GOVERNANCE

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Barriers to resilience and agility

'Having identified the potential responses to a disruptive risk, it is of paramount importance to consider how the responses change the risk-return characteristics of the strategy and also the extent to which the reward systems support or block effective implementation.'

Hans-Kristian Bryn and Carl Sjostrom

What metrics will our grandchildren judge us by?

'The trap we see teams falling into is starting with the information they already have or are being asked to report. The organisations getting it right let strategy lead instead: they bring together metrics they must report on with metrics that give them a picture of their purpose and its success.'

Dr Scarlett Brown

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Barriers to resilience and agility

Hans-Kristian Bryn and **Carl Sjostrom** look at how boards can avoid creating unintended barriers to resilience and agility in a disrupted world.

The increasingly uncertain and unpredictable economic and geopolitical environment facing businesses has accelerated since the 24 February invasion of the Ukraine. As a consequence, many of the approaches to strategy, risk management and the alignment of pay and reward are out of balance. In this article we try to reframe some of the established beliefs to help organisations navigate better the increased complexity they are facing from disruption, for example:

- Political uncertainty.
- New inflationary pressures, including costs, access to capital, shifts in supply and demand, and the prospect of stagflation.
- Supply risks and the rise of nearshoring.

In an earlier article on integrating, risk, return and reward in business cases[1], we set out a structured approach that can help organisations optimise capital allocation and the use of scarce resources.

We also highlighted the benefits of testing the business case against a range of risks to understand better the likelihood of expected outcomes and mitigate against underperformance, and to consider whether the reward systems encourage the desired actions and behaviours.

‘Unfortunately, the business environment is neither linear nor can it be expressed in a single dimension …’

The model we set out is easy to implement and requires the organisation to take a more considered approach to changes in the different contexts facing businesses.

Unfortunately, the business environment is neither linear nor can it be expressed in a single dimension and, as discussed in H-K Bryn’s recent article[2], there is a continuous flow of new risk factors that need to be considered as organisations evaluate the resilience of their strategy and business models. It is clear from our work that companies are finding it increasingly difficult to balance the trade-offs between:

- Protecting shareholder value and delivering growth.
- Manging the pay implications of the social divide and rewarding the talent that is essential to organisational survival and success.
- Having a linear relationship between pay and performance and operating in a non-linear world.

Resilience and agility are commonly used terms to describe organisational capabilities. Although the terms are not always well defined or understood, they are important in times like these. We don’t consider that there is a single approach that is optimal for all or that resilience or agility are perfect or complete answers.

However, it is key to consider whether the company is unintentionally creating barriers to resilience and agility. Since risk and reward are key influencers of the actions and behaviours that convert strategy into performance[3], we argue that reviewing risk and reward can highlight barriers that stop us from a resilient and agile response to disruptions.

Resilience is key to all stakeholders. Shareholders generally value less volatility, business interruption and adverse media coverage. Equally, customers and suppliers are also looking for predictability and stability across the areas of financial, operating and reputational resilience.

When an organisation builds its resilience against disruptions that can impact its competitive position it may not insulate itself from the effect of other risks crystalising. A key resilience related risk appetite question for the board can therefore be: ‘how much cashflow volatility and share price volatility are you willing to accept for risks individually or in aggregate?’

A thorough stress test of the strategy should include an assessment of the disruptions that could either prevent the organisation from executing the strategy and deliver the planned benefits or delay the implementation timetable. Much of this can be achieved by considering how the risk parameters and the company’s reward structure limit actions and behaviours by creating barriers to respond effectively to the disruption.

Given that strategy execution is a function of how an organisation acts and behaves to deliver the strategy, both the risk boundaries and reward signals that guide those actions and behaviours are core tests to the organisational resilience to disruption and – indeed – the agility of the company’s response.

Many organisations are using the term agile in relation to software development, management style and culture. However, in the context of this article we recognise agility as how prepared the company is to anticipate and act decisively, having processes for making faster decisions in smaller increments and a willingness to go back and iterate to get the best rather than acceptable outcomes.

We can again use risk and reward to test whether we have created internal barriers to agility by evaluating scenarios

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> ‘In many cases, it will be necessary to redesign the reward structures to ensure that the intended actions and behaviours are incentivised.’

against how the risk framework and reward structures limit our ability to anticipate and execute effective mitigation against disruptions.

Having identified the potential responses to a disruptive risk, it is of paramount importance to consider how the responses change the risk-return characteristics of the strategy and also the extent to which the reward systems support or block effective implementation. In many cases, it will be necessary to redesign the reward structures to ensure that the intended actions and behaviours are incentivised. For example, disruption to energy supply might require a different energy mix (eg country of origin, renewables) or contract structure (eg duration, fixed/floating). However, if the reward systems are based on reduction of energy costs only, the management actions and behaviours may not deliver the intended outcome. Any German company that shifted all its energy supply to natural gas in response to nuclear plant closures would have been caught out by the consequences of the Ukrainian conflict, but would this have been the case with different risk and reward frameworks?

The analysis described above requires a willingness to challenge status quo and to identify self-imposed or self-created barriers. In many recent discussions, we have been struck by the sequential, and linear, approach to analysing risks. In our opinion, the increased uncertainty and complexity calls for analysis of the aggregate impact of risks and better scenario analysis. For example, many organisations face the challenge of responding to disruptive forces in multiple parts of their business concurrently rather than having the luxury of responding to one disruption at a time.

Boards and leadership teams who invest time to have these discussions will make their organisations more resilient. They may also reach a point where they can use risk and reward to reverse stress tests as to how severe a scenario would have to be to either threaten the viability of the business model[4], the financial resilience of the firm or the time horizon for delivering projected shareholder returns. This would in turn allow assessment of how decisive and agile responses are likely to be, pointing to those that require dismantling to facilitate the desired actions and behaviours to perform in an unpredictable and disrupted world.

Carl Sjostrom is an independent senior adviser to company boards and management, working across Europe and with most industries and forms of ownership. With a focus on reward and performance, Carl is a frequent speaker and commentator on topics of strategy, executive pay and corporate governance issues from an international perspective.

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1. See H-K Bryn and C Sjostrom, ‘Integrating risk, return and reward in business cases’, *LinkedIn*, September 2021.
2. See H-K Bryn, ‘2022 – a mid year risk perspective’, *LinkedIn*, May 2022.
3. See C Sjostrom and H-K Bryn, ‘Risk, actions and behaviours’ (parts 1 & 2), *Governance*, issue 308, April 2020, and issue 309, May 2020.
4. See H-K Bryn, ‘Resilience statement – friend or foe?’ *LinkedIn*, May 2021.

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- How does what we've done connect to the long-term success of the business?
- Could a third party help us measure or evidence our impact?

Boards' responsibility to oversee purpose, culture, values, and their company's impact on society and the planet is no longer a question of if; it's a question of how. Coupled with technology that can bring innovative metrics and measures at boards' fingertips, this provides businesses with a new opportunity to have a net-positive impact on the world around them. Thinking about measures of success – what we value, what we measure, and how we make the impact we want to – will be a crucial first step in that direction, and provide a framework for boards to bring together parts of governance that are still too often disparate: purpose and responsible business, strategy, reporting and communications, and impact.

Dr Scarlett Brown is Director of the Board Intelligence Think Tank. Board Intelligence is a mission led company that helps boards and leadership teams be a driver of performance and a powerful force for good. We use our convening power across boardrooms up and down the country to run an independent think tank, for all business leaders committed to creating a fairer future. In 2022 this includes running research programmes into how measures of success in business can be changed to better align with the needs of the planet and society, and looking at the role of the governance professional in creating a fairer future. To get involved in the work of the think tank contact thinktank@boardintelligence.com or visit www.boardintelligence.com/thinktank

1. CIPD, Responsible Leadership Through Crisis, 2021 and 2020.
2. Adapted from the Future of the Corporation, 2021.
3. CIPD, Organisational Culture and Climate: an evidence review, July 2022.
4. FRC, Creating Positive Cultures, Opportunities and Challenges, December 2021.

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