders, despite these trading activities being within the boundaries of the historic strategy
  - BAU failures contributed at other stumblers, but were not the major reasons

- **The vast majority are the result of taking on a new strategic challenge**
  - Major M&A, diversifications, self-imposed growth targets, new competitors etc
  - Stumbles were sometimes triggered by operational failures – but this was due to the new challenging stretching the organization beyond what it had historically being required to do

- **This greatly narrows where companies need to be alert to a potential stumble, and guard against it**
  - Best place to look for potential stumbles is in the new challenges that a company takes on
  - Best group to focus on is the “leadership team” who drive strategy creation and execution,
  - e.g., CEO, Kitchen cabinet, Executive team CEO/Chairman/COO, Executive+Board

In the case studies we traced back the root cause of stumbles

- **Often the proximate cause of a stumble is not the root cause, for example:**
  - A profits warning may be the result of failing to meet a market change
  - Exiting a poor diversification acquisition may be caused by inappropriate growth targets

- **Most compliance issues have underlying causes**
  - Barclays prioritized growth – sending mixed signals about compliance
  - BP leadership team took an ”Exxon-lite” approach that did not apply the full safety improvement process to rigs that they did not own e.g,. Deepwater Horizon

- **Example: VW suffered a major compliance challenge in the US when it was found to met emissions standards only by having rigged engine software**
  - But, the fact that the stumble was initiated in the US hints at the underlying reason;
    - Growth target to reach 10 million vehicle global production
    - Target required a major increase in US market share
    - Only source of advantage was the environmentally friendly high mpg of its diesel engines
  - Organisation found a way to make diesels compliant with new, stringent regulations that reduced the particulates that diesel engines could release
    - VW organisational culture emphasized delivering on targets, or else…
    - HQ informed of the problem but did not intervene

Surprise 4: Only a minority of stumbles are unavoidable

- **Many previous studies claim that it is a change in the external environment that causes corporate failure (stumbles)**
  - Competitor or technological or market change
  - Inadequate response
  - Underperformance

- **We have classified the challenge faced by some of our 55 stumbles as unavoidable, for example**
  - Carrefour's rejuvenation of its base business
  - Nokia's response to the rise of the iPhone
  - BP organizing for profits and safety

- **Only about a quarter (27%) of our stumbles were unavoidable:**
  - And some of these are just performing poorly in the ore (e.g., Carrefour)
  - But still worth checking for dangerous changes in the environment
  - Just not the main source of stumbles

Nokia had no choice but to respond to the iPhone

- **In June 2007 Apple launched the iPhone OS1.0**
  - In development since 2004 (Project Purple); previous unsuccessful JV with Motorola
  - 6.1m units sold before replaced by iPhone 3G in July 2018
- **By 2007 Nokia had c.40% share of the mobile market**
  - Led by N95, launched Sept 2006
  - First carphone in 1982, mobile in 1987 (Cityman 900), camera phone in 2003
- **But, unable to deal with Apple's entry into smart phone market**
  - Nokia took 2 ½ years to launch their iPhone killer, the N97
  - Delay stemmed from use of the outdated operating system, produced by Symbian, which was a joint venture
  - Historical strategy had been to customize software to the phones, rather than focus on a single operating system
  - Finnish team relatively inexperienced in the required knowhow
- **Stumble**
  - Stockprice dropped 46% in the two years before Kallasvuo was forced out
  - Elop, Kallasvuo's replacement hired from Microsoft also unsuccessful and left three years after being appointed
  - Eventual sale of the mobile business to Microsoft

Surprise 5: The majority of challenges were self-induced

- **70% of the 55 examples were driven by taking on a challenge that did not need to be taken on**
  - Tesco’s push into the US
  - Internationalisation and diversification by BT
  - Ambitious growth target set by VW

- **These are decisions taken by the leadership team**

- **Leadership team frequently has control over whether such future challenges are taken-on**
  - Ex-ante one option is for companies to avoid self-induced challenges e.g., targets, potential acquisitions, diversifications
  - Once assumed, or if unavoidable (e.g., due to market changes, competitor actions) , the challenge must be addressed, but
    - might be structured in a way to reduce the risk of failure e.g., BT could have forensically monitored early contracts
    - Can sometimes be backed out of e.g., investment in financial assets
  - In most cases, other companies in the same environment avoided stumbling
    - Either avoided the challenge or dealt with it differently and more successfully
    - (Only exception; commodity companies)

For example, Tesco chose to enter the US market, and stumbled

- **In mid-2000s Tesco had built a leading position in UK supermarket retailing**
  - And had expanded internationally and into internet grocery shopping

- **After two years of studying the US market Tesco's opened its first Fresh & Easy store in Los Angeles in November 2007**
  - Over 200 stores opened with > £1b investment
  - After a series of strategic and operational problems Tesco exited US in 2012/13
  - Meanwhile business failed to fully respond to changes in core UK market, especially rise of discounters
  - Combined with accounting issues to create stumble

- **Entering the US was a self-induced challenge**
  - Came unstuck since Tesco's did not develop the market position and business model to succeed in US
  - Driven in part by an inapproriate growth target, not deliverable in UK alone

- **Leadership team deficiencies central to stumble**
  - Despite having a great deal of desk-top information on the US market, there was a lack of understanding of US consumers and markets
  - Team deployed led by Tim Mason (UK marketing director), reporting directly to Leahy
  - Overconfidence and slow response (denial?) as early results dissapointed

70% of stumbles were avoidable

Category of stumble	Number	Percentage	Examples
Avoidable	39	70%	
• Large M&A	8	41%	RBS, Veolia, EdF
• Diversification	23	14%	BT, Time Warner, Apache
• Aggressive growth target	8	14%	VW, BG Group
Unavoidable	15	27%	Nokia, BP
BAU	2	4%	UBS (Grubel), Soc Gen
Total	*56**	*100%*	

* Two companies faced twin challenges and nature of challenge was unclear for one company

Surprise 6: Often the challenge is amplified by predictable factors

- **Sometimes the underlying problem turns into a stumble because of an amplifying factor**
  - Alone the problem would not have created a stumble (as defined)

- **The most frequent amplifier was not accounting and planning for cyclicality in cyclical businesses, thereby turning some problems into stumbles**
  - Example: All the mining companies made investments that were then exposed when commodity price crashes

- **Other amplifiers, which may be overlooked when evaluating the challenge**
  - Leverage and off-balance sheet liabilities (e.g., EdF debt levels)
  - Taking on multiple challenges, especially if they result in conflicting priorities (e.g., BG Group taking on the challenges of Improvements in production <u>and</u> Growth)
  - Challenges managed within complex/difficult organisational or governance structures e.g.,
    - Organisations where complex tasks are outsourced (BP)
    - Overly decentralized organisations (Swedbank, AIG)
    - Complex/diversified/matrix/international organisations (BP, VW)
    - Difficult boards (Italian banks)
  - Zero-sum or winner-takes-all industries, particular when up against strong competitors (e.g., trading against Goldman Sachs, competing against Apple in smart phones)

Types of amplifier and examples

Type of amplifier	Examples
Cyclicality	• Mining companies stumbled when falls in commodity prices exposed the weaknesses of their diversifications
Leverage and off-balance sheet liabilities	• EdF made several large acquisitions fueled by debt; the lack of value creation and the financial crisis resulted in a significant fall in value
Multiple challenges	• BG Group took on the challenges of Improvements in production <u>and</u> maintaining an ambitious growth target • Ericsson faced the challenge of dealing with a low cost competitor, Huawei, and also diversified from products into services
Challenges managed within complex/difficult organisational or governance structures	• BP was a highly decentralized organization with various cultures in different parts of the business – some of which were less compliant with safety practices than others. Similar argument applies to Barclays • Swedbank did not send senior executives into its acquisitions in the Baltics and the Ukraine, contributing to highly aggressive lending practices that resulted in significant write downs in the crisis
Zero-sum or winner-takes-all games against strong competitors	• Many of the stumblers in the financial crisis were, in effect, gambling in a game against more sophisticated competitors such as Goldman Sachs and JP Morgan Chase • Nokia ended up in a “winner takes all” competition for the smart phone business against Apple and Google

Surprise 7: Stumbles mostly caused by the leadership team not doing what they should know needs to get done

- **Adopting a new challenge (self-induced or unavoidable) gives rise to a new and different required market position and organization**

- **This creates a gap between this existing and required position and organization**
  - Ranging from minor to extensive levels of required change

- **Stumbles occur because this gap is not closed**

- **Usually the gap, and what needs to be done to close it, is known or knowable**
  - Few stumbles caused by unexpected factors

- **This points to the cause of stumbles being a failure of the leadership team**
  - Changing market position and organization to meet the challenge is a key responsibility of leadership management
  - The examples of comparable companies and subsequent leadership teams suggests that in most cases a different team could have done better…
  - …even in cases where the gap might have been too big to have closed completely e.g., Nokia, Yahoo

BP was unable to close the organizational gap

- **BP recognized that they had to take on the challenge improving safety**
  - Decentralised organisational model created a wide variation in safety practices
  - US downstream business in the spotlight after Texas City disaster killed 15 people and an Alaskan pipeline had a major lead of crude oil
  - Hayward promised a “laser-like” focus on safety
  - Plenty of examples e.g., Exxon, Shell, Dupont

- **The required changes were fudged – “Exxon-lite”**
  - Improvements require a shift towards more central; on partially implemented
  - Safety performance included in incentives, but only 10% and based on the wrong type of metrics (outcomes not process metrics)
  - OMS (operating management system) used to create standardized processes; but not applied fully to BP operated assets which were owned by other companies e.g., Deepwater Horizon (which was owned by Transocean)
  - Auditing function reduced in some areas e.g., US team hired from Dupont

- **After the tragedy, BP addressed all these areas e.g.,**
  - OMS applied to all operations under BPs control
  - Centralization
  - Board-level oversight

Surprise 8: Why leadership teams fall short in their efforts to reduce the risk of stumbling

- **Ignorance: A lack of knowledge and understanding**
  - If the leadership team lack the required knowledge then this may be enough to result in a stumble
  - Ignorance comes from a mix of the team members knowledge and the information that they do (or don't) receive

- **Missing capabilities: Lack of capability to understand and deal with the challenge**
  - A mixture of the innate abilities, education and experience of the team

- **Bias: Lack of objectivity in acknowledging risk. Two main biases:**
  - Hubris/overconfidence
  - A bias to growth

- **Frequently compounded by pressures that cajole leaders into taking on more risk**

Examples of why stumblers fall short

- **BP**
  - Information; unaware of full extent of the problems
  - Bias; overconfidence that the measures undertaken were adequate

- **AIG**
  - Information; unaware of the presence of toxic assets on business unit balance sheets
  - Bias to growth resulted in maintenance of high growth profit targets that led to business units “perking up” their returns by holiding assets that gave superior returns

- **RBS**
  - Incompetence; RBS expert at taking cost out of acquisitions; less familiarity with dealing with potentially toxic assets
  - Bias; overconfidence, board encouraged acquisition, lack of challenge to Sir Fred

- **Carrefour**
  - Incompetence; Executive team lacked expertise in the French market

Pressures on senior team can also contribute to them taking on potentially inappropriate challenges

- **External factors**
  - Core market stagnation or market share max out e.g., BT
  - A tough unavoidable challenge in the core business e.g., Ericsson diversified because it faced margin pressures in its core
  - Aggressive competitors, putting pressure on for a strong response e.g., VW potentially pressurized by Toyota’s target for increased global market share
  - Attractive adjacent markets e.g., mining commodities expanded outside of their core markets because commodity prices rose together; CVS attracted by vertical integration that proved attractive in the long run (but only after CVS stumbled due to flawed execution)

- **Internal factors**
  - Past successes, leading to hubris and/or a pressure to keep growing e.g., BG Group, AIG
  - A beguiling strategy for the core business e.g., VW’s goal of global scale implied an increase in US market share; UBS wanted to add investment banking and asset management to strengthen its private banking position
  - Influential stakeholders or advisers

Discussion: The causes of stumbles

- **Thinking of a stumble, or near stumble, that you have experienced, was our characterization of the reasons for most stumbles an adequate description?**
  - A company takes on a strategic challenge
    - Typically an avoidable growth challenge
  - The difficulty may be amplified by a variety of factors
    - e.g., cyclicality, leverage and off-balance sheet liabilities, multiple challenges, complex/difficult organisational or governance structures, zero-sum or winner-takes-all games against strong competitors
  - The leadership team fails to make the necessary changes in market position or organisational capabilities, due to a mix of:
    - Missing information
    - Missing competencies
    - Biases (particularly over-confidence or a bias to growth)

    …exacerbated by perceived pressures on the team

- **Suggest discussing in groups of two or three, then sharing in plenary**

Agenda

- **Who stumbled?**
- **Why did they stumble?**
- **What can be done to reduce the risk of stumbling?**
  - Insights from the case studies
  - Proposals
- **Summary and round-the-table**

We took two approaches to understanding what companies do to mitigate the risk of stumbling

- **Strategies taken by other companies in similar situations, but who avoided stumbling e.g.,**
  - Goldman Sachs, JPMorgan Chase, MunichRe (versus SwissRe), Handlesbank (versus Swedbank) in the Financial crisis
  - Toyota (versus VW), Exxon (versus BP) following compliance failures
  - Nokia (versus Ericsson, post exiting smart phones), in response to the threat of Huawei to their networks business

- **What new leadership teams did when they took over a company that had stumbled e.g.,**
  - Tesco closed US and focused on fixing the UK business
  - BP were much more aggressive in implementing changes that adequately addressed poor safety culture and performance
  - Carrefour appointed a CEO with more relevant experience and focused more on cost reduction in a price-competitive business
  - CVS stuck with the same strategy of vertical integration and focused on managing the integration of the new acquisition
  - Barclays cut back on investment banking and enforced firm-wide values and behaviours

Cases suggest four ways to mitigate risk of stumbling (I)

1. **Lower the risk of stumbling by reducing the size of the gap between the current market position and organization and that required to address the challenge taken on; several variants**
   a) Change to a less difficult or more appropriate challenge e.g., Mining companies, Citigroup (post-Pandit) focused on cost reduction rather than growth
   b) Stick with the challenge but reduce the gap by lowering the level of the ambition e.g., BT lowered international growth ambitions
   c) Stick with the challenge but work harder to fix gaps e.g., CVS, Morgan Stanley stuck with the strategy but plugged gaps in execution

One way to mitigate the risk of a stumble is to reduce the size of the gap between the current and required market position and organisation

Ways to close the gap	Examples from the case studies
Change to a less difficult or more appropriate challenge	*BHP* sold off its US Shale gas investments, reversing its move to enter that business
Stick with the challenge but reduce the gap by lowering the level of the ambition	*BT*. BT kept its international business but lowered the ambitious growth rate and worked hard to improve its organization's capabilities to manage the remaining contracts *Citigroup*, after the departure of Vikram Pandit, cut back on the size of it's ambitious international network of countries, withdrawing from a number of countries to improve profits
Stick with the challenge that has created the gap, but work harder to reduce the gap	*CVS*. After stumbling over a tricky vertical integration, the next leadership team stuck with the strategy which proved very profitable *BP*. After Deepwater Horizon major organisational changes were made to address deep structural and cultural safety problems. Safety was monitored through committees which reported up the hierarchy to board level. The upstream organization was centralized to get more consistency. The operating system was extended to contractors

Cases suggest four ways to mitigate risk of stumbling (II)

2. **Strengthen the leadership team and ongoing processes; several variants**
   a) Changes across the entire organization, to rewire compliance processes at BP and Exxon, or quality management and compliance at Toyota
      - Powerful but expensive; appropriate for dealing with ongoing, major challenges

   b) Changes at BU level to strengthen capabilities to grow into new businesses at Goldman Sachs

   c) In many cases changes to the top team were used to bring in change the leadership, strengthen the team and/or respond to any changes to the challenges taken on

Backup

Examples of strengthening the leadership team and ongoing processes (I)

	How BP improved compliance (post Macondo)	How Goldman Sachs entered new markets
Summary	*Broad-based changes: Re-wire organisation with limited changes at the top*	*Focus on BU leadership: Creative co-CEO model to make imported skills effective*
Reinforce leadership team (Corporate/BU) • People • Culture/values • Incentives • Constructive dialogue	• Replaced CEO and Head of Upstream with insiders • Strengthened monitoring and incentives for safety compliance (changing the metrics to be predictive and not just outcome focused)	• Hire experts as co-head of BU e.g., Fischer Black • Pair with Goldman Sachs insider • Work hard on alignment to partnership ethos and incentives
Strengthen organization processes	• Top-to-bottom rewiring of operating processes and information flows	
Other changes to the organisation	• Centralise upstream structure and reporting	

Despite the different approaches, a common feature is that the Corporate leadership team plays a critical role in avoiding stumbles

Examples of strengthening the leadership team and ongoing processes (II)

	How JP MorganChase survived the crisis	**How Carrefour responded to stumbling in France**
Summary	*Top team: Foster well-informed constructive dialogue and information sharing*	*CEO: Replace stumbler CEO with someone competent to deal with the challenge*
Reinforce leadership team (Corporate/BU) • People • Culture/values • Incentives • Constructive dialogue	• Mixture of Dimon loyalists, long-term locals and new hires • ”Italian suppers” style of debate • “Get the dead cat on the table” • Leads to sharing of information across silos e.g., sub-prime • Dimon taps contacts down the hierarchy	• Replaced Olafsson, a Swede from Nestle, with Georges Plassat, a Frenchman with a long career in super and hypermarkets
Strengthen organization processes		
Other changes to the organisation		• Allowed more local buying decisions

Levels are typically determined by where the critical information flows from and where decisions have to be made

Cases suggest four ways to mitigate risk of stumbling (III)

3. **Add extra safeguards to handle specific challenges**
   - Provides a more customized and flexible approach to reducing risk
   - Suitable when new challenges emerge (e.g., Nokia) or ongoing challenges become more difficult (e.g., financial crisis)
   - But can face resistance when biases or competence of leadership team is challenged

4. **If all else fails, a full stumble might be averted by a timely and well-targeted recovery**

Another approach is to add extra safeguards to handle specific challenges

In “Think Again” we identified four types of additional safeguards, with three types of benefit

Type of safeguard \ Benefit	Better information and analysis	Mitigating impact of biases	More able top people
1. Data, analysis and expertise	✓✓✓	✓✓	✓
2. Debate and challenge		✓✓✓	
3. Governance		✓	✓✓
4. Target setting and monitoring	✓✓	✓✓✓	

Source: Think Again, Why Good Leaders make bad decisions and How to keep it from happening to you

However, our 2018 survey on safeguards suggested that the most powerful safeguards can be difficult to introduce

- **Safeguards that are aimed at providing better information and analysis are somewhat helpful and relatively non-controversial**

- **However, safeguards aimed at mitigating the impact of biases, or gaps in senior team capabilities, are often resisted**
  - Some company cultures more open to strategic risk management than others
  - Those that most need extra safeguards also likely to be those that are most resistant
  - Cunning interventions required
    - Need to be highly focused on areas where their value is clear and they are unlikely to attract significant pushback from powerful parties
    - But, may provide only incremental mitigation

- **For more information, see Appendix, which contains some representative slides from our work in 2018**

The last throw of the dice is to recover effectively

- **Some stumblers made things worse through their initial response**
  - BP's response was speedy but poorly handled e.g., the amount of oil being released was under-reported, notable gaffes from Tony Hayward
  - VW dragged its heels; When an academic paper described the illegally high levels of emissions from its cars, VW dug itself into a bigger hole by spending 18 months denying to the authorities that there was a problem
- **Comparable companies who suffered from a near-stumble, but avoided its worst effects, responsed in a more timely and accurate fashion**
  - Like BP, Exxon had experienced some serious compliance issues, culminating in the Valdez oil spill – but responded accurately, with major organisational changes, to become an industry leader in compliance
  - Toyota faced a host of criticisms over product quality, which exploded in 2010 and led to the recall of more than 20 million vehicles – but within a few months it responded aggressively to mitigate the fallout and has largely recovered

Implication: A timely, well-targeted response can reduce the amount of damage and the CEO being forced out

Implications: Two approaches to mitigation

1. Ongoing work to strengthen defences

1. Reinforce corporate and BU leadership teams e.g., people, culture/values/constructive dialogue, incentives

2. Strengthen organisation e.g., processes, structure, incentives, audit

2. Extra mitigation, triggered by specific challenge or event

Modify/ shape the challenge → Add safeguards → Recover well

Agenda

- **Who stumbled?**
- **Why did they stumble?**
- **What can be done to reduce the risk of stumbling?**
  - Insights from the case studies
  - Proposals
- **Summary and round-the-table**

Proposed framework for avoiding a stumble

Highlight challenges

- Self induced
  - M&A
  - Diversification
  - Growth targets
- Unavoidable
  - Competitor
  - Market
  - Technology
  - Compliance

Understand sources of risk

Recognise amplifiers

- Cycle
- Leverage
- Multiple challenges
- Complexity (org/ governance)
- Zero-sum or winner-takes-all games

Identify risks of poor decisions

Risk of stumble

Mitigate risks

Diagnose potential weaknesses in closing market and organisational gaps*:*

- Missing information
- Missing competencies
- Biases
- Pressure on leadership team

Strengthen ongoing decision making

Reinforce corporate/ BU leadership team

- People, culture, dialogue

Strengthen organization

- Processes, structure, incentives, audit

Respond to specific challenges and events

Modify/shape challenge

Add safeguards, polish quality of execution

“Fullback” options

Timely, well-targeted response

Greatest resilience comes from general and specific mitigation

- **Ongoing work to increase defences is valuable**
  - Improving leadership team for challenges ahead
  - Embed risk-managing culture
  - Permit and practice constructive dialogue
  - Align incentives with mitigatory behaviours

- **And there are actions to mitigate specific challenges and events**
  - Modify/shape the challenge to reduce risk
  - Add safeguards
    - Information/ analysis
    - People (e.g., experts, influencers)
    - Decision process (debate, challenge, governance)
    - Monitoring and feedback
  - In extremis, “fullback” options
  - Recover well

- **Mitigation requires working on people, processes, information**

Avoiding stumbles through people is powerful but slow to build

- **A key line of defence is the people that you have**
  - Obviously sometimes this is the problem too!

- **Existing processes can be co-opted**
  - Succession planning and People plan to create the right skills longer term
  - Incentive scheme can used to channel behavior and reduce possible triggers
    - Eg remove any bias to growth; ensure downside risk shared
  - Culture and values slow to build, but can be used to reinforce approach
    - Long termism, real value creation, realism, etc

- **In the short term the people options are probably centered on ensuring best foot forward**
  - Adding key hires to mitigate risk
  - Specialist/consulting expertise
  - Senior advisor

Processes can be adapted or strengthened

		Use/tweak existing process	Add new process safeguards
Ongoing decision "infrastructure:	1. Identify general challenges with potential to lead to stumbles 2. Identify amplifiers 3. Identify general causes of poor decisions (information, competence, bias, pressures)	Adapt risk register to include possible stumbles Inc list in LT plan Strategy days/ Board strategy discussion	Ad-hoc informal discussions NED interviews Annual 'stumbles' paper
Event specific safeguards	4. Diagnose gap between existing and required position and organization created by challenge	Increase focus on description of gap in business case	Separate business case and gap management team
	5. Modify/ shape challenge to better suit current position and model (iterate)	Include alternative options based on key gaps in business case	
	6. Create plan to close key gaps	Gap identification and plan	Require gap plan sign-off
	7. Identify potential stumble triggers	Strategy scenarios Sensitivities	Trigger audit: Bias audit, Competence audit, Information audit, Pressures audit
	8. Execute plan to close gap	Steering committee Progress reports	Stumble/trigger reviews

Some stumbles can be saved by a fullback

- **Sometimes the challenge and how to adapt to it is not remedied by process or people**

- **There are a number of ‘fullback’ options available**
  - Chair fires the CEO, or CEO eases Chair out
  - SID intervenes
  - A sub-group on the board block
  - Shareholder activists intervene
  - Financial advisor or broker refuses to back the change
  - Creative head of strategy finds way to shine the spotlight on a particularly risky strategy or threat
  - Whistleblower acts

- **These are all in extremis options**
  - Will almost certainly lead to loss of some of the leadership group
  - Significant short term pain and disruption

- **But many of these routes would have been materially better than what actually happened at some of our stumblers**

Applying the framework: Tesco

<u>Challenge</u>
Self induced US expansion

Big move rather then test & learn

Understand sources of risk

<u>Amplifiers</u>
Distraction from UK low-cost competitors

Impact of online on bricks & mortar

(Accounting issues)

Identify risks of poor decisions

Risk of stumble

Mitigate risks

Missing info re US market
- Consumer understanding

Used UK executives rather than acquisition

Overconfident CEO/senior team
- Reluctance to hear bad news
- No plan B

Bias for growth and to win in US

Pressure on leadership team
- Partly self-created

Strengthen ongoing decision making
Stronger board? CFO?
Change incentives
Less toxic performance culture
- Constructive dialogue

Improve information flows

Respond to specific challenges and events
Adapt challenge; More trial/testing
Learning (dialogue)
Quicker recovery: Better reporting
Consider changing CEO
- Stronger board

Discussion

- **Working in groups, identify a challenge where there is the risk of a stumble**
  - Which of the ways of mitigating risks would you use? Any other ways? (See slide “Proposed framework for avoiding a stumble”)
  - If the Chairman was concerned about the same risk, how would the answer change, if at all?

- **Supplementary questions**
  - Overall, how strong is your organisation at:
    - Understanding sources of stumbler risk (challenges and amplifiers)
    - Diagnosing potential weaknesses in closing market and organisational gaps (information, capabilities, biases, pressures)
    - Mitigating risks (ongoing and challenge/event specific)
  - Who is/should be responsible for all of this?

Finally, beware traps when mitigating risks

Trap	Examples and underlying reasons	Potential solutions
Mitigation not applied equally well across the organization	BP, JPMorgan Chase (organisational change required)	• Compliance management best practices e.g., independence, board level reporting, incentives
Mitigation doesn't work first time, but action to address is delayed	Carrefour, Deutsche Bank (difficult tasks)	• Recognize the size of the position/ organization gap to be closed • Monitor progress • Presume anchoring is taking place
Mitigation works for most visible challenge - but fails to address other challenges	Wells Fargo (Hubris/ missing competencies)	• Robust annual stumblers review
Mitigation works for most visible challenge – but new challenges emerge	Goldman Sachs (industry evolution)	• Robust annual stumblers review
Mitigation creates early warning signs that are then ignored	VW (Hubris/ missing competencies)	• Board level reporting?

Some further solutions to traps are useful in all situations e.g., assumption of hubris, constructive paranoia, strong upward flow of information, effective governance

Discussion (time-permitting)

- **Imagining that you have successfully made the case that stumblers need more attention, and extra mitigation has been approved in principle, what might yet go wrong?**

- **Does this align with our list of traps? What would you add?**

Agenda

- **Who stumbled?**
- **Why did they stumble?**
- **What can be done to reduce the risk of stumbling?**
- **Summary and round-the-table**

MEMBERS MEETINGS IN 2020

- **5th March 2020: Economic Growth and Business Value Creation** with Neil Monnery

- **4th June 2020: Building an open innovation ecosystems and partnering with startups** with Rebecca Homkes and guest speaker

- **24th September 2020: From Coal to Biotech: Portfolio Transformation at DSM** with guests Hein Schreuder and Rob van Leen

- **10th December 2020 (tbc): Strategic agility and growing through uncertainty** with Rebecca Homkes and Stephen Bungay

SEMINARS IN 2020

- **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: Strategic Decisions** with Jo Whitehead

BOOTCAMPS 2020

2020 ASMC Strategy Bootcamp: 5th – 8th October 2020

Topics:

- Strategy and value creation: The strategy story
- Strategy tools
- Strategy and finance and Building a business case
- Corporate strategy
- Strategy under uncertainty

NEW! ASMC Corporate Innovation Bootcamp: 1st – 3rd December 2020 (tbc)

Topics:

- Preparing for corporate innovation
- Learning better sessions from startups: Ideation and Growth
- Ideation sprints: Getting to the idea
- Market acceleration: Growing your ideas
- Open innovation: Successful partnerships
- Guest speakers: CVCs, entrepreneurs, and company founders partnering with large corporates

NB. *Custom offerings of both are available*

APPENDIX: Selection of slides from November 2018 Members meeting

In 2018 we conducted a survey into how a selection of these safeguards are used to reduce stumbling risk

- **Questionnaire completed by about 30 strategists; follow up interviews with about half**
  - Mostly heads of strategy
  - Some CEOs, CFOs, Chairmen
- **Main focus was what tools and techniques they used to reduce the risk of a bad strategy**
  - Whether they used them
  - Frequency
  - Perceived value
  - Examples of other approaches
- **Key findings:**
  - Most valuable and commonly used are ongoing processes for monitoring results in execution; but typically focused on smaller stumbles e.g., BU projects
  - Traditional techniques commonly used, with variable value
  - More powerful, challenging techniques valuable but not often used; difficult to introduce into many senior teams

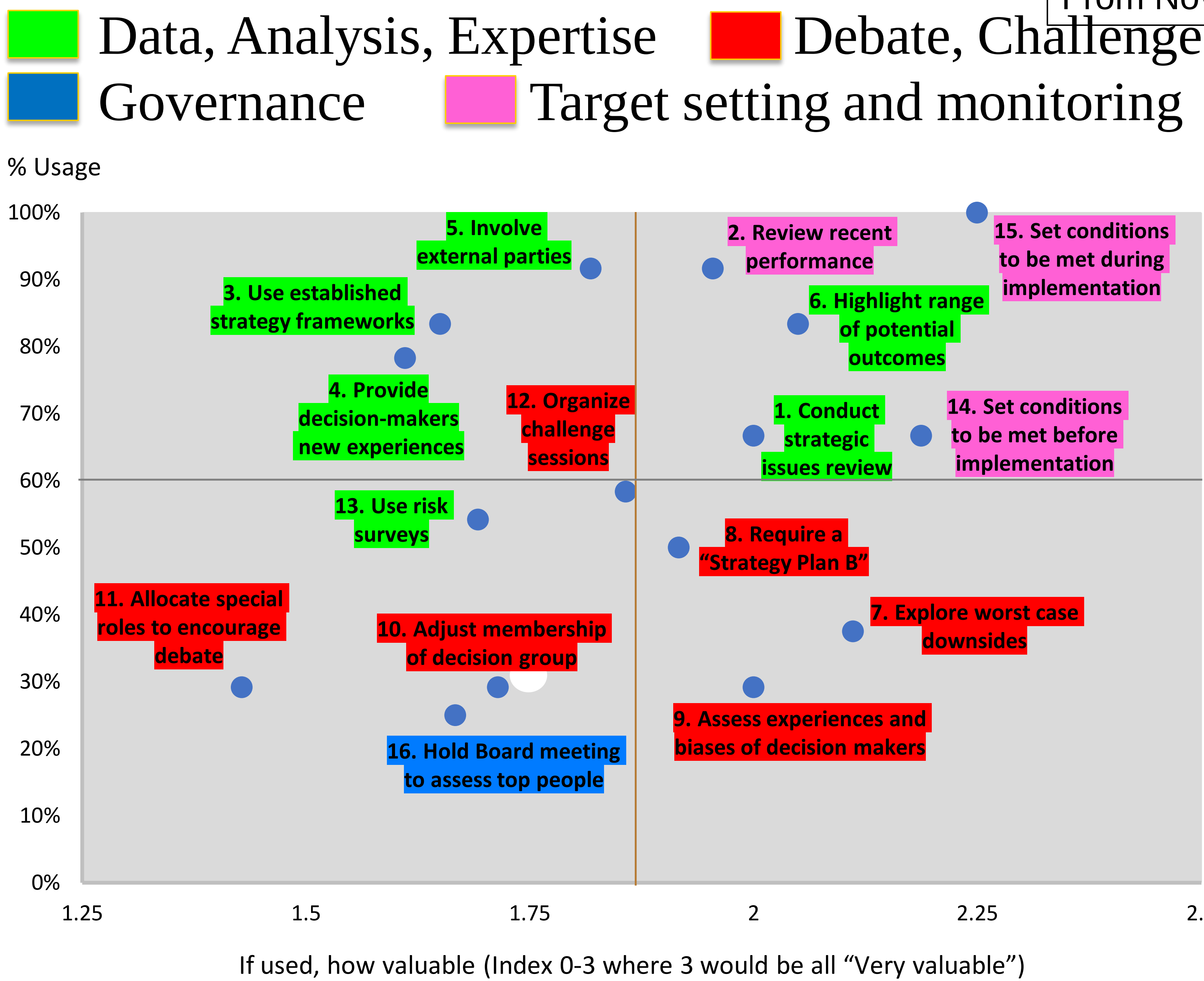
From Nov 18

Information problems easier to address than bias and ability problems?

- **Adding data, analysis and external expertise is common**
  - But limited value in addressing bias or top people's ability
- **Increasing debate and challenge or questioning top people's ability less common and often not seen as successful**
  - Different skills required to improve debate and challenge?
  - Challenging top people's ability hard to do?
- **Target setting and monitoring used and valuable both in improving information and reducing impact of biases**
  - Tie decision-makers to the mast before they are tempted
  - But can't monitor and control one-off big bets

See next slide for data !

From Nov 18


Data, Analysis, Expertise
Debate, Challenge
Governance
Target setting and monitoring
% Usage
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
1.25
1.5
1.75
2
2.25
2.5
If used, how valuable (Index 0-3 where 3 would be all "Very valuable")
5. Involve external parties
2. Review recent performance
15. Set conditions to be met during implementation
3. Use established strategy frameworks
6. Highlight range of potential outcomes
4. Provide decision-makers new experiences
12. Organize challenge sessions
1. Conduct strategic issues review
14. Set conditions to be met before implementation
13. Use risk surveys
8. Require a "Strategy Plan B"
11. Allocate special roles to encourage debate
10. Adjust membership of decision group
7. Explore worst case downsides
9. Assess experiences and biases of decision makers
16. Hold Board meeting to assess top people

From Nov 18

Strategy team career background a possible constraint on use of debate and challenge techniques

- **Strategy team most often with analytical background**
  - Experienced in techniques providing more data and analysis?
- **Less prior experience in psychology, sociology**
  - Lack know-how with techniques to challenge biases?

From Nov 18

Some company cultures more open to strategic risk management than others

- **“Risk managers”**
  - A wide range of techniques used to prepare well and consider potentially damaging biases
  - Supportive and conservative CEO, culture of challenge, often strong head of strategy
- **“The Jungle”**
  - Challenge difficult, techniques to address biases face strong resistance
  - Ad hoc and/or “guerilla tactics” used to influence decision making if possible

From Nov 18

Example of the spectrum of company cultures

- **“In a previous role I didn’t have much power and I couldn’t directly challenge key executives, so I used some of these techniques to build consensus within the senior team that there were risks that needed to be looked at further:**
  - Reviewing past investments to learn about what typically goes wrong
  - Using strategy frameworks like the cash cow matrix to frame the situation and highlight areas of risk
  - Conducting external and sometimes internal surveys or interviews to identify areas of weaknesses

- **When I moved to being Head of Strategy at a new company, the CEO was conservative and keen to make sure we didn’t stumble (Risk manager). I did a lot of work on risks – but it was a mix of informal discussions and some staff work – so I didn’t often need to use the techniques, except within my own team or to help my own thinking”**

From Nov 18

Barriers to successful use of techniques suggest some questions to ask before getting started

- **Focus**
  - + Focus is on risks from competitor activity
  - - Very limited time wasted on other risks
- **Value-added**
  - + Significant benefits from changes in senior team understanding and challenge to biases; potential for follow up by strategy team and others
  - - Significant use of senior time
- **Resistance**
  - + Strategy function driving the process (limited power)
  - - No resisters
  - - Positive experience from offsite (e.g., avoiding any senior executive making stupid decisions during the wargame)

From Nov 18

Interviews suggest a number of tactics to boost focus and value-added and reduce resistance

- **Focus**
  - Introduce only when technique is of clear relevance; “I couldn’t have suggested using this technique a year ago but now everyone sees the importance of understanding this risk
- **Value added**
  - Combine engaging activity to engage with biases and in depth information and analysis
  - Use to improve the business case (not just knock it down)
- **Resistance**
  - Adapt tools to focus on critical biases e.g., pre-designed wargaming offsite
  - Position new techniques as enhancement/extension to techniques already in use
  - Hold informal discussions with key actors to test and build the case for new techniques
  - Conduct early issues analysis to establish need for further attention to risks; “…before people adopt particular positions”
  - Apply techniques informally e.g., as a thought experiment, in conversation with members of the senior team
  - Apply techniques within the strategy team and bring the results into senior team discussions
  - Let others come up with the idea of introducing a technique by asking e.g., “What would we need to know to understand the downside and whether we could manage it”
  - Use the authority of the CEO (judiciously)