STRATEGY

A Guide to Building a More Resilient Business

by Martin Reeves and Kevin Whitaker

July 02, 2020

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In the midst of the Covid-19 crisis, we have become painfully aware of the fragility of supply chains, health care, and other critical systems. Many leaders have announced the intention to build back their businesses more resiliently, but not many know how to do so. Few business schools teach resilience, and today's managerial toolkit is dominated by financial performance management. As a result, very few companies are able to explicitly design for, measure, and manage resilience.

Why Resilience Is Important

We can usefully define resilience as a company's capacity to absorb stress, recover critical functionality, and thrive in altered circumstances.

Resilience is especially important today because the business environment is becoming more dynamic and unpredictable. This is a result of several enduring forces stressing and stretching business systems — from accelerated technological evolution to a greater interconnectedness of the global economy to broader issues such as rising inequality, species depletion, and climate change.

There is no better example of system stress than the coronavirus crisis. Humans impinging on the natural environment have enhanced the risk of cross-species infections. Dense urban populations facilitated the rapid initial outbreak of the disease. International travel facilitated its global spread. Extended global supply chains have broken down. Economic activity has been massively disrupted, and inequalities and social tensions have been exacerbated.

And Covid-19 is not a one-off. SARS, MERS, and Ebola forewarned an inevitable global pandemic, and there is every reason to expect that we will see others in the future. Furthermore, the same circumstances are also conducive to the spread of a cyber-virus and to economic instability that could result from climate change or social tensions.

The Challenge of Measuring and Managing Resilience

Traditional management approaches have several important limitations that make measuring and achieving resilience difficult:

- Companies have been designed predominantly to maximize shareholder value from dividends and stock appreciation. Very few companies even attempt to measure resilience beyond merely disclosing specific material risks.
- Companies and shareholders often focus on maximizing short-term returns. In contrast, resilience requires a multi-timescale perspective: forgoing a certain amount of efficiency or performance today for the sake of more-sustained performance in the future.
- Companies have been mainly focused on creating and executing stable plans, which works well when causal relationships are clear, predictable, and unchanging. Resilience deals with what is unknown, changeable, unpredictable, and improbable — and has significant consequences.
- In the current model of corporate capitalism, each company is treated as an economic island to be optimized individually. While this simplifies management and accountability, it masks the extent of economic and social interdependence between different stakeholders. In contrast, resilience is a property of *systems*: an individual company's resilience means little if its supply base, customer base, or the social systems upon which it depends are disrupted.

Managing for resilience therefore requires more than just grafting new ideas or tools onto today's approaches. It requires a fundamentally different mental model of business — one that embraces complexity, uncertainty, interdependence, systems thinking, and a multi-timescale perspective.

Of course, many companies already undertake some form of risk management — but mostly to understand and minimize exposure to specific, known risks. Resilience must deal also with unidentified risks, and it must consider the adaptations and transformations a company must make to absorb environmental stress and even turn it to advantage.

Building Resilient Enterprises

Companies can **structure** their organizations and decision processes for resilience by embracing six principles of long-lasting systems:

- **Redundancy** buffers systems against unexpected shocks, albeit at the expense of short-term efficiency. It can be created by duplicating elements (such as by having multiple factories that produce the same product) or by having different elements that achieve the same end (functional redundancy).
- **Diversity** of responses to a new stress helps ensure that systems do not fail catastrophically, albeit at the expense of the efficiencies obtainable through standardization. In business, this requires not only employing people from different backgrounds and with different cognitive profiles but also creating an environment that fosters multiple ways of thinking and doing things.
- **Modularity** allows individual elements to fail without the whole system collapsing, albeit while forgoing the efficiency of a tightly integrated organizational design. Because a modular organization can be divided into smaller chunks with well-defined interfaces, it is also more understandable and can be rewired more rapidly during a crisis.
- **Adaptability** is the ability to evolve through trial and error. It requires a certain level of variance or diversity, obtained through natural or planned experimentation, in combination with an iterative selection mechanism to scale up the ideas that work best. Processes and structures in adaptive organizations are designed for flexibility and learning rather than stability and minimal variance.
- **Prudence** involves operating on the precautionary principle that if something could plausibly happen, it eventually will. This calls for developing contingency plans and stress tests for plausible risks with significant consequences — which can be envisioned and prepared for through scenario planning, war games, monitoring early warning signals, analyzing system vulnerabilities, and other techniques.

- **Embeddedness** is the alignment of a company's goals and activities with those of broader systems. It is critical to long-term success because companies are embedded in supply chains, business ecosystems, economies, societies, and natural ecosystems. Articulating a purpose — the way in which a corporation aims to serve important societal needs — is a good way to ensure that the company does not find itself in opposition to society and inviting resistance, restriction, and sanction.

Beyond these structural options, a company can deploy **migration strategies**, such as shifting its business portfolio mix across products, channels, geographies, or business models to maximize opportunities and minimize adversity. The principal lever for this is capital allocation. Most companies tend to spread resources relatively equally across different businesses and units, but extreme circumstances usually need more-decisive reallocation, which requires both the business intelligence and the mental agility to see new risks and opportunities before they become apparent to competitors. A key concept here is sufficiency: Many companies will be seeing and piloting new models under changing conditions, but only those that allocate sufficient capital with sufficient speed will succeed in shifting the center of gravity of their business.

Then there are strategies of **environmental shaping.** To a latecomer in an established market, the business environment is a given. But a pioneer in an emerging opportunity can shape the environment. By imagining possible new realities, especially in dynamic environments, and then realizing them through shaping and persuasion, companies can reduce their exposure to unfavorable shocks. Migration and shaping go beyond risk mitigation by creating and exploiting new opportunities to flourish.

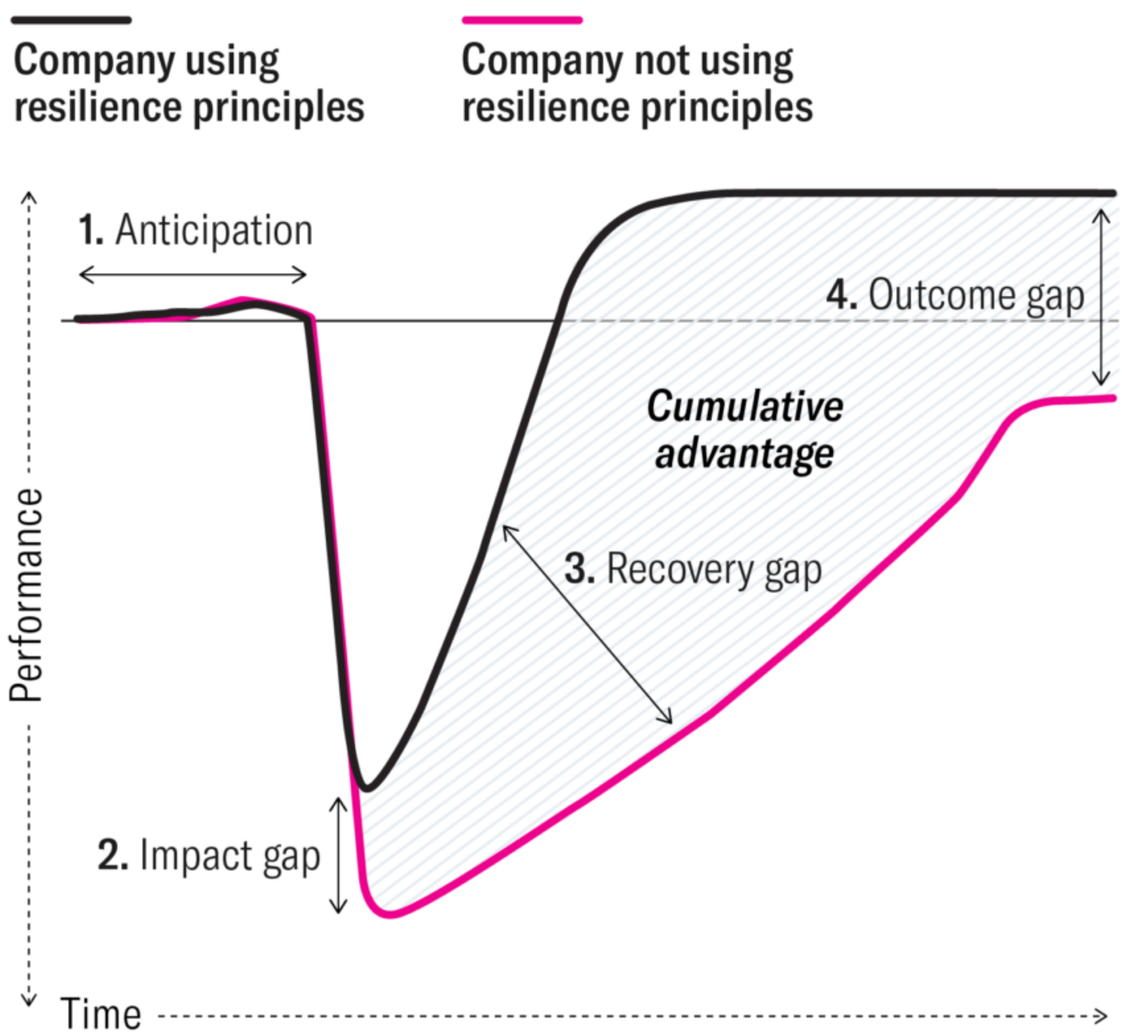
Finally, companies can increase their resilience through **collaboration** with other players. Business ecosystems, such as digital platforms, can increase their collective resilience through access to new capabilities, through increased flexibility, and by reducing the fixed cost of entry into businesses where assets can now be shared. Shared platforms essentially create "real" insurance against the unexpected through investment in shared execution, adaptation, and innovation mechanisms.

The Benefits of Resilience

When confronted with unanticipated stress, a company that employs resilience principles has multiple advantages that play out sequentially:

Assessing Companies' Relative Resilience

When confronted with unanticipated stress, a company that employs resilience principles has multiple opportunities for advantage that play out sequentially. Cumulatively, these can give a company a significant edge in value over competitors.



Source: Martin Reeves

First is an **anticipation benefit**, representing the ability to recognize threats faster. Though this may not be immediately manifested in performance, it can be detected via other signals, such as when a company articulates its resilience plans (something most companies were slow to do in the case of Covid-19). It can also drive advantages in subsequent phases.

Next is an **impact benefit**, representing the ability to better resist or withstand the initial shock. This can be achieved through better preparation or a more-agile response.

Then there is a **recovery speed benefit**, representing the ability to rebound from the shock more quickly by identifying the adjustments needed to return to the prior operating level and implementing them swiftly and effectively.

Finally, there is an eventual **outcomes benefit**, representing increased fitness for the new post-shock environment.

Cumulatively, the four gaps produce a significant difference in value. As we observed in China during the initial Covid-19 shock, most sectors and companies came down rapidly and synchronously, but during the recovery phase there was a marked divergence in company performance.

How to Become a More Resilient Company

Crises are opportunities for change. With Covid-19, companies have a unique opportunity and necessity to revisit their business models to build greater systemic resilience, starting with the following six actions.

1. **Seek advantage in adversity**. Don't merely endeavor to mitigate risk or damage or restore what was; rather, aim to create advantage in adversity by effectively adjusting to new realities.
2. **Look forward**. In the short run, a crisis many appear tactical and operational, but on longer timescales, new needs and the incapacitation of competitors create opportunities. Crises can also be the best pretext for accelerating long-term

transformational change. One of the key roles for leaders is therefore to shift an organization's time horizons outward.

3. **Take a collaborative, systems view**. In stable times, business can be thought of as performance maximization with a given business model in a given context. Resilience, by contrast, concerns how the relationships between a business's components or between a business and its context change under stress. It requires systems thinking and systemic solutions, which in turn depend on collaboration among employees, customers, and other stakeholders.
4. **Measure beyond performance**. The health of a business is not captured only by measures of value extracted, which tend to be backward-looking. Measuring flexibility, adaptation, and other components of resilience is critical to building a sustainable business. This can be done quite simply by looking at either benefits or capabilities.
5. **Prize diversity**. Resilience depends on being able to generate alternative ways of reacting to situations, which in turn depends on the ability to see things with fresh eyes. Resilient businesses prize cognitive diversity and appreciate the value of variation and divergence.
6. **Change as the default**. Alibaba founder Jack Ma sees change, not stability, as the default. Resilience is less about occasional adjustments under extreme circumstances and more about building organizations and supporting systems predicated on constant change and experimentation. This is partly to avoid rigidity and partly because iterative incremental adjustment is far less risky than a massive one-shot adjustment.

With the mainstream of business education and managerial practice focused on managing performance, resilience represents not just an opportunity to mitigate risk but also an opportunity for competitive advantage for enterprises who choose to focus on it. Andy Warhol famously said that in the future, everyone will be famous for 15 minutes. In today's business world, transient high performance is commonplace; it is sustained performance by resilient companies that stands apart.

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Stephen Moffitt 17 days ago

This article provides a level of detail for one of the characteristics of adaptive companies that I outline in my recent article, "Reflecting on Adaptability: How to assess a company's ability to thrive in uncertain times" (https://medium.com/@stephen.moffitt/reflecting-on-adaptability-f8e3f24e07d2). In addition to resilience, companies need two other characteristics in this dynamic and unpredictable environment: innovation and speed in decision-making. Without these, companies run the risk of being reactive instead of proactive in shaping their future.

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