

Overcoming the Root Causes of Adaptation Failure

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 briefing memo, we described the root causes of adaptation failures that occur despite the accurate anticipation and assessment of a potential threat (i.e., a so called "grey swan"). In this memo, we'll review various ways these can be addressed at three different levels: the individual, the team, and the organization as a whole.

At the individual level, taking action to adapt to potential threats to our most strongly held assumptions and beliefs can be blocked by the substantial cognitive dissonance this creates. To some extent, this can be overcome through the use of prospective hindsight (what we call "pre-mortems"), which starts with the assumption that a strategy or company has failed, and asks what actions could have been taken to avoid that outcome. The power of this approach is based on research findings that reasoning about events that have already occurred is much less emotionally taxing than thinking about what may happen in the future.

To overcome our over-optimism about how quickly a company can respond to developing threats, assessments should explicitly include estimates of how quickly a threat will develop and the amount of time required for a company to adequately adapt if this occurs. Moreover, ongoing monitoring of key indicators should continuously update these estimates, including the amount of "safety margin" remaining (i.e., the time required to adequately adapt compared to the time remaining until a threat reaches a dangerous threshold).

At the group level, it is critical that leaders create a culture in which taking action to adapt to critical risk exposures – whether to lessen the chance of their occurrence, and/or to minimize their potential impact – is viewed as normal and not deviant behavior. It is also critical for leaders to establish incentive systems that balance long-term and

short-term results, to avoid the over-discounting of the future benefits of acting to adapt to potential threats.

While these individual and group level actions can help to reduce the risk of adaptation failures, the inescapable truth is that the board's role is critical, as many of the most powerful root causes operate at the organizational level.

The board's attitude towards risk sets the tone for the entire organization; discussions about strategic threats and warning indicators should be a standard item on their meeting agendas. However, directors must also implement processes and systems that strike a balance between being overwhelmed by potential false alarms and failing to take action to adapt in time to accelerating strategic threats.

Along with the intelligence and defense communities, meteorological services have done extensive research into effective warning techniques. It can be very helpful for boards to adopt the simple three level warning process used by the UK Met Office, that includes, from the lowest to highest level of warning, "Be Aware", "Be Prepared", and "Take Action." Awareness involves the identification of potential existential threats, establishment of warning indicators to monitor their development, and identification of potential adaptation options (especially those that would help protect against multiple threats). When the adaptation "safety margin" shrinks to a certain level, Preparation includes more intense monitoring and the development of detailed adaptation plans that can be funded and executed when and if the "Take Action" stage is reached.

By taking a disciplined, systematic approach to prioritization, this approach helps avoid overloading directors with information, while also ensuring sufficient board dialogue with management about the most important threats.

In theory, company "risk registers" should perform this function; however in practice few do, because of the mix of strategic and non-strategic risks they contain, and the slow and often politicized process through which they are updated – both of which often obscure accelerating threats. This highlights the potential benefit of a board using advisors who do not also work for management to support its warning process.

As we have previously noted, organizations also have an unfortunate tendency to underfund and poorly implement adaptations that challenge established businesses and beliefs. For this reason, the board must also insist on clear accountability for the execution of these plans, and receive regular reports on their status; “trust but verify” must be the order of the day.

Failure due to a “grey swan” – a threat that has been anticipated and accurately assessed, but in advance of which effective adaptations were not undertaken – is undoubtedly the most devastating and embarrassing circumstance that can befall a company and its board. While the root causes at work are powerful, there are also steps that boards can and should take to address them.

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

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