THE
BOARD
MINDSET™

The vital attribute of exceptional boards

DISRUPTION ISN'T OPTIONAL

MBA students learn to use the Expected Monetary Value (EMV) to evaluate risky opportunities. An individual's reaction to risk, however, is far more complex. In fact, individuals seldom consistently fall neatly into the *risk neutral*, *risk averse*, or *risk seeking* categories. We vary in our reactions, depending on the situation and myriad other factors in our lives. Often senior leaders, board members, economists, and analysts treat *risk aversion* as a preference, but at other times, they act as agents for and champions of change.

For example, after directors anticipate the value they can expect an investment will yield at some time in the future, they calculate this value by multiplying each of the possible outcomes by the likelihood each outcome will occur and then summing all those values. By gauging expected values, investors can choose the scenario most likely to give the desired outcome.

Scenario analysis uses estimated probabilities to examine possible outcomes for a proposed investment. This approach also helps investors determine whether they are taking on an appropriate level of risk given the likely outcome of the investment.

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Sound complicated? It is. In trying to identify all the risks a firm faces, directors can turn risk management into an overwhelming, paper-processing, statistical exercise that distracts them from focusing on the decisions that really matter—the strategic ones that define the firm's success or threaten its existence.

When they don't grasp the assumptions and limitations of complex and costly ERM tools and models, these directors operate under a false sense of security. Some of them might even consider themselves innovative thinkers. However, few companies have been bold enough to introduce genuinely disruptive innovations—the kind that results in the creation of entirely new markets and business models. To do so requires them to improve their abilities to spot risks, evaluate them, and then grow *because* of them not *in spite* of them. Boards have access to big data, but they too often lack big judgment.

John Steinbeck said, "Change comes like a little wind that ruffles the curtains at dawn, and it comes like the stealthy perfume of wildflowers hidden in the grass." Change may come to individuals like that, but in most organizations, disruption is more like a tornado than a gentle wind. The COVID pandemic disrupted business as usual, but there's nothing new about disruption. Demands of the marketplace, the accelerating pace of globalization, innovative technology, and new alliances all have created needs for leaders to help their people respond quickly and repeatedly to change. Responding to disruption will never be optional, but successful directors should realize that disrupting for the greater good has now become mandatory.