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978-1-107-16466-6 — Resilient Organizations
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Introduction

Are you satisfied with how things are going in society, politics and business? In 2015, the Edelman Trust Barometer,[1] an instrument that measures confidence in institutions, governments and businesses, reached an all-time low among the informed public, indicating that leaders must change course. In general, leaders seem to have learned little from the financial crisis of 2008, which has been described as the result of 'a perfect storm of events':[2] excessive financial leverage, imprudent acquisitions, diversification based on dubious synergies, fallacious risk management and governance systems, and problems associated with the vertical and horizontal coordination of the banking network. On an economic level, the effects have been felt across the globe. In Europe, the sovereign-debt crisis created high levels of debt for families as well as trade deficits, while unemployment rose to a historical high and strict austerity measures had to be imposed. In the financial sector, many banks lost more than 90 per cent of their share prices. Many of those that survived have yet to recover. Was the financial-services crisis a rare event or are we likely to see more of such volatility in the future? How can firms prepare for such events? How can leaders change the way they make decisions?

This book is about resilience – the ability of companies to adapt to, resist and recover from external shocks. It is also about the role that leaders play in creating resilient firms. Like the sovereign-debt crisis, the financial crisis has shown that companies need more resilient business models. However, the goal of developing resilience – prospering despite catastrophic events – generally only appears to become a management priority after a shock has occurred. This is a little like doing the physiotherapy exercises a doctor prescribed long ago after yet another bout of back pain. How long should one do the exercises? Most likely until the pain passes and the physiotherapist is no longer checking.

[1] The Edelman Trust Barometer is available at: www.edelman.com.
[2] http://useconomy.about.com/od/Financial-Crisis.

A root cause of such behaviour is our inability to think about the long-term effects of our actions or to make decisions that maximize value creation for all stakeholders. Many leaders seem to have already forgotten the causes and effects of the 2008 crisis. They are happy to start each new fiscal year with the goal of meeting the expectations of their investors for the following four quarters.

To protect them from high expectations in the short term, new CEOs often begin their terms by issuing a 'shock profit warning', as was recently the case for Shell. Just two weeks after taking office in December 2013, Shell's new CEO, Ben van Beurden, announced that the company's profit would be 25 per cent lower in 2013 than it was in 2012. One year after their appointments, top executives usually explain that the results of their long-term measures are not yet observable. In the third year, many seem to be tempted to optimize annual profitability by gambling on risky projects, and by decreasing investments in marketing, R & D and other measures that may be advantageous to potential successors, while they prepare for the next mandate. CEOs of large American companies serve an average tenure of less than seven years (estimation for the period 1992–2005; Kaplan and Minton, 2012). These dynamics relate to many companies. However, we would like to see more CEOs who choose to restrain current performance in favour of their successors. Such generous conduct tends to be more evident in family businesses or in companies led by responsible leaders.

To support managers in their attempts to create resilient companies, we must start a debate on what constitutes responsible leadership and how it can be achieved. Responsible leaders maintain their personal and professional integrity. Moreover, they know how to build trust and ensure that certain ethical principles are respected. In more practical terms, responsible leaders follow business practices based on the dictates of sustainability and long-term development. In other words, they engage in 'sound and prudent management'. Such brave managers relinquish short-term profit in favour of stable and enduring long-term performance.

This book is for those managers and entrepreneurs who want to begin a journey aimed at increasing the resilience of their companies and, thereby, act as responsible leaders. In addition to evidence from international firms, the book features many examples from Italian firms that have excelled despite very difficult home-country conditions. We provide a method of measuring performance – VOLARE – that integrates existing measures with theoretical insights. We also offer concrete examples of seven drivers of resilience. In beginning our discussion of how to increase company resilience, we assert that:

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1. Resilient companies show higher levels of authenticity. They approach the business in coherence with their traditions, competences, brand image and values.
2. Resilient companies have a high level of customer centricity. They are dedicated to the care of their customers and their needs, and they are willing to sacrifice short-term profitability in order to tie in customers in the long term. Employees identify with this strategy and are proud to be able to add value for customers before they think about shareholders.
3. Resilient companies have relatively simple business models and are determined to preserve key competencies by clearly linking their products and services to specific resources and capabilities.
4. Contrary to common beliefs, aggressive geographical diversification often increases the fragility of an organization, as it is difficult to assess and control all local risks. These problems increase with greater geographic diversification. Resilient companies hold a strong position in their home markets and prefer to develop strong positions in a few additional markets as opposed to weak positions in many markets.
5. Decision makers in resilient companies employ a long-term perspective that goes beyond their mandate.
6. Leaders in resilient companies make strategic decisions. In addition, they manage to combine speed with quality of decisions.
7. Resilient companies are led by CEOs and relatively small top-management teams (TMTs). Members of such teams have strong specialist and functional backgrounds, and they are bound by shared values.

This book will enable readers to analyse the merits of each of these assertions and assess their relevance for their own contexts. In particular, in today's business world, managers find themselves having to make decisions in a wide variety of areas. For example, they need to understand how to internationalize and in which markets; which businesses are worthy of investments; whether to lean towards intense diversification of activities or focus on a specific business; which image to convey to consumers; how to motivate employees; whether to simplify the organizational structure; and whether to make decisions quickly or to be meticulous at the expense of speed. An understanding of how to act in the face of these trade-offs can ensure survival beyond a crisis, thereby creating the possibility to be resilient. The book serves as an intuitive guide to facing these challenges and to achieving sustainable results over time.

We trust that this book will help trigger not only a shift that puts business processes on a path towards greater resilience, but also a change towards responsible leadership. We need leaders who think about the consequences of their actions and take responsibility for them. As simple as this may sound, it requires fundamental change, which is not easy to achieve. We often encounter managers who are disappointed or disheartened, and who find it difficult to change things around them. In the face of the challenges posed by energy overconsumption, waste proliferation and population growth, it is difficult to establish new standards and to change behaviours. Managers may find themselves thinking: 'What can I do as a small player in this game? If I change, the system will not be affected at all.' Such thoughts, although understandable, frequently end up in a finger-pointing exercise of identifying someone who starts changing. When you feel unmotivated or like giving up, we recommend watching a short video in which Malala Yousafzai,[3] a fourteen-year-old girl and a recipient of the Nobel Peace Prize, recounts her battle to ensure the right to education of women in her country. We all need a little of her energy to make changes for the better.

This book is based on a research project entitled 'The Nature of Resilient Firms' carried out at SDA Bocconi School of Management. The three-year study had the dual objective of measuring resilience and ascertaining its main drivers, and of identifying the international 'champions' in economic sectors that were particularly affected by external shocks. These companies managed to produce positive results despite the crisis. The project also identified those companies that experienced greater problems. The VOLARE indicator, which is described later in this book, enabled us to assign a resilience rating from 0 to 10 (with 0 being the lowest and 10 the highest) to 705 listed companies active in seven industries. These industries included banking, automotive, pharmaceutical and energy, all of which have been affected recently by external shocks. We analysed the main choices implemented by these companies, and we combined quantitative and qualitative research techniques in order to determine the drivers of resilience. The information obtained was integrated with secondary data, such as business documents, institutional sites and newspaper articles.

The book is organized in ten chapters. The first chapter offers a brief overview of the meanings and applications of the term 'resilience' in the fields of psychology, ecology, systems, materials science and economics. These different

[3] The video is available on YouTube at: www.youtube.com/watch?v=gjGL6YY6oMs.

spheres provide conceptual cues that allow us to develop our definition of resilience as the ability of companies to anticipate shocks and not bend to them. We also explain the underlying model of our research – resilient businesses show relatively high and stable performance over time. Such companies have learned to manage some strategic variables or drivers of resilience better than others.

In the second chapter, we explain that the first step towards resilience lies in changing the way that we measure performance. After a brief discussion of the limitations of commonly used performance indicators, we introduce a new method for measuring long-term financial results. The proposed indicator is called VOLARE, and it is a formal performance-appraisal system that combines the average long-term (ten years) return on equity and the volatility of return on equity. The application of this performance measure to a large set of companies from different industries allows us to distinguish resilient firms from firms that are less able to absorb market shocks. We also propose using VOLARE when making investment decisions on the firm or business-unit level. Too often, firms only look at short-term profitability measures when allocating resources to business units. As a result, they underestimate the long-term profitability impact as well as the risks associated with such investments.

The following chapters describe the individual resilience drivers in detail. Chapter 3 sets out to improve our understanding of the role of authenticity – the ability to be credible in the eyes of consumers and shareholders. We define authenticity and how it applies to business-management practices. There are two types of authenticity. The first is 'type authenticity': the more one is identifiable with a specific category (e.g. type of product, market, customer segment) the more authentic one is. The second is 'moral authenticity': the more one is identifiable with some predetermined reference values, the greater one's authenticity. Authentic companies are recognizable and credible to consumers, employees and social actors. As a result, authenticity has a positive effect on resilience. It serves as the underlying logic for understanding all of the decision challenges and drivers of resilience described in the subsequent chapters.

Chapter 4 discusses customer centricity – the ability to prioritize the customer above any other stakeholder – and suggests three ways in which it can be pursued: love for the product, excellent processes and innovation. Companies that know how to develop customer centricity tend to be more resilient than companies that try to please their shareholders first.

Chapter 5 explores the 'ideal' level of product diversification. The relationship between diversification and performance has been studied for some time and has given rise to ambiguous interpretations. Our research shows that when a company focuses on a few products, the likelihood of being resilient and obtaining a high VOLARE rating increases. Most turnaround processes start with a return to the core business, which implies divestment of superfluous elements, and focusing on primary and core competencies. The rules for pursuing a product-focused strategy are therefore outlined with the use of examples and best practices.

Chapter 6 introduces the resilience driver 'market focus'. In this regard, we discuss the criteria for selecting geographical markets in which to operate. In the internationalization process, caution offers rewards in terms of resilience. Size is no guarantee for stable and positive performance over time, especially in the presence of external shocks. Resilient companies selectively invest in foreign markets and develop a set of coherent geographical areas as a competitive base. They develop foreign markets with the objective of making them second-home markets – markets in which they are as strong as in their home market. Resilient firms prefer to obtain their foreign revenues from a strong presence in five markets rather than from a weak presence in fifty.

Chapter 7 identifies long-term orientation as a key variable in the level of business resilience. Too often, decisions only take short-term results and current profit maximization into account. In contrast, strategic decisions are complex decisions that commit substantial amounts of resources to the purpose of achieving a desired long-term vision. These decisions are hard to reverse and often reduce short-term profitability. Companies must therefore possess a type of ambidexterity – the ability to manage current activities while developing strategic activities or projects. Concern about the results of potential successors – and acting accordingly – increases the likelihood of being resilient. The chapter explores the nature of strategic projects, the origins of a long-term orientation and how this capacity can be developed.

Chapter 8 examines the ability of TMTs to make strategic decisions. Due to the increasing complexity of the economic environment, companies desiring good and stable performance over time must be able to make decisions faster and faster without sacrificing quality. A well-designed formal strategic process enables companies to be efficient in decision making and thereby save time, and to gather ideas from people within and outside the organization, and articulate their contributions. The decision-making process can occur in unstructured and informal meetings, but it can also be organized within strategic workshops or annual events programmed to define the strategic guidelines. Knowledge of how to organize a strategic workshop helps improve the quality of decisions. This chapter proposes a strategic-process tool and describes how to best organize a strategic workshop.

Chapter 9 explores the last driver of our resilience model: ownership structure, top-management-team composition and organizational design decisions that have an impact on effectiveness. We start with a discussion of the ownership structure's impact on the composition of TMTs. We then discuss the optimal size for TMTs, and whether their members should be specialists or generalists.

Finally, we conclude by providing a practical process tool for managers and entrepreneurs who wish to increase the resilience of their organizations. As firms are not naturally resilient, they have to be made resilient. Our resilience model identifies seven core drivers of resilience that support the process of making a firm more resilient. In the final section, we show managers how to test the level of resilience in their companies using a benchmark score.