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# SUCCESSFULLY CONFRONTING STRATEGIC RISK: THRIVE OR SURVIVE

***Continuous Board Focus on Strategic Risk is Essential to Ensure the Long-Term Prosperity of Any Business***

By Lin Lu

Strategic risks are those which will affect a business in fundamental ways, not the incremental financial, operational and compliance risks businesses confront in their daily operations. Blockbuster went from a household name for video-rental with $6 billion in revenue to nonexistence because it failed to understand the impact of the internet and missed the next big thing: streaming and video applications. Nokia once dominated the handset market but lost it because it failed to anticipate and respond nimbly to the smartphone tidal wave. Companies that failed to anticipate and respond to fundamental changes in the marketplace put substantial stakeholder (investors, employees and communities) value at risk.

Opposite outcomes are also possible. For example, Microsoft avoided the fate of becoming a dinosaur because of its successful shift of business model and timely execution of its refreshed strategy. IBM has reinvented itself more than once over its long history and may be on the verge of doing so again.

Strategic risk management must be a CEO and board level priority. At its core, strategic risk management is about business strategy and business model change management. It is understanding risks that may be consequential and pose significant risks to shareholder value and understanding how those risks might be met. To do this well, boards must be prepared to discuss and debate fundamental questions of strategic risk to shape business strategy, allocate resources, and monitor progress with ability to course correct.

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## Assess Strategic Risk and Incorporate Mitigants in Setting Corporate Strategy

Today's successful organizations are most often driven through the creation, execution and ongoing reevaluation of fully scoped strategic business plans, processes in which boards play a critical role. To achieve plan outcomes with confidence, boards need to have a clear understanding of the strategic risk exposure incorporated into plans, as well as the mitigants required to address those risks.

Today's strategic risk is driven by accelerated technological advancement, massive data digitalization in all aspects of economic life, rapidly shifting customer needs, and continuously changing external and internal operating environments. These change cycles are accelerating, and as a consequence the sustainability of business models is being challenged more frequently with often material consequences to revenue sources and profit. A strategy formulated without a mechanism to understand the evolving strategic business risks will most likely fail to guide the organization through choppy waters.

**Questions Boards Should Consider:**

- Does your board review a risk management framework that includes a definition of strategic risk?
    - *A consistent, cross organization definition provides consistency to ensure on-going identification and assessment of strategic risk.*
- Does your board and C-Suite regularly identify the trends that affect the organization’s business model, assess how best to capture the upside of those trends, and develop action plans accordingly?
    - *For example, fintech started as disruptor, then partner, then competitor to traditional banks as they grew in size. Banks large and small are taking a hybrid path in their relationships with fintech companies.*
- Does your board assess business models from a customer perspective?
    - *Do they understand customer evolution throughout the plan lifecycle? Is the business creating products and services that will meet the demands of the future? What business model would serve customers better? How could the competitor landscape change in this regard?*
- Does your board review changes to organizational business models required to limit risk exposures, and over what time horizon?
    - *What is the impact on earnings and franchise value of business model changes? What could be the adverse impact if organizational assessments of risk turned out to be incorrect?*
- Does your board review the capabilities required to address the identified strategic risks and thrive?
    - *Does the board ensure that appropriate talent is in place to address these risks? Are there cultural impediments in place and - if so - how are they addressed?*

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**Provide Sufficient Resource Allocation to Support Strategic Plan Execution**

Organizations benefit when strategic plans are rigorously exercised to ensure that resource allocations can both support plan outcomes and meet performance expectations from stakeholders in the quarterly and yearly reporting cycle, a sometimes-difficult balancing act. Strategy can only create value when it is well executed and - of course - a basic role of boards is to ensure that organizations provide sufficient resources to properly fund operations, including approved strategic plans.

Boards should take a broad view when considering the types of actions and resources that might be required to execute business model shifts. For example, organizations may find that mergers or acquisitions have the highest potential for successful outcomes. In today’s environment, boards increasingly find that significantly accelerating digital and data initiatives are key to achieving goals. Evaluations of organizational workforces in the context of new strategic plans are more likely than ever to reveal the need for large scale culture and talent programs to improve internal execution capabilities. Evaluations may reveal a need to overhaul or reinvent products both to retain current customers and attract new ones in an altered competitive environment.

**Questions Boards Should Consider:**

- Does the board understand how, and when, investments in strategic plan execution will translate to growing customer bases, earnings and franchise value?
    - *Do all stakeholders share that understanding and are they updated as the plan unfolds?*
- Is the board comfortable that the organization has sufficiently invested in strategic assets to reduce risk – human capital, innovation, customer capital?
    - *To innovate successfully, the right talent and skills are essential.*

- Has the organization safeguarded resources required to keep existing businesses competitive if a significant change to the mix of products and services is planned?
    - *Ensure that all customers are served well, and that on-going financial, operational and compliance risks are managed within the risk appetite.*
- Has the organization sized the timing of funding needs and adequately prepared for unexpected shifts in those requirements?
    - *Funding requirements should be put in the perspective of timing and relative strategic risk mitigation priorities. For example, organizations may need to increase technology spend beyond the budgeted plan because there is an urgent need to accelerate digital transformation in order to realize important strategic objectives.*

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**Monitor Progress and Course Correct When Needed**

Successful boards monitor the performance of strategic plan executions closely and, together with executive management, regularly reevaluate them in light of new or modified strategic risks. Because strategic risk is assessed against changing external and internal conditions, it is important to ensure the assessment remains relevant and that plans are adjusted in a timely manner when required. For example, if the pace of digitization in a target market has significantly exceeded the limits envisioned in the plan, the plan scenarios should be adjusted, and basic business plans reevaluated and adjusted.

Because risk is inherent in strategy and strategy execution, exceptional boards have an ongoing understanding of plan execution and should use that insight to consider what, if any, intervention may be required to achieve strategic goals. Interventions might take the form of extra financial allocations, recalibration of priorities across the business, enhancing capabilities to fill newly apparent skills gaps, recognizing and addressing required culture changes to improve accountability, or otherwise better equipping teams to achieve desired results. Boards can perform this role through its performance oversight activities including the annual strategic plan review, business performance review and annual finance plan sign off.

**Questions Boards Should Consider:**

- Does your board require regular external inputs to stay up to date about potentially disruptive forces that may impact the business?
    - *This helps the board constantly refresh its own knowledge in what matters the most strategically. If needed, the board can also commission specific research or assessment if it is of significance for strategy formulation.*
- Is the board comfortable that management has defined clear metrics to measure progress of strategic plan execution?
    - *Clear metrics set consistent expectations across all stakeholders and inform internal execution performance. Clear metrics enable the evaluation of yearly commitments in revenues, returns and customer satisfaction in the context of long-term transformation goals.*
- Does your board ensure that incentives are aligned with strategic risk management and motivate employees beyond the annual performance management cycle?
    - *Making sure that personnel have reason to maintain a long-term focus can ensure program execution over time.*
- Does your board conduct “what if” plan scenarios with executive management to stress test against a range of disruptive external and internal conditions?
    - *Scenario exercises can expose plan weaknesses and suggest fixes that would be difficult to execute without advance, contingent preparation.*

## ABOUT THE AUTHOR

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In her current role, Lin is responsible for the transition and integration of the Citi Australia consumer business portfolio acquired by NAB (The acquisition is subject to regulatory approval to complete), and the design and build of a fully digitized white label and unsecured lending manufacturing business. Prior to her current role, Lin spearheaded a successful transformation of 1st line risk management as Group Chief Controls Officer at NAB, a strategic imperative for the overall business strategy implementation of the bank.

Lin is a member of Australia Institute of Corporate Directors (AICD). Lin serves as a member of the Advisory Board for Shared Assessments and served on the Advisory Board of the American Bankers Association's Certified Enterprise Risk Management, and Security Innovation Network Steering Committee. Lin sat on the faculty for the 2017/2018 ABA Enterprise Risk Program at the Robert H Smith School of Business and the 2018/2019 Stonier Graduate School of Banking Risk program at Wharton. Lin received her MBA in Finance and Strategy from the London Business School.

## FEATURED EVENTS

*The following events are produced by friends of the BRC:*

**15th Annual Shared Assessments Third Party Risk Summit**
May 4-5, 2022
Ritz-Carlton Tysons Corner, McLean, VA
*The Shared Assessments Third Party Risk Summit is the premier global, multi-industry event to shed light on processes, technologies and efficiencies in third party risk management. Join leading experts in risk management to identify trends, leverage new technologies, and share best practices.*

**Spies, Lies & Nukes Conference**
May 1-3, 2022
Hacienda del Sol resort in Tucson, AZ
*Join Valerie Plame and several of her legendary, highly decorated CIA colleagues as they dive into the secretive world of espionage. Hear intriguing, provocative, and sometimes shocking conversations on cyber-attacks, covert actions, nuclear scams, recruiting real spies from those that lived in the "wilderness of mirrors" for years.*

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