

MANAGING UNCERTAINTY

Strategies for surviving and thriving in turbulent times

Michel Syrett and Marion Devine

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Preface

WHEN IN 2009 we first thought of writing a book on managing uncertainty, it was through intellectual curiosity about what our research would reveal.

A wealth of work on the topic had been published in the previous decade, but as much of it was written by academics, it was theoretical and not based on commercial good practice. Much of it was dated and nothing had been written since the global financial crisis that unleashed a new era of uncertainty for organisations to cope with.

Our initial instinct that the 2008 crisis was out of the ordinary proved correct. When it occurred, many senior executives assumed that it was another turn in the boom-and-bust cycle that had characterised macroeconomics in developed economies since the end of the second world war. They reacted accordingly, cutting costs and "hunkering down" for what they supposed would be a painful but short period of austerity.

However, the crisis has ushered in a period of unprecedented uncertainty, with the economic unknowns augmented by political and social unknowns arising from such developments as the Arab spring and the anti-capitalist and anti-austerity protests in a number of developed countries.

Uncertainty is here to stay. Not for nothing did a secretary-general of the United Nations recently comment that the first years of the 21st century may well prove "a decisive moment in the human story", requiring co-operation by politicians and business leaders across all boundaries to respond to the interconnected threats the world currently faces (see Chapter 1).

A book that examined the implications of managing uncertainty

in more practical terms seemed overdue when this book was first commissioned. By the time it was written the case was overwhelming.

We wanted to use the research to explore three questions. First, how do business people define uncertainty? - because precise definitions lead to concrete solutions. Second, is managing uncertainty becoming a defined management discipline like change or talent management? Third, what are the implications, not just for strategy determination (the focus of most of the early work on the topic) but for an organisation's overall development and culture?

The feedback gleaned from senior executives interviewed for the book suggests that, in their eyes, there is no precise definition of uncertainty and therefore no precise solution. Some see the task of managing uncertainty as no more than an extension of financial risk management, entailing the need for financial "buffers" brought about by greater liquidity.

Others saw the challenge in broader terms, entailing a more flexible approach to strategy formulation and shorter, more regular reviews of progress and change, using non-financial measures as well as more conventional fiduciary ones. There was no consensus on a distinct and coherent set of skills to help support the task.

The imperative stressed over and over again by the business people we talked to related to an organisation's "strategic readiness" for sudden and unexpected threats and opportunities - through a combination of strategic flexibility, strong navigational leadership, resilience, collaborative partnership, predictive learning and agility. This focus is reflected in the book's structure and conclusions.

> Michel Syrett and Marion Devine **June 2012**

1 Introduction: managing in an uncertain world

There are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know.

Donald Rumsfeld, US defence secretary, 2001-06

Historians may well look back on the first years of the 21st century as a decisive moment in the human story. The different societies that make up the human family are today interconnected as never before. They face threats that no nation can hope to master by acting alone – and opportunities that can be much more hopefully exploited if all nations work together.

Kofi Annan, UN secretary-general, 1997–2006

DONALD RUMSFELD GOT IT RIGHT. When he used the above analogy, he was speaking at a press briefing in 2002 about the absence of evidence linking the government of Iraq with the supply of weapons of mass destruction to terrorist groups. His words were criticised at the time as an abuse of language by, among others, the Plain English Campaign. However, Geoffrey Pullum, a linguist, disagreed, saying the comment was "completely straightforward" and "impeccable, syntactically, semantically, logically and rhetorically".

Whatever the rights and wrongs linguistically, the quotation provides a perfect starting point for this book.

We are now living in a world which combines known knowns, known unknowns and unknown unknowns, and the growth of the last category presents business leaders with a new and little-charted management challenge.

At the heart of the traditional approach to strategy lies the assumption that by applying a set of powerful analytical tools, executives can predict the future of any business accurately enough to allow them to choose a clear strategic direction.

But what happens when the environment is so uncertain that no amount of analysis will allow us to predict the future? What makes for a good strategy in highly uncertain business environments? How can organisations prepare themselves for the challenge of anticipating and responding to unanticipated events? What individual and organisational capabilities are required?

The uncertain world order

The need to focus on the challenges of an uncertain world has never been more urgent. Much of the academic and consultancy work undertaken on managing uncertainty was conducted in the 1990s and the first few years of the 21st century and the resulting analysis was largely theoretical. Furthermore, it is now apparent that the research and analysis were carried out during a period when world economies were enjoying what proved to be an Indian summer of growth and stability.

This book will argue, among many things, that the financial crisis of 2008 has proved a watershed. What was originally thought by many organisations to be just another cycle in the boom-and-bust that characterised the post-war era has turned out to be the harbinger of an enduring period of financial instability. This has been accompanied and aggravated by political and social upheaval and environmental crises – all of which have profound implications for international business.

In-depth interviews with 40 senior executives supported by 50 responses to an online survey by the Ashridge Consulting Group in 2010¹ found that business leaders experienced an abrupt and dramatic change in their organisation's environment as a result of the economic downturn. Many of these executives believed this change was likely to persist long after the downturn's immediate effects.

All participants had sufficient experience to be able to recall previous economic downturns. However, they felt that the 2008 crisis was different because of the:

- speed and abruptness of change in their markets;
- depth and magnitude of decline in some markets (such as automotive, property, construction, shipping);
- inconsistency in and unpredictable nature of changes across different sectors;
- breakdown of trust in institutions, particularly financial ones, that had always been considered reliable;
- global nature of the recession such that all regions and most countries had been affected;
- interconnectedness of markets, geographies and institutions;
- lack of availability of credit and finance.

The report's authors commented:

[Business leaders] have been thrown into a world of uncertainty and ambiguity. Any sense of stability in the present or confidence in their ability to predict reliably the future has disappeared ... A wave of anxiety has been unleashed across organisations, markets and society. This reflects a "fear of not knowing".

Ashridge is not alone in this conclusion. Ronald Heifetz, a management thinker, in an article published in *Harvard Business* Review in 2009, concluded:²

It would be profoundly reassuring to view the current economic crisis as simply another rough spell that we need to get through. Unfortunately, though, today's mix of urgency, high stakes, and uncertainty will continue as the norm even after the recession ends. Economies cannot erect a firewall against intensifying global competition, energy constraints, climate change, and political instability. The immediate crisis – which we will get through, with the help of policymakers' expert technical adjustments – merely sets the stage for a sustained or even permanent crisis of serious and unfamiliar challenges.

How we ended up in this situation was also described vividly by Mark Thomas, a business strategy expert at PA, and author of *The* Zombie Economy in an interview conducted for this book:

I think perhaps we have all been spoiled. The truth is that in some ways, the last 20 years until the crisis were a relatively easy period for managing in. The cost of capital was coming down and down and it was, in theory, ever easier for companies to earn a return above the cost of capital and to generate shareholder value. It was therefore by and large a boom time in the stockmarket. We believed the NICE decade – non-inflationary, continuously expansionary growth – was going to go on forever. In that sense, it was a benign environment for quite a long time.

But I think what is happening now is so big that even people who are very experienced are still taken aback by the scale of uncertainty. It is genuinely a difficult time to be managing, even if people have not been spoiled in the last decade. This is genuine uncertainty on a scale none of us have ever seen before. There are very few people out there with useful frames of reference.

Speed and multiplication

It is worth pinpointing two facets of the turmoil that the world has endured since 2008.

The first is the sheer speed of events and the extent to which they multiply. What began as a bursting of the American housing-market bubble and a rise in foreclosures ballooned rapidly into a global financial and economic crisis. Some of the largest and most venerable banks, investment houses and insurance companies declared bankruptcy or had to be rescued financially. By October 2008 credit flows had frozen, lender confidence had dropped and one after another the economies of countries around the world dipped towards recession.

The second is the knock-on effect the original crisis had on world markets. The crisis exposed fundamental weaknesses in financial systems worldwide. Despite co-ordinated easing of monetary policy by governments, trillions of dollars in intervention by central banks and governments, and large fiscal stimulus packages, the crisis failed to abate.

What began in industrialised countries quickly spread to emerging markets and developing economies. As an American Congressional Report published in October 2009 commented:³

The global crisis now seems to be played out on two levels. The first is among the industrialised nations of the world where most of the losses from subprime mortgage debt, excessive leveraging of investments, and inadequate capital backing credit default swaps (insurance against defaults and bankruptcy) have occurred.

The second level of the crisis is among emerging-market and other economies who may be "innocent bystanders" to the crisis but who also may have less resilient economic systems that can often be whipsawed by actions in global markets.

Most industrialised countries (except for Iceland) have been able to finance their own rescue packages by borrowing domestically and in capital markets, but many emerging-market and developing economies have insufficient sources of capital and have turned to help from the International Monetary Fund (IMF), World Bank, or from capital surplus nations, such as Japan, and the European Union.

Yet the very measures taken by industrialised companies to protect themselves from the effects of the crisis precipitated even bigger problems. Excessive borrowing by governments to finance rescue packages, particularly in the euro zone, led quickly to unmanageable debt. This was aggravated by a lowering of credit ratings by financial institutions and a consequential increase in interest rates.

Convergence and interconnectivity

The steady stream of global upheavals that followed in the wake of the 2008 economic crisis illustrate how events that were previously thought to be unconnected are converging – a fact stressed time and again by executives and others interviewed for this book. (See Appendix for a list of executives' names and job descriptions.)

Eric Beinhocker, a senior fellow at the McKinsey Global Institute, and author of *The Origin of Wealth*, highlighted how the world has

always seemed uncertain but that technology has changed perceptions and emotional reactions to uncertainty:

If you read history, you have to feel that everybody thought their world was pretty unstable. If you were sitting here in the 1930s, the world would look like a pretty uncertain place and in fact, they would have been right. Each era has its own big issues and effects. What has changed, because of technology, is our ability to understand what is going on around the world and the way this influences our own decisions and actions.

Previously in history, your own patch of the world might have felt okay and you would have been blissfully unaware of the great traumas going on in another patch of the world. Sitting here today, London is pretty calm but all sorts of things are happening in the Middle East which are on the news on a 24/7 basis. So our perception and feeling about uncertainty is certainly different.

World events like the Arab spring of 2011 and the contemporaneous earthquake in Japan that devastated its eastern coast illustrate how interconnected the world has become – and consequently much more uncertain.

As Lewis Booth, executive vice-president and chief financial officer of Ford Motor Company, commented when asked whether we are living in a more uncertain world than in the past:

Interdependence has without doubt brought in much more uncertainty. As an example, think of the issues you see arising out of the earthquake in Japan, which is affecting very small suppliers that supply global manufacturers, with the impact rippling around the world affecting any number of large manufacturers. Think also about the consequences of the Arab spring and the impact that this is likely to have not only on the supply and price of oil but on migration and the composition of Middle Eastern markets. The sheer scale of events piling one on top of the other is making business keener to anticipate and respond effectively to the unexpected.

Dick Nanto, a specialist in industry and trade for the American Congress, explained the consequences in 2009, anticipating both the Arab spring and riots and protests in Europe and the United States:4

Financial crises impact on political leadership and regimes within countries through two major mechanisms. The first is the discontent from citizens who are losing jobs, seeing businesses go bankrupt, losing wealth both in financial and real assets, and facing declining prices for their products.

In democracies, this discontent often results in public opposition to the existing establishment or ruling regime. In some cases it can foment extremist movements, particularly in poorer countries where large numbers of unemployed young people may become susceptible to religious radicalism that demonises Western industrialised society and encourages terrorist activity.

Looking ahead

Is this period of intense disruption temporary, or will the state of uncertainty of the past half decade persist? A report by Foresight, part of the UK Government Office for Science (see Chapter 2), pinpointed 11 "dimensions of uncertainty", which will determine the political and economic environment in which businesses will operate in the period leading up to 2050.⁵

An important question, for example, is whether increased globalisation will cause countries to veer towards nationalism to protect their power or towards more federal and economic blocs via bilateral and multilateral agreements. Will global economic shocks help create a global model that is laissez-faire or highly regulated? Will future international and civil wars be fought state versus state, state versus non-state, or non-state versus non-state? Who will own and have the right to benefit from scientific and technology-based innovation? Will new communications technologies lead to the emergence of borderless or virtual communities? Will future or continued economic development be contingent upon sustainable development?

The main aim of the report is to show how these dimensions of uncertainty affect each other. For example, the supply of welleducated and trained labour on which business relies is related directly to the interaction between advances in science, technology and innovation (which determine the skills required by industry), the domestic government's education and skills policy (which determines the internal supply of skilled labour) and migration trends and policy (which determine the external supply).

TABLE 1.1 Dimensions of uncertainty

1	Balance of power and governance architecture
2	Economic integration, governance and models
3	Security and conflict
4	Science, technology and innovation
5	Education and skills
6	Communities and communities
7	Demographics and migration
8	Health and well-being
9	Climate change
10	Natural resources
11	Values and beliefs

Source: UK Government Office for Science, 2009

If, during a period of rapid technological advance, a government simultaneously cuts back on education and professional training funding and restricts immigration, for economic reasons, there are likely to be shortages of skilled labour in key industries. In a completely different sphere, better-educated individuals are generally more aware of the relationship between lifestyle, diet and health leading to greater consumer demand for products and services supplied by industries that are shaped by or connected to health and well-being.

The report's authors conclude:

Today's problems can be so immediate and all-pervasive that they can act as blinkers which result in a myopic focus on the present, to the exclusion of a more strategic vision of the future. Given that some elements of the future will be profoundly different from

those of today, it follows that the shape and purpose of policy and organisations must adapt and change in order to meet the challenges and opportunities of a new strategic environment.

The long-term consequences of the different choices and pathways outlined by the report's authors is explored in greater detail by Foresight's American counterpart, the Rockefeller Foundation, in a 2010 report published in collaboration with the Global Business Network.

The report outlined four possible "world scenarios" in the years leading to 2050, based on the relationship between low or high levels of technological adaptation and weak or strong levels of political and economic alignment. From worst to best, they encompass the following:

- Hack attack. An economically unstable and shock-prone world in which governments weaken, criminals thrive and dangerous innovations emerge. This might encompass:
 - development goals being postponed or abandoned;
 - Islamic terror networks extending to Latin America;
 - international aid agencies forced to scale back;
 - widespread violence against minorities and immigrants;
 - an Indo-Pakistan water war.
- Lock step. A world of tighter government control and more authoritarian leadership, with limited innovation and growing protest from local populations. This might encompass:
 - an African embrace of authoritarian capitalism using the China model;
 - intercontinental trade being hit by strict controls designed to prevent the spread of disease.
- Smart scramble. An economically depressed world in which individuals and communities develop localised, makeshift solutions to a growing set of problems. This might encompass:
 - greater venture-capital spending in sub-Saharan Africa;
 - the development of low-cost water purification devices that halve diarrhoea deaths in Asia;
 - new diagnostic techniques to combat local diseases in developing countries;

- an increase in local protests against government authoritarianism, particularly in China.
- Clever together. A world in which highly co-ordinated and successful strategies emerge from addressing urgent and entrenched worldwide issues. This might encompass:
 - the global economy "turning a corner";
 - the development of cheap solar power;
 - a green revolution designed to combat food shortages;
 - radical American and Chinese emissions targets;
 - the emergence and acceptance of transparent and improved international and domestic governance.

Scenario planning of this kind is now common among government planners and the institutes that support them. Yet given the uncertainties that now beset the world, it is surprising that commercial organisations have not followed suit.

Shell is famous for scenario planning. In looking at its strategy over the medium and long term, its scenario planners are asking similar questions to those posed by planners at Foresight and the Rockefeller Foundation. The company is focusing on a number of specific global issues, including the following:

- **G20 governance.** Can the G20 take on a meaningful role? Can it evolve into the hub of a networked system of global governance, bringing in other global issues such as climate change?
- The China-America relationship. Can China and America work co-operatively on a range of issues from global economic recovery to energy and climate change? Will the relationship act as a marker or template of the evolving longer-term geopolitical adjustment between established and emerging powers?
- New policy paradigms. How can we build the capitalist model and drive new political energies to move economies on the firm path to recovery?

Shell is not seeking to come up with a crystal ball that will predict when crises affecting the business are likely to occur. Rather, as Jeremy Bentham, vice-president, global business environment, says, it is a matter of turning your thinking into what the critical uncertainties are and planning or allowing for them in your strategic thinking.

New patterns of uncertainty

Arnoud De Meyer is a former professor of management studies at INSEAD, an international business school, and the Judge Institute of Management at Cambridge, and now president of the Singapore Management University. De Meyer anticipated Rumsfeld's analogy when he postulated four types of uncertainty that firms may encounter as separate phenomena or in some form of combination:⁸

- Variation comes from many small influences that cannot be easily anticipated individually; however, the resulting variation from a firm's expected outcome can be identified and managed.
- Foreseen uncertainties are identifiable and understood influences that may or may not occur. This form of uncertainty is often resolved through risk management and scenario planning.
- Unforeseen uncertainty is more difficult to manage as a company is unaware of the event's possibility or has discounted its likelihood. There is no contingency plan in place. This form of uncertainty requires businesses to work more flexibly, employ more novel strategic approaches and work more closely with suppliers and customers on which the firm is most dependent.
- Chaos is where unforeseen events invalidate a firm's basic premise and strategy. The firm's best option is to redefine its objectives and business approach. Organisational learning is at a premium. Managers also have to be resilient yet adaptable, and nimble, creative and clear-headed in assessing the options and deciding what actions to take.

In these circumstances, traditional approaches to strategy, risk and change are no longer appropriate. Among the challenges facing senior executives are the following:

■ **Strategy determination.** The traditional assumption underpinning strategy formulation has been that the future can be predicted through the use of powerful analytical tools

and therefore that it is possible to set a clear strategic direction. Now that no amount of analysis will provide a reliable set of indicators about the future, how do you determine strategy when the operating environment is uncertain and potentially volatile?

- **Strategy execution.** This is still dominated by methods developed in the 1980s with the adoption of total quality management. This presumes that goals are determined at the top and the methods required to achieve these goals are driven downwards through the organisation. The emphasis is to achieve "buy-in" to these methods at middle and junior management levels. However, uncertainty breeds flaws. Internal politics and turf wars are just some of the hidden forces that can distort strategy execution and cause unexpected outcomes.
- Risk management. This is the identification, assessment and prioritisation of risks followed by co-ordinated and economical application of resources to minimise, monitor and control the probability and/or impact of unfortunate events. As such, risk management is a transactional financial discipline. While it is an important tool in managing uncertainty, it is not enough on its own to enable senior executives to set the context of events that are difficult to anticipate or to identify alternative strategies. Nor does risk management enable an organisation to achieve the right level of adaptability and "readiness". It is a reactive rather than proactive process.
- Programmes that often take up to five years to fulfil and are initiated on senior management terms may well be derailed by unpredictable events. Effective communication and consultation with the workforce, early in the process, is crucial to the success of change programmes. Yet senior executives are hampered by the fact that they may no longer have a clear vision of where the organisation will be in five years' time. They are therefore unable to provide the strategic leadership that has been their conventional task during change management programmes.

The essence of this book

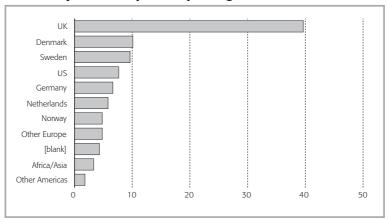
The indications are that the current period of disruption and unusual uncertainty will continue, and the aim of this book is to answer the questions that any manager faced with managing uncertainty will want to know the answer to. Chief among them are the following:

- How effective were companies in anticipating and responding to the disruption of the past five years and what changes to strategic planning emerged as a consequence? (Chapter 2)
- Is managing uncertainty the same as risk management? If not, in what way does it differ? (Chapter 2)
- What kind of leadership is required to steer an organisation effectively through periods of uncertainty? (Chapter 3)
- What do "agility" and "resilience" two organisational capabilities perceived as essential in managing uncertainty mean in practice? (Chapters 4 and 5)
- What new forms of collaborative working underpin the need to develop closer relationships with customers, employees and strategic partners in order to respond effectively to uncertainty? (Chapter 6)

To help answer these questions, PA Consulting Group (PA), in collaboration with the authors, conducted a survey of 205 senior executives from international companies and public-sector organisations in various countries and regions in spring 2011 (see Figure 1.1). In analysing the data, survey responses were compared with total shareholder return (TSR) for the organisations involved (92 in total). The survey questionnaire, which was also used as the basis for follow-up interviews, is reproduced in the Appendix. The results of the survey (henceforth referred to as the managing uncertainty survey) – are explored in greater detail in Chapters 2–6.

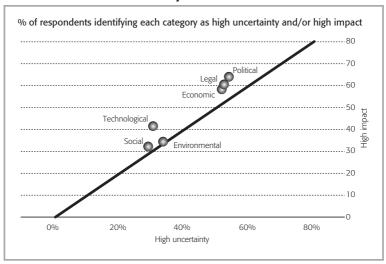
It was clear that the survey respondents were extremely concerned about the scale of the uncertainty affecting their businesses. They recognised that what started as an economic crisis was now a tangle of economic, political and regulatory issues (see Figure 1.2). The combination of these unpredictable risks makes it imperative for businesses to become better at managing uncertainty.

FIG 1.1 Respondents by country or region, %



Source: © PA Knowledge 2011

FIG 1.2 Sources of uncertainty



Source: © PA Knowledge 2011

The overriding conclusion of the book is that the ability to manage uncertainty effectively is predicated less on senior executives adopting a set of distinctive management skills – as in the case of risk or change management – and more on inculcating a number of important organisation-wide capabilities that will contribute to a firm's "strategic readiness". Developing this further, there are six capabilities that organisations need to develop: strategic anticipation, navigational leadership, agility, resilience, open collaboration and predictive learning. The following chapters will examine each in turn.