Navigating opportunity & risk in today's boardroom

A report from the
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Executive summary

With a fast changing geopolitical environment of increased regulation, rapid digital innovation, market convergence and transforming customer behaviour, boardroom decision-making requires a higher tolerance for and comfort level with risk than ever before.

Nothing has demonstrated this more powerfully than the UK's vote to leave the European Union. The implications of the decision will take months and even years to work through.

The Brexit vote may have thrown everything up into the air for UK business, uncertain about where and how the pieces will land – but the truth is, there were already divergent views about growth and economic prospects even before that historic vote.

This report draws on research, conducted pre-Referendum in April and May 2016 amongst 200 mid-market company executives, which reveals that while businesses were on average narrowly exceeding their performance targets, there were significant concerns about the economic outlook and so strategic ambition was edged with caution.

We challenged these company directors to reveal how they manage to navigate between opportunities and risks to get comfort around making decisions with imperfect data, allowing their business to respond to market change in a responsible, agile and controlled way.

Clearly among listed companies there is pressure from stakeholders for the board to be both confident and bold in pursuit of increased market share, while also managing the associated risks. In fact, when we asked these c-level executives to rate how ambitious they believed their current business strategy is on a scale of 1 (not at all) to 10 (extremely ambitious) they give an average score of 7.2.

Such a score feels respectable but perhaps underwhelming. This somewhat cautious approach would appear to be closely related to concerns about the changing geopolitical macro environment with 'economic uncertainty', the 'need to make the strategy acceptable to shareholders and investors' and 'regulation or legislation' being highlighted as the top deterrents to strategic ambition. And if there were concerns back in April and May, one can only speculate how hugely they will have become accentuated now, in the post-Referendum climate.

Routes to growth

When asked which strategies were most likely to deliver transformational growth, respondents selected 'business acquisition or merger' and 'investing in technology' as the key priorities. But there was also a tendency towards generally safer options like 'launching new products/services' and 'capital investment'.

The results suggest that despite executives being aware of where the opportunity for transformational growth lies, the associated risks may be holding them back from making bolder decisions.

So how should executives navigate through this territory – which has now become even more difficult given Britain's Brexit path?

Connecting the dots

Risks can be broken down into two essential categories, the internal risks that are within leadership's control to mitigate and manage; and the broader, external risks that need to be factored into any medium to long term business decision-making.

From an internal perspective, boards have to be clear where to focus their internal governance and processes in order to manage vulnerability around issues such as supply chain, data privacy, tax transparency and employer responsibilities. Understanding the barriers to being bolder and tackling those key opportunity areas is the first step.

We found that internal factors such as 'the need to make the strategy acceptable to stakeholders', 'finding the right time' and a 'lack of appetite for risk in the boardroom' all play a part in holding back decision making.

However, in today's climate, the external risks and barriers are just as significant: nearly a third (31%) of directors indicated that uncertain economic conditions are constraining strategic decisions and 24% said that regulation/legislation is having the same effect.

The winning organisations are likely to be those that don't look at individual risks in isolation, but are able to join the dots and see the interconnectivity between them. It's only by gaining an end-to-end view that businesses can tackle issues robustly and sustainably.

Those that can do this will have a solid base from which to also go after the opportunities that undoubtedly exist.

Times of change are times of opportunity as well as threat

Our research found that there was a direct positive correlation between those with the greatest ambition and those who achieve the best financial performance.

This is confirmed by the findings of the KPMG Global CEO Outlook Report 2016 which surveyed over 1200 CEOs around the world (also pre-EU Referendum). In specifically looking at the results relating to the 150 UK CEOs who were interviewed we see a more optimistic picture with 89% reporting growth over the previous three years and 72% expressing confidence in growth in the UK economy in the next three years. 96% planned to increase headcount and the overseas markets thought to have the greatest potential were the US and India.

In this research cyber security was considered the greatest concern of CEOs and 88% were worried about maintaining customer loyalty. More information can be found at www.kpmg.com.

So for now the question is, can businesses negotiate the momentous changes taking place around them and, through sophisticated risk management and calculated ambition, come out stronger than before?

Strategic ambition battling with uncertainty

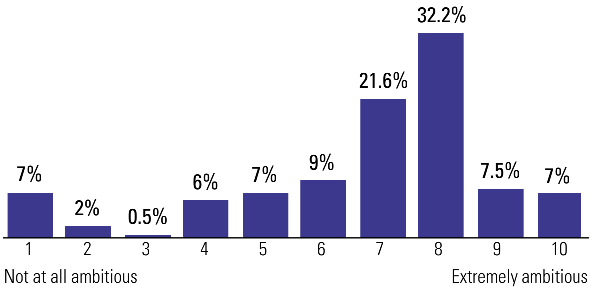
Business may be wrestling with uncertainty like never before in the wake of the Referendum result. However, our research conducted a few weeks prior to the vote shows that a climate of uncertainty already prevailed, albeit on a much lower scale.

This was evidenced by the fact that, when asked how ambitious their company's strategy is, executives rated themselves somewhere in the middle. If a score of 9 or 10 would be unequivocally ambitious and a score of 5 or less would be risk averse, then the average score returned of 7 out of 10 suggests that companies were, to some extent, hedging their bets both ways.

Looking at it through a positive lens, the average score of 7 does suggest reasonable ambition amongst mid-market boardrooms. All of the uncertainties and unknowns that businesses are operating in has not – or had not - killed off the corporate instinct for growth and success. And, indeed, nearly a third of respondents (32%) gave themselves an eight.

But less than 15% of executives returned a 9 or 10, while one in ten business leaders plumped for a rock bottom score of between 1 and 3.

How ambitious is your current business strategy?



And what would that score be now, were executives to be polled again post-Referendum?

That may be a question for another day as the post-Brexit landscape becomes clearer.

What have the main barriers to strategic ambition and growth been over the last three years?

It may come as no surprise to learn that the biggest deterrent was seen as the uncertain economic outlook (31%). This was closely followed by the need to make the strategy acceptable to shareholders and investors (26%) and by regulation or legislation (24%). These three factors stood out clearly at the top of the list.

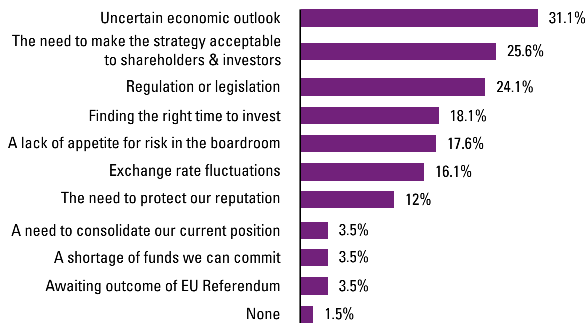
What may come as a surprise is that waiting for the outcome of the Referendum (the research having been conducted in the spring of 2016) hardly featured – only 3.5% of respondents mentioned it. It may be that many respondents saw the Referendum as being included or implied within an 'uncertain economic outlook' in any case. But the extent to which it was not seen as a separate risk of its own was perhaps surprising – and maybe indicated that most business leaders were not seriously contemplating the prospect of a 'Leave' outcome.

Meanwhile, nearly a fifth of business leaders (18%) admitted that a lack of appetite for risk in the boardroom had been a key barrier.

It is an understandable response to uncertain times to 'batten down the hatches' and concentrate on maintaining position, managing risk and safeguarding reputation – but does this mean that opportunities for growth are being missed?

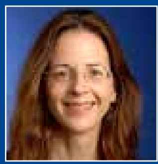
Overall, the picture that emerged was of UK plc in relatively conservative and cautious mode – something that will have been hugely multiplied now.

In the past three years, which of the following have been significant deterrents/barriers to your strategic ambitions and growth?



Point of View

Yeal Selfin, Head of Macroeconomics at KPMG in the UK, comments on uncertain times ahead



Yael Selfin
Head of Macroeconomics
KPMG, UK

What was already looking like quite a tricky outlook for business has just become enormously more complex and difficult: Rubik's Cube becomes Gordian knot. The Brexit vote will see the UK economy navigating in extremely turbulent waters over the coming months, as the initial shock waves touch all parts of the UK economy and reach much further afield.

In the short term, the thick fog of uncertainty will make it hard for businesses to plan beyond the immediate horizon, while the price of a journey with an as yet unknown destination will take a heavy toll on the economy. We could see UK GDP growth, at a minimum, 0.5% to 1.5% lower on average than if the vote had gone the other way.

In the longer term, a lot will depend on the path the UK succeeds in carving for itself, whether it chooses to sail the seas alone or manages to join a flotilla of like-minded others to make its prospects stronger. However, the economic impact will be significant under most outcomes, with UK GDP potentially 4% to 6% lower by 2031 than if the UK had voted to remain in the EU.

Businesses need to reassess priorities and adjust for fresh realities in terms of new tariffs and other trade restrictions, pressures on wages and labour availability, and a deterioration in public finances. It's vital that businesses think beyond just themselves. Even if they think they won't be heavily affected directly – what will this mean for their supply chains, and how could that impact them?

It will be a mixture of risks and opportunities. A weaker pound means imports of materials and goods will become more expensive. But there could be opportunities and upsides for exporters to grab.

Then there are companies' employees. Staff from overseas may not want to stay in the UK long term, worrying that they may not have a permanent future here anymore. This will be a concern for many businesses.

Will consumers now tighten their belts, trade down, spend less?

Consumer reaction will be hugely important too. Revenue from consumers is usually very sensitive to the economic cycle. Will consumers now tighten their belts, trade down, spend less? Then there is the wider, international picture. In Europe, the impact so far looks like it will be less dramatic than in the UK and we now expect GDP growth to fall to about 1.5% in 2016 and a bit lower in 2017, compared with earlier expectations of 1.7% GDP growth over the next two years.

But still, in reality the impact is difficult to call. Much will depend on the progress of exit negotiations with the UK, and the implications of those. Market reaction will be key. In the US, they are likely to become increasingly preoccupied with their presidential election in November. China meanwhile is already grappling with a slowdown in its economy and a strengthening dollar is making life harder.

There are all sorts of uncertainties, therefore, right across the world. It's going to be a rollercoaster ride for businesses.

The key thing is to think hard about what the most likely implications of Brexit are for the business and its customers and plan accordingly. Business leaders need to have a number of scenarios that they have thought through and are as ready for as they can be.

Investment in technology tops the agenda, but M&A could be the way to go

– companies are still looking to grow, organically thorugh the launch of new products and services and inorganically through M&A

When asked about the top priorities in executives' current three year strategy, one area stood out clearly at the top – investing in technology (52.5%). In today's rapidly evolving world where technology increasingly drives and dictates business performance and consumer interactions, this comes as no surprise. Indeed, it's reassuring that executives recognise the extent to which digital capabilities are critical: it would have been concerning had technology not come out at or very near the top.

Not far behind technology came two more traditional mechanisms for driving growth: launching new products and services (44%) and M&A (42%). Only just behind these were two further priorities, one traditional (capital investment, 39%) and one more newly emerging (customer focused operational transformation, 38.5%).

There is an interesting mix, then, of the old and the new in executives' top five priorities. Investing in technology and customer focused operational transformation are in a sense two sides of the same coin – it is through technology that the ability to put customer needs and expectations at the heart of operations will be effected.

But the route to growth is by no means only about digital transformation. M&A will always feature in the mix, as will the need for funding and investment. While any business that does not keep renewing and refreshing its product/service offering will most likely only stagnate.

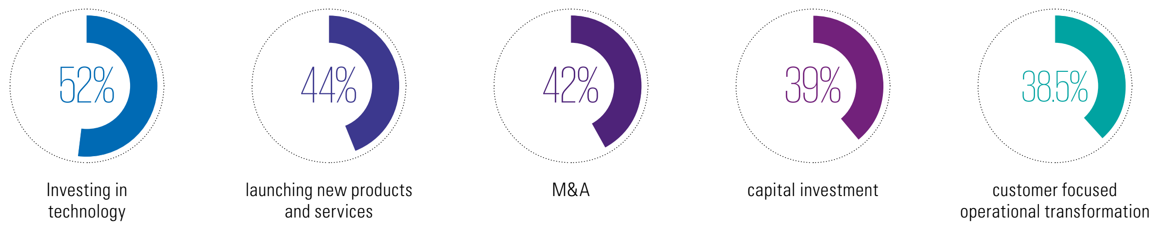
The enduring importance of M&A was underlined by the fact that, when asked which measure had the greatest potential to actually deliver transformational rather than incremental growth, it was M&A that came out on top, pushing technology into second place. For many, then, deals are still the fastest route to growth – though clearly, any deal needs to be the right one if it is to deliver success.

It's also interesting to look at what did not feature as top priorities. Simply increasing headcount was near the bottom (11.5%) – although the more focused goal of headhunting the best talent was much higher up (27%). Meanwhile, media organisations might be concerned to see that increased advertising only featured as a priority for 8.5% of business leaders.

Clearly, in a multi-channel and fast-moving marketplace merely hiring more people and buying public awareness are no longer seen as solutions for competitive success. It has become more complex than that.

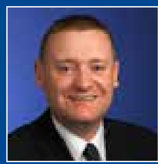
Executives' appreciation of the new breed of challenges facing them can be seen in the fact that nearly a quarter (22.5%) listed cyber security and supply chain optimisation amongst their top areas of focus. Whilst cyber resilience is a defensive rather than proactive growth measure, it is nevertheless a pre-requisite given the ever-present threat to corporates of all kinds. Enhancing supply chain efficiency and linkages, meanwhile, is a critical factor in delivering the technology and customer focused transformation that executives crave.

Top priorities in executives' current three year strategy



Point of View

A view from Warren Middleton, Partner in Risk & Management Consulting at KPMG in the UK



Warren Middleton
Partner in Risk & Management Consulting

These results certainly reflect what we're seeing in the marketplace. Clients across sectors are concerned with enabling a better customer experience through technology, providing greater connectivity and a more customer-focused proposition. Technology enables them to both deliver a better service and understand and measure customer data in much greater depth. Mobile apps and platforms, cloud-based solutions – these are at the heart of driving up innovation and responsiveness. Data privacy and cyber security are very real concerns but many of our clients are on the front foot, building cyber resilience not only into their own organisation but also throughout their supply chain.

Technology is feeding into other areas too – such as launching new products and services. Companies are using technology to help them do that, to better understand customers in order to package products and services based on a more holistic view. We're also seeing more white labelling of products through joint ventures and partnerships. This is especially widespread in Financial Services, for example.

The notion of partnership is also important in supply chain optimisation, which is crucial if operational transformation is going to work in practice: companies are recognising that they need better sight not only of their own supply chains but of their partners' chains too.

We'd already been seeing something of a slowdown in activity as the Referendum drew nearer and companies became more cautious

It's no surprise that M&A featured highly – it's always going to be part of a company's arsenal. But as well as M&A, we've been seeing a lot of the flipside – disposals, with organisations selling off unprofitable non-core areas or 'old world' parts of the business, in order to invest in the acquisition of more 'new world' digitally driven assets.

But where will M&A go now, post the Brexit vote? We'd already been seeing something of a slowdown in activity as the Referendum drew nearer and companies became more cautious.

At the moment, it's very hard if not impossible to read the future. Doubtless there will be a period in which companies take stock of the seismic events unfolding and wait to see how the political dust settles. Deals could be significantly depressed for some time – but on the other hand if a target's share price drops due to Brexit concerns it could present new opportunities for some, keeping deal activity alive. We will just have to wait and see.

Calculated risks, strategic confidence

As we have noted, it's the heavyweight factors of the uncertain economic outlook, the importance of keeping shareholders and investors on board, and the tightening regulatory environment that are the top barriers to companies achieving growth.

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But in the light of this, how have companies actually been performing against target?

Just as executives were largely held somewhere in the middle in terms of ambition, so performance has been holding up – but not much more than that.

Overall, executives reported that they had narrowly exceeded turnover target in the last financial year, with an average score of +1 (on a scale of -5 to +5). The bulk of companies sit somewhere between +3 and -2 against target. Around one in ten companies are outliers at either end, with 10% at +5 and just over 10% sitting between -3 and -5.

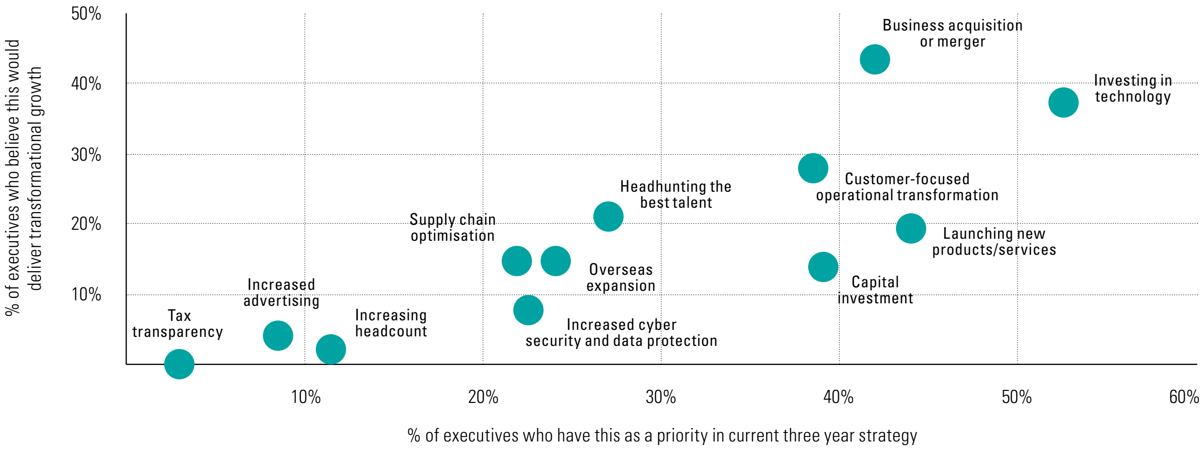
On the positive side, it is encouraging that even in a challenging climate, a significant percentage of businesses have been managing to outperform their targets. And given that companies on average say they are being reasonably ambitious (7 out of 10), this is a commendable achievement.

But the fact remains that this outperformance is largely modest. +1 on a scale of 1 to 5 hardly sets the pulse racing. More worryingly still, nearly four in ten executives admit that their company has missed its own revenue goals.

Clearly, there is more that most companies could do to unlock transformational performance and growth. Our research found that the more ambitious an organisation's strategy is, the more on average they outperform their targets. Have they simply been behaving too cautiously in the light of the prevailing climate – or have they been trying to take advantage of opportunity but going about it the wrong way?

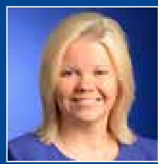
For now, though, the landscape has changed. Whether companies will push themselves harder to be more ambitious, given the outcome of the Referendum, must be heavily in doubt until conditions have stabilised and a new roadmap has been drawn.

Comparing current strategic priorities with those which are believed to offer transformational growth



Point of View

A view from Katie Clinton, Head of Internal Audit for KPMG in the UK



Katie Clinton
Head of Internal Audit KPMG, UK

I think it's clear that, since the financial crisis, organisations have developed a reasonable handle on the risks to which they're exposed. The need to protect reputation, the imperative of keeping shareholders and other stakeholders onside, the obligation to meet ever-tightening regulatory requirements – all of these things have become ingrained in corporate consciousness.

But there's a sense that companies have perhaps been missing out on some of the potential upsides. They have become more adept at mitigating and managing risk – but have they also been keeping alive to the opportunities?

Of course there has been a general wariness given the range of uncertainties. The Referendum was part of this as it got closer. And clearly, given the result of the vote, uncertainty has risen exponentially now. Companies' grip on dealing with risk will certainly be put to the test. But it's something that I believe they are equipped to deal with.

As enormous as Brexit is for us here in the UK and Europe, there were already wider factors at play: the economy is uncertain globally, as evidenced by the slowdown in China. Add to that geopolitical uncertainties such as Russian adventurism and the increasing terrorist threat internationally, and we already had an extremely difficult climate to bet on.

For me, the key thing is for companies to map out the interconnectivity of the risks they're faced with. Risks are most potent when they combine with other risks, for example a regulatory risk linking to a reputational risk or a competitive threat.

Once you have mapped out and understood that risk landscape, you're in a much better position to act positively. There are upsides associated with change, not just downsides. In a world where digital is ever more central and where new disruptive technologies are constantly emerging, the market convergence and changing customer behaviours that come with it are opening up new avenues of possibility.

Pre-Referendum, most companies' report cards would probably have read 'doing OK at the moment' – they were on average just exceeding their turnover targets and they harboured respectable levels of strategic ambition.

Now, with the stakes dramatically raised, it is those businesses who can really put their risk management experience into practice – and remain attuned to opportunity too – that will be best placed to ride out the crisis and even strengthen their market positions.

Key takeaways for your boardroom agenda

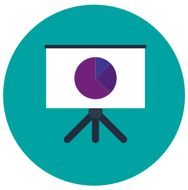
Business requires imagination to make the most of opportunity. Can you see the upsides just as clearly as the risks?

1.

Brexit

42 years of accumulated decision making will be turned on its head. Your competitors will be facing similar turmoil, so look for opportunities for relative advantage. Have you been through your business from top to bottom and identified all the areas of potential? Where are your competitors more exposed than you? By getting a better understanding of your business and your supply chain, being able to act faster might mean getting one step ahead of your opponents.

2.



Growth

An economy growing less quickly provides opportunities to those who can take advantage. Those who can offer better value for money may see significant growth as their customers seek to reduce costs.

3.

M&A

What about deals – who is now in range? That might include your business, so perhaps you need to consider defending yourself from a hostile takeover. Is now the time to revisit the acquisition scanning? Or does now provide the perfect time to divest areas? If risk is priced in, why not exit now if the sell story makes sense?

4.

The customer journey

Will the current fast-changing environment affect the way your customers deal with you? Just as you are reviewing your business from top to bottom, so too are your customers as it is easier than ever to compare products, services and prices. What will they find? How can you use this as an opportunity to secure your customer loyalty and expand your market share?

5.

Digital

Is your business digitally optimised? Are you maximising the potential of mobile technology, the cloud and other digital channels to deliver greater efficiency, better meet customer needs and help your people be more effective? Innovation and investment in technology should be a core element in your growth strategy.

6.

Cyber

Every company is at risk from cyber attack – but by minimising the risks you also have an opportunity to gain competitive advantage and strengthen your market position. What can your board do to ensure the business is adequately equipped to prevent and respond to cyber incidents? With ever-longer and more complex supply chains, your third-party partners and suppliers could represent a weak link. How can you build cyber resilient supply chains which work collaboratively to respond to cyber incidents?

For further inspiration for your boardroom agenda visit **www.kpmg.com/uk/boardroombites**

For the latest guidance on Brexit visit **www.kpmg.com/uk/brexit** and register on the KPMG portal for regular updates.

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