Britten Coyne Partners
Strategic Risk Governance Briefing Memo #5

The Root Causes of Adaptation Failures

Governing strategic risk is one of the most important functions a company's board performs. Research shows that companies frequently fail to anticipate, accurately assess, and adequately adapt to existential threats to the success of their strategy and the survival of their organization. Collectively, these failures are often termed "risk blindness."

In our last four briefing memos, we described the root causes of anticipation and assessment failures and steps that directors can take to address them. In our next two memos, we'll examine adaptation failures that occur despite the accurate anticipation and assessment of a potential threat.

Broadly speaking, firms can adapt to these threats by either by taking actions that reduce the likelihood they will occur, and/or actions that reduce the negative impact if they do. Failures to adapt to potential threats take place at the individual, group, and organizational level.

At the individual level, there are a number of ways our cost/benefit analysis of adaptive actions can become distorted. If we consider the problem on a threat-by-threat rather than on a portfolio basis, we will undervalue robust actions that produce benefits across multiple threats. While the likelihood of a threat becoming dangerous may be high over a longer period of time, in the near term it will often be much lower. In this situation, if our time horizon is short (e.g., because of our incentive structure or expected remaining time at a company), we will usually undervalue the benefits of adaptive actions relative to their near-term cost.

As individuals, we also have a tendency to underestimate the speed at which threats could develop, and overestimate how quickly our organization can respond to them, giving rise to the "too little, too late" story behind many corporate failures.

Another obstacle to taking pre-emptive action to adapt to potential threats is the cognitive dissonance this often creates. Adaptive actions force us to acknowledge that key beliefs or assumptions have a significant chance of being wrong. The more central these are to our view of the world, the more difficult this is, both rationally and emotionally. Moreover, once we have made an important choice in the face of uncertainty – like committing to a corporate strategy – we unconsciously edit our memories to strengthen its justification in our mind and our emotional attachment to it. These normal human reactions can cause us to resist the need to take adaptive actions and/or to deride such actions when others propose them.

These individual sources of adaptation failure are further compounded by group level interactions. An individual who pushes for actions to shape or hedge potential threats runs the risk of being seen as "not a team player", a "naysayer", or someone who is "trying to reopen the strategy debate." The greater the uncertainty facing a company, and the more intolerant of dissent its CEO, the more powerful these concerns are likely to be, as that is when our individual need for group affiliation is felt most strongly.

At the organizational level, another plot line that repeats across failed companies is the reluctance of senior managers to invest scarce resources in actions to adapt to trends that represent a fundamental threat to the business that gave rise to their success. Put differently, those who have the greatest investment in the status quo are usually the last to see the need to adapt.

This is only reinforced by the tendency of successful managers to hire and promote people in their own image, which strengthens dominant organizational beliefs. Closely related is the tendency to poorly execute adaptive actions that are reluctantly taken; for example, corporate history is littered with stories of failed acquisitions of smaller companies that were undertaken to obtain important new capabilities.

Finally, as organizations succeed and grow larger a bureaucratic mindset often develops, with an increasing focus on efficiency, predictability, and avoiding errors of commission. In this culture it is usually difficult to win support for investing scarce resources to adapt to potential threats whose timing and potential impact inevitably remain somewhat uncertain – right until the need for action becomes unavoidable, even if it is often too late to be effective.

In evolutionary terms, the painful truth is that variation and selection processes within organizations usually do not work very well, and fail to produce adaptations that sustain competitive fitness over time. The evidence for this can be seen in business survival rates, which show an exponential decline in the number of companies that remain independent as the time horizon extends.

When you look at all the forces involved, it is easy to understand this outcome. In our next briefing memo, we'll review what boards can do to address the powerful root causes that are at work.

Next up: How organizations can avoid these pitfalls, and adapt in time to strategic risks.

For more information about how Britten Coyne Partners can help your organization manage and govern strategic risk, please contact us:

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