StrategicRISK

SPECIAL REPORT:

BUSINESS TRANSFORMATION

Times are changing fast and that means new risks on top of old risks. So how do you stay one step ahead when market disrupters are bowling through every industry?

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Impossible to dodge

Long-established business truths are being thrown into the air by an unprecedented wave of market disrupters, and no industry is safe.

It would be difficult to name a single sector of the business world that isn't being transformed by outside forces that, in some cases, threaten to undermine long-established companies and even entire industries.

Consider this (far from encyclopaedic) list.

The oil and gas industry is confronting historically low prices for hydrocarbons that have put entire business models in jeopardy.

The bricks and mortar shopping industry is battling with online giants that have already claimed many notable victims.

The global steel industry, as we'll see, is automating rapidly in order to survive in a period of falling demand.

The automotive industry, long dominated by century-old giants of the combustion engine, faces a revolution in electric vehicles that is attracting many new competitors from left field, such as Dyson group, a world leader in compact electric battery technology.

Retail banks have been shocked by a stream of technology-driven developments such as fintech, blockchain, online logarithm-driven lenders, and a market-savvy mortgage-broking industry.

Even the wealth management industry, one of the most consistently profitable of all businesses in the financial sector, faces competition from 'robo-advisers' and other logarithm-based upstarts.

THINK SMALLER, FASTER

Size is no guarantee of survival. Partly state-owned Air France–KLM is engaged in a tough battle with the emerging phenomenon of low-cost, long-haul carriers such as Norwegian that, which chief executive Jean-Marc Janaillac says requires a top-to-bottom overhaul of the group. As for the transport industry in general, it's in a state of constant upheaval. As we speak, transport companies are linking up with electrical giants to trial battery-driven – and even automated – trucks.

Even iconic new-technology companies cannot afford to rest on their laurels in this disruptive world. At the turn of the millennium, Apple probably thought iTunes would dominate online music for years to come – but that was before Swedish start-up Spotify launched its subscription-based streaming model in 2008. Although Apple Music, as the service is now branded, currently has 38 million subscribers, Spotify boasts 71 million paying customers.

The Asia-Pacific region is in the eye of this particularly disruptive storm. A case in point is China, where the 'Three Barrels' – the state-owned oil giants – face competition from the 'teapots', much nimbler privately owned refiners that are rapidly becoming an integral element in the nation's energy sector.

Australia, an economy that has long been dominated by a small number of firms with an unusually high share of the market (in effect, oligopolies), is no exception.

Associate professor Kwanghui Lim, a specialist in business innovation at Melbourne Business School, notes: “Investment in Australia and elsewhere in the Asia Pacific has been difficult and costly because these oligopolies have split the market among themselves.” But, as he points out, that’s changing rapidly as companies such as Amazon, ‘unicorns’ (companies with $1bn-plus market value), smaller start-ups, and Europe, UK and US firms with online subsidiaries, invade just about every sector from energy to hospitality.

WHAT IS TO BLAME?

But what’s causing the latest wave of volatility? Take your pick: automation, AI, a collapse in red tape reducing barriers of entry into many markets, changing consumer tastes, online competitors, globalisation, fragmentation of business markets, the boom in start-ups.

Actually maybe not globalisation, argues Douglas Dow, professor in business strategy at Melbourne Business School, though that’s been a long-running, much-blamed phenomenon. It was globalisation that was considered – wrongly, as it happens – to have triggered the Great Depression of the 1930s. “More likely, it’s automation and artificial intelligence that’s created this peak in volatility,” he says. For example, he cites research into the American steel industry that attributes the steady loss of jobs in the sector to increasing automation rather than imports.

NOTHING NEW

Yet there’s no end in sight, not in the immediate future anyway. In any transformative cycle of change such as in the dotcom boom, Dow says, there’s an earthquake followed by ripples that produce incremental changes. “These incremental changes – aftershocks – can go on for years. And I think that’s what we’re going through right now.”

In the meantime, some of these incremental changes will not only be felt for years to come, but may also date back decades or longer. As Kwanghui Lim explains: “While the rate of change is getting faster, there are big changes going on beside automation and artificial intelligence.”

He cites the steady diffusion of electronic devices such as the (by now) old-fashioned computer and mobile phone that continues to transform entire economies, particularly in Africa where many western companies are now engaged. He also cites the slow but inexorable spread of agricultural technology around the world. These and other late-stage incremental changes continue to run in the background, influencing markets in important but almost invisible ways.

And one of the most disruptive incremental influences is the steady fall in the price of technology. As Deloitte notes, the cost of a 3D printer, once found only in factories, collapsed from $300,000 in 2000 to $1,300 in 2012, and can now even be knocked together by tech-savvy individuals for a few hundred dollars.

Yet, there’s some consolation for harassed CEOs who feel overwhelmed by relentless forces disrupting their best-laid plans. According to Dow, we might be through the worst of the current bout of disruption. “We can measure change by the degree of volatility,” he explains, “and right now volatility is not going up. Volatility is probably at a peak.”

There’s other good news. As we see in the next article, volatility is manageable.

Q&A: DIGITISATION AND DATA IN A HYPER-CONNECTED ORGANISATION

Gareth Byatt, principal consultant of Sydney-based Risk Insight Consulting, sees three main, interconnected forces that will keep you on your toes.

WHAT DOES THE INTERCONNECTED WORLD MEAN FOR US?

Connectivity in business and commerce (as well as socially) has been progressing for millennia. But now it’s speeding up, with today’s products and services being designed, produced and traded all around the world. Competition is truly global. The World Economic Forum sees this “hyper-connectivity” as an opportunity that spurs innovation. But there are also dynamic risks to manage. These risks must be properly understood by businesses in order for them to prosper.

HOW DO ORGANISATIONS HANDLE THE HUGE AMOUNTS OF DATA – THE “NEW OIL” – AVAILABLE TO THEM?

The capturing and use of data is a vital element in today’s business world – the *Economist* described data as the “new oil”. Better data helps you make better and more risk-informed decisions. We’re still working on how to fully harness the increasing amounts of data we are capturing. The important thing for organisations is to be proactive in approaching their data.

WITH CYBER ATTACKS ON THE RISE, ISN’T THE DIGITISATION OF BUSINESS A SERIOUS THREAT?

We’re living in the age of the fourth industrial revolution where the Internet of Things (IoT) and AI are becoming the new normal. Businesses must embrace these developments but still be diligent about managing cyber risk.

I also want to highlight geopolitical uncertainty as an important area of uncertainty in our interconnected world. Regulatory and trading environments in different geographic regions and countries are changing constantly, in part to keep up with the digitised world. These bring new compliance requirements that can lead to sizeable fines and reputational damage in the event of breaches.

Organisations also need to build in resilience to avoid major disruption to what are often complex supply chains such as from extreme weather or public health outbreaks. Scenario planning can help. Businesses can design scenarios that predict how risks would affect them and then agree on measures to work through them.

Overall though, it’s vital that businesses instil a constantly proactive culture that anticipates risk and uncertainty.

How do you roll with the changes?

In these times of transformative change, it is possible to fight the volatility – and it starts with knowing your business, your customers, and your competition, better.

When Fiat Chrysler chief executive Sergio Marchionne took over the American automotive giant at virtual bankruptcy, one of his first actions was to shut down the executive headquarters and move his desk down to middle-management level where he could find out what was really going on.

This, say specialists in business transformation, was a textbook move. First, it put the executives in the loop. Second, it improved the quality of decision-making. As a bonus, it was good for morale. And, most importantly, it helped management stay in touch with rapidly changing customer habits and tastes.

This is why StarHub, Singapore's second-largest telco, spends much of its time, money and technology in learning how to keep its 2.5 million subscribers happy. As vice-president of M&A and corporate strategic planning Ryan Tan explains: "Singapore is a saturated market with more than 160% mobile phone penetration, so we not only look at defending our mobile market share but also the ARPU per user. Thus, while market share is always a concern, we also look to grow our share of their wallet and continue to enhance the stickiness of our services, thus reducing our churn rate. To do so, we are always exploring innovative services and offerings as part of our value proposition."

LEARN FROM YOUR STAFF

Business transformation starts with your people – your internal stakeholders – as another company in the republic, the state-owned lottery Singapore Pools, fully understands. The only licensed lottery operator in Singapore, it is in the middle of an internal exercise called "business transformation", which is designed to adapt the business for the medium-term future. Among a wide range of issues that its risk manager Jeffrey Yeo has identified is an issue that comes down fundamentally to how effectively management engages with its frontline and back-end staff.

As he explains, it's vital that staff understand what's expected of them, that they are provided with the skills necessary to get the job done, and that they fully comprehend the group's strategic direction. If none, or only some, of these things happen, management's objectives are put at risk.

"IN A TIME OF CHANGE, THE MOST IMPORTANT THING MANAGEMENT CAN DO IS TO DEVELOP THE ART OF LISTENING."

Professor, Melbourne Business School
Douglas Dow

Fiat Chrysler's remarkable turnaround under Sergio Marchionne has shown that one of the most important volatility-fighting tools for managers is to ensure they put themselves in the loop. This is why CEOs must get out and about, advises professor Douglas Dow of Melbourne Business School. "In a time of change, the most important thing management can do is to develop the art of listening," he says.

In short, get closer to the customer and to those employees who have the market intelligence that the C-suite needs to stay ahead of the game.

And here, by the way, CEOs shouldn't hide behind customer surveys, because they just don't tell management what they need to know. "They are very rigid," the professor adds. "They only measure what they are intended to measure. All they will ever reveal is a slight level of dissatisfaction."

FOLLOW THE START-UPS

Another important volatility-fighting tool, especially for long-established companies vulnerable to new and nimbler competition, is to find out what they're doing that you're not. At a time of 'business fragmentation', big companies are there to be aimed at. In fact, the historic advantage of economies of scale has been supplanted by a new doctrine of "dis-economies of scale" that can tip the balance away from legacy organisations in favour of the leaner and meaner opposition, as the global taxi industry has discovered from the Uber phenomenon.

And if your competition is coming in the form of start-ups, one of the most effective responses is to adopt the lean methodologies they're using. This is why some of Australia's biggest companies such as Australia Post, Telstra and National Australia Bank have installed incubators, often staffed with Ph.Ds, who work on innovations that could produce transformational results.

In this, GE is one of the leaders, explains associate professor Kwanghui Lim who teaches strategy and innovation at Melbourne Business School. In late 2013, GE invested $30m in Quirky, a start-up that crowd sources ideas and puts them through a pipeline to convert a mere brainwave into a high-selling product. One of the results of this collaboration was Aros, a smart air conditioner that flew off the shelves.

As GE has discovered, the acquisition of much smaller, highly innovative companies can have a disproportionately beneficial effect on the parent company. The Quirky partnership allowed GE to extend its research and development capabilities by tapping into a much broader ecosystem of product design talent.

To put it another way, the tail wagged the dog.

GET TO THE LAB

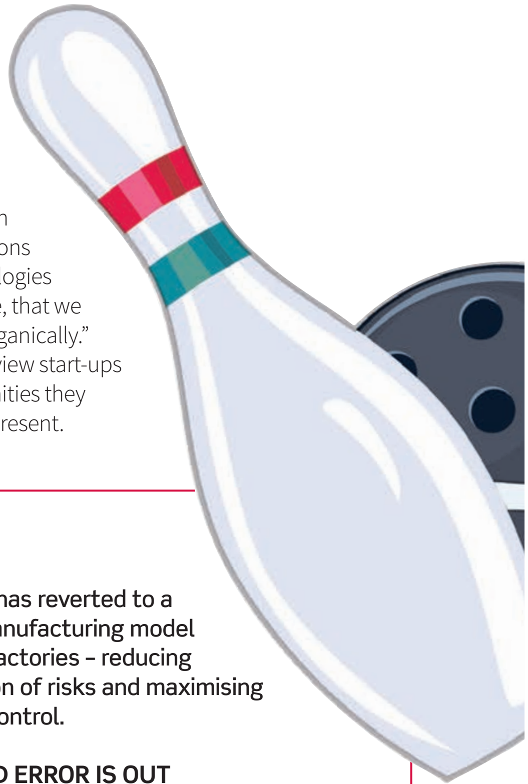
It's important though, says Kwanghui Lim, that bigger organisations adapt the start-up's methodology in their own particular interests.

"Established firms are investing in a different set of solutions," he explains, giving the example of an insurance firm that might install blockchain technology in order to streamline transactions for long-standing customers, while a start-up would want to use the tool to undermine its much bigger competition. "Each company's view of its customers is very different," he explains. "An existing firm doesn't want to lose customers – new technology should be complementary to the business – while a start-up has nothing to lose."

And this is exactly what StarHub is hoping for following a S$200m ($151.7m) series of acquisitions in 2017 that are intended to carry the telco through current and future volatilities.

"Organic growth is not enough for the group," explains Tan. "We recognise that M&A is a useful tool to strengthen our business model by acquiring innovative companies that are aligned with our strategic direction. Of course, acquisitions will also afford us exposure to new technologies and products, as well as innovative people, that we may otherwise find hard to grow purely organically."

In other words, big companies should view start-ups as laboratories and embrace the opportunities they offer rather than bemoan the threat they present.



EXPERT VIEW: RISK MANAGERS MUST ANTICIPATE, ANALYSE, ADAPT

Times are changing. It's up to you whether you see that as a concern or an opportunity, says David Hill, AIG's head of liability risk consulting, Asia Pacific.

"VENTURES NEED TO PIONEER NEW AND UNPROVEN CONCEPTS WITHOUT FAILURE. TRIAL AND ERROR IS NO LONGER IN THE TOOLBOX."

Head of liability risk consulting, Asia Pacific, AIG
David Hill

We are operating in a new environment where we are dealing with exceptional risk factors. Change is taking place on top of change, owing to the interconnectedness of risks, supply chain complexity and interdependency. Then there are advancements in technology: machine learning, AI, quantum computing, along with autonomous vehicles and energy storage. All these factors come together, forcing change at an exponential rate.

As an illustration of this in an extended enterprise business model: when a new outsourcing partner is added to the chain, it is not only one supplier that is introduced, but an additional supply chain and a new risk portfolio.

CHANGE BEGETS CHANGE

The Thai floods of 2011 are, unfortunately, an illustration of escalating consequences. Hard drive manufacturers' disruption affected PC production in the US and China, which impacted co-suppliers of processors and memory in Taiwan and elsewhere. In 2012, the World Bank ranked the Thai floods of 2011 as the fourth greatest economic natcat loss. It has since been surpassed by nine events.

Management's challenge is traditional in concept, but the interconnectedness of risks is challenging the practicality of approaches to identify, analyse, treat. This is why Tesla has reverted to a vertical manufacturing model in its gigafactories – reducing proliferation of risks and maximising ability to control.

TRIAL AND ERROR IS OUT

Whether this new environment is a cause of concern or opportunity will be determined by the adaptability of businesses. If we accept that change is unavoidable, businesses will need to reconsider their risk tolerance in light of this. Risk tolerance should allow for a degree of failure to attain the targeted success objective. Yet, societal values lower the tolerance for failure. There is greater corporate accountability, as well as shareholder and media outrage. Consequently, ventures need to pioneer new and unproven concepts without failure. Trial and error is no longer in the toolbox.

RISKS ARE ADDITIVE

Risk managers therefore need to keep the risk agenda active, current and relevant. It is easy for fatigue to creep into the risk process as a result of 'risk normalisation'. There's often a need to compete for the attention of the board, with compelling arguments to accept, avoid or treat risks. This is important and on-going because the portfolio of risks is continually growing. New risks rarely replace old risks – they're additive.

Lastly, anticipating the horizon has never been more important. We're all familiar with legacy risks – asbestos hazards, plastics pollution, for example – but we must anticipate and make provision for unintended legacies of this new, complex business environment.

And so for the next 100 years…?

A long life is no longer something any company can take for granted. But in a business world where life expectancy is falling fast, international logistics group Mainfreight is planning for the long term. Here they tell *StrategicRISK* how they plan to stick around.

"Everything's about culture," insists Bruce Plested, chairman and founder of international logistics group Mainfreight, a 40-year-old company with 2017 revenues of NZ$2.3bn [$1.67bn] and more than 7,000 employees.

"That's how we're building a 100-year company. All our decisions are based on the assumption that we're going to be here for the next century. And for us, the next 100 years starts again every day."

A 100-year company? In a commercial environment preoccupied with, at best, a five-year horizon, you don't hear many managers talking about the next decade, let alone the next century. And especially not in the logistics industry, one of the most turbulent of any sector. In the case of Mainfreight, which is listed in New Zealand but has operations in 22 countries including mainland USA, Australia, Asia, UK and Europe, Russia and Ukraine, the very notion of a 100-year outlook was optimistic, even laughable, when it was launched.

Founded in 1978 by chairman Plested, a former construction worker and night school-trained accountant, with savings of $7,200 and a ten-year-old Bedford truck, he was up against long-established, Australian-owned freight companies that dominated the sector in New Zealand and certainly didn't see the fledgling Mainfreight as a threat.

But today? Mainfreight is the giant of the New Zealand logistics industry and, since launching an international expansion around the turn of the millennium, has become a significant operator in many regions of the world. Today, about 75% of its revenues come from outside New Zealand.

In a nearly day-long round of interviews with *StrategicRISK*, chairman Plested, now 76, and group managing director Don Braid shared some of the group's secrets to longevity in an industry that almost routinely claims victims.

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Chairman and founder, Mainfreight
Bruce Plested

HOW DID YOU DEVELOP THE 100-YEAR MAINFREIGHT CULTURE?

Don Braid: "It's empowerment. The secret is bottom-up, not top-down. We're not hierarchical. We do all we can to make sure that the decisions are made all the way down the line, by the people in our team who are closest to the customer. This puts us in a far better position to satisfy the customer. And we never use the word 'staff' – we are a team or a family.

"For us, culture is a flywheel that never stops. We work on it every day. When you give people the opportunity, they flourish. But we know from

"WE DON'T HAVE A MAINFREIGHT HEADQUARTERS – IN FACT, THE WORDS 'HEADQUARTERS' AND 'HEAD OFFICE' ARE BANNED. WE'RE HERE SOLELY TO SERVICE THE BRANCHES. THEY'RE THE POWERHOUSES."

Group managing director, Mainfreight
Don Braid

experience that it can take decades to create a culture in a new company."

WHAT PRACTICAL MEASURES DO YOU USE TO CREATE THAT BOTTOM-UP CULTURE?

Braid: "There are several. We put up the weekly profits of each branch [Mainfreight has 242 locations around the world]. They're on the wall – everything's there for the team to see. Volumes of freight in and out, profit margin on the deliveries, punctuality… Every branch has its own P&L. We've learned this is extremely empowering.

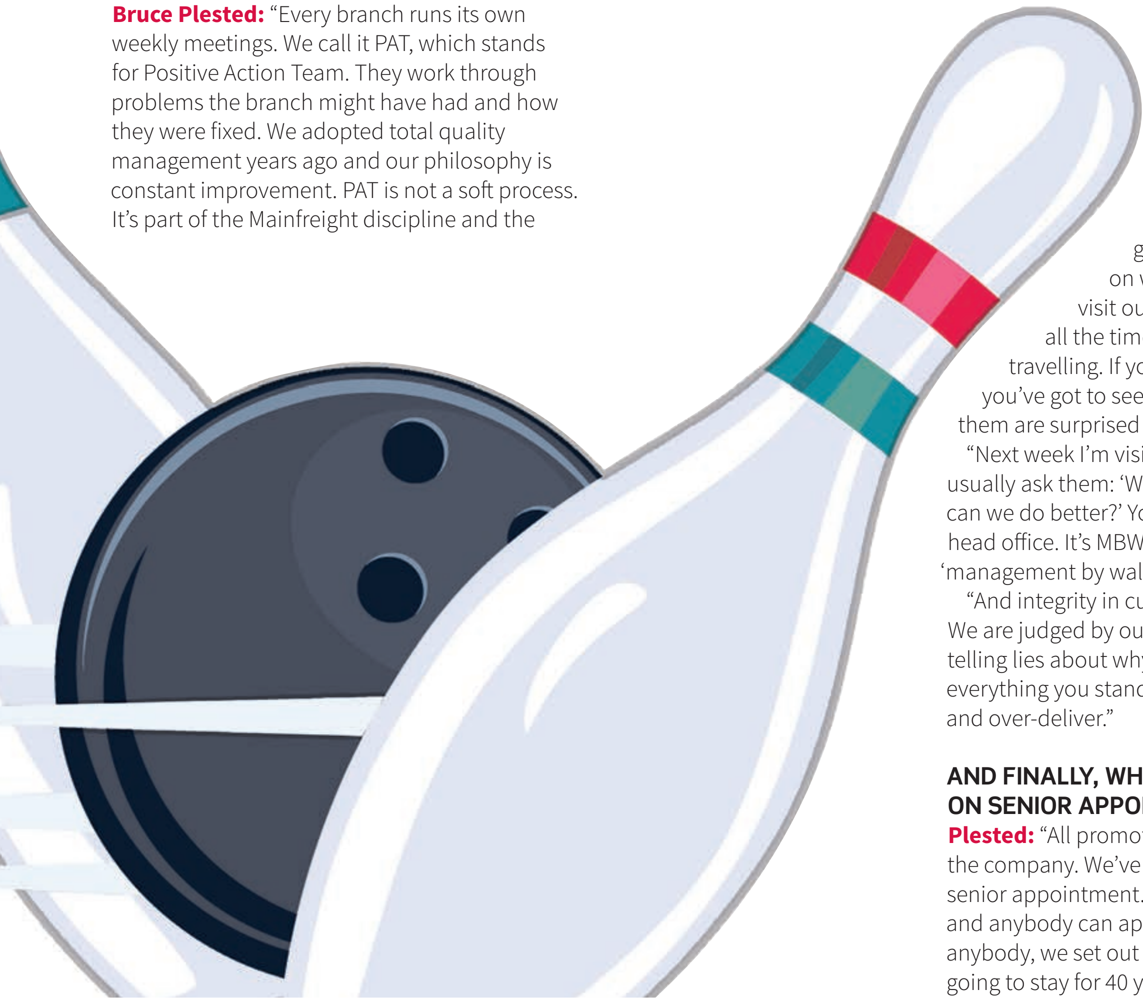
"Our team likes to see the business succeeding. The branches also produce their own newsletters – it's their words and their pictures.

"We reward everybody for producing good results. On top of their wages, everybody in the branch shares in 11% of that branch's profits, regardless of their position. Providing, of course, that a profit is made."

HOW HAVE YOU MAINTAINED WINNING PERFORMANCE OVER THE YEARS?

Bruce Plested: "Every branch runs its own weekly meetings. We call it PAT, which stands for Positive Action Team. They work through problems the branch might have had and how they were fixed. We adopted total quality management years ago and our philosophy is constant improvement. PAT is not a soft process. It's part of the Mainfreight discipline and the minutes go up on the walls along with the weekly branch profits."

Braid: "We don't have a Mainfreight headquarters – in fact, the words 'headquarters' and 'head office' are banned. We just have a national office and its job is very simple: We're here solely to service the branches. They're the powerhouses. Anybody can walk into the national office and talk with us about a problem. And they do all the time."



HOW DO YOU GO ABOUT ATTRACTING BUSINESS AND RETAINING CUSTOMERS?

Plested: "After culture, it's sales. They are the two big things for Mainfreight."

Braid: "In the national office we try to get rid of all the corporate nonsense so we've got the freedom to concentrate on what really counts, like sales. We visit our customers around the world all the time – even though it means a lot of travelling. If you want to be a growth company, you've got to see your customers and most of them are surprised when the CEO turns up.

"Next week I'm visiting six large customers and I usually ask them: 'Why did you pick us?' and 'How can we do better?' You can't do that sitting in a head office. It's MBWA – the old Harvard term of 'management by walking around'.

"And integrity in customer relations is everything. We are judged by our actions. Once you start telling lies about why freight is lost or late, you lose everything you stand for. We aim to under-promise and over-deliver."

AND FINALLY, WHAT'S MAINFREIGHT'S POLICY ON SENIOR APPOINTMENTS?

Plested: "All promotions are made from within the company. We've never gone outside to make a senior appointment. All jobs are advertised internally and anybody can apply for them. And when we hire anybody, we set out to treat them as though they're going to stay for 40 years."