A Study of Risky Business Outcomes

EMERALD STUDIES IN GLOBAL STRATEGIC RESPONSIVENESS

Series Editor: Torben Juul Andersen

Recent Books in Series:

The Responsive Global Organization: New Insights From Global Strategy and International Business
Edited by Torben Juul Andersen

Strategic Responsiveness and Adaptive Organizations: New Research Frontiers in International Strategic Management
Edited by Torben Juul Andersen, Simon Torp, and Stefan Linder

Adapting to Environmental Challenges: New Research in Strategy and International Business
Edited by Torben Juul Andersen and Simon Sunn Torp

Strategic Responses for a Sustainable Future: New Research in International Management
Edited by Torben Juul Andersen

Navigating Corporate Cultures From Within: Making Sense of Corporate Values Seen From an Employee Perspective
By Michael Jakobsen and Verner D. Worm

Responding to Uncertain Conditions: New Research on Strategic Adaptation
By Torben Juul Anderson

A Study of Risky Business Outcomes: Adapting to Strategic Disruption

BY

TORBEN JUUL ANDERSEN

Copenhagen Business School, Denmark

emerald PUBLISHING

United Kingdom – North America – Japan – India – Malaysia – China

Table of Contents

This page intentionally left blank

List of Figures and Tables

Figures

Tables

About the Author

Torben Juul Andersen is Professor of Strategy and International Management and Director of the Global Strategic Responsiveness Initiative, Department of International Economics, Government and Business at the Copenhagen Business School, Denmark.

Preface

More than five years ago, we were contemplating the need for further studies to help us better understand how organizations, or firms, respond to rapidly changing environmental conditions often interrupted by extreme unexpected events. Indeed, the beginnings of the *Emerald Studies in Global Strategic Responsiveness* book series emerged from a similar urge to uncover how responsive global organizations could adjust and adapt their business operations across multiple overseas markets as they deal with unpredictable changes in the turbulent reality that describes the global marketplace.

In recent years, we have seen these turbulent conditions excel as international business activities have been affected by several abrupt and largely unexpected disruptive incidents including a pandemic, a major military conflict, and mounting geopolitical tensions. Hence, we have observed a general development toward global business contexts characterized by radical uncertainty with many unknown factors in play that call for new and more effective ways to deal with the changing risk landscape. As the recent incidents of pandemic and war have demonstrated, most institutions were not prepared for the ensuing chaotic, uncoordinated, and somewhat divergent approaches adopted typically influenced by national political interests. Hence, we continue as societies to struggle with ways to deal with the severe economic ramifications imposed by these events including the formation of resilient global supply-chains in a world of increasing regional tensions while dampening the intermediate effects of inflationary pressures not seen for decades. In short, the challenges foreseen a few years back have not diminished but have rather exacerbated.

Back then, we noted how organizations operating in the global economy were exposed to a daunting array of possible risk events including fiscal crisis, cyberattack, social instability, governance failure, and an increasing frequency of extreme weather incidents. In view of these challenges, some organizations were noted as adjusting better to the changing conditions and thriving under adverse odds whereas many others, maybe most, had a hard time adjusting. This fundamental issue inspired the formulation of a research project attempting to better understand how the observed performance differences were related to strategic response capabilities and expected adaptive outcomes. It was observed as a regular empirical artifact that over given time periods several firms would outperform their peers competing under comparable business conditions and generate favorable performance outcomes whereas a vast number of the firms seemed to produce often extremely poor financial returns. While these extreme occurrences often are overlooked in mainstream management studies, we thought they might provide some interesting insights. Hence, we attempted to study this phenomenon closer to gain more insights about how competing firms and organizations respond and adapt when they are exposed to adverse conditions that at times are inflicted in the form of sudden unexpected events. So, the project attempted to fill an apparent gap in our understanding of how the common contours of realized economic performance come about.

Other motivations include the seeming increase in extreme environmental events of various kinds that generate many surprising disruptions and strategic discontinuities that largely went unnoticed before. This means that contemporary business environments present complex and dynamic contexts where many extreme events may arise that are difficult to predict and therefore notoriously hard to respond to. Hence, it may be difficult for otherwise successful firms to observe ongoing changes and orchestrate effective responses to major shifts in the competitive environment, which in turn may have an adverse effect on their economic fortunes. These characteristics could explain the observed performance data of few over-performers and many underperformers. They also accentuate concerns for strategic adaptation whereby organizations can adjust to gain a better fit with the changing business environment over time where we need a better understanding of the adaptive processes that may lead to the extreme observed outcomes. Hence, the study aimed to develop a deeper understanding of the phenomenon with few high-performers and many extreme negative outcomes typically observed in the empirical data. The insights derived from the study should ideally help organizations increase their awareness of strategic adaptation and improve their response capabilities to gain better adaptive outcomes with stronger performance avoiding downside losses while thriving from an ability to exploit emerging opportunities.

This four-year research effort eventually received financial support from the Independent Research Fund Denmark (Danmarks Frie Forskningsråd Grant #8019-00046B) with the formal title: Risky Business – Managing in a world with extreme exposures (2019–2022). We acknowledge and appreciate this support that made the ensuing reporting of findings possible.

The project name, Risky Business, also the title of a (famed) Tom Cruise movie (1983), and as the movie hints, risky events and circumstances also present opportunities, even if partially self-inflicted, but we know too little about how firms can take on risky initiatives and exploit them to their advantage as the external circumstances change. So, the research project was inspired by an urge to better understand the regularly observed fat-tailed distributions of financial returns across firms, where many of them underperform but a few excel displaying higher performance with lower performance risk. Hence, implicit in this effort was an aim to better understand why some firms appear to adapt rather well to extreme exposures consistently outperforming their peers in the industry when many more of the firms underperform with a substantial number of them posting extreme negative returns.

The project collected extensive datasets for all registered European and North American firms over the 25-year period 1995–2019 which spans diverse economic scenarios of global expansion, recession, and recovery up until the COVID-19 pandemic in 2020. The analyses of both datasets reproduce the extreme left-skewed performance distributions with small positive tails of high-performers across different geographies, industrial sectors, and time intervals. More refined analyses of complete datasets show how the left-skewed returns are associated with negative risk-return relations as high-performers generate superior average returns at lower variation in returns. It is further shown that unfavorable risk-return outcomes are related to overconfident executives whereas high-performers retain a high degree of investment flexibility.

These results resonate with propositions arguing for the advantages of interactive decision-making processes where executives use frequent dispersed insights to update ongoing strategy deliberations expressed in a quantitative model. This strategic responsiveness model is used as a basis to perform computational simulations that show how it can produce empirically observed negatively skewed performance distributions and inverse risk-return relationships. Hence, the studies altogether indicate that interactive collaborative decision-making processes can drive effective strategic adaptation to extreme exposures.

The book presents some of the key findings from this four-year research program conducted between 2019 and 2022 investigating the commonly observed left-skewed distributions of financial returns based on reported accounting performance.

As international economic actors struggle to make necessary adjustments that align their transnational production structures and global value-chains with the evolving political reality, it is clear that multinational organizations must improve their ability to deal with uncertainty and abrupt events. This also includes concerns about increasing demands to deal with potentially extreme weather effects from climate change influenced by ongoing degradation of the natural environment, for example, CO_2 emissions, waste, and pollution. Hence, it is becoming apparent that organizations are incapable of resolving these challenges on their own but require collaborative solutions for sustainable long-term outcomes. We hope that this monograph of sequentially ordered book chapters provides relevant insights to current thinking about strategic adaptation, needed response capabilities, and the formation of resilient organizations within the global economic systems.

The nine chapters that constitute this monograph are included as standalone contributions although they emerge as sequential presentations much in line with the planned progression of the research project. This should provide for flexible use of individual chapters while presenting progressing insights that lead to a conclusion to the extent such is possible. Nonetheless, we hope this can contribute with some interesting and insightful reading.

Torben Juul Andersen
Frederiksberg, March 18, 2023