



# Managing Trade-offs: Prediction, Adaptability and Resilience

Here's the CEO and board agenda for the long "dance" of recovery from the Covid-19 crisis.

**By James Allen**

**James Allen is a senior partner in Bain & Company's London office and coauthor of *The Founder's Mentality*. He formerly led Bain's Global Strategy practice and helps lead our CEO Forums and Founder Summits, all of which have moved to virtual support.**

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Around the world, governments and business leaders are preparing for the “dance”—the long period of time from full lockdown through industrialized vaccination, when we’ll continue to coexist with the Covid-19 virus (what some are calling “adaptive recovery”). Even though customers and employees forgave companies for their shortcomings in the early, chaotic days of the pandemic, now they will demand that leadership teams quickly learn new dance moves and perform flawlessly. At the same time, executives will hope that owners expect less and give them time to master their footwork.

But there is good news: The steps that leaders take today will earn them the spotlight for years to come. Think about the crisis as a “dress rehearsal” for a new world. Before the curtains rise again, going back to work is vital not only to recovery, but also to enable teams to build on experience and retool for the future.

The CEO agenda has changed forever—especially during the long dance. Today, leading CEOs must focus on three “dance moves”: prediction (how to anticipate future scenarios), adaptability (how to respond better and faster to changes) and resilience (how to ensure that inevitable mistakes don’t kill the firm). These moves will enable companies to advance where they can, retreat as soon as they must and adapt as needed.

If organizations could truly master even one move, CEOs might have an easier job on their hands. Imagine, for example, if companies could impeccably predict the future—they wouldn’t need to be adaptable or resilient. But no firm will ever be perfect in one area. Success requires trade-offs. This balancing act has dominated our recent conversations with CEOs and their boards. And it is likely to intensify and monopolize government discussions as well: As political leaders weigh stimulus packages, they will seek to share the costs with the private sector. Echoing the 2008 financial crisis, they will demand that companies become more resilient.

Prediction, adaptability and resilience will each scream for 100% of CEOs’ money, time and attention. During the long dance, deciding how to allocate resources across these three priorities will be a critical part of the CEO and board agenda.

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## Prediction

The post-pandemic world will be more turbulent and less global. Governments will be more interventionist, but their policies will be less homogenous. Strong, local insurgent competitors will emerge more often (see, for example, “Consumer Products: Now’s the Time to Double Down on China”). This will require companies to empower more experimentation and business building at the local level. In addition, trends in digital and automation will accelerate rapidly and be unforgiving to laggards. The cost of the “middle” will become too high for most companies to sustain. For the organization, the “middle” includes middle management, regional span breakers and the endlessly negotiated roles of the global center. For the product portfolio, the “middle” includes propositions that don’t really compete in premium segments, solutions that don’t really delight customers, or channels that don’t really serve. Companies must become leaner and faster, so they can invest more effectively and respond quickly in a more disruptive world. Winning firms will be big *and* fast.

In this environment, the future of each company, industry and market will never be perfectly clear. Management teams must stop trying to anticipate the future with exacting precision. Instead, leading firms will prepare alternative scenarios and employ them when making investment decisions. They will collect information from diverse listening posts—including frontline employees and customers.

This approach to scenario planning was standard a few generations ago. But faced with decades of relative stability, some companies, even entire industries, have lost the art of true scenario planning (world-class tech companies, who flex their prediction muscles daily, are an exception). The purpose of scenario planning was *never* to accept scenarios “as-is,” but rather to identify the worst possible outcomes and actively lower the probability that they will occur. In this way, leading companies can shape the future that is best for them.

Enlightened boards, however, recognize that prediction is, at most, one-third of the issue. They also want to see how scenario planning translates into decisions around adaptability and resilience. Stakeholders will not give companies credit for accurately predicting several black swan events on slide 238 of the pre-read for the board meeting. They will demand that the executive committee actively considers a world full of darker swans.

## Adaptability

To build a more adaptable organization during the long dance, CEOs will need to navigate three related, yet distinct, courses of action: Avoid a snapback to old ways of working, create a learning organization and build new businesses.

## Avoid snapback

It's ironic that the lockdown has actually liberated CEOs: It forced them to circumvent governance, backward-looking strategic and financial reviews, and alignment processes. As a result, firms are now smarter, faster and more adaptable. CEOs love that their organizations are doing things that used to take months or years in a matter of weeks. And they want to sustain these new habits.

But at the same time, the organizational costs of this new way of working are mounting. It may not be sustainable: Key leaders are exhausted. Swaths of employees feel disempowered and isolated. They are keen to get back to the way things were before. The “war room” approach to crisis management, by design, only engages a small percent of the leadership team and can create fragility in parts of the organization—which ultimately hurts the firm’s resilience. For example, the pandemic has almost entirely shut down one company’s major global supplier for weeks. In the spirit of “doing whatever it takes,” a local team found several local suppliers to keep the factory running and products on the shelves. There wasn’t time to engage global procurement with their negotiating skills and benchmarks. The costs of these pricey local deals have destroyed margins. They’ve angered global teams, which negotiated lower-cost deals and now have other suppliers calling for the better deal. While the local team made the right call for customers in the short-term, there’s a lot to sort out when the dust settles. CEOs and war rooms have approved thousands of similar decisions for the right reasons. But there is a bill to be paid.

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Leading CEOs will address these organizational costs, and at the same time, prevent a return to old ways of working. One CEO described his approach: “I ask my people, ‘If we could bottle one positive behavior that you’ve seen during Covid-19 and distribute it across the company, what would it be?’ Then I ask, ‘And what would you stop?’ I’m ending every meeting with this, and it is so energizing. And I’ve got more than enough of their ideas now to stop snapback.”

Lockdown has not only liberated the CEO, it has also freed local leaders from top-down governance. Often asking for forgiveness, rather than permission, they've innovated, disrupted and bullied their way to solutions that surmount obstacles and serve customers.

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### **Create a learning organization**

One critical new way of working that CEOs must “bottle” is organizational learning through local experimentation and global scaling. Lockdown has not only liberated the CEO, it has also freed local leaders from top-down governance. Often asking for forgiveness, rather than permission, they've innovated, disrupted and bullied their way to solutions that surmount obstacles and serve customers.

In doing so, local teams have found support from the center. Some global leaders helped scale top solutions across the firm. They reimaged marketing and sales budgets overnight, showing the organization what costs are critical and what are dispensable. They solved huge supply chain issues, teaching the organization how to strengthen its operations.

In order to ensure that this burst of experimentation and learning doesn't become a historical oddity, leading CEOs will systematically protect the fundamental new relationship between global and local. They will set a clear agenda for the core business (or, as we like to call it, “Engine 1”): Continue the same pace of experimentation and learning throughout the long dance. The core will reform every way of working and reimagine every dollar, peso and rupee of the cost bar. They will question every sacred cow and put an end to many. Global champions will partner with local leaders to select and scale the best solutions. As one CEO noted, this global-local collaboration gives the firm direction: “I am always hesitant to say we need to ‘learn more’ from our experiments. What I say now is, ‘We need to learn how to prioritize and scale our experiments.’ That has given us focus.”

### **Build new businesses**

Finally, leading CEOs will focus the organization on building new businesses. Before Covid-19, business building was lost somewhere on the CEO's endless agenda. But in the long dance and turbulent world to come, it will be an essential survival skill for adaptable firms.

CEOs can start by liberating part of the organization with an “Engine 2”—their Engine 1 isn’t the right environment for nurturing new businesses. Engine 2 will have a single goal: Do whatever it takes to meet our most important customers’ needs during the long dance, no excuses. They will innovate, enter new categories and bet big on winning channel formats.

As they find success, Engine 2 leaders will bring lessons back to Engine 1, helping the entire company redevelop the capabilities and organizational processes of great business builders. With a “technology mindset,” they will ensure the center is more modular, distributed, redundant where it matters and supportive of plug-and-play business ideas from local teams. The company will function like an operating system with apps. For this to work, senior leaders will need to rediscover the insurgent values, or the Founder’s Mentality, that originally helped their young firm grow and triumph. And recruit and promote people who excel at identifying and scaling innovative ideas.

If the company can launch the next set of businesses that customers want now, it can thrive in any scenario. Meanwhile, companies without business building skills will be held hostage to a disruptive world.

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## Resilience

Often relegated to a back seat, the Covid-19 pandemic has brought the value of resilience to the forefront. CEOs and government leaders have paid the extraordinary price of underestimating its importance. Many firms built global supply chains for efficiency, shirking resilience. They worked incredibly well, until they didn’t. Firms built call centers for efficiency as well. And while they considered resilience to an extent, by building multinational options in India and Bangladesh, it still failed them. They didn’t pay for an additional buffer to ensure that call center employees could work from home.

As firms recover and retool from the pandemic, the rubber will eventually meet the road. Leading firms will have defined scenarios and worked hard to become big, fast and more adaptable in a changing world. They will make a series of investment decisions. But the defining question in their success will be, “Are those decisions resilient?”

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At the risk of oversimplification, resilient firms protect the investments that really matter, by working hard to avoid costly scenarios and building buffer capacity. To define their most important investments, their CEOs consider “swing values.” They don’t solely protect investments that drive returns. They also protect against scenarios that could cause dramatic losses. While we hedge against shifts in commodity pricing, for example, we don’t always apply this approach to our management strategy. The best CEOs will start the resilience debate by asking, “Based on swing value, what are the top 15 to 25 areas that will determine our future value?”

From there, leaders can move to avert costly scenarios. The leadership team will need predictions, to understand in detail the worst-case scenario for each of their important investments. Before the pandemic, we exercised these muscles for the tough investments—maybe a factory in Yemen or major bet on a new IT system. But even then, we didn’t fully assume turbulence. Going forward, too many leaders will continue to evaluate resilience on the assumption of a globalized world, slow-moving digital adoption and scale efficiencies in a stable marketplace. Winning firms, on the other hand, will question their biggest predictive assumptions and challenge themselves to consider the more turbulent world ahead. And leading CEOs won’t accept scenarios as objective truths. They understand that with no action taken, there’s a 33% chance that everything will go wrong—and will actively intervene to reduce that 33%.

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CEOs can also protect the investments that really matter by building buffer capacity through three broad areas: options, hedges and insurance. These aren’t simply financial instruments. Buffer capacity can include alternative suppliers, redundant technology systems or provisions that enable call center employees to work from home.



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In choosing the buffer capacity for investments, leading CEOs will understand the acceptable costs. Let's be clear: Buffer capacity is never free. Greater resilience will cost more. Following the 2008 financial crisis, banks faced more capital requirements from boards and governments. This cost money, most notably in declining return on equity.

But the cost of buffer capacity also doesn't need to be obscenely high—as it often appears to be. In fact, the costs only swell when the firm doesn't take action to prevent the worst-case outcome. When leaders present the astronomical, unmitigated costs of resilience to the board, they're forced to reduce the risk agenda. They can't afford to cover everything, so they focus on a very narrow set of scenarios and call the rest “black swans.” This is not risk management, it is abdication—and the fault lies with management.

Leading CEOs know that the costs of buffer capacity drop considerably when the firm is better at prediction, or real scenario planning with intervention. They know it will plummet with adaptability—which is why they want the firm to become a world-class business builder, with more modular, redundant and networked core capabilities. The winning firms of tomorrow will have an integrated agenda: resilience, with prediction *and* adaptability. CEOs will run it. Boards will demand it. And governments, once again faced with the extraordinary costs of private sector bailout, may start to regulate it.

CEOs can bring tremendous clarity to the firm by recognizing the interconnected nature of their agenda—across prediction, adaptability and resilience. But defining the agenda for the long dance, or the “what,” doesn't make it easy to fund or execute. It will be difficult to navigate and will require incredible investment. CEOs will have to determine “how” to reanimate the organization after lockdown, and do so in a way that enables, rather than hampers, retooling. In the near term, this will require deep work. This is your moment.

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