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Captains in Disruption

Even when facing a crisis, some CEOs know how to anticipate the worst, plan a response, and navigate to advantage. You can do the same.

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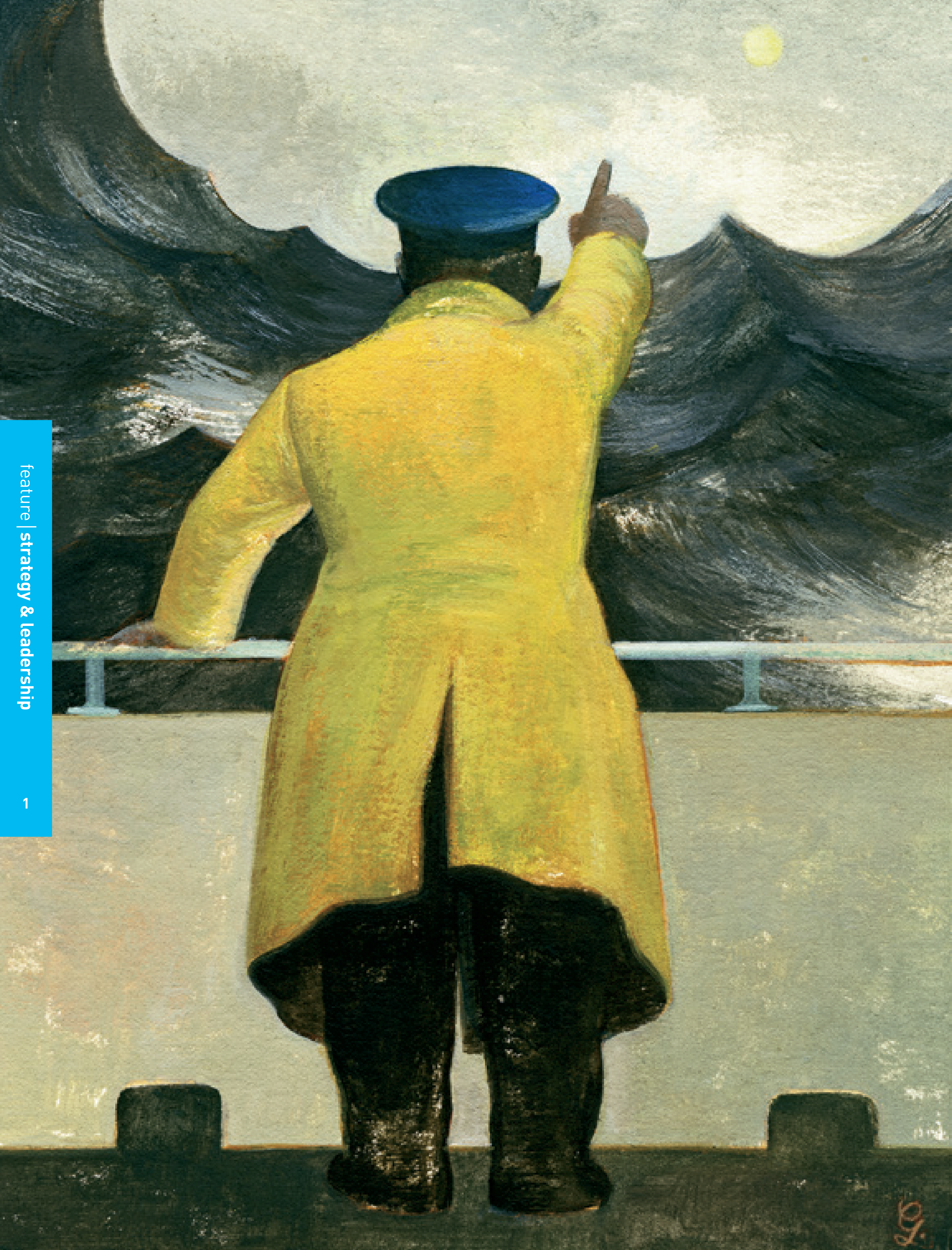

EVEN WHEN facing a crisis, some CEOs know how to anticipate the worst, plan a response, and navigate to advantage. You can do the same.

by Ken Favaro, Per-Ola Karlsson, and Gary L. Neilson

CAPTAINS IN DISRUPTION

Sooner or later, every corporation will face disruption. It may be the result of a decrease in its competitive advantage, a shift in the regulatory environment, or some catastrophic event that affects its ability to operate. No matter what the underlying cause, the chief executive is the person most accountable for managing the disruption. He or she must recognize its dynamics, anticipate its likely effect, develop a response, manage that response, and sustain the necessary changes. If the CEO is not directly involved in guiding his or her company through the storm, the entire company is likely to suffer—and, in extreme cases, disappear entirely.

There is no single formula for managing a disruption, because it can come in any number of forms. Any event that has the potential to adversely affect a company's business model or ongoing operations is disruptive. Some disruptions involve shifts in the dynamics of competitive advantage for an industry, stemming from a variety of causes—technological breakthroughs that favor new rivals, global changes in labor arbitrage, shifts in cost structure, or new rivals entering markets from adjacent sectors. Some are instigated by regulatory upheaval, such as the structural changes to the U.S. healthcare market set in motion by the Affordable Care Act. Virtually every CEO of a hospital system in the U.S. is confronting a major disruption to its business model as a result (*see "Putting an* I *in Healthcare," by Gil Irwin, Jack Topdjian, and Ashish Kaura,* s+b, *Summer 2013*). There are also event-specific disruptions, such as economic downturns, idiosyncratic geopolitical and natu-

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ral events, and unforeseen internal company events such as sudden major trading losses or public scandals.

The severity of these events can vary considerably, as can the duration. Some disruptions, like the rise of the Japanese auto industry in the 1970s that eventually crept up on U.S. and British carmakers, are so gradual that, like a frog in a pot of water, company leaders may never realize they are slowly boiling to death. Others are sudden and devastating, like the 2011 floods in Thailand that crippled the country's hard-drive manufacturing sector and revealed extreme vulnerabilities in the industry's supply chain.

Since the mid-1990s, disruptive events have become increasingly difficult to deal with. Technological evolution, ongoing globalization, two huge financial bubbles, the rapid pace of change in emerging economies, the deregulation and re-regulation of a number of industries, and waves of political turbulence in some regions have made the world a more challenging place to do business. For example, banks and financial institutions have had to rethink their business models after the financial crisis. And retailers and many parts of the media industry have seen their revenue streams fall away with the rise of new, technologically enabled competitors.

Yet even in the worst disruptions, some companies do better than others. These companies have leaders who recognize the crisis and act accordingly, either in advance or in time to recover. Some of the most celebrated cases are those of IBM, which shifted to business services before the rest of the computer industry did; BMW, which rebounded decisively from near-bankruptcy in the late 1950s; Ericsson, which reinvented itself in 2002–03 after nearly being driven out of business by sudden competition from Asia; and Lego, which rebuilt its supply chain and regained profitability after its retail channels dramatically changed.

In this article, based in part on our research on chief executive performance, we consider the steps that many CEOs are taking to become effective captains during disruption—captains who can not only manage through it, but turn it to their advantage. We have also directly observed CEOs managing disruption at a number of companies, and have drawn on interviews with two people who understand the issues in depth. Antony Jenkins took over as CEO of Barclays PLC to manage the bank through its response to the LIBOR rate-fixing scandal that struck in the summer of 2012. Clayton M. Christensen, the professor and management author who first charted the dynamics of disruption in *The Innovator's Dilemma: When New Technologies Cause Great Firms to Fail* (Harvard Business School Press, 1997), has explored a variety of disruption dimensions, including the personal impact in his new book, *How Will You Measure Your Life?* (with James Allworth and Karen Dillon; HarperBusiness, 2012).

To act effectively as captain of their company in a time of disruption, CEOs must lead in three ways. First is *preparation*: The CEO must make sure his or her company anticipates potential disruptions and puts in place the capabilities that will be needed when the time comes. Second is *response*: When a disruptive event occurs, leaders must develop the appropriate strategic and operational plans, which could include focusing on fewer products and services, engaging in large-scale business transformation, reorganizing the company's structure, initiating mergers and acquisitions, launching a new wave of innovation, or making a change in leadership. Finally, there is *implementation*: CEOs need to set the response in motion and carry it out sustainably, ensuring that their company reaches the end goal.

Anticipate and Prepare

For every company in every industry, the first stage in managing disruptions is to learn to anticipate them and recognize their signs before they hit. You can't predict every future challenge. But you can think about the kinds of disruptions that might be particularly devastating to your company, and prepare accordingly, shaping the degree of preparation to the nature and likelihood of the risk. Even environmental and natural disasters can be—and must be—prepared for. It's particularly important for companies to pay attention to risks that they feel shielded from because of their own competence and capabilities. These can even include environmental and natural disasters. For example, though the earthquake that caused a tsunami to hit Japan in March 2011 was one of the strongest ever recorded anywhere, more than 75 deadly earthquakes have been recorded in Japan since 1900. Should Toyota have been able to anticipate and prepare for the effect an earthquake might have on its highly concentrated network of suppliers in northeast Japan? Perhaps the company's confidence in its just-in-time manufacturing system blinded it to the vulnerability of its supply chain. Might your company be similarly vulnerable to the disruption of strengths that you have built up over time, and that you currently take for granted?

Anticipating disruption goes beyond the conventional practices of risk management. Virtually every company now employs a process to assess and address risk. These practices typically concentrate on day-to-day risks, those run in the ordinary course of business, including credit and foreign exchange risk, data security issues, and operational risks inherent in managing large-scale projects.

For truly disruptive events, many companies adopt a similar approach at a larger scale: They build analytic models assigning a probability and potential loss value to various kinds of risks, and then design preparations for each of them depending on their likelihood and potential for loss. Several recent events, however, have highlighted the limitations of this approach. Highly improbable events do occur, and failure to anticipate them—or even to imagine them—can be devastating. A further limitation lies in the relative strength of the risk models themselves. The financial firms that concluded in the mid-2000s that they had tamed the risks inherent in the subprime mortgage market soon discovered that their confidence was overstated.

The key to the problem, says Clayton Christensen, lies in the nature of data itself. "How can you make sense of the future," he asks, "when you only have data about the past? That's the role of theory, to look into the future." In other words, you have to think through the reasons that the pattern of behavior in the data in this case appears to be different. Christensen adds that in most companies, top executives do not have access to candid insights from people at all levels—perspectives that they need if they are to plan for future disruptions. "Data is heavy. It wants to go down, not up, in an organization," he says. "Information about problems thus sinks to the bottom, out of the eyesight and earshot of the senior managers."

In Christensen's view, chief executives (and other senior leaders) can compensate for these limitations only by learning to ask better questions. "Instead of looking at the data about today's performance, I [need to] keep my attention on the questions I need to ask so I can catch the issues of the future.… For instance, if you're concerned about disruption, you ask: 'Which competitors are threatening me and which am I more likely to threaten?' Disruption is a question about who's going to kill whom."

It falls to the CEO to ask questions this way, and to oversee the enterprise-wide thinking required to assess potential disruptions. Executives within business units and functional silos tend to focus on making progress toward their unit's business objectives, and not to think deeply about longer-term threats to the whole company. Only the CEO can ensure that the company is taking a multifaceted approach to sensing and recognizing trouble. Chief executives must be willing to lead the effort directly, drawing on past methods of gauging risks and disruptions, while also admitting that the old ways of doing business are no longer adequate.

Plan and Respond

Once a potential disruption has been recognized as a real threat, it is time to develop a plan and initiate the first wave of reaction. The wake-up call will likely happen in one of two ways: Either the company's leaders will realize that it is vulnerable to a potential disruption and thus needs to be shaken up proactively or an event-driven disruption will occur, and the leaders will see that the company must respond immediately.

Sometimes a CEO must plan a response to a sud-

In most companies, top executives do not have access to candid insights from people at all levels—perspectives they need if they are to plan for future disruptions.

CEO
2012

den, unexpected disruption. When the LIBOR rate-rigging scandal broke in mid-2012, Antony Jenkins was the very successful head of the retail and business banking division of Barclays, then the U.K.'s second-largest bank. After both the bank's chairman and its CEO resigned, Jenkins took on the role of CEO. He knew that the entire organization had to confront the scandal along with the pain that executives and staff felt about how Barclays was being portrayed in the press. At the same time, the financial-services industry as a whole was still navigating the collapse in trust that had followed the crisis of 2008–09—along with the reversal of globalization, heavier regulation, and a more adverse macroeconomic environment. This was a new and difficult situation for every bank.

Upon his appointment, Jenkins immediately made it clear to the bank's 140,000 employees that short-term thinking and a focus on immediate profits—attitudes that had contributed to the LIBOR scandal and to aggressive tax practices in the structured capital markets division—would no longer be tolerated. (Barclays announced the closure of the structured capital markets division in February 2013.) He carried out a strategic review of the bank's business units, which numbered more than 70. He then developed an overall strategy and new direction for the bank called TRANSFORM (Turnaround; Return Acceptable Numbers; and Sustain Forward Momentum).

"While there are many great things about Barclays," Jenkins says, "the organization had had a cataclysmic experience. As a result, people were prepared to listen. The staff recognized that the environment had fundamentally changed and that we needed to respond. We could no longer focus exclusively on short-term profitability. We needed to think more broadly about the stakeholders we serve. The existential crisis helped me in this regard."

Jenkins emphasizes the need to involve all stakeholders in asking the right questions and finding the right way forward. In managing the reaction to the LIBOR scandal, he spoke with politicians, the media, consumer groups, and regulators, in addition to bank employees. The day after the new strategy was made public, in February, he hosted a stakeholder breakfast. Some of the comments he heard were not easy to take, but it showed that he was willing to engage. "You have to meet stakeholders with humility, be prepared to listen, and then lay out a clear plan," he notes. "And be willing to talk to those who do not necessarily agree with you."

According to Jenkins, the precepts for leading a large company through a highly disruptive crisis are straightforward: Make sure you have a clearly defined objective and a compelling reason for it, develop a viable and credible plan for reaching that objective, and relentlessly and authentically pursue it. So far, so good: The day after the announcement of the new strategy, Barclays' stock price rose 9 percent.

When planning a response to disruptive events, all chief executives should bear in mind several principles:

1. The CEO is the single most critical player in crafting and carrying out a response. The CEO must take immediate responsibility for the situation and be willing to hold him- or herself accountable for the ultimate success of the company's response. For example, at Barclays, Jenkins knew he had to personally make clear his lack of tolerance for the kinds of activities that had led to the bank's problems.

Whether the cause of the disruption is internal or external, foreseeable or entirely unpredictable, it is up to the CEO to set the pace of change. Sometimes it is necessary to short-circuit things; to force action, decisions, and transparency. After the first swift reaction, things may slow down a bit as decision makers deal with the long-term consequences of the disruption, but the company should still retain most of its momentum.

2. It is critical to begin breaking down human inertia. Complacency in the face of change comes naturally to any large organization. The chief executive must explain the situation and describe the new agenda in simple, clear terms. He or she must find simple but compelling messages to show that the old ways of being successful won't work anymore. The changed nature of the game must be communicated to all stakeholders, both inside and outside the company, in a way that galvanizes this particular culture.

When Stephen Elop became CEO of the Nokia Corporation in 2010, he wrote a note, now famous within the company, in which he likened Nokia's situation to standing on a blazing oil platform. The company faced not just a fairly new competitor with Apple's iPhone, but a rapidly rising new product category, the smartphone, which Nokia had not found a way to counter. "We have to go faster, and harder, and more aggressively now than we've ever gone before," he said. Employees, he added, have two choices: Either jump into the water, even if it's 100 meters deep and freezing cold, or get burned. The note was controversial because some felt it pushed Nokia toward too much change, too quickly—but aggression was its point. It provided a clear statement that the company would be fearless in facing up to its dire competitive situation.

At the same time, a CEO should make clear that the company needs to be forward-looking, and declare a kind of amnesty for past activity. Decisions made and actions taken in previous years may have made sense at the time, but they must change as the situation changes. A new marketplace requires different ways of doing business, and it won't work to simply carry on with legacy practices (and, in some cases, legacy products or services). If this requirement isn't understood throughout the organization, executives can waste time defending their past behavior and actions.

When communicating the need for change, CEOs should describe the path ahead as clearly as possible, including the specific steps that will get the company through to the other side. For example, a few of the U.S. healthcare companies facing the disruptive changes of healthcare reform have developed a strategic communications process in which they explicitly lay out—for investors and employees alike—the decisions that must still be made in executing their strategy for managing disruption. On a regular basis, these executive leaders formally review the company's choices and progress, ask their board to approve major changes, and reevaluate their components.

3. CEOs must make cogent decisions about the team of top executives. They must give people a chance to come on board with the new system and remove those who resist. If anyone visibly resists the changes, it soon becomes evident—to them and everyone else—that they are now at the wrong company. This process can be designed in ways that treat everyone, including those who exit, with respect. Nokia CEO Stephen Elop kept the senior leadership team largely intact, but set up an initiative, called the Challenger Mind-Set, in which executives were given a chance to show how well they could adapt. It was clear that those who could not perform would be better off elsewhere. Changes in top management must of course be made carefully, but even one or two visible changes can dramatically reinforce people's awareness that the situation is serious.

4. It is often important to choose a small team of top decision makers to lead the response. Paradoxically, the more profound the changes planned, the faster they need to take place. A small team of top leaders can maneuver more nimbly than a large group.

Implement and Sustain

All too many companies, when faced with business crises, have initiated appropriate responses but have then been unable or unwilling to carry them to completion. When that happens, the issues that scuttled the response remain unaddressed, and the company will ultimately be even less prepared to face the next crisis. Ultimately, to implement a plan and sustain a company during disruption means looking closely at both the organizational design and the company's culture. It's up to the CEO to make sure that the structure and the culture are ready for the necessary changes and set up to support the new strategies and each other.

Organizational redesign. In most cases, response to disruption necessitates a shift to a more nimble, focused, and strategically aligned organizational structure—one that encourages other people to change, rather than trapping them in outmoded processes or approval gates. The new structure must enable people to cooperate fully across internal boundaries, even if that runs counter to long-standing patterns of communication or control.

One example of this type of redesign is Amedisys Inc., a provider of healthcare to patients in their homes. The Amedisys business model had long been built around payments from Medicare and other insurance companies. With pressure on Medicare prices squeezing profits considerably, Amedisys CEO Bill Borne, who founded the company and designed its original business model, decided that it would have to change. Amedisys should be paid for outcomes rather than offering a menu of narrowly defined services.

To pilot the new approach, Borne and the Amedisys top team created a "pirate ship"—an organizational unit kept separate from the mother ship, set up to prototype and offer a broader range of care for its clients. With any such skunkworks efforts, it is important to think through the separation in advance; how soon, and how thoroughly, can the insights and operations of the pirate ship be brought back to the main vessel?

Ultimately, the kind of organizational change typically needed to respond to disruption must be an ongoing effort. Says Barclays' Jenkins, "It is about being continually dissatisfied with what you are doing. What is the next thing to drive for? There will always be a next phase. It is about constantly challenging and creating an organization that is never satisfied."

Culture change. As difficult as organizational redesign may be, truly changing a large company's culture in response to a disruption can be even tougher. But it is no less important. In the case of one large car company facing declining sales and a weak cash position, top executives had devised both a new strategy and a new operating model, but didn't know what to do about their culture. They knew it had to be changed: It was slow and bureaucratic. The CEO set up a team of several of his best executives, who started defining the company's cultural priorities: speed, willingness to take risks, and greater accountability.

The CEO understood that the only real way to change a company's culture is by changing behavior. He began by asking his top team to make decisions in days and weeks, not months or years. They didn't announce the change; rather, they just practiced the new behavior themselves, and it spread. Because the top 50 or so senior executives had become very isolated—the company had as many as 15 layers in its hierarchy—they began interacting informally with people lower down in the structure who actually knew what worked and what didn't. The result was a much clearer picture of how the company operated, with the added benefit that the people involved became zealots about the need for change. The company made sure to act quickly on the best ideas generated through the process.

At Barclays, Antony Jenkins faced a tough task when he became CEO: to restore the bank's public reputation and renew its internal culture. Though he had spent time at Citibank between 1989 and 2006, he began his career at Barclays in the early 1980s. Despite his time away, he considers himself an insider, which he feels has been a singular advantage since becoming CEO. In his view, it would have been incredibly difficult to come in from the outside and try to change Barclays. As an insider, he was already familiar with the strategic and cultural challenges facing the organization, and having the opportunity to "road-test" different approaches in individual business units was a significant benefit in taking on the CEO role.

"I was able to prototype what I believed in, first at Barclaycard and then at retail and business banking," he says. "This became the foundation for my thinking about how to change the larger organization."

Using his earlier experience, Jenkins developed a vision of a "go-to bank," and turned it into action in the TRANSFORM program. The program was then approved by the board of directors, and presented publicly in February 2013. Now the challenge will be to sustain momentum and to run the bank to serve the interests of all its stakeholders.

Promoting cultural change, in Jenkins's view, is feasible. "Leadership drives culture, and culture drives organizational performance," he says. "Organizations look at how you behave, not what you say, and you can't do it if you are not authentic and relentless. Do what you believe is right and do not get distracted by all the

For any CEO who leads a company successfully through a disruption, that success will likely become his or her defining moment.

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voices outside commenting on your plan."

In this implementation phase of managing through a disruption, what CEOs do is at least as important as what they say. Too many leaders in crisis simply send memos from on high, rather than determine a course to do things differently. There is also a risk in trying to frighten people into changing their ways—the burning platform sometimes just scares them into freezing instead. Finally, CEOs confronting disruption need to reach out to people throughout the company who can help them cross-organizationally, and do so through informal interactions. Cross-organizational interaction is by far the biggest accelerator of change (*see "Culture and the Chief Executive," by Jon Katzenbach and DeAnne Aguirre,* s+b, *Summer 2013*).

The Defining Moment

The Great Recession gave the CEO of virtually every company around the world a strong taste of the impact of a deeply disruptive crisis. Some chief executives thrived, making their company stronger than ever. Others simply muddled through. Still others watched as their company succumbed to the trauma.

The best CEOs understand that disruptions will happen, and that no company can insulate itself completely from their effects. But they also know that in any crisis there can be an opportunity. Companies that survive major disruptions are likely to come out even stronger, and better able to anticipate and prepare for the next one. As Clayton Christensen notes, it's difficult to think this way, because leaders are always tempted toward complacency. "Almost all of them," he says, "probably including me, tend to stop asking good questions—or else their successors do. For example, [former Intel CEO] Andy Grove really got the concept of disruption. His famous phrase, 'Only the paranoid survive,' was a statement about how to [anticipate and] respond to disruption."

For any CEO who leads a company successfully through a disruption, that success will likely become his or her defining moment. If you are a chief executive, that's the hidden opportunity disruptions provide. The next disruption to your company could be the event that most determines how you will be regarded and remembered as a leader. ✚

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Resources

Amy Bernstein, "Yossi Sheffi: The Thought Leader Interview," *s+b*, Spring 2006: MIT's leading supply chain expert says business leaders have to figure out how to bounce back from the unthinkable.

Christopher Dann, Matthew Le Merle, and Christopher Pencavel, "The Lesson of Lost Value," *s+b*, Winter 2012: A study of companies with shrinking shareholder returns shows that strategic risk—self-induced disruption—is the number one cause.

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Art Kleiner, "The Discipline of Managing Disruption," *s+b* [online only], Mar. 11, 2013: The interview with Clayton M. Christensen where the quotes in this article first appeared.

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