Deloitte. on...

DISRUPTION

RETAIL
Uncertainty is an uncomfortable position. But certainty is an absurd one.

Voltaire
Missing the boat

Back in its heyday, Borders boasted more than 500 outlets around the world, stretching from Singapore to New Zealand to New York City to its flagship store in Ann Arbor, Michigan. Second only to Barnes & Noble, Borders had grown to become a multi-billion-dollar brick and mortar retailer specializing in books and music and part of the top 100 US retailers.

A few short years later, Borders filed for bankruptcy and went out of business—yet another big-box chain adding to the list of disappearing strip-mall retailers. What happened?
Missing the boat

No single defining issue led to Borders’ downfall; rather, it was attributed to a combination of strategic risks that, for too long, went unidentified or unaddressed. Their failure to quickly establish an online presence, their lag in developing an e-book reader, and their overinvestment in real estate, CDs, and DVDs were all contributing factors. Unfortunately, this is not an original story. Over the past decade, strategic risks have accounted for 86% of significant market losses for companies – the other 14% come from operational, legal & compliance, and financial risks. Despite this, companies spend only 6% of their risk management efforts on managing strategic risks, with the other 94% spent on the other three areas. So why are companies investing only 6% on the area that causes an overwhelming amount of the value destruction? Part of the reason is because strategic risks are difficult to spot and manage with traditional risk management techniques – it’s not currently in their toolbox, but they need to acquire it.¹

In the end, technical disruption and underlying consumer behavior changes attacked the basis of Borders’ strategy and their inherently biased belief that consumers wanted to browse and purchase books in large mall-based stores. Not recognizing and fully appreciating the impact of disruptive trends, driven by the transformative power of e-commerce and the rise of the Internet, Borders was left shooting in the dark.
Is your organization merely looking at risks without looking for or considering the upside of disruptions? You can’t hit what you can’t see…
Assess for Success
Trends are converging, further complicating an already competitive landscape for retailers. It won’t be enough to identify the trends or even the intersections between multitudes of trends; rather, retailers will also need to inventory, prioritize, and scenario plan against those of the highest order. Doing so can enable companies to take risks and turn them into opportunities.

Retailers should accelerate discovery, by scanning ruthlessly, and seize upon those risks that can undermine its competitive advantage, market position, or long-term performance; and transform these insights into actionable, sustainable plans.

The bottom line? Maintaining your competitive position is predicated on your organization’s ability to identify, assess, and respond to disruptive threats.
A brave new e-world

Borders is only one of many retailers who succumbed to disruption. Former titans like Blockbuster, Tower Records, Linens N’Things, and Circuit City struggled mightily as they ceded market share to smaller, more dynamic competitors.
A brave new e-world

The retail landscape, across the board, has changed dramatically in the past few years. Between 2010 and 2014, of the country’s top 100 retailers, 12 companies dropped off the list and of the remaining companies, 33 experienced less than 1.5% in annual domestic sales growth.² Added to that, the average life span of a US company is shrinking, dropping to an average of 18 years³ in 2012. That’s a staggering 74% drop from the 61-year lifespan reported in 1958.

So, what’s driving this new pattern of turbulence?
Introducing the new normal

We are living in a volatile, uncertain, complex, and ambiguous world of constant disruption – and the rate of change is accelerating. Social, technological, environmental, political, and economic trends have converged to create disruptive threats that are shaping consumer behavior and preferences, including how, when, and where they make purchases—which is now “everywhere and on every device.”
Introducing the new normal

The rise of e-commerce, new forms of payment, and collaborative consumption have transformed the consumer-retailer relationship—creating opportunities for new business models and introducing uncertainty to traditional ones. So what determines whether a retailer will succeed or fail in the face of these strategic risks?

The demise of retailers like Borders was not caused by board members or executives who didn’t care or take active steps to manage their companies through trying times. In fact, their responsibilities include setting the company’s strategic vision, dealing with crises, and managing the company’s risk portfolio. But strategic risks don’t always make it onto the radar until it’s too late.

In hindsight, it’s easy to see the disruptive signals that toppled many leading retailers. But in reality, these signals were often faint and hard to spot, and few companies even knew to look for them. Strategic risks can attack the basis of your competitive advantage, undermining your ability to sustain exceptional performance. Without historical precedent, strategic risks are immune to traditional risk management methods.
Strategic risks are risks that threaten to disrupt the assumptions at the core of your company strategy.

Spotted early, strategic risk can fuel game-changing innovation and opportunities. Identified too late, they can erode your value proposition and destroy your customer base and business model. So, what’s a retailer to do?

When all think alike, then no one is thinking.

*Walter Lippman*
Recognizing and dealing with strategic risks requires us to look past the most pressing “here and now” challenges to anticipate encroaching disruptions that are further away and harder to spot.

All companies strive to meet shareholders’ growth and profit expectations – that’s the job of management. It’s particularly challenging, however, for those competing in an ultra-competitive, razor-thin margin retail environment.

Binoculars, anyone?
Binoculars, anyone?

Traditional risk management practices assess risks based on the likelihood that they will occur, requiring us to believe that what’s going to happen in the future will be a repeat of what’s happened in the past. They are not designed to sense new changes or risks. Companies need both.

Few risks are as difficult to control and measure as those arising from innovation, competition, or external macro forces. Current risk governance models are often too narrowly prescribed and inward-looking to be insightful with respect to strategic risks.

Whether something is a risk or an opportunity often depends on timing and how soon you spot it. As a result, ignoring strategic risks can be comparable to rearranging deck chairs on the Titanic. In other words, what’s the point of focusing on seamless execution if your ship is on a collision course?
Strategic Risk Management (SRM) complements traditional risk management efforts by incorporating risk into broader discussions on corporate strategy. SRM allows you to look forward and identify potential threats that are the result of new business conditions that could radically transform your company’s competitive environment or performance. By developing an understanding of your organization’s strategic risks, you create an outside-in view of your operating environment—and in the process, expose vulnerabilities in your company strategy.

To effectively navigate the changing business landscape, retailers should incorporate both a strong ERM discipline and an SRM view—enabling them to stay on top of internal and external risks.

One of the tests of leadership is the ability to recognize a problem before it becomes an emergency.

Arnold H. Glasow
Confronting biases

Seeing things that are hard to see—like strategic risks—is complicated by the fact that we’re human. As humans, we have inherent biases hardwired in our brains. We bring those biases into everything we do.
Confronting biases

While your organization may be adept at managing operational and execution risks, what about those that are external to your organization and industry? We can’t expect the solutions of the past to fix today’s or tomorrow’s problems. Effectively navigating strategic risks requires us to imagine the future from outside our comfort zones and to do this, we have to challenge the biases we’ve accumulated over time.

Sometimes our biases can distort what we see and how we act. One famous demonstration of this phenomenon is the *Duncker Candle Problem*. In 1945, Karl Duncker asked subjects to attach a lit candle to a wall in a way that would prevent it from dripping wax onto the floor using only a candle, a box of thumbtacks, and a box of matches. The solution is to place the lit candle in the box and thumbtack it to the wall. Duncker found that a subject’s ability to find the solution was greatly affected by how the tools were presented. When the thumbtacks were placed in the box, the subject saw the box only as a vessel to hold the tacks and failed to complete the task. However, when thumbtacks were presented outside of the box, the box was seen as a tool and was used to solve the problem.
The Duncker Candle Problem demonstrates what is called “functional fixedness,” a bias that prevents us from using familiar objects in new ways.

Here’s the kicker – adding financial incentives for participants made it worse! In 1962, psychologist Sam Gluckberg continued Dunker’s test by giving a monetary incentive to half of the participants. In a fascinating twist, the subjects who had financial incentives performed worse than those without. In fact, performance was shown to decrease proportionally to increased monetary value. Gluckberg’s outcome countered common beliefs around financial incentives, and showed that a sharp-edged incentive system can actually undermine the brain’s ability to overcome cognitive biases.

The lesson? As disruptions continue to occur at a faster pace, no one can afford to be fixed into one way of thinking. Leaders who have the ability to evaluate situations from multiple perspectives—even those that we take as straightforward—can help influence future success of their company. In fact, exceptional leaders understand that these “risks,” if identified early, can be used as levers for improving your competitive position.
Accelerate Discovery

Prepare for Surprises

Confront Biases

Scan Ruthlessly

Smart Companies

-30%

-20%

-40%

-50%

-80%
What smart companies will do

The challenge before executives today is to find new ways to adapt to quickly changing conditions, identify potential threats as early as possible, and spot opportunities that may reveal themselves through disruption. Fortunately, there are tools to help companies survive in this changing world. Smart organizations have developed a system to deal with unexpected changes that threaten their business models.
This system should include people, processes, and capabilities to:

1. **ACCELERATE DISCOVERY:** Today’s retailers must create regular, systematic mechanisms to accelerate the pace at which they discover sources of surprise.

2. **SCAN RUTHLESSLY:** Any potential source of change won’t come with a big sign that says “disruptor.” Performing trend analysis and future scanning can surface small, subtle indicators of change across a range of industries and domains that could add up over time to produce a tipping point.
CONFRONT BIASES: “That will never happen” is the most dangerous phrase in today’s C-suite. No matter how experienced, no leader or institution is immune to biases and once you admit you have them, you can begin to step outside yourself to observe them.

PREPARE FOR SURPRISE: When an emergent risk turns into a strategic threat, it’s too late to study the problem. You have to respond with confidence, clarity, and precision.
Do it with the best knowledge you can find—about the world, your organization, and your team. Great companies recognize that it is the events they rarely can predict that will reshape their businesses. Standing still is not an option.
Get ready.

Join the conversation.

**In person**

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1 How to live with risks” “http://HBR.org”
2 HBR.org July-August 2015 issue
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