In Uncertain Times, focus on your Strategy

*Prof. Nils Stieglitz

While boards have always had to deal with periods of high turbulence and uncertainty, the current business environment poses unique challenges. Today, the global economy is undergoing transformations along multiple dimensions and strategy needs to work actively and sustainably to help companies succeed in turbulent times.

Global economy in transformation

Sweeping geopolitical changes are transforming the global economy. Free trade between China and Australia, North America and the European Union has been a key growth driver for three decades. Still, these regions' political and economic connections have strained in recent years. Russia's attack on Ukraine in 2022 destroyed existing trade relations vital for energy and agriculture markets. Africa might be facing a lost decade as it once again becomes the scene of geopolitical power-plays, as many foreign countries vie for influence and control. India has made remarkable progress in recent years domestically and abroad, but it remains uncertain what direction the country ultimately plays on the global stage.

Political changes have profound macroeconomic consequences. They may bring about the end of globalization as we know it. Global regionalization rather than integration might become the new normal. That would put a dent in growth rates and company profits. A decade of low-interest rates could end with higher inflation and interest rates around the globe. This will impact costs of capital for startups and established firms as well as the viability of investment projects.

Board decision-making also has become more complex as non-financial goals in many Western companies increasingly complement financial targets. The key driver here is ESG accounting – the incorporation of Environmental, Social, and Governance requirements in the economic calculus of companies. ESG offers a new management philosophy as an antidote to shareholder value maximization. It transforms how companies collaborate and manage supply chains. Boards are increasingly faced with tough choices as they must not only juggle trade-offs between short-term profitability and long-term growth but also between financial and non-financial goals.

> “In times of high uncertainty, innovation holds the potential to shape rather than react to changes in the business landscape.

ESG also feeds a slew of new regulations, especially in Western economies, reflecting the expectations of their constituents. The trouble here is that smart, global standards are difficult to agree on. Quite to the contrary, it looks like many countries and economic blocs will pursue their own regulatory agenda to embed ESG. This is because active industrial policy and economic protectionism have recently made a strong comeback. Much the same is true for data protection rules that make building global digital business models increasingly more difficult.

Finally, digital technologies, especially the advances in artificial intelligence, open up new opportunities for transforming entire industries. For example, ChatGPT has taken the world by storm, even if its business application is still unclear. However, Microsoft's announcement to combine ChatGPT with its Bing search engine holds the prospect of transformative disruption. It could bring down Google as the premier search engine, something financial experts and industry regulators would not have foretold just a few months ago.

These transformative changes create risks and opportunities as old certainties give way to new uncertainties. To benefit from transformation, boards must focus on strategy rather than detailed annual plans or quarterly financial results. Strategy means getting the big picture right. It requires a board to have a keen understanding of the business landscape and a long-term policy to seize selected opportunities while mitigating significant risks. That is not easy to accomplish, but a few principles help boards formulate strategy in turbulent times.

Strategy in turbulent times

First, in their strategy, boards need to concentrate on fundamentals. As discussed, companies face many changes in their business landscape. At the same time, some things will not change, and these fundamentals give companies a sound footing for their strategy. That is a question seldom asked and discussed in board meetings. For example, fashion trends are a fact of the apparel industry. In addition, human beings tend to signal their belonging to an in-group, a fundamental psychological trait independent of cultural background or upbringing. Companies that understand these dynamics stand to benefit. For example, luxury companies have become extremely adept at commercializing belonging to a (global) social status group, while simultaneously being able to adapt rapidly or even create new trends.

Second, an understanding of distinctive advantage is critical. Companies have long-term success if they can do things differently than their competitors. They have distinct advantages that allow them to offer better quality or deliver products and services at lower costs. For example, Google's success rests on an unmatched search technology, access to massive amounts of data to train search algorithms, and a solid well-known brand. Many companies struggle with a precise formulation of distinction. They often answer with misleading platitudes (e.g. “our team”) or only provide superficial analysis (e.g. “our brand”). Especially when faced with transformative changes, a deep understanding of distinctive advantages is essential.

Consider Eastman Kodak, once one of the largest, truly innovative companies in the world, it was the market leader in analog photography, with deep expertise in the underlying chemical processes. It also launched the first digital camera commercially available. When it became clear that digital transformation would change business and leisure photography, its top management claimed, “we are a photography company” and tried to transform the company into a digital powerhouse. It failed spectacularly. Why? Because Eastman Kodak's distinctive advantage resided in chemicals and not in photography per se. To compete, it had to transform its entire technological and operational foundation – a daunting task. At the same time, a company such as Sony benefited – while not strong in photography, it was already digitally savvy. What was competence-destroying for Kodak was competence-enhancing for Sony. It would have been much better to embrace the company's advantage in chemicals and build a strategy from there. Kodak's arch-rival Fujifilm did precisely that and is nowadays much more successful.

Understanding distinctive advantage allows boards to ask the next hard question in strategy – what technological, political, or societal transformation might destroy the advantage in the future? Answering the question helps the board scan the business landscape for serious threats and risks and separate strategic transformation from operational shocks. Take the global Covid pandemic, for example. For virtually all companies, the pandemic was a significant operational challenge, but it did not fundamentally transform any industry (even if it accelerated some trends such as flex work). Some companies overreacted as they were too concerned with short-term adaptations rather than long-term strategy. Some players scaled back capacity massively in the airline industry as they expected a long-term decline in global passenger numbers. The fate of the Airbus A380 is symbolic. Many airlines stopped deploying the world's largest passenger plane, some of them such as Lufthansa decided to phase out the aircraft for good. However, air travel recovered quite quickly and airlines that misperceived the pandemic as transformative found themselves at a disadvantage.

Rediscover Scenario Thinking

Unfortunately, understanding whether a trend will be transformative, operational, or insignificant is very often difficult. For example, will the global economy enjoy a new golden age of global integration, will 'slowbalization' continue,

or will we even face an era of global fragmentation? Hard to tell, but a strategic question multinational companies can't avoid answering in formulating strategy. As the correct answer is hard to find, boards need to rediscover the art of scenario thinking. Scenario thinking helps boards to analyze trends systematically and to understand their interactions.

Most importantly, it forces boards to consider possibilities and alternative futures. Crucially, scenario analysis is more than just fleshing out three, four possible futures. It needs to provide a diagnosis, an analysis of key transformational drivers. Ideally, such an analysis offers clarity about risks and opportunities common across multiple scenarios. For example, a fundamental trend is an aging population in most advanced economies (including China), with strong population growth in emerging markets. This will have important ramifications for such diverse global industries as healthcare, fashion, and entertainment. Risks and opportunities common across scenarios provide a sound footing for formulating strategies despite high uncertainty.

Scenario analysis also informs thinking about distinctive advantages under uncertainty. It provides context for understanding how the company can compete in the future. For each scenario, one may discuss whether it will enhance or weaken competitiveness, thereby gaining a deeper understanding of how transformation impacts distinctive advantage. It also provides guidance for future actions. Scenarios force board members to consider long-term implications for competitiveness rather than short-term financial effects, as scenarios usually have a time horizon of three to five years.

Have a Plan B

Uncertainty requires the board to consider a portfolio of viable options which could increase growth, profitability, or sustainability. Companies flourish and grow if they may pursue a wide range of options in times of uncertainty as they are well prepared for many (not all) future scenarios. During the debt crisis in the Eurozone, German Chancellor Merkel claimed her government's policy to be 'without alternatives'. This is the opposite of strategy – strategy provides a framework for options a company may or may not pursue. Put bluntly, always have a plan B. A key task of the board is not only creating options but prioritizing and choosing among them. If the choice set is limited, the board has not done its job. It also lacks a fundamental skill needed to survive in today's business landscape – the ability to innovate.

The genius of Steve Jobs was his ability to identify and to execute on new options that his predecessor at Apple did not see. That's the essence of innovation – pursuing novel options, be it new products, services, markets, or business models. In times of high uncertainty, innovation holds the potential to shape rather than react to changes in the business landscape. Boards need to be active champions of innovation, constantly questioning the status quo and signaling an openness to take risks in the pursuit of innovation.

Understanding your distinctive advantage and thinking in scenarios will give you the tools to turn those plans A, B, C, etc. into creative new options and enact them successfully. In an age of uncertainty, focus on your strategy. ■

***Prof. Nils Stieglitz** *is the President and CEO of Frankfurt School of Finance & Management. He serves on the editorial boards of Organization Science and Strategic Management Journal and is a Senior Editor at the Journal of Organization Design. His primary research interests are strategic decision-making and organizational adaptation. His research was published in the leading academic journals such as Management Science, Organization Science, and Strategic Management Journal, among others. His research and opinions have appeared in newspapers and other media outlets such as Business Week, Financial Times, Harvard Business Review, Neue Zuricher Zeitung, New York Times, The Economist, and Wall Street Journal.*