GETTING PREPARED FOR NOVEL RISKS: LESSONS FROM THE NORDICS

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Companies are increasingly confronted with significant, and sometimes existential, events that they would not have been contemplated even six months earlier. Pandemic and the war in Ukraine being prominent examples. Professors Kaplan, Leonard, and Mikes of Harvard and Oxford labeled these events as "novel risks," suggesting they come "from unforeseen events, from complex combinations of apparently routine events, and from apparently familiar events occurring at an unprecedented scale and scope."

Our research team, which includes a past public company CEO and current chair of several boards, strategy consultants, and a professor at Harvard Business School, wanted to gain insight into how corporate practices and processes in Nordic companies were evolving in the face of novel risks. Nordic leaderships teams provide an interesting benchmark globally since they have had exceptionally large exposures to both recent seismic events: the pandemic and, due to their geographic proximity, Russian invasion of Ukraine.

We interviewed and surveyed more than 40 top leaders at 14 global businesses in multiple Nordic countries, spanning air travel to industrial manufacturing to consumer-facing sectors. By fortuitous chance, in February 2022, we launched a survey about how companies were evolving their internal practices due to the pandemic with some emphasis on ensuring greater resilience for the future. While the survey was out, unclarity about whether Russia would invade Ukraine became a reality, and then new uncertainties about how long the invasion would last and its consequences arose. Our survey thus provided a unique window into how the companies had prepared for the next novel risk.

After reviewing the data, we conducted 10 detailed semi-structured interviews to closely understand from the executives their perspective on their management processes within the organizations. Most of these companies had major operations in Russia, and all of them were materially affected through factors like energy prices.

We summarize our findings into five key lessons.

Lesson #1: Agile ways of working replace standard corporate processes when crisis hits

When the unexpected crises hit, and the business landscape became blurry, many normal corporate practices and processes were temporarily upended in the companies we interviewed. Agile ways to operate and make decisions emerged instead - without much pre-planning. Executives "rolled up their sleeves", focusing on actions with near-term consequences and for existing products and services.

Many standard corporate processes were temporarily eliminated or postponed. For example, normal long term planning cycle was pushed forward 6-12 months on average. Planning horizon was shortened, and less attention was devoted to long-term growth and M&A. Executives said that these topics would become more central later. But in that moment, "We focused on the most important things", said one.

Management practices were also impacted. Executives said that they spent less time with CEO - and did not feel any worse for it. They also cut the use of external advisory services. To balance this, networking with their peers - also outside of their companies - became more prominent. In a crisis everybody understood that decisions had to be made quickly. As a result, there was no room for politics. "It felt great to be in the middle" said one.

Picture we get from our conversations is that the fact that Nordic companies had faced two novel risks in a very short time span, has left a lasting mark in their corporate processes. Next crisis will not be a similar shock anymore. "Plan B ideology has become a permanent state of being", summarized one executive.

Lesson #2: Diverse business portfolios have built-in advantages

We observed that the companies that had diverse business portfolios were better positioned to navigate the shocks than companies that were more focused. For example, shocks were less likely to propagate in a wide country portfolio, reducing the business' overall exposure to new events. Decentralized country portfolio also enabled for easier exits operationally. Many companies in our sample made such sudden exits from Russia. One leader evoked the old wisdom to "not put too many eggs in the same basket."

Geographically decentralized operations also had important informational advantages that became evident in the shocks. As an example, executives noted that the on-the-ground operations in China provided valuable early signals of pandemic's likely impacts, and, thus, they were able to respond quicker and more efficiently.

As an example of the risks focused businesses can face, one of the companies we studied saw it's unique strategic advantage in logistics being completely swiped away as a result of Russia's retaliation to Western sanctions, forcing a comprehensive revision of company's strategy.

Even though crises inherently seemed to value diverse operations, executives said that a consistent message and policy was challenging to implement in these settings. For example, messaging about Russia across all operations everywhere needed to be consistent. In the search for decentralization advantages, CEOs must ensure they can keep everyone aligned on the really big matters.

Lesson #3: Companies moved from management hierarchy-based mindset to more location-based approach

Two-thirds of the executives we surveyed felt that corporate governance had significantly or very significantly changed since the start of the pandemic. The most consistent change was that decision-making power was moved towards local geographies. This was necessary since the circumstances and needs varied by location, and different areas needed different responses, as many of these companies have Asian and North American operations in addition to Europe. It is interesting to observe that the companies we interviewed deliberately retained most of these policies developed in 2020. One leader summarized, “There has been a shift from a management hierarchy-based mindset to a more location-based approach.”

Our surveys and interviews identified several key benefits from this move, such as ability to make rapid changes when faced with new risks. Interestingly, a subtle corollary of a more location-based decision making was also a more meritocratic and less political organization compared to 2019. One executive noted: “When responsible people can make their own decisions, it increases employee satisfaction.”

Another executive said, “The pandemic changed the way the business is conducted forever. Now that businesses understand the potential to manage in a less centralized, more virtual and arguably more efficient manner, I do not expect a return to pre-pandemic management philosophies”.

Counter-balancing the shift towards localization, however, executives noted that more frequent management reports on finance and operations were necessary. Business unit heads were expected to provide much more detailed reports of their specific situations in management team meetings. One summarized it as “Less daily oversight. More policy and procedures.”

Executives were mostly comfortable with this tradeoff. Many said that technology enabled sustained coordination while allowing for decentralizing decisions. One respondent noted: “Meeting protocols are more flexible, which enables higher engagement on higher number of meetings. On the other hand, physical meetings are needed for important and new matters.”

Lesson #4: Decision making based on scenarios loses value in an ambiguous setting

Leaders we interviewed had been using scenario planning to analyze opportunities and risks to their companies’ revenues or margins across locations globally. Scenario planning typically refers to a strategic planning method that organizations use to make flexible long-term plans against a defined set of alternative external events and outcomes. These scenarios capture the known or foreseen risks, and they were effective against stable uncertainties. However, when the novel events happened and the business landscape became ambiguous, executives felt that key scenario parameters suddenly became unclear… making it impossible to parse the future up into discreet scenarios. One leader noted: “There is great reason to be humble. Looking at the risk side, the company has already fumbled two times. The pandemic and the war were not on the risk map at all before they happened.” Interestingly, the term “scenario planning” became used in the companies we interviewed often as a de facto term for short term financial forecasting and business planning in a “base case/best case/worst case” fashion.

Even companies that continued to use scenarios, adjusted their planning approaches. Some increased the number of scenarios to cover a larger set of outcomes. Some mentioned that they now required that extreme worst-case scenarios be included in all divisional plans and budgets. Many also emphasized that defining actionable actions was more important than neat scenario descriptions. “Key is to find out what actions to do in a certain scenario rather than to specifically determine what the scenario is. Our goal is such that implications are already painted in, and that the implementation phase can then be started quickly”, said one executive.

Hybrid work environment increased complexity of planning and forecasting in a middle of a crisis. Leaders we interviewed said that hybrid setting created a bigger threshold for expressing views, and it increased the likelihood of misunderstandings.

Ukraine invasion, moreover, added yet another level of complexity for planning. Executives said that non-monetary perspectives suddenly intervened in business decision making, especially moral values of the company, shareholders, and customers. Boards became more involved in business decisions. While some leaders appeared at ease with this - and perhaps even relieved - others were frustrated. “Sensible business decisions could not be made.”

Instead of trying to define scenarios and corresponding action sets, many companies had moved to using “general guidelines in how to handle all kinds of scenarios,” as one executive noted. These guidelines included how to recognize critical vulnerabilities in their businesses and defined actions how to ensure business continuity - whatever happens (More about action guidelines, see attached “Action Guide to Navigate Novel Risks”).

Lesson #5: Using pre-existing organizational units creatively appears to be a promising recipe

Most companies we interviewed were still in the early phases of defining consistent organizational preparedness for the next shock. Many had launched task forces and emergency response teams to keep informed about the pandemic and its forecasted consequences. Organizations with complex global supply chains moved to ensure their resiliency. Others had begun developing basic “Plan Bs” for events once viewed as unthinkable (e.g., an invasion of their own country).

Interestingly, some companies built their response on structures and processes that already existed in the company before the shocks and then tailored them in a creative way. A good example of this was a company that had an already existing dedicated business planning and forecasting team devoted to handling the large volatility in their industry.

The unit consisted of experts who had the right expertise on route planning and capacity management. It also had a robust set of guidelines and processes on how to deal with emergencies. As a result, upper management did not need to be involved in operational decisions. “Emergencies are business as usual to us”, noted the executive we interviewed.

When pandemic hit, Chief Operating Officer and his team took the control of the unit. The processes and practices of the unit became a basis for a wider company response. The unit was super-sized and re-purposed to handle first the pandemic, and then the effects of the war in Ukraine

Should some unexpected event happen again, this team is ready to be re-activated again to deal with the next novel risk. Arrangement like this may be a promising way for companies in managing novel risks going further.

Conclusions

Taking these lessons altogether, we can see that the Nordic companies have adjusted their management processes and organizational designs when confronted with novel shocks. Better shock-response ability is now more deeply ingrained in their corporate DNA. It also appears that more localized decision making, balanced with stronger controls is the direction many global companies based in the Nordics are moving. Many are now more aware of the need to diversify their businesses and footprints to reduce exposure to novel risks. And many are experimenting with ways to quickly repurpose and re-resource existing organizational units when the next shock comes. When the next novel risk occurs, it looks certain that Nordic companies will be operationally and managerially better prepared for it. ■

ACTION GUIDE TO NAVIGATE NOVEL RISKS

We summarize the key lessons from the Nordics into an action guide to successfully navigate the novel risks before the crisis event and during the crisis event.

Actions to take before the event happens:

ACTION 1

Maintain a vigilant and rigorous awareness of the company's vulnerabilities. Leaders can't predict the next novel shock, but they can have a rigorous working list of their leading vulnerabilities. Glaring vulnerabilities, like single-sourced supply chains, can be corrected. Don't focus on point estimates but on ranges of impact. One leader noted "In strategy work, crises are not a big thing in themselves; the major impact comes through their consequences like shortages of raw materials."

ACTION 2

Possess a strong balance sheet and enough cash reserves to sustain the business through major short-term harm. Again, while the shock is unknown, the financial reserves needed to survive three months with a 50% revenue decline are calculable. Executives never expressed regret about being able to act when others in their industry were frozen financially.

ACTION 3

Develop clear, general guidelines to undergird any crisis management. Companies need pre-defined response teams that are well prepared. The roles and responsibilities of management team and the board are defined. One leader noted: "In a crisis situation, the members of the management team start working more from their own sentiment, which is why crisis management requires someone to point out the general direction of actions to be taken."

ACTION 4

Ensure strong employee attachment to the organization. The departures of key talent can compound a crisis in a devastating way. Organizations with strong bonds to employees have a head start. The worst case of "workers didn't care at all what was happening" can be avoided.

Actions during the crisis:

ACTION 1

Ensure ability to make quick-enough decisions, but not too quick. There is a tension here. One leader suggested, "It's better to make 10 decisions quickly and let a few go bad than not make any decisions at all." Yet other leaders gave examples where they acted too quickly. "Demand a deep understanding" said one leader. The pandemic favored faster decision-making organizations, whereas the jury is out on Russia.

ACTION 2

Maintain strong technology and internal communication. Better communication speed was often cited as benefit of the pandemic experience for when the Russian invasion took place. Mastery of these tools and digitization is a core competency for handling novel risks.

ACTION 3

Be mindful of the business' reputation and consequences of actions taken. Actions taken in a crucible moment define a company, and "Reputation eventually comes to a spotlight."

ACTION 4

Be present and visible. The leader's physical presence is of vital importance. One leader summarized: "Leaders must pump energy and visibility into the organization to keep it from being paralyzed. Ensure positive messages spread and squash negative rumors."

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