Back to the Future
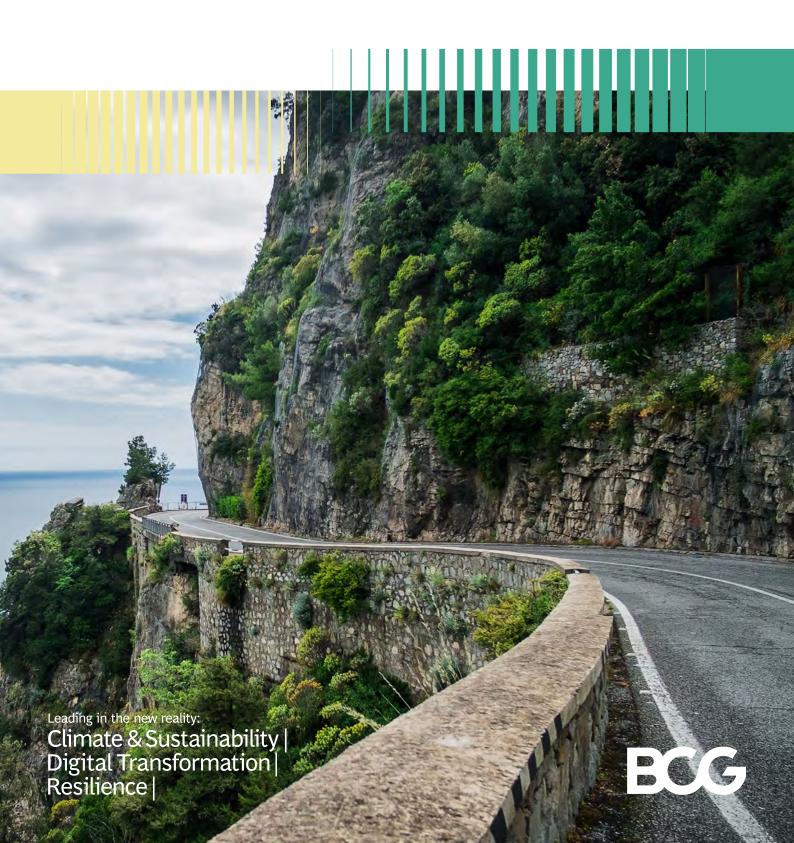
Resuming the Long-Term Agenda for Business

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Leading in the new reality:
Climate & Sustainability|
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Back to the Future

For most business leaders, the past year has been defined by a laser focus on navigating the COVID-19 crisis. The coming months will certainly provide more pandemic-related challenges, but as vaccinations progress and economies recover, the critical issues and timeframes of business will broaden.

What are the key challenges that will drive the longer-term change agenda? We would highlight three pivotal themes that will drive many others emanating from enterprises, business ecosystems, and the natural ecosystem. First, the pandemic has illuminated the need to build **resilience**. There will be more unexpected shocks in the future, and our research suggests that resilience is also valuable beyond crisis periods. Leading companies will codify and institutionalize lessons from recent experience. Second, the shift to new distribution and working models has accelerated the **digital transformation** agenda and raised the associated competitive stakes. And third, **climate change** will come into even greater focus. Though emissions growth was temporarily reversed during the pandemic, it will resume as economic activity recovers. However, the crisis has also given new reason for optimism by demonstrating our capacity for investment and mobilization against common challenges.

In order to succeed in 2021 and beyond, leaders across sectors and regions must pursue these themes by adopting three related imperatives: build resilience systematically, digitize for advantage, and address the bottlenecks to effective climate action.

1. Build Resilience Systematically

COVID-19 has made clear the value of resilience in business, and leaders around the world have spent the past year making efforts to minimize disruption. But the resilience agenda is not finished now that we are past the most acute phase of the crisis—it needs to be a continuing priority. Resilience is not only about mitigating stress but also about adapting to and thriving in new circumstances.

Resilience is a strategic concern for businesses. Crises are about survival, but they are also about seizing an opportunity to gain advantage. For example, in China (which experienced the shock and recovery cycle first), the spread in performance between leading and lagging companies was nearly twice as wide as it was in the preceding year. That pattern was not an aberration; our research shows that the gap between winners and losers consistently increases during crises.

It is not surprising, then, that resilience has a significant impact on long-term success. Though industry crises happen infrequently, they have a disproportionate effect on long-term competitive advantage: two-thirds of companies that outperformed their industries over the past 25 years were outperformers during crises.

Yet even though some companies have been more resilient than others, few have codified a playbook for how to systematize and replicate this capacity. A significant opportunity awaits companies that embed resilience thinking, systems, and behaviors to thrive amid any potential disruption. The study of long-lived natural and social systems reveals six traits that businesses can apply to be generally resilient:

- **Prudence**—developing early warning signals to detect potential threats and preparing for plausible downside scenarios

- **Redundancy**—building buffers for critical supplies or capacities to limit the potential impact of a shock

- **Diversity**—having a variety of capabilities or products that respond differently when a crisis occurs

- **Modularity**—separating components of the business so a failure in one part does not cascade to the whole

- **Adaptability**—having the ability to rapidly adjust to new circumstances by experimenting, identifying appropriate responses, and amplifying them throughout the organization

- **Embeddedness**—aligning the business's goals with those of partners and communities, which makes external cooperation and support more likely during a crisis

For example, Airbnb's resilience enabled it to recover faster from the COVID-19 shock than its peers. Like most travel and lodging businesses, Airbnb was severely hurt by the crisis initially, seeing its bookings fall by nearly 80%. However, whereas traditional hotel chains offered large buildings in city centers, Airbnb had a diversity of rental options—including more spacious or secluded offerings that rose in demand while traditional tourist locations fell. Additionally, the company adapted rapidly to the new circumstances, launching new campaigns to raise awareness of an expanded array of remote offerings and adopting new safety precautions. As a result, it recovered more than half of its lost business by the end of 2020, well ahead of many peers.

Building resilient businesses will require a new mindset for many leaders. Instead of focusing exclusively on maximizing efficiency, resilience involves building new capabilities that may come at a short-term cost. And instead of managing short-term shifts in performance, resilience requires a focus on consistent long-term value creation and a balancing of short-run efficiency against long-run effectiveness.

2. Digitize for Advantage

Before the pandemic, digital technology was a primary driver of growth. Financial markets were increasingly dominated by technology companies, and organizations across all industries were engaged in efforts to digitize. COVID-19 massively accelerated the digital agenda; e-commerce adoption sped up and many companies announced permanent remote work policies, among other shifts. In the Fortune Future 50, our ranking of public companies with the greatest capacity for sustained long-term growth, more than half of the world's top firms are in technology industries, and tech capabilities are a key factor in other industries as well.

However, digital transformations are by no means straightforward—most such efforts fail. One trap is to confuse efficiency or new functionality with competitive advantage, leading companies to digitize and streamline existing processes without taking opportunities to revamp the business model. Another trap is to separate insight and action; cutting-edge data and analytics systems can add only limited value if they are not connected to decision making. Yet another trap is to focus on digitizing only the internal workings of the company, eschewing opportunities to tap into external capabilities.

Underpinning many of these pathologies is the fact that the advantage created by any particular product or business model is shorter-lived today. Companies therefore need to pursue dynamic advantage, based on continuously learning, adapting, collaborating, and shaping environments. A transformative digital agenda should therefore pursue capabilities to achieve those goals. This involves using sensors and nontraditional data sources to expand the organization's powers of perception; applying AI to expand the organization's powers of cognition; connecting data and AI systems to autonomous decision engines that can expand an organization's capacity for adaptation; and leveraging digital platforms to enhance powers of collaboration through digital ecosystems.

For example, the Chinese insurer Ping An was founded in 1988 as a traditional insurance company, but it recently transformed to become a digital leader. The company created a wide variety of digital services to build customer relationships and generate data; it invested heavily in AI; it connected customer databases throughout the business with AI systems and decision platforms; and it formed collaborations, such as a digital joint venture with Alibaba and Tencent, to enhance its capabilities further. These capabilities helped it become the world's most highly valued insurance company.

As companies digitize, it is just as important to refocus human cognition on areas that will create synergies with technology. While AI can find patterns in data at massive speed and scale, humans remain distinctly advantaged at diagnosing underlying causes (for example, decoding the impact of long-term trends) and imagining new possibilities (for example, creating brand-new offerings to serve new customer needs). Humans also have a unique role to play in innovating the governance and ethical models for an algorithmic age. And humans alone can articulate the social purpose and ethical values of an organization. By combining human and machine capabilities synergistically, leaders can create new types of organizations that advantageously combine the powers of machine and human cognition.

3. Address the Bottlenecks to Effective Climate Action

Climate change is already affecting companies and societies, and if not urgently addressed, it threatens to undermine the broader economic, social, and political systems upon which business depends. It is now widely agreed not only that societies need to take action but also that businesses have an important role—they are large, powerful actors; they span national boundaries; they are good at making change happen; and they can counterbalance the limited ability that governments in many regions have to act.

Indeed, many companies have announced commitments to address climate change. Yet the numbers say the scope and speed of pledges are insufficient to match the urgency of the problem—outcomes are still headed in the wrong direction. To overcome the bottlenecks to prompt, sufficient action, leaders need to take several important steps to escalate efforts.

Increase ambition and urgency. Greater commitments and faster progress will be required to sufficiently address the challenge of climate change. This is likely to involve increasing the scope of businesses' efforts—decarbonizing not only their own organizations but working to reduce emissions across their full supply chains and ecosystems. And it will involve moving beyond reporting and transparency, putting greater focus on actions that can be taken to solve the problem.

See constraints as opportunities. If climate action is conceived as a necessary burden, that tends to promote a mindset of incrementalism and minimum viable action. But emissions reduction is not just a burden—it will also present opportunities for the businesses that solve problems first. This might manifest in a reduction of long-term risk, such as the negative impacts of climate regulation or the possibility that existing assets lose viability. It could also manifest in more immediate value creation in the new markets that are now emerging for lower-carbon products and technologies. Framing the climate challenge as an opportunity can unleash creativity for bolder, more imaginative solutions.

Reimagine business models. Sustainability is still often treated separately from core business strategy, and it often assumes the status quo business model—but taking sufficient action will require integrating sustainability and strategy. To do so, leaders need to apply "sustainable business model innovation," which aims to reimagine business models to co-optimize for business and societal benefits. This involves testing the sustainability limits of the existing business model as it scales; applying modular innovations to address the identified bottlenecks; linking those innovations to business advantage; and scaling solutions across the business and beyond.

Shape the landscape. Leaders can wield influence beyond their own organizations to shape the business context in ways that accelerate progress. This might involve supporting or encouraging legislation that shifts the playing field in favor of climate action. It might involve creating new sources of information, such as improved reporting standards, to better align beliefs about the scale of the problem and the progress made against it. And it may include innovation in capital markets to create global signals and pricing mechanisms that can guide resource allocation.

Foster collective action. Climate change is often framed as a "prisoners' dilemma" in which individual actors cannot coordinate effectively. But this is not necessarily the case—bottom-up collective action can transform the game into one that can be addressed cooperatively. Coalitions of companies can create conditions that incentivize action, such as by instituting industry standards or regulation, or by signaling that there will be critical demand for solutions. Seven of the ten largest companies in the world leverage vast, global, digital ecosystems, but the governance agenda of these new structures is still ill-defined. Rather than waiting for a seemingly inevitable restriction of the power and influence of the largest ecosystems, leaders can preemptively seize the initiative to deploy these new structures toward collective action on our biggest common problems.

For example, Walmart's Project Gigaton initiative aims to avoid a billion metric tons of greenhouse gas emissions by reducing energy use among its suppliers and partners. The company did not impose specific standards but instead encouraged partners to set specific and achievable emission reduction goals and established forums for convening smaller suppliers.

As the post-COVID world emerges, leaders will need to shift their attention back to longer-term challenges. By building resilience, digitizing for advantage, and supporting collective action on climate change, leaders can put their businesses in position to succeed in and help shape the new reality.

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