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Strategic courage in an age of volatility

Today's challenging environment requires business leaders to hone their edge in three critical areas: insights, commitment, and execution.

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The late Brazilian car-racing champion Ayrton Senna once said, "You cannot overtake 15 cars in sunny weather, but you can when it's raining." Well, there's been no shortage of downpours in recent years. We're living in a world where new shocks—the war in Ukraine, the return of inflation—have been layered onto earlier shocks—a deadly global pandemic, supply chain disruptions—that in turn were layered onto, and dramatically accelerated, long-standing trends such as digitization and sustainability.

In almost all our recent conversations, CEOs, board members, and other business leaders share with us a common sentiment: this combination of shocks has created perhaps the most challenging environment management teams have ever faced—and one that likely won't change anytime soon. We have entered an age of volatility.

Such stormy times test leaders' mettle. Today, some are pulling off the racetrack and looking for shelter. Others, however, are changing to wet-weather racing tires and stepping on the gas.

Indeed, we see two types of business leader emerging. The first type adopts a cautious and defensive posture in dealing with the volatility and uncertainty. These leaders are hunkering down and concentrating on the threats here and now. Scenario planning, resilience preparation, balance sheet management, near-term efficiency drives, and careful inflation monitoring are core areas of their focus. These leaders are in a strategic "wait and watch" mode as conditions unfold. In our experience, the majority of senior executives fall into this category.

But we see a second type of leader as well—one who is taking all the right defensive actions while also leaning into the volatility, using it as a catalyst to galvanize action around new opportunities. The current disruption has invigorated these leaders' mindset of moving forward boldly, and they are rejuvenating elements of their strategy that may have been dormant. These leaders are playing both offense and defense.

That's a sound approach. Our research on corporate resilience shows that defense-only postures tend to lead to median company performance, while offense-only stances deliver a mix of occasional wins plus some catastrophic failures. The best leaders and companies are ambidextrous: prudent about managing the downside while aggressively pursuing the upside. These leaders are thinking about the next decade, not the next month. Many of them are spurring their organizations to rethink opportunities and reset the strategic gameboard in light of the current volatility. They are reevaluating their M&A strategies amid lower valuations, making more dramatic resource reallocations, reimagining their workforce and talent proposition in a hybrid post-COVID-19 world, and taking a long-term view on innovation and growth. As one CEO we recently spoke with said, "I don't want to benchmark our performance to the industry—I want to reinvent the industry."

What distinguishes these two leadership mindsets? Is it intrinsic differences in risk appetite? Does one group have a better-honed management microscope (looking at the near term), while the other prioritizes the telescope (gazing out toward the longer term)? Or is there some other intangible that leads these management teams and their organizations to operate differently?

As they start to create value from volatility, we see the ambidextrous management teams thriving rather than merely surviving in this environment. These leaders, who are both prudent and bold, are honing three types of edge to create "alpha" in organizational performance: in insights, in commitment, and in execution. CEOs and boards should challenge their companies on the extent to which their organizations can credibly claim to have each edge—and if they don't, how they can develop it, rapidly.

The insights edge

When what is likely to happen is clear, understanding it more deeply than others may be useful but is not imperative. But, as financial traders know well, when volatility is high, an insights edge generates great value. It may not be possible to be right every time, but seeing accurately through the fog 10 percent more often than your rivals is a substantial competitive advantage. That requires investing the resources, time, and effort to go beyond conventional analysis of conventional data that generate conventional wisdom.

An insights edge comes from granularity, depth, and diversity. Granularity is necessary because the interaction of shocks with trends is playing out differently around the world. For example, as the supply of food and metals is disrupted owing to the war in Ukraine, Chile, which has both in abundance, is experiencing a different type of shock from Sri Lanka, which does not have them on hand. Depth of insight is important because the real impact often comes from the second or third bounce of the ball: suppliers' production issues cause disruption down your value chain (such as wire harness producers in western Ukraine that frequently impede production for European automotive OEMs).

As for diversity, remember that in most circumstances where some claim "nobody saw it coming," the situation had, in fact, been noticed by a good number of people, the COVID-19 pandemic being a recent example. In a world of increasing convergence across sector ecosystems (what we refer to as the "death of SIC codes[1]"), diversity of insight requires going beyond sources within your company, or even your industry, and seeking out perspectives from other industries and from disruptors across industries.

To build an insights edge, one large global bank, for example, recently assembled its more than 70 chief country officers and used their collective wisdom to home in on trends and market- and industry-level insights that it then disseminated to sales teams to drive sharper client opportunity identification. Centrally capturing the knowledge of its many geographically dispersed leaders and turning it into an institutional capability has given the company an advantage with clients. The CEO of another financial institution, meanwhile, created a task force on inflation, led by the chief strategy officer, that consulted a range of experts (including rating agencies, advisers, and banks) to form a "house view" on potential inflation scenarios. The group then drew out implications of each scenario—along with the upsides and downsides—for every business and function. This investment in insights has given the company an ability to adjust quickly to a range of macroeconomic developments.

Questions you might ask to build an insights edge:

- Do we have full visibility into our supply chain, including third- and fourth-tier suppliers, the risks embedded in those relationships, and our options for strengthening the supply chain's resilience through dual-sourcing and in-region manufacturing?

- Is our understanding of the transition to net zero nuanced enough, including the value upsides of some nongreen assets as the transition progresses, the likely declines rather than increases in some green premiums, and how carbon borders may shift trade flow?

- Are we evaluating our portfolio at a granular enough level and fast enough pace to see region- or segment-specific headwinds and tailwinds that a higher-level view may obscure?

- How intimate an understanding do we have of our customers and end consumers, and are we able to gather changes in consumer sentiment rapidly and continually?

- Do we have a mechanism to pick up signals from across the organization, including geographic leaders and commercial financial planning and analysis, on a regular basis—or, better still, in real time—and distill them quickly into options the organization can act on?

- Are we building a culture that is diverse, inclusive, and externally oriented enough to capture signals from outside our company or industry and solicit thoughtful contrarian perspectives from across ecosystems—or are we collecting perspectives from the usual suspects and telling ourselves that constitutes insight diversity?

- Have we built digital and analytics capabilities across the enterprise—from data collection and governance to machine learning—that yield cutting-edge proprietary insight?

[1] Standard Industrial Classification of sectors by four-digit codes.

- Are our scenario analyses and risk identification sufficiently creative or do we risk falling prey to a failure of imagination about what could happen?

The commitment edge

As important as knowing what to do is doing it promptly and with sufficient ambition. The half-life of decisions has collapsed, requiring more frequent evaluations of whether choices made a few months or even weeks ago still make sense. What differentiates bold leaders and leadership teams isn't moving in the right direction—which most do eventually—but doing so decisively before others have mustered the collective confidence to commit. In the face of uncertainty, these leaders' mindset is to act and adjust, not watch and wait. After Russia's invasion of Ukraine, for example, BP announced its plan to divest its Rosneft stake quicker than many stakeholders expected and before most other companies had evaluated their Russia posture and presence. This decision turned BP from one of the international companies most invested in Russia to one cited as an exemplar of decisive reaction.

Resource commitments that are large enough to materially affect the company's trajectory are as important as speed. The acceleration of trends is increasing the returns on sizeable, well-placed bets, given the variance between leading industry performers and the also-rans (exhibit). Our research on resource allocation, digital strategy, sustainability, and numerous other topics has shown that those who move early and at scale gain significant advantages. In other words, fortune favors the bold.

For instance, one US financial services CEO challenged the notion of a physical return to the office postpandemic. Instead, he pushed the company to reimagine long-held norms surrounding how, where, and when work could be done with the goal of building competitive differentiation in the market. By mobilizing an enterprise-wide effort that drew on employee and customer preferences, leading-edge data, and innovations in other industries, the organization was able to design a flexible working model that dramatically reduced its real estate footprint and carbon emissions, increased its attraction and retention of a diverse workforce, and drove adoption of new hybrid working norms.

Questions you might ask to build a commitment edge:

- What are our "billion-dollar beliefs," and are we betting sufficiently boldly on them?

- Is our top management team effective at committing decisively to strategic choices, or do we need to change the team's membership, processes, or mindsets to ensure they can?

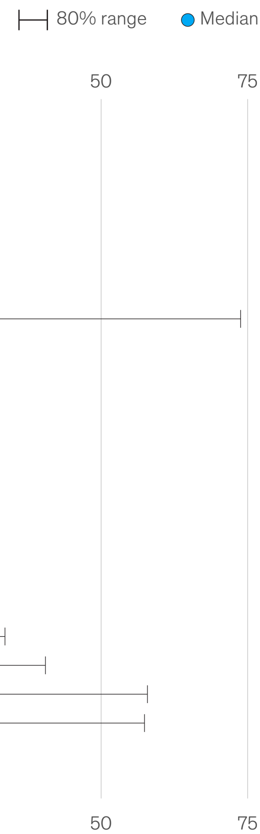
- Have we engaged the board sufficiently in developing scenarios and responses to them so that our governance does not hold back bold moves at key moments?

- Do we embrace the mindsets of growth leaders who see and seize opportunities?

Exhibit

Shareholder return averages hide considerable variance within sectors.

Distribution of total shareholder returns by industry, CAGR 2019–22,[1] %



[1]Data as of July 31, 2022.
Source: S&P Global; Corporate Performance Analytics by McKinsey

- Have we developed an "offense playbook" for bold moves such as M&A and divestments that is ready to be activated when a trigger point is reached?

- Can we ring-fence a portion of our capital and operating expenditure to redeploy dynamically as opportunities and threats emerge during the year?

- Do we keep continual track of how far industry peers, leaders in other industries, and cross-industry disruptors are moving so we can act at sufficient scale?

The execution edge

Execution is the third competitive edge for an age of volatility. The ability to execute well is always valuable, of course, but just as volatility drives up prices of stock options, it likewise raises the value of strategic options—the ability to rapidly pivot in response to changing conditions. Once you have the commitment to act, capturing the value of those actions requires an execution edge, especially in situations where moving first confers an advantage.

A central source of an execution edge is speed: getting things done fast and well. The life sciences sector famously executed at a rapid pace to develop the first COVID-19 vaccine. Similarly, a leading building-materials company navigated the pandemic with greater resolve than several industry peers because its leadership team included many who had led businesses during the global financial crisis and thus were experienced at handling rapid market changes.

The pandemic has been both a petri dish and a catalyst for innovating ways to increase speed, making it a valuable capability as an endogenous part of strategy. Speed matters in today's volatile environment; leaders and organizations that break down silos, streamline decisions and processes, empower frontline leaders, and cut through slow-moving hierarchies and bureaucracies will have a clear edge. Research by McKinsey and the Harvard Business School found that companies that had launched agile transformations before the pandemic performed better and moved faster during the crisis and its aftermath than those that had not. Agile organizations had this edge because they already possessed the processes and structures that proved critical to adapting to the COVID-19 crisis, from cross-functional teams to clear data on desired outputs and outcomes for key customer journeys.

Questions you might ask to build an execution edge:

- Are we reinventing our organization for speed?

- Is our technology stack modern and modular enough, and are we paying down our tech debt fast enough so that our technology accelerates rather than constrains execution?

- Are our capabilities that underpin growth—such as marketing, customer experience, sales, and pricing—strong enough for this era?

- Have we done enough to shift procurement from a valued "utility" function to a source of strategic competitive advantage in creating value from volatility?

- Can we create the balance sheet flexibility to execute bold moves in tougher times?

- Are we able to build new businesses with the agility and ambition of a disruptor, while harnessing the reach and resources of an incumbent?

- Have we institutionalized the transformation best practices that enable organizations to "get stuff done," such as high-cadence, disciplined initiative tracking and a transformation office?

- Do we codify the lessons from significant past experiences—important acquisitions, recessions, and crises—into playbooks and dry-run their execution so they become second nature?

John F. Kennedy once observed that the word “crisis,” when written in Chinese, is composed of two characters—one represents danger, the other opportunity. He wasn’t altogether correct on the linguistics, but the sentiment holds: times of crisis, disruption, and volatility require courage from leaders to make bold strategic choices. It’s also a chance to leave less-creative rivals in the rearview mirror. Q

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