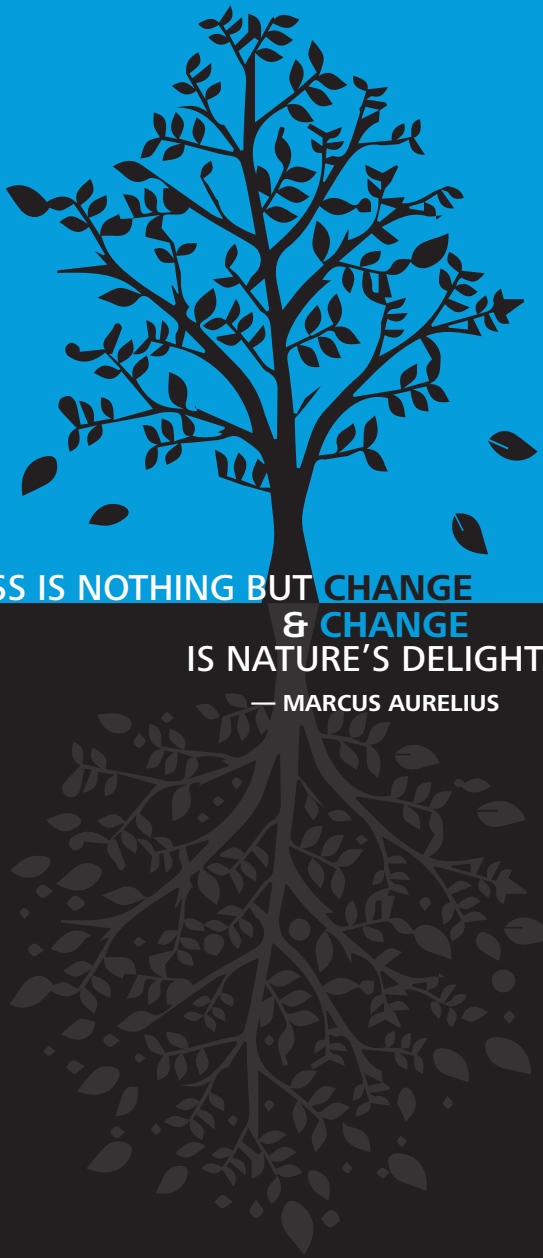
DISRUPT

Deloitte. *on...*

DISRUPTION



"LOSS IS NOTHING BUT **CHANGE**
& **CHANGE**
IS NATURE'S DELIGHT."

— MARCUS AURELIUS

Objects in Mirror

Remember a few years ago, when every street corner and strip mall seemed to have a big blue Blockbuster?

In 2004, Blockbuster was the dominant, unassailable leader in home video rental, with 9,000 stores and 60,000 employees. Who could have predicted that just six years later, the industry giant that took out nearly all the neighborhood mom-and-pop rental shops would itself be taken out?

Conventional wisdom says Netflix destroyed Blockbuster, but it's actually a more nuanced story.

Blockbuster was brought down by a series of strategic risks that generated fatal disruptions to its business.

The first disruption was e-commerce, which came in the form of Netflix, free of expensive real estate leases and able to liberate customers from punishing late fees. Blockbuster allowed Netflix to get a several-year head start in online rentals, and by that time, the former giant lagged way behind in online subscribers.

Blockbuster might have had a chance to retain the customers who still wanted to pick out videos in person, but there was a second disruption afoot, Redbox's grocery-store kiosks. Redbox ate into Blockbuster's remaining offline video rental business, because it provided a way for people to rent videos in person that didn't rely on thousands of employees or dedicated storefronts.

The third disruption was the advent of streaming video. Since Netflix had all the subscribers online, it was the leader by a long shot.

In hindsight, Blockbuster wasn't taken down by a single competitor, but by its own failure to respond when strategic risks threatened the underpinnings of its business model.

The lesson isn't simply about the importance of real estate costs or new technology. It's about how to sense the future and respond accordingly when this sort of disruption has become a permanent fact of life.

You can be on top of the world today and hanging on for dear life five years from now.

Whether you're a prosthetics maker watching the rise of 3D printing, or an auto manufacturer witnessing the rise of collaborative consumption, the message is clear: objects in the mirror may be closer than they appear.

Welcome to VUCA, the New Level Playing Field

Stories like Blockbuster's seem to be happening more often than ever before: top automakers go bankrupt; leading retailers collapse; and the most prestigious names in news struggle against the relentless erosion of their businesses. So what's behind this new pattern of turbulence?

We live in a world the U.S. Army War College has dubbed VUCA: volatile, uncertain, complex, and ambiguous.

In business, the VUCA world is the culmination of 50 years of movement from an industrial to an information economy.

It's the result of everything from automation to outsourcing, deregulation to globalization, personal computing to the Internet. These changes have vastly improved productivity and connectivity, paving the way for tremendous business innovations and consumer benefits.

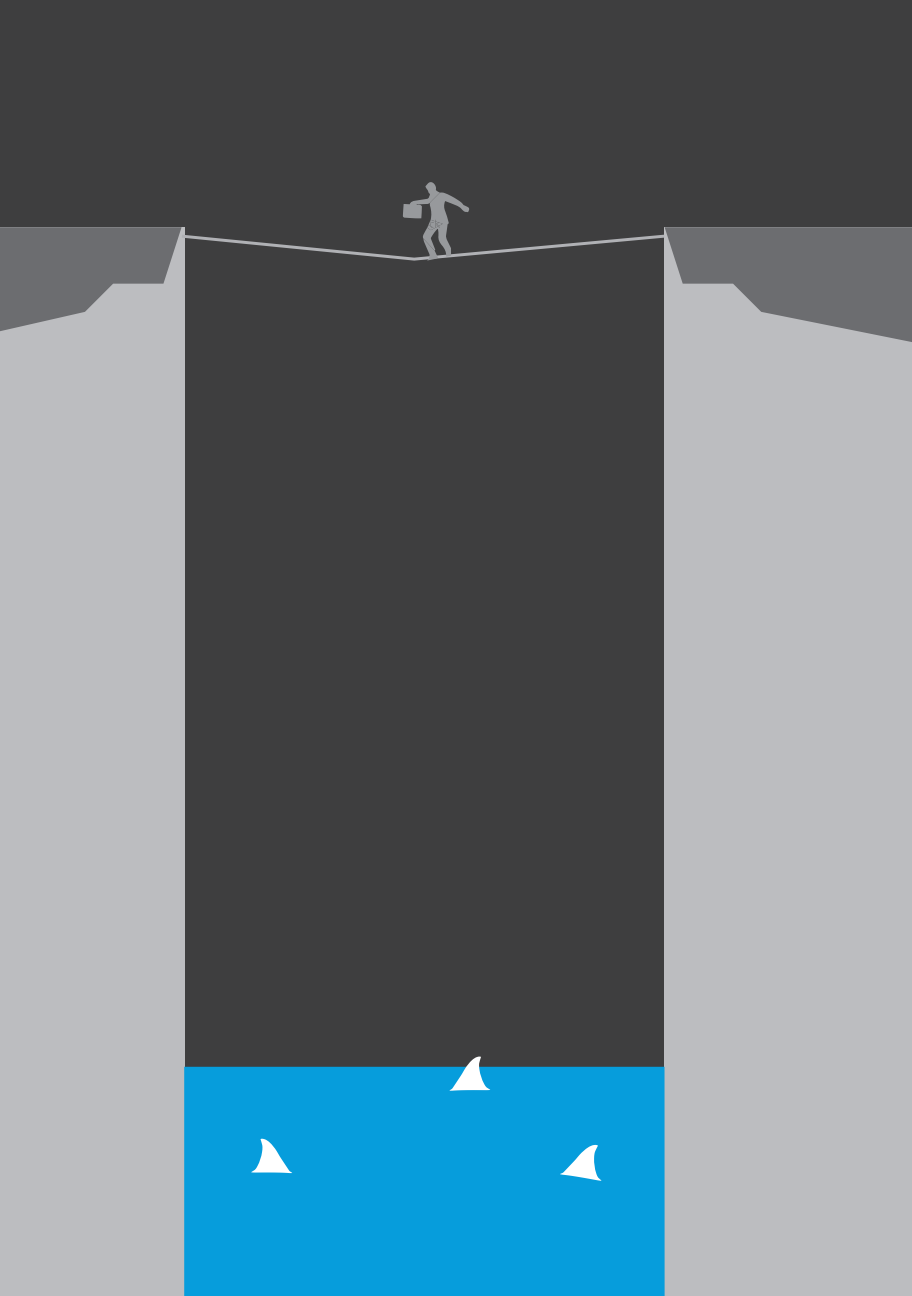
But there's a flip side to this progress. In the VUCA world, companies face increasing demands from customers they've never served with needs they've never had to meet, relentless productivity pressure thanks to competitors with lower costs, and business model threats from upstarts in new sectors. Then throw in other macro trends like the shifting geo-political landscape; the rapid adoption of social, mobile, and cloud-based technologies; and the changing demographics of customers and employees.

Now, turn the heat way up with a new 24/7 feedback culture, where customers can vilify companies and damage their reputations via social media, and it's easy to see how the 15 years since the term VUCA was coined have only made it more relevant.

Of course, the story is far from over: technological advances will only continue, and the speed of innovation will only increase, creating more and more opportunities to disrupt industries. Maybe even yours.

The challenge facing organizations today is how to anticipate, adapt, maneuver, make decisions, and change course as needed in a VUCA world.

And really, the only way to respond is by changing your approach to risk. You're not out for a leisurely drive, sticking to the straightaway and steering clear of danger. You're a Formula 1 driver, using every hairpin turn and unexpected development as an opportunity to secure the lead.



Risk Is Not a Game

Because of the complex world in which companies now operate, strategic risk has earned a rightful position at the top of the executive agenda. Boards want to know that the executive team is "on it," and CEOs want to make sure they're not missing it.

Yet spotting and responding to this special category of risks is unfamiliar territory – a challenge even for those who know they have to do it.

In part, that's because it's often not clear what to look for. Not every risk – not even every important risk – is a strategic risk.

Strategic risks are the ones that threaten to disrupt the assumptions at the core of a company's strategy.

They frequently result from changes to the business environment, and they have the potential to destroy the value creation and profit generation model of the company.

The trouble with strategic risks is there's often no historical precedent to draw from to assess their potential nature and impact. Sometimes they're the product of a visible trend, but often they appear as a surprise. Subtle and difficult to quantify, strategic risks can't be managed in the traditional ways with

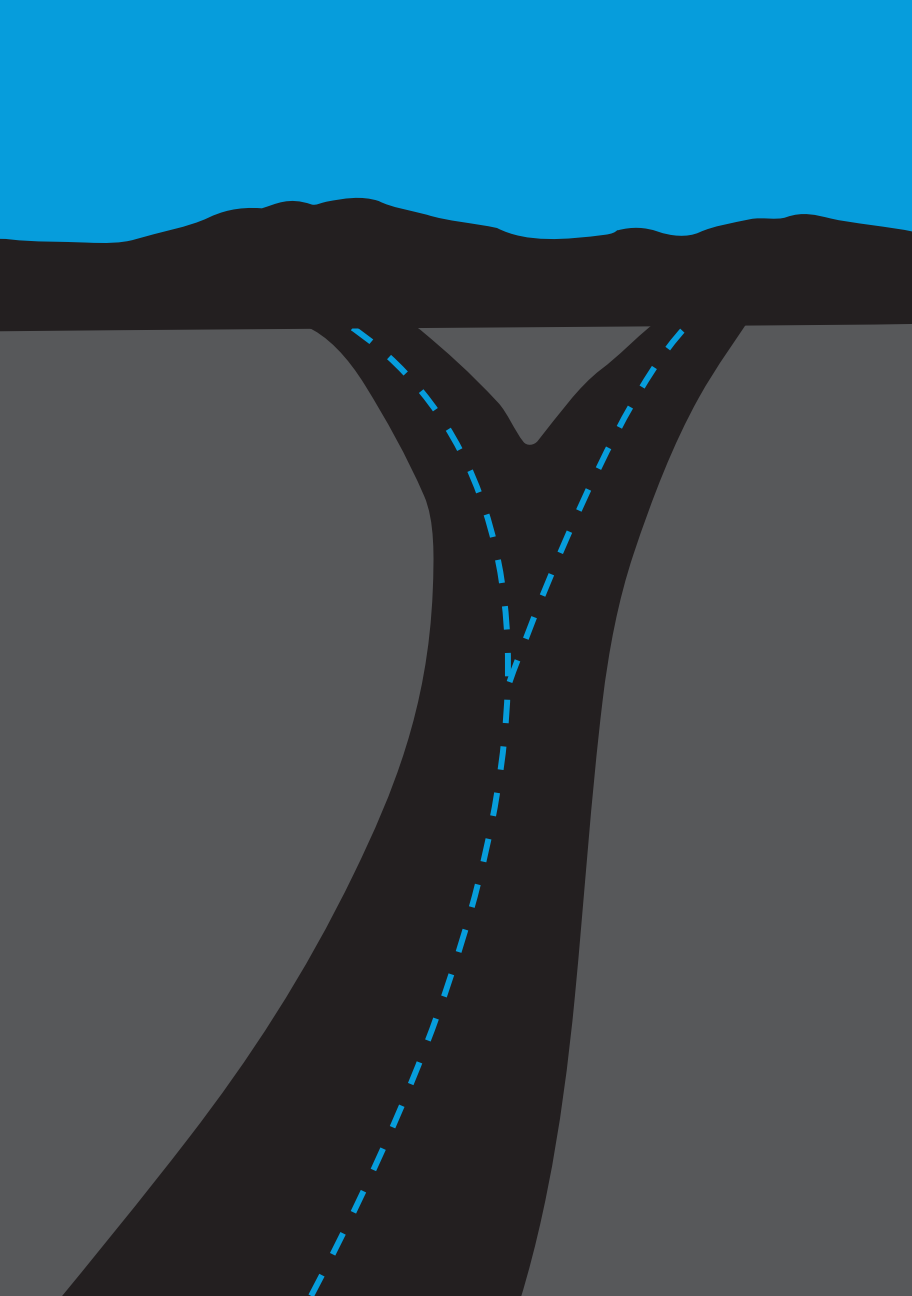
Enterprise Risk Management programs or software. And hard as they are to spot in time or manage, they are extremely difficult to recover from.

What auto industry CEO could have predicted that decades of downtown redevelopment, combined with the rise of the Internet, would spawn a generation of Millennials who would connect online to share cars?

The other way strategic risks can be confusing? They're not just "something to mitigate." There is great potential for upside here.

Spotted early and handled well, they can be the basis for game-changing moves that reorder the field.

They can decimate what had looked like an indomitable leader, but they can also point the way to new options or the next market – the way BMW has launched its own car-sharing service DriveNow, or the way Avis is positioning its acquisition of ZipCar.



We're Only Human

Part of the trouble organizations have navigating strategic risks is inevitable: organizations are populated by humans, and human thinking is inherently flawed – especially when it's asked to look at something as ambiguous and complex as the future.

The growing discipline of behavioral economics has shed light on just how hard-wired we humans are for some key cognitive biases.

The very way our brains work to make quick decisions can also get in our way.

And demonstrated success is no defense. Smart and successful people – even Nobel Prize winners and CEOs – are no more immune to bias than anyone else.

For example:

- **The Overconfidence Bias** convinces us to trust our gut when we shouldn't, and makes us unable to calibrate the limits of our own knowledge. We don't know what we don't know, and we overestimate the truth of what we believe;

- **The Availability Bias** encourages us to inflate the importance and likelihood of things we saw or read recently (and are thus most available to us in memory), giving us a distorted view of what's really important;

- **The Confirmation Bias** causes us to pay more attention to information that fits what we already believe while discounting information that may contradict our current beliefs; and perhaps worst of all,

- **The Optimism Bias** fools us into thinking that nothing bad will happen and all our plans will work out as we intend.

These and other biases cause us to misunderstand the likelihood of events that could reshape our businesses and confound our ability to respond to them. In fact, emerging research points to more than just cognitive but actual physical ways the human body will predictably respond when presented with risk. We're wired to take shortcuts and act fast, but these impulses inevitably distort what we see and how we act.

Born That Way

Anchoring Anthropic bias Attributional bias Availability bias Barnum effect Base rate neglect Behavioral confirmation Belief perseverance Bias blind spot Clustering illusion Confirmation Bias Conjunction fallacy Contrast effect Cultural bias Dilution effect Disconfirmation bias Egocentric bias Endowment effect Experimenter's regress False consensus effect Framing effect Fundamental attribution error Gambler's fallacy Group-serving bias Group attribution error Halo effect Hindsight bias Hostile media effect Hyperbolic discounting Illusion of control Illusion of validity Illusory correlation Impact bias Infrastructure bias In-group bias Just-world phenomenon Kuleshove effect Lake Wobegon effect Logical fallacy Loss aversion Media bias Memory bias Mere exposure effect Misinformation effect Negativity effect Negative perception of the color black Notational bias Out-group homogeneity bias Overconfidence bias Pathetic fallacy Peak-end rule Physical attractiveness stereotype Planning fallacy Picture superiority effect Positivity effect Preference reversal Primacy effect Priming Projection bias Pseudo-certainty effect Pseudo-opinion Publication bias Recency effect Regression fallacy Reporting bias Risk-aversion Rosy retrospection Sample bias Selection bias Selective perception Self-deception Self-serving bias Spacing effect Statistical bias Status quo bias Sunk cost effects Tunnel vision Trait ascription bias Valence effect

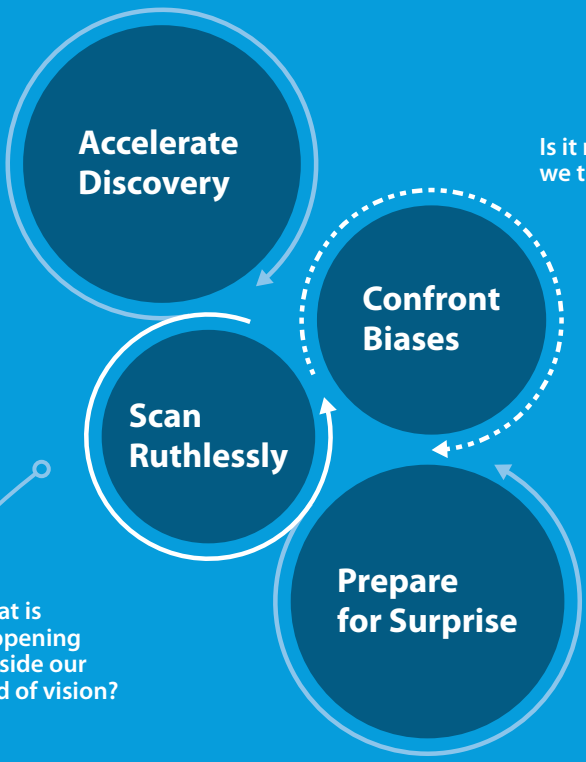
And if our own biological and cognitive biases don't get us, some common organizational constraints probably will:

- **Poor communication:** siloes, divisions, and turf wars;
- **Bureaucracy and centralization:** misguided attempts to control uncertainty with processes and hierarchies;
- **Busyness:** endless days of meetings, conference calls, and emails that rob us of the time to look past the present and into the future;
- **Group-think:** the "organizational consensus" on the future, and the prevalence of yes-men who can't really tell their bosses the truth; and
- **Reactive governance:** packed board agendas that encourage report-outs rather than proactive discussion and engagement.

This cluster of individual and organizational constraints conspires to prevent us from making the choices we'd like to make with the kind of clarity we'd like to have.

It's a **systemic** problem that requires a **systematic** response.

How can we spot trends and disruptors more quickly?



Is it really what we think it is?

What is happening outside our field of vision?

How do we prepare for the unexpected?

What Smart Companies Will Do

Fortunately, the tools to help companies survive in a VUCA world do exist. And since the complex circumstances in which we now live are never going to vanish, smart organizations will develop a system to deal with unexpected change.

1 ACCELERATE DISCOVERY.

Today's organizations must create regular, systematic mechanisms to accelerate the pace at which they discover sources of surprise.

How will today's trends unfold in surprising ways in 5 years?

Which trends should I pay attention to?

What would make today's strengths tomorrow's vulnerabilities?

Instead of putting up the normal "intentional blinders" after settling on a strategy, this new permanent discovery mode requires fresh thinking from the outside-in and learning from people who have vastly different experiences and perspectives.

The same people, having the same conversation, in the same meetings, using the same tools, will always end up in the same place. Not until you change who's in the room and how the conversation is facilitated can you expand your perception of a plausible future and how you should prepare for it.

2 SCAN RUTHLESSLY

Any potential source of change won't be coming with a big sign that says "disruptor." It won't be coming from the usual places. And there won't be just one.

Leveraging expert partners for trend analysis and future scanning can surface subtle indicators of change that could add up over time to produce a tipping point. (Ford's Global Director of Consumer Trends scans other industries like health care and communications for ways to get Ford in front of coming movements such as global aging.)

There are also ways this can be done internally. It's an accepted innovation practice – at least for products and services – to create protected enclaves, shield them from the rest of the culture, and give them license to challenge the dogma. But we don't do that often enough for the company itself.

Smart companies will set up internal "red teams" to play the role of corporate adversaries and task them with identifying small changes in the market that could kill the company in the future.

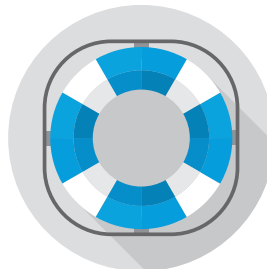
3 CONFRONT YOUR BIASES.

***"That will never happen"* is the most dangerous phrase in today's C-Suite.** No matter how experienced, no human is immune to cognitive or institutional biases, and once you admit you have them, you can begin to step outside yourself to observe them at work.

At every strategic turn or important decision, ask yourself what uncertainties or biases might be in play. Aggressively seek out information that contradicts what you believe. And then, involve third parties who will constructively critique and challenge your points of view and strategies. (Warren Buffet famously challenged his own biases by inviting one of his most vocal critics, a hedge fund manager who was shorting Berkshire Hathaway's stock, to participate in the company's annual meeting.)

4 PREPARE FOR SURPRISE.

When an emergent risk turns into a strategic threat, it's too late to study the problem. You have to respond like a Navy SEAL, with confidence, clarity, and precision.



How do SEALs prepare for special operations without knowing what surprises will come? They rehearse readiness.

One of the hardest jobs of leadership is to act quickly in an ambiguous environment. But you get better at it with scenarios and learning journeys that identify triggers and outliers, and help you think through a broader range of possibilities. You may not be able to predict the future, but you can certainly prepare for it.

Preparing for strategic risk may not yet be on your performance review, but as a senior executive, **you're certainly on the hook for it.**

Doing it now may be harder than ever, thanks to VUCA and the pace of change. But "business as usual" is a fantasy, and denial is just a shortcut to an early exit.

Discover. Scan. Confront. Prepare. Do it with the best knowledge you can find – about the world, yourself, and your team.

And then get ready.

Because doing nothing could be the deadliest strategic risk of all.

Interested? Join the conversation.

In person

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#strategicrisk, #disruption