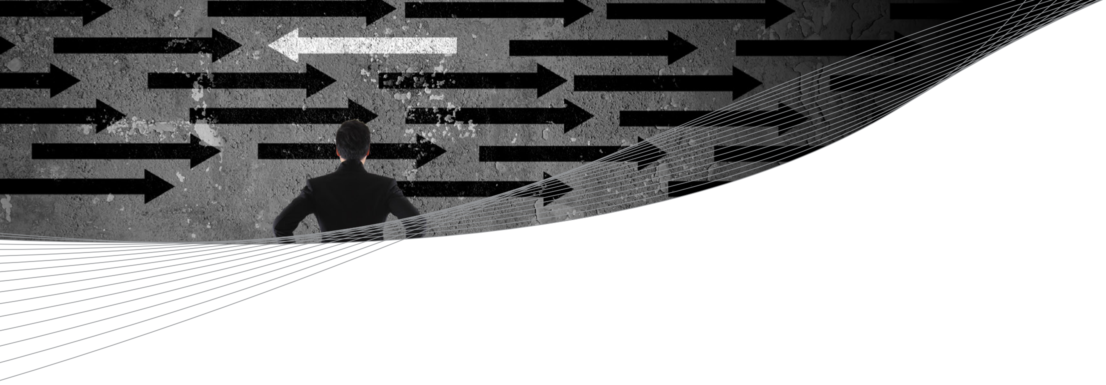

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The Bulletin

Does Your Organization Face Change With Confidence?

In a global survey[1] involving 275 board members and executives across a broad range of industries, one of the top 10 risks cited by respondents was that resistance to change may restrict an entity's ability to make necessary adjustments to its business model and core operations. This finding is important because in a rapidly evolving business environment, executive management and the board of directors need to be able to face change with confidence.

This issue of *The Bulletin* explores *facing change with confidence* – what it means and why it is vital to the long-term survival and prosperity of any enterprise, whether public, private or not-for-profit. Specifically in focus are the what, why, when and how underlying "facing change with confidence."

The Nature and Impact of Change

Focusing on change is important for many reasons:

- Change is *inevitable*. The world in which companies conduct business, and the needs, wants and expectations of customers, are constantly shifting.
- Change is *necessary*. If organizations fail to improve their products, services, processes and capabilities continuously, they ultimately will encounter serious performance gaps relative to more adaptive and agile competitors.
- Change provides both *opportunities* to enhance enterprise value and *threats* that can impair it. Missing the signs of either can have far-reaching effects. Examples of opportunities include pursuing new sources of revenue growth, establishing sustainable competitive advantage, improving business performance and optimizing costs. Threats include cybersecurity, third-party fraud, serious control deficiencies, volatile foreign exchange fluctuations, punitive regulatory penalties, loss of talent and reputation-damaging quality breakdowns.
- Change can be *disruptive*. It can challenge the fundamental assumptions underlying a company's strategy and business model.
- Change can have *unintended consequences*. For example, a cockpit door lock designed to address the risk of a terrorist taking over a plane, likely a response to the September 11, 2001 attacks in the United States, was a key factor in the recent Germanwings airplane crash. This countermeasure enabled an allegedly suicidal co-pilot to commit mass murder when the captain left the cockpit.
- Finally, change must be *expected and embraced* by organizations. This will ensure their products, services, processes and risk management capabilities are improved continuously as the business environment evolves.

In some ways, the global marketplace is like a chess game. Facing an array of choices, leaders make moves on the board, placing their bets on new strategies, products, services, markets, acquisitions, and research and development. These choices are made with the intent to pursue opportunities to grow and create enterprise value.

However, unlike a real game of chess, there are multiple players in the global marketplace, not just a single opponent. Customers, competitors, shareholders, regulators, suppliers, governments, the plaintiffs' bar, financial markets and other players make moves on the board at any time, regardless of whether the organization itself chooses to make a move.

The point is, whether leaders act or not, markets are constantly changing, affecting their companies' competitive positions, strategies, risk profiles and prospects for continued success. The only way to survive and prosper in this dynamic environment is to have a superior, adaptive and resilient business model and strategy so management can drive and remain abreast of change rather than stuck in a constant reactive mode.

Simply stated, the world is changing; failure to navigate change and address its implications to the business is a recipe for disaster. Clinging to the status quo is equivalent to sitting still on the board as opponents constantly make moves. It increases management's uncertainty in terms of sustaining the enterprise's competitive position and understanding what they don't know.

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1 *Executive Perspectives on Top Risks for 2015: Key Issues Being Discussed in the Boardroom and C-Suite,* North Carolina State University's ERM Initiative and Protiviti, 2015, available at www.protiviti.com/TopRisks.

Change With Confidence

"Change with confidence" has multiple meanings. In this context, "change" is used as both a noun and a verb. As a noun, change is the act of altering or transforming something, as well as the result of doing so. As a verb, change means making something different or replacing something.

A very narrow view of the phrase "change with confidence" would suggest the discipline of change management, which focuses on applying leading practices to initiate and sustain organizational change. But the phrase reaches much further than that. Most certainly, it suggests that response readiness is important, as is an enterprise's agility and resiliency and the mindset of its leaders to embrace change as a way of life and market reality. It is action-oriented, suggesting knowledge not only of what and why to change, but also when and how.

> Whereas disruptive innovations may have once taken a decade or more to transform an industry, research shows the elapsed time frame to disruption has compressed considerably.

What to Change and Why – Incremental Change

Change comes in small and large doses. Small doses usually result in incremental improvements in business processes. When operational and financial results fall short of expectations set by management's objectives and quality, time, cost and innovation performance goals, focused efforts are undertaken to eliminate non-value-added activities and enhance suboptimal processes. Incremental change may also address new requirements arising from changes in laws and regulations, contracts and internal policies.

Alternatively, incremental change may focus on improving customer and employee satisfaction levels. Whatever the drivers of incremental change, the continuous improvement discipline is never-ending, as internal and external factors constantly raise the bar for processes to scale to achieve business objectives.

Especially important is understanding the *real opportunity or issue* underlying the need to change. For example, which value drivers or attributes are institutions addressing? Do they need to:

- Increase revenue or reduce costs through greater efficiency (time and/or cost improvements), new markets and channels, or greater value delivered?
- Increase effectiveness through better quality and/or higher impact?
- Improve risk management through better risk assessments, improved risk quantification, more-focused risk responses, and/or better risk reporting and monitoring?
- Improve capabilities to deliver greater benefits or new and enhanced products and services?
- Improve information for decision-making?

In addressing change, it is important to look beyond symptoms and focus on root causes. A root cause is a condition or a sequence of events that can, or is likely to, lead to an undesired consequence or outcome. Root causes can point to opportunities, such as a new law or regulation; an emerging technology gaining acceptance in the marketplace; or a specific insight for improving products, services and the customer experience. They can also point to issues, such as poorly written policies, a process or systems failure, or inadequate training.

Root cause analysis is a technique to source fundamental causal factor(s) underlying a variation in performance that, if eliminated, would improve performance. The analysis is directed to systems and processes, not to people. Once the correct opportunity or issue is fully understood and defined, relevant data is gathered and evaluated, possible underlying causes are identified and systematically reduced, multiple interrelated causes are considered, and corrective actions are formulated to eliminate the root causes at the source. Actual results are then monitored over time, and the technique is applied again until acceptable results are achieved.

There are many tools available to facilitate root cause analysis.[2] No matter the tool, the more rigorous the analysis performed, the more likely the correct opportunity or issue will be identified – and the more confidence management can have in implementing a relevant solution. Implementing simplistic solutions based on symptomatic causes, or a single cause when there are multiple interacting causes, are highly likely to end in failure and disappointment.

What to Change and Why – Disruptive Change

Breakthrough improvements are often disruptive. Managers today face disruptive change to business models and even entire sectors. Whereas disruptive innovations may have once taken a decade or more to transform an industry, research shows the elapsed time frame to disruption has compressed considerably. More important, it continues to shrink, leaving very little time for reaction. Sustaining a business model in the face of digitally enabled competition requires constant innovation to stay ahead of the change curve.[3]

There are powerful forces reshaping our world, forcing leaders to rethink the assumptions underlying decisions relating to consumption, resources, labor, capital, competition and other key factors. For example, one group of authors asserts that

[2] Examples include Pareto charts, process mapping, cause-and-effect diagrams, tree diagrams, brainstorming techniques, rigorous question-asking (why-why charts) and benchmarking.

[3] *Big Bang Disruption: Strategy in the Age of Devastating Innovation,* Larry Downes and Paul Nunes, Portfolio/Penguin, 2014: www.penguinrandomhouse.com/books/315420/big-bang-disruption-by-larry-downes/9781591846901.

there are four great disruptive global forces that collectively are formulating a radically different world:[4]

1. **The shifting locus of economic activity to emerging markets and cities within those markets –** The balance of power of the world economy is shifting east and south at unprecedented speed. Nearly half of global gross domestic product (GDP) growth between 2010 and 2025 will come from 440 cities in emerging markets – 95 percent of which are little-known small- and midsize cities.[5]
2. **Acceleration in scope, scale and economic impact of technology –** Always a significant force in overturning the status quo, the growth in processing power and connectivity through technology has been exponential. In addition to that growth, there is the concurrent data revolution, which delivers unprecedented amounts of information to consumers and businesses in increasingly convenient ways, spawning new approaches to analyzing data, doing business and fulfilling customers' needs.
3. **Changing demographics –** The human race is aging as fertility rates fall. In 2013, about 60 percent of the world's population lived in countries with fertility rates below those needed to replace each generation.[6] The consequence of this trend is staggering, if left unabated. For example, the European Commission estimates that by 2060, Germany's population will shrink by one-fifth, and the number of working-age people will fall from 54 million in 2010 to 36 million.
4. **The increasing degree to which the world is becoming more connected through trade and movements in capital, people and information flows –** The links made possible through technology have spurred a fresh dynamic era of globalization with its attendant opportunities and potential for unexpected volatility. This connectedness matters because it is changing the competitive landscape through more entry points, formidable emerging market competitors, blurring traditional sector boundaries and enablement of small businesses and startups. Established incumbents must prepare for entrants from anywhere, build new global ecosystems and become more agile in an interconnected world.

The reality is clear: To stay ahead of the disruption curve, business leaders must quickly discern the vital signs of change and the related implications to their business model. To do that, they must do four things well:

1. **Understand the critical assumptions underlying the business model –** Management's assumptions about markets, customers, competition, technology, the economy, and regulatory and other external factors reflect the fundamentals that shape the overall business strategy. Because the enterprise's business model is typically designed to function within the market environment management envisions, a dramatic shift in any of these factors would likely require an updated evaluation of the model's continued validity.
2. **Apply scenario analysis to evaluate plausible and extreme events or combinations of events that could invalidate one or more critical assumptions –** Scenarios help managers understand the susceptibility of the business model to change and identify the most critical quantitative and qualitative risk indicators that can impact the business model significantly (i.e., the "vital signs"). Scenarios focus attention on the potential sensitivity of changes in the fundamental business model assumptions. For example, industries that lack strong entry barriers may be especially vulnerable to technological shifts and are therefore likely to face new and unexpected sources of competition.

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3. **Conduct competitive intelligence activities focused on the vital signs –** To facilitate timely recognition of change, the competitive intelligence function focuses on key indicators, as discussed above, evidencing whether scenarios of greatest concern are developing or have occurred. In doing so, the function aligns its activities with what matters most: the critical strategic assumptions. Thus, competitive intelligence creates transparency by seeking out nontraditional information sources that may offer decision-makers a contrarian view. In effect, the function serves as the "eyes and ears" for the chief executive officer (CEO) in monitoring the external environment.
4. **Distill timely information about assumptions, scenario analyses and intelligence gathering, and report insights obtained to decision-makers –** The above activities provide ongoing feedback on the relevancy of the strategy and business model. For example, executives should receive timely, quality information regarding customer behavior, including what's working and what's not working in fulfilling the customer experience and how the company is doing relative to its competitors. This information must be unfiltered, meaning it must be received directly from customers and provide a reliable view of their experiences interacting with the organization and its offerings. For example, are customers remaining loyal to the company, or are they "one and done"? Does

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[4] *No Ordinary Disruption: The Four Global Forces Breaking All the Trends,* Richard Dobbs, James Manyika and Jonathan Woetzel, Public Affairs, New York, 2015: www.mckinsey.com/insights/mgi/no_ordinary_disruption.

[5] *Urban World: Cities and the Rise of the Consuming Class,* Richard Dobbs, Jaana Remes, James Manyika, Charles Roxburgh, Sven Smit and Fabian Schaer, McKinsey Global Institute, June 2012: www.mckinsey.com/insights/urbanization/urban_world_cities_and_the_rise_of_the_consuming_class.

[6] *The Global Spread of Fertility Decline: Population, Fear, and Uncertainty,* Jay Winter and Michael Teitelbaum, Yale University Press, 2013: news.yale.edu/2013/06/20/book-global-spread-fertility-decline.

management know why? Should management take a fresh look at the company's customer interaction processes and re-examine their effectiveness? Are there aspects of the business model that have been compromised?

The trends are unmistakable, their implications to established business models will be highly disruptive, and the speed to disruption is compressing. Today's world is undergoing a sea change that will redefine the dominant players in the global economy. In this environment, the status quo has no future and is constantly "on the clock." Executives and directors need confidence that they have the insights to recognize the effects and implications of the profound market changes unfolding before them.

When to Change

Time to act is a precious asset in a rapidly changing environment. It arises only when there is timely recognition of performance issues, market opportunities and emerging risks, and an understanding of their implications to the enterprise's processes and business model. Time to act means that root causes of subpar performance and the implications of emerging market trends are evaluated in the cool of the day rather than under duress; therefore, options to act can be formulated with confidence.

Unfortunately, time to act can be squandered. Having knowledge of poor performance or emerging opportunities or risks, and not converting that knowledge into hard choices and actionable plans to innovate processes and offerings, is as useless as having no knowledge at all. To ensure timely reaction:

- **Foster an organizational culture that facilitates sourcing of root causes of subpar performance and consideration of the impact of changing market realities on critical business model assumptions –** Together, managing by fact and empowering process owners drive continuous improvement of business processes. When subpar performance and/or trending metrics signal the vital signs, it helps to engage a diverse group of stakeholders who understand the customer, corporate strategy, technological innovations and evolving markets to evaluate the signals, conduct the required analysis, and formulate ideas and recommendations on how to proceed. With respect to changes in the marketplace, continuous dialogue among business areas, alignment of incentive compensation with short- and long-term performance goals, senior management involvement, and an active board help shape the desired culture of understanding and addressing the implications of change.
- **Incent managers to translate root cause analysis and altered assumptions into actionable revisions to strategic, business and product plans and process improvements –** Incentives that are skewed to maximize revenues without fostering sensitivity to changing market conditions can create serious organizational blind spots. For example, if signs of vulnerability arise – such as next-generation innovations offering diminishing improvements – and are ignored, that's a problem. If process and product owners have difficulty identifying new ways to enhance offerings, that's another sign of trouble. If feedback from customers indicates that they are considering alternative offerings, then disruptive change is brewing. If there are no incentives to question the durability of the business model, then the road traveled leads to that dead end when obvious market pressures and declining financial results force acknowledgement that the business model is stagnant. By that time, it's either too late to salvage it, or the change process becomes more painful than it needs to be.
- **Seek organizational resiliency –** The ability and discipline to act decisively on necessary revisions to strategic, business and product plans and improvements to processes in response to changing market realities are hallmarks of a resilient institution. Insulation from reality in a rapidly changing world is lethal. To position the enterprise as a resilient early mover, decision-makers must be in direct contact with the unvarnished truth. Whether the focus is on the viability of the enterprise's strategy and business model or on core customer-facing and support processes, management must have a strong inclination to act as necessary to sustain superior long-term performance. When companies don't respond to disruptive change, it's usually because they don't have a single version of the truth. This dysfunction can arise from incentives that do not encourage resiliency, and management being out of touch with the customer and uncommitted to managing by fact.

Today's world is undergoing a sea change that will redefine the dominant players in the global economy. In this environment, the status quo has no future and is constantly "on the clock."

In summary, confronting change with confidence means accelerating the decision-making process regarding actions to address significant performance issues, market opportunities and emerging risks. In business environments exposed to disruptive change, adaptive processes are needed to rapidly alter underlying assumptions to reflect newly changed circumstances. Disruptive change is a double-edged sword, simultaneously presenting one of the biggest opportunities and risks a company can face. What separates the winners from the losers in managing change is the ability to recognize the vital signs and act on them decisively.

How to Change

The improvement of products, services and processes and the implementation of new strategic initiatives require focused and disciplined approaches that are consistent with the organization's structure, culture and operating philosophy. To enable continuous or breakthrough change with confidence, buy-in must be obtained from executive management (and the board of directors for significant changes in strategy, processes and systems). The following are suggestions for accomplishing that buy-in:

- **Secure top management commitment and support –** Discipline starts at the top with a committed CEO and executive management team who demonstrate unwavering support for undertaking action plans that create and sustain momentum for change.
- **With executive management's assistance, develop a business case that clarifies why change is the only option –** A strong business case sets forth the value proposition and economic justification for undertaking change, addressing the internal and external pressure points that create the need for change, as well as the state of readiness and existing structures that can drive or constrain change.
- **Focus on the big picture with a compelling shared vision –** Once the need for change has been established, a clearly stated shared vision of the future state is needed to describe the scope, goals and objectives for the change initiative. The vision should also articulate the "what's in it for me" for everyone expected to contribute to the change design and implementation.
- **Set realistic goals –** Change objectives and goals should be understandable, measurable and actionable, as well as consistent with the enterprise's capacity for making the change happen.
- **Develop a clear plan of action –** A well-defined plan for change supports the business case and provides a road map for management to proceed, as well as milestones by which to monitor progress.
- **Make periodic use of management checkpoints –** Checkpoints keep the change program on-plan and on-strategy, serving as a reality check and reaffirmation of executive-level support while also providing needed motivation to move the change design and implementation activities along.

In addition to executive management support, other key stakeholders need to provide support, such as line-of-business leaders, operating personnel and process owners most affected by the change. Their buy-in is obtained first through evidence of executive management's support. They also will likely need convincing that, in terms of effecting the change, their interests and those of the enterprise are inextricably linked. The following are suggestions for achieving their ownership and commitment:

- **Obtain stakeholder involvement and commitment –** Identify key leaders throughout the organization and gain their support for the change; an effective change process transitions key stakeholders along a continuum from awareness to buy-in and ultimately to ownership.
- **Establish accountability for results –** An understanding of the people and accountability issues is a vital part of the change process; therefore, clearly articulated goals must be set forth so the individuals responsible for effecting change are held accountable for results.

CHANGE ENABLEMENT PRIORITY →	CONSEQUENCE IF UNADDRESSED
Top management commitment and support	No leadership or role models
Compelling business case for change	No action
Clear shared vision	No direction or focus
Realistic goals	No credibility or impact
Well-defined action plan for change	No road map
Stakeholder involvement and support	No commitment or momentum
Accountability for results	No ownership
Manage the "human side" and effective communications	No endorsement of change or consistency in execution
Process view of implementing change	No systematic approach
Align performance measures	No achievement of objectives or realization of benefits
Align process with the culture	No success

Sustainable Change

Nothing Happens

- **Enable change by focusing on the "human side" –** Too often, the change focus is limited to technical matters, such as policies, processes, organization, measures, reports, systems and data. Although these things are important, there are people-related issues that also need to be addressed as well to ensure everyone who matters is focused on executing the change (e.g., revised performance expectations, compensation incentives, training, ongoing communications and knowledge sharing).
- **Support the implementation process –** The change journey requires a systematic project management discipline and must be supported with dedicated resources, appropriate standards, measures and feedback mechanisms. In addition, key personnel must be empowered to do what's needed to make the desired change happen.
- **Align organizational, process and individual performance measures –** The firm's reward systems and incentive plans should be aligned with the change process through appropriate performance metrics at all levels. While related to addressing the "human side," alignment is also about the hard work needed to ensure that the enterprise's processes and the people who execute them are in sync with the change goals and timeline.
- **Align the change process with the firm's culture –** The change cannot be seen as an independent initiative or "another program." Instead, it must become an organizational imperative integrated with "the way things are done around here." It bears noting that if there are limitations or dysfunctional behaviors in the existing culture, there may be a need to transform the culture to effect the change. The steps above can help facilitate this transformational process.

The above change enablement practices are summarized in the schematic on the previous page, along with the consequences that may result if they aren't addressed. If executed effectively, they lead to sustainable change. If not, nothing happens.

How Can Management Know?

Confidence is about knowing. Probably the most important aspect of the change process is correctly diagnosing the opportunity or issue precipitating the need for change. If they know what the real opportunity or issue is, most managers believe they can allocate the appropriate resources to address it.

Business context, root cause analysis and management by fact are important elements to consider when framing the real opportunity or issue. The various forms of cognitive bias and the groupthink phenomenon they encourage can shortcut the process of understanding the need for change. Conformity can be dangerous, as it often leads to convergence too quickly, shortcutting what is in essence a divergent conversation in which alternative views and salient contrary information can be shared. Thus, it is important to manage the effect of bias on the fact-gathering and analytical processes leading to identification of the real change opportunity or issue.

REGARDLESS OF THE CONTEXT, EXECUTIVE MANAGEMENT AND THE BOARD OF DIRECTORS CAN FACE CHANGE WITH CONFIDENCE WHEN THEY KNOW WHAT TO CHANGE AND WHY, WHEN TO CHANGE, AND HOW TO CHANGE.

Sometimes a fresh set of eyes can enhance management's confidence. To that end, an outsider with experience and expertise in the specific opportunity or issue the change is intended to address might offer useful perspectives that might not be considered otherwise.

Summary

Facing change with confidence is a multifaceted discipline. It encompasses organizational agility and resiliency and an acceptance of change as a market reality requiring adaptive response mechanisms. It necessitates timely recognition of root causes of unacceptable performance variability, as well as the vital signs of new market opportunities and emerging risks arising from disruptive market forces. Most important, it demands timely action based on this knowledge. And finally, once there is commitment to act, it requires an effective change enablement process that drives the organization from awareness to buy-in to ownership in order to ensure the change is sustainable.

In this era of continuous and disruptive change, early movers are more likely to survive and prosper. The context of change may be about incremental, continuous change to close performance gaps, or, alternatively, it may be focused on breakthrough, disruptive change to find new sources of growth and leapfrog competitors. Regardless of the context, executive management and the board of directors can face change with confidence when they know what to change and why, when to change, and how to change.

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