ISSUE 124

BOARD PERSPECTIVES:
Risk Oversight

# STRATEGIC RESILIENCE: ARE YOU AMONG THE 30%?

Sir Winston Churchill's observation — "However beautiful the strategy, you should occasionally look at the results" — takes on fresh meaning when nearly seven in 10 directors voice the need to strengthen the strategic resiliency of their organisations.

A National Association of Corporate Directors survey noted that almost 70% of directors report that their company's existing strategies will become completely irrelevant over the next five years.[1] A top concern for the third straight year, this statistic alludes to the struggle of companies and their boards to keep pace with fast-moving market developments that can create or destroy enterprise value and frustrate the achievement of performance goals if not addressed in a timely manner.

Strategic resilience is likely at the root of the directors' concerns due to two issues. First, there is the competitive environment and sheer pace of change in the digital economy. Second, most performance metrics are retrospective in nature, recording history as it occurs and focusing on the question of "How are we doing?" instead of "Where are we going — and how can we get there?" Metrics not linked to critical strategic assumptions or key execution risks inherent in the strategy may not provide sufficient reaction time for leaders to focus efforts on putting the strategy back on track to deliver expected results.

Strategic resilience is the capacity to turn threats into opportunities and the ability to take advantage of opportunities in a timely, non-crisis-like manner.[2] That kind of resilience is only possible

[1] *The 2019-2020 Public Company Governance Survey*, National Association of Corporate Directors, 2019, available at www.nacdonline.org/analytics/survey.cfm?ItemNumber=66753.

[2] "Strategic Resilience," *The Palgrave Encyclopedia of Strategic Management*, Liisa Välikangas, author, Mie Augier and David J. Teece, editors, July 1, 2016, available at https://link.springer.com/referenceworkentry/10.1057%2F978-1-349-94848-2_375-1.

protiviti®
Face the Future with Confidence

through continuously anticipating and adapting to market trends that can severely impair the earning power of the core business and enacting needed change before the need for change becomes perilously evident — which, in the digital economy, is too late.[3]

This is why the ex post facto characteristics of the so-called lag metrics dominating performance management systems of many companies may be a contributing factor to directors' concerns about keeping pace with changing markets. Such metrics are historical and output-oriented in nature, dealing with quality, cost, time, and customer and employee satisfaction. Alone, they are not enough. As the underpinning of perpetual renewal, strategic resilience requires more forward-looking measures in order to monitor performance. Lead metrics are input-oriented, offer an earlier warning of emerging issues and are more conducive to enabling needed change.

When linked to critical assumptions on external market factors and key risks relevant to the strategy, lead metrics offer an early warning of strategic irrelevance by pointing to market opportunities and emerging risks that warrant immediate attention in the C-suite and boardroom. When coupled with tolerance levels linked to performance objectives and targets, these key risk indicators provide boundaries of acceptable outcomes related to achieving business objectives — that is, they feature both the upside boundary of exceeding the target and the downside boundary of trailing the target. A breach of these boundaries triggers management follow-up.

To illustrate, an organisation with multiple operating units uses selected strategic documents and business plans to develop a profile of the critical risks around key strategic initiatives. This profile includes risks to the strategy's execution and risks inherent in the strategy. In making this assessment, management considers plausible and extreme scenarios that could invalidate critical assumptions underlying the strategy. For scenarios having the greatest impact, key risk indicators, trending metrics and other relevant information are identified to facilitate monitoring processes and, for high-velocity scenarios, the development of response readiness plans.

Many of an organisation's most critical risks are driven, at least in part, by the digital economy. Performance monitoring is deficient from a strategic resilience standpoint if it doesn't address signs that the business model is decaying as circumstances change. That is why directors need to concern themselves with the lack of agility in keeping pace with changing market realities, including the existence or threat of nimbler competitors; ensuring the company has the talent needed to compete and win over the long term in the digital age; addressing changing demographics and demands for new skills that are altering the workplace; managing the restrictive burden of significant technical debt that constricts resilient responses; and engaging in out-of-the-box thinking about the business model's continued relevance.

After confirming the risk profile with the executive team, the organisation evaluates conceptual alternatives for reporting on strategic execution and selects an approach to provide transparency into strategic execution risks; augment quarterly strategic reviews in order to enable timely actions and necessary course corrections; identify signs of stress on the business; and supplement the chief executive's strategy communications with the board. As part of this process, the organisation identifies potential metrics, with an emphasis on lead metrics. Not intended to replace the lag performance metrics currently in place, lead metrics are focused on trends and warning signs that the business model may be under threat from alternative offerings, losing its grip on customer loyalty, facing displacement by emerging technologies, or impacted by other external factors affecting critical assumptions, indicating the strategy is losing steam.

[3] "The Quest for Resilience," by Gary Hamel and Liisa Välikangas, ***Harvard Business Review***, September 2003: https://hbr.org/2003/09/the-quest-for-resilience.

Working with owners of different aspects of the strategy, recommended metrics are reduced (by as much as 60%) to the vital few. Criteria such as availability, relevance (to strategic risks), criticality (the most important metrics) and practicality are considered in this process. Concerning availability, there is an emphasis on using metrics that currently exist, either formally or in shadow systems. With respect to criticality, less is regarded as more. As for practicality, the standard adopted is that a metric's insights must merit its development costs.

Using these criteria, the organisation narrows metrics down to a family of measures that are either currently available or can be tracked at a reasonable cost. By working with key process owners, tolerances are developed to provide the foundation for a scorecard that tracks whether actual performance is meeting or exceeding the target, short of the target within tolerance limits, or badly missing the target.

The metrics and underlying thresholds are used to develop indices for various risk categories to trend quarterly for use in communicating with the board. Trending reports help answer three questions: (1) Are we riskier this quarter than we were last quarter?; (2) Are we entering a riskier time in delivering our strategy?; and (3) Why? Because the indices are based on risk metrics, a drill-down capability is available to answer the "why" question. The result is a scorecard providing early warning signals of increasing risk exposures or potential opportunities that indicate the need for management action. This is the kind of anticipatory perspective every board should expect.

Every organisation needs to ask the following questions: When the company's fundamentals change, on which side of the change curve will we be? Will we be facing a market exploitation opportunity or the need to react to the crisis of an obsolete strategy?

Strategic resilience is made possible from the time advantage attained from knowledge of a unique market opportunity or an emerging risk, and from actionable decision-making options created for the organisation's leaders before that knowledge becomes widely known in the market. Using forward-looking reporting linked to the strategy, companies can function as early movers and see change on the horizon as a potential market opportunity, rather than a looming crisis.

## Questions for Boards

Following are suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Are directors satisfied that executive management assesses the company's execution of the strategy comprehensively, with a forward-looking point of view linked to critical strategic assumptions and risks? Are strategic execution monitoring and actionable early warning capabilities in place to inform management in a timely manner of new market developments?
- Does the chief executive set the tone for strategic resilience through actions and words, emphasising the importance of improving digital readiness, staying close to the customer, keeping an eye on relevant market trends, organising for speed and embracing change?
- Would the board characterise the company's decision-making processes as "high-velocity, high-quality"? For example, does the process keep things simple, flatten the organisation, and emphasise taking necessary risks, failing fast and listening to feedback?

## How Protiviti Can Help

Protiviti assists directors in public and private companies with identifying and managing the organisation's key risks. We provide an experienced, unbiased perspective on issues separate from those of company insiders and an analytical assessment process that is aligned with the unique characteristics of the risks the company faces, including its strategic risks. Traditional methods of risk measurement tend to generate information that is difficult to aggregate and interpret across multiple types of risks, lines of business and geographies. Traditional risk reporting also lacks transparency into underlying data and does not allow for resilient, actionable management.

We assist organisations with developing an approach to monitoring their strategic execution risks that is tailored to their specific needs. The Protiviti Risk Index™ offers an innovative approach to risk reporting by combining an effective, efficient and customised risk management tool with leading data visualisation technology. The Protiviti Risk Index™ helps business functions become enablers of growth through the use of efficient tools for risk identification, aligned reporting and actionable analytics built on an integrated technology platform.

### Audit Committee Self-Assessment Questions

*In these dynamic times, it is best practice for boards and their standing committees and individual directors to self-assess their performance periodically and formulate actionable plans to improve board performance based on the results of that process. To that end, audit committees should consider the illustrative questions we have made available at* ***www.protiviti.com/US-en/insights/bulletin-assessment-questions-audit-committees****. These comprehensive questions consider the committee's composition, charter, agenda and focus, and may be customised to fit the committee's assessment objectives in light of current challenges the company is facing.*

### Is It Time for Your Board to Evaluate Its Risk Oversight Process?

*The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused on the opportunities and risks that truly matter. It offers boards a flexible, cost-effective tool for assessing their risk oversight and mirrors the way many directors conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at* ***http://theboardinstitute.com/board-risk-meter/****.*

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and our independently owned Member Firms provide consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit to our clients through our network of more than 75 offices in over 20 countries.

We have served more than 60 percent of *Fortune* 1000® and 35 percent of *Fortune* Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on https://blog.nacdonline.org/authors/42/. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.

© 2020 Protiviti Inc. An Equal Opportunity Employer M/F/Disability/Veterans. PRO-0220-IZ-ENG
Protiviti is not licenced or registered as a public accounting firm and does not issue opinions on financial statements or offer attestation services.

protiviti®