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On the board's agenda | US

The role of the board in an age of exponential change

In a time of exponential change, both risk and opportunity abound. To survive and thrive, companies should recognize the opportunities at hand and take deliberate action. Successful organizations will find ways to move toward long-term transformation with quick, concrete actions, identifying scalable growth opportunities with the potential to fundamentally transform the business. Board members have a unique role to play in guiding transformation, challenging the basic assumptions of an organization, and helping foster a positive culture of exploration and experimentation to help keep the business evolving as its environment changes.

Center *for*
Board Effectiveness

Is your company ready for exponential change? Questions for directors to ask.

Board members who embrace exponential change will likely find more and more ways to affect their organizations for the better. Questions like these can help assess how company management understands the environment, and how to shape that understanding to help the company thrive amid rapid change.

1. How are we responding right now to new technologies or business models affecting our industry? Are we keeping up with the pace of change? How are our competitors responding?
2. Are there new players entering our space from what have traditionally been seen as other industries? What are they doing differently?
3. What is the most common attitude toward change among employees? Are there departments or divisions that are more resistant than others? More welcoming?
4. Where does management see the business in 10 years? Twenty? What would our company need to look like to succeed in that future? What can we do on a small scale, from within the business, to test movement toward that vision?
5. What new initiatives are currently happening within the company? Which of these has the potential to scale significantly in areas new to us? What two or three business initiatives will best accelerate our movement toward that future within the next six to 12 months?
6. Do we have the critical mass of resources needed to pursue such new initiatives? If not, how might we attain them? What metrics will we use to measure success?
7. How do the company's strategic planning and capital allocation processes align with a focus on the future and exponential change? Do they need to be revised to ensure they bring in key considerations of exponential change?
8. What's the most promising edge of our business—one with the potential to scale into the new core of the company?
9. In the face of these changes, what is the cost of doing nothing, or moving too slowly?

Doing business in an age of exponential change

We live in an age of unprecedented innovation. Powerful technologies—from quantum computing to additive manufacturing, synthetic biology to blockchain and bitcoin—are generating disruption across industries, changing fundamental aspects of how businesses operate. And technology isn't the only arena for change; everything from politics to the nature of work is in flux. The resulting upheavals create significant risk for even the largest, most dominant enterprises. If businesses don't put themselves in a position to respond appropriately, they risk being left behind.

With risk comes opportunity. Technology is enabling us to do things once inconceivable, and such exponentials—innovations whose rate of change creates rapid leaps in performance relative to cost—are not just the domain of research labs, startups, and incubators. Large global organizations can also harness them with dramatic effect. But doing so may require a relentless focus on the new, engagement with nontraditional business partners, bold thinking, discipline, and a commitment to reshaping business as usual.

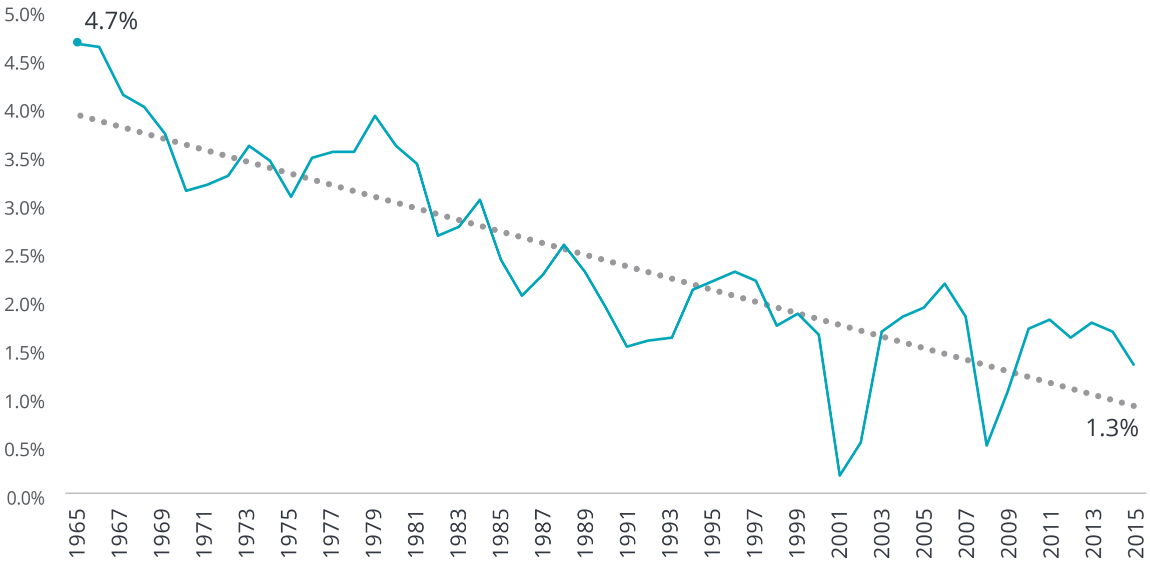
Large enterprises that have historically dominated their industries can thrive in these conditions, and should recognize the opportunities at hand (and their potential impacts), take deliberate action, and themselves evolve into exponential organizations. Indeed, companies that don't respond intelligently to the mounting performance pressure generated by exponentials are likely to be eclipsed by competitors that see, and seize, the opportunities they present.

Under pressure: Common responses to exponentials and falling ROA

Exponential technology is already creating an abundance of opportunity—against a decades-old backdrop of mounting performance pressure. So far, response to that pressure has been generally unsuccessful. Deloitte's analysis of return on assets (ROA) for all public companies in the US since 1965 shows that ROA has collapsed by a striking three-quarters over that period, reflecting decline in 11 of 13 economic sectors.[1] (The remaining two, health care and aerospace and defense, have seen no significant gains, but it is likely that they too will soon be adversely affected.)

[1] *Success or struggle: ROA as a true measure of business performance* by John Hagel, John Seely Brown, Tamara Samoylova, and Michael Lui; copyright 2013 Deloitte University Press

Figure 1. Return on assets for the US economy, 1965–2015



Firm performance, as measured by ROA, continues to decline.

Source: Compustat; Deloitte analysis.

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Companies appear to be responding to this situation in one of three ways:

- **Denial:** "It might be happening to others, but my company is different. Right?"
- **Delay:** "Yes, things are changing, but don't panic. Let's wait for things to clarify a bit; there's plenty of time to respond."
- **Defensiveness:** "Time to move aggressively! To survive, we need to do what we've always done, but just push harder, using technology to make it faster and cheaper."

It's not clear that any of these responses will serve businesses over the long term. For better or worse, the effects of exponentials and the decline in ROA transcend industries and sectors, leading inevitably to universal disruption. So what can board members do to help steer their organizations through turbulent times?

Possibilities and pitfalls: Short-termism and the antibody effect

If a company is going to turn these myriad pressures into opportunities, a defensive strategy is unlikely to work. Instead, corporate management should consider rethinking the fundamentals of the business—including those business models that have driven success in the past. A board that can help guide its organization is a powerful asset here.

Board members are well positioned to view an organization to help it avoid common pitfalls. One example is "short-termism": The structure of the business environment, compensation system, and investment landscape lead CEOs and CFOs to focus heavily on the next quarter. But in a business environment undergoing fundamental shifts, focusing on immediate results at the expense of the long view could be deadly. If a company does not react—and move decisively—it could be out of the picture.

To complicate matters, the approach to transformation is a crucial factor. A top-down, big-bang approach to large-scale internal change may elicit major resistance from within the organization—the "antibody effect." In large organizations, there is a powerful "immune system" that wants to protect the way things are done, because it's been successful in the past. This is a natural human reaction, and not inherently bad—but in times of transformation, it can undermine necessary change. To overcome such resistance and drive change from within the ranks as well as the top, leadership may need to affect the larger corporate culture. That means showing those at all levels of the organization how shared transformation can keep the company healthy and strong for all involved—and then effecting change in ways that walk the talk, rewarding transformative work at all levels.

Zoom out, zoom in

How can board members help a company flourish immediately and over time, engaging both management and the rank and file around a shared view of the future? The answer can lie in two essential building blocks for successful transformation, "zoom out/zoom in."

- **Zoom out:** Suggest that management develop a clear and compelling view of how a company and its business landscape will be different a decade or two down the road. Consider what the markets the business participates in today might look like in 10 or 20 years, and what shape it might need to take to continue to grow and create increasing value in that changed market.
- **Zoom in:** Encourage management to identify two or three promising concrete initiatives that can be taken in the next six to 12 months to accelerate movement toward the long-term (zoom-out) destination. Focus on near-term planning, identifying the highest-impact near-term initiatives that can test the assumptions of the long-term vision—and accelerate the path toward that vision. Consider how the business might tap into its broader business ecosystem to accelerate growth and change.

In this approach, the near-term operating initiatives provide management with new information about the marketplace and needed capabilities, while generating feedback to refine the long-term view and support deep long-term transformation. That goal, in turn, helps select and shape the next set of short-term initiatives. Such iterative processes accelerate learning, supporting institutional innovation and helping companies tap into the opportunities of tomorrow. Over time, the company develops new zoom-in initiatives, each of which further refines the larger, long-term trajectory identified in zoom-out planning.

Note too that the short- and long-term goals here are inextricably linked. Most scenario planning/development exercises explore potential futures... then management goes back to business as usual and nothing changes. In contrast, the zoom out/zoom in approach is practical rather than theoretical. Zoom-in planning is not over until management agrees on two to three new initiatives to implement. It requires the business to prioritize these initiatives, preventing the common tendency to spread resources too thin across too many projects.

Seize new opportunities by scaling edges

When determining where to focus transformation efforts, a central goal is to reduce risk, yet retain the potential to transform an entire organization. The zoom out/zoom in approach can be very helpful in identifying promising aspects of the business—those that could in fact scale to become its new core.

To reduce the risk of exciting antibodies within the existing core of the business, a process called "scaling the edge" can make it possible for businesses to reinvent themselves while minimizing potential risks—and maximizing impact.[2] Scaling the edge starts with the recognition that, in a rapidly changing world, most firms have a promising "edge" that can become a catalyst for change. This edge can take many forms, but it's most often an emerging business opportunity, one that addresses unmet needs in the marketplace and/or harnesses capabilities shaped by new technology.

An edge is a growth opportunity that has the potential to scale—so much so that it can eventually replace the existing core of the business. A true edge should align with larger trends disrupting the industry so that it can scale very rapidly. Edges involve fundamentally different business models and practices from those of the core. They become magnets to attract small clusters of change agents who can focus on building the edge, rather than directly confronting the core of the business. Ideally, a company identifies a promising business on the fringe, or "edge," of the organization, then establishes new teams to foster exponential innovation, growing the edge until it becomes a viable new core for the company.

[2] *Scaling Edges: A pragmatic pathway to internal change* by John Hagel, John Seely Brown and Duleesha Kulasooriya; copyright 2012 Deloitte Development

Roles for board members in transformation

As businesses begin to explore the fundamentally new world generated by exponential change, board members have an important role to play in guiding transformation. Their unique position—charged with advising, guiding, and challenging company management—puts directors in a perfect place to help focus the company on what really matters and its evolving role in the world. In particular, directors can rethink their role as strategic advisors, challenging the basic assumptions of an organization in ways that can build healthy transformation and keep the business evolving as its environment changes. Here are six ways board members can serve their organizations in times of great change:

1. **Own the big picture.** The board is in a strong position to think big and focus on opportunity. It can take a longer view, helping executives identify a company's highest priorities and steer toward them over time. Directors can also help management avoid taking a defensive posture in response to change, or clinging too tightly to the status quo.
2. **Focus on the future.** Management teams can be easily consumed by short-term pressures. When that happens, the board can help build awareness of larger issues, ensuring that the organization thinks beyond the next quarter or next year.
3. **Champion creativity.** Directors can help liberate management to think more boldly and creatively about the future, framing change positively to help the company be the best it can be. That includes asking genuine questions and challenging orthodoxies when necessary.
4. **Inspire boldness (but rein in impulsiveness).** If management is reluctant to take any risks on new possibilities, directors can remind executives of the relationship between risk and reward. If executives are chasing every squirrel in the forest, the board can help focus their attention and energies on effective action.
5. **Convey urgency (and discourage panic).** Today, the biggest opportunities are more time sensitive than ever. Once goals are identified, the board can help drive confident, focused movement on time sensitive opportunities.
6. **Foster learning and model important behaviors.** To thrive in a time of great change, one should be both curious and well informed. Directors can serve the business by being a source of new ideas and information, modeling curiosity, and helping corporate management reflect on, and learn from, recent initiatives. Board members are in the unique position to continue to ask challenging questions of management, and themselves.

What scaling edges looks like

Today, technology makes scaling an edge easier than ever before. Scaling edges is designed to maximize a transformation initiative's chance of success by doing three things: minimizing initial investment, maximizing potential return, and compressing lead times. In line with that vision, edge team initiatives should be quick to implement—building key capabilities and relationships while testing assumptions and understanding around the company's long-term vision. In addition to growing internal capabilities and making targeted acquisitions, they have the potential to drive leveraged growth, adding value in the markets they target.

To stay under the radar and move quickly and flexibly, edge initiatives shouldn't have big budgets or a lot of resources from the core. Instead, edge teams should think creatively about how to leverage external digital infrastructures and networks—harnessing external resources and infrastructures such as cloud computing, big data analytics, and social software to scale the edge extremely rapidly, with far fewer resources than would ever have been possible before.

In line with the zoom out/zoom in framework, the progress of an edge initiative should be periodically evaluated to assess whether it's scaling rapidly and broadly enough to become the new core of the business, and to look for insights that enforce or challenge assumptions about the future. Resist the temptation to focus on financial metrics; instead, identify operating metrics that can serve as leading indicators of the performance the edge is seeking to generate (even if they're marginal to the business's current performance in the near term).

Similarly, an initiative's performance at any specific time is less important than performance over time. High-priority initiatives will likely undergo quick iterations with constant feedback loops to deliver maximum impact and value. Short, iterative cycles let an edge receive and use feedback more quickly, compacting time between investment and return and accelerating the learning process. Phased rollouts and formal feedback loops between internal and external ecosystems can also help teams gather rapid feedback.

By accelerating learning rather than focusing solely on short-term outcomes, an edge initiative can become a catalyst for transformation, helping a company tap into transformative opportunities that can harness the potential of exponential change.

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