Digital Disruption & Transformation Risks

Center for Excellence in ERM
White Paper Series

St. John's University

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Digital Disruption and Transformation Risk Headlines

The headlines are eye-catching and perhaps a little scary:

- AI will displace 40 percent of the world's workers as soon as 2035
- 40% of companies will be dead in ten years
- Digital Disruption Has Only Just Begun
- AI helps cities predict natural disasters

- Dow Jones Digital Chief Helps Shape Massive Restructuring
- Models Will Run the World
- Old Money Billionaires are Chasing New Tech Riches.

While some spend time trying to define and identify exactly what is happening… one thing is clear: this digital disruption and transformation risk is real and it is important. Companies and leaders sense the risk and are reacting. What makes it difficult is distinguishing the hype from reality. Making that even more difficult is the fact that so much angel investor type money has moved earlier in the process, seeking companies and ideas before they ever go public. The result is that executives seeking to learn what others are doing must look elsewhere (other than public filings and public information). ERM leaders gathered at the Center for Excellence in ERM Fall 2018 ERM Summit to discuss what others are seeing, the impact of these disruptions, the associated risks, business changes, expectations, and how companies are responding.

It's Prodigious & Growing

The first issue addressed was just how real the digital disruption and transformation risk is to companies. Is it hype or do risk leaders think it is real? Figure 1 shows their belief – **85% of those surveyed agreed that digital disruption and transformation risk will have a *significant* impact.**[1] And it's not just that many are concerned about the impact. What also concerns risk leaders is that this digital risk may be at an early stage and getting even larger. One participant stated, "we may be barely half way there" and another noted that connected devices could grow from 12 billion in the world today to 50 billion in the near future. There was also concern at the Summit about how the digital change allows so many companies to compete in new areas (creating new previously unseen competition) by lowering barriers to entry or challenging traditional business models.

[1] Note that the survey results and interpretations are based on the attendees of the ERM Summit in New York.



The Levers of Disruption

Given the impact, it's imperative to understand the levers of disruption. The risk leaders were asked which skill or technology they see as "most disruptive or transformational." The rankings are listed below with artificial intelligence, data analytics, big data, blockchain, and cloud service rounding out the top five most frequently listed disruptive skill or technology.

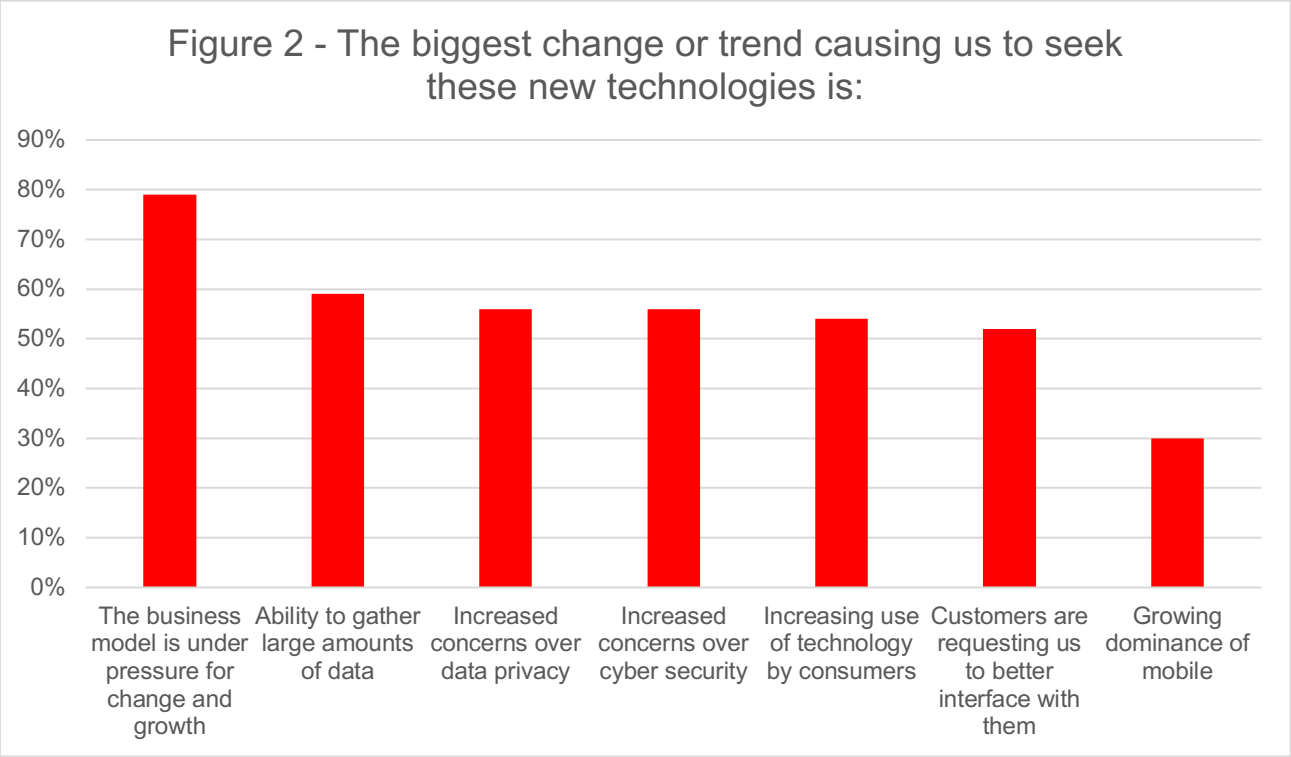
1. Artificial intelligence	2. Data analytics
3. Big data	4. Blockchain
5. Cloud service	6. Machine Learning
7. Data science	8. Drone technology
9. Social media enhancements	10. Software
11. Robotics	12. Self-driving cars
13. Cognitive computing	14. Smart phones
15. Wearables and augmented reality (tied)	

What's Driving the Risk So High

What's causing all this risk besides new companies competing in new areas and working with new skills or technologies? There were many drivers identified by the risk leaders. The top risk drivers discussed during the Summit were:

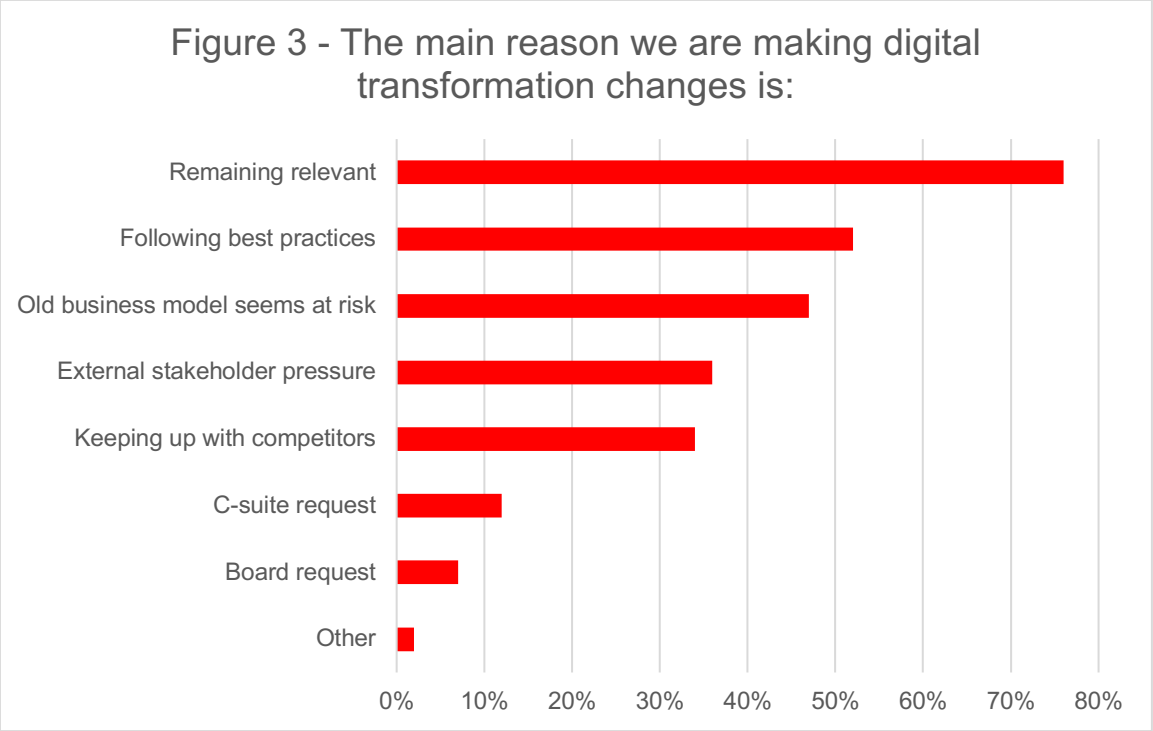
- Customers and demographics,
- Increasing regulations,
- Data availability, and
- Speed (how fast things seem to be changing).

When asked in the pre-ERM Summit survey, the top answers were even more revealing (Figure 2) and highlight the risk and pressure that organizations are feeling. The top reasons are related to the business model, data concerns, and big data becoming available. For example, **the number one reason companies are moving forward was that they felt their business model was under pressure for change and growth**. A startling 79% of the respondents believed this. The second highest ranked reason was the availability of large amounts of data. Companies are starting to connect the dots on data and perhaps are staring at an untapped mountain of data and opportunity. Increased concerns over cyber security and over data privacy were tied for the third most commonly listed reason.



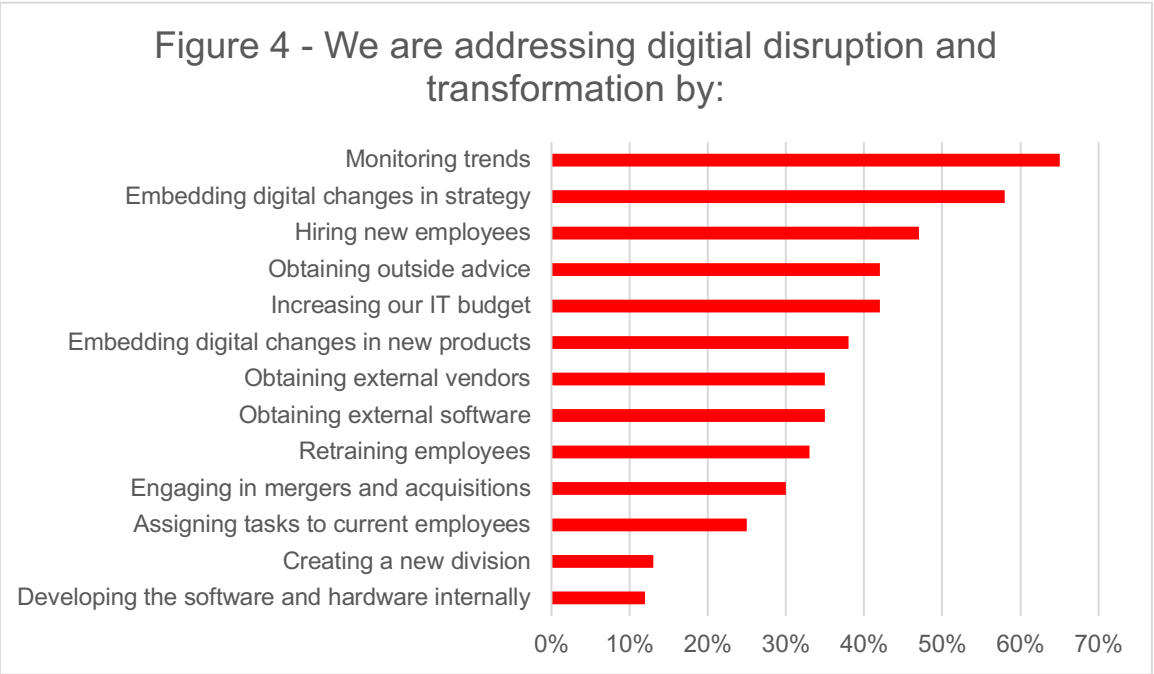
Perhaps some of the pressure on business models is externally driven and the answers shed light on this possibility. As seen in Figure 2, ***customer*** **changes are driving a lot of the changes, with 54% agreeing that increased use of technology by consumers is a driver, and 52% agreeing that customer requests for better interfaces is a driver**. And not to ignore mobile's continuing disruption, 30% agreed that mobile was a driving force.

On the opposite side of what's driving the change the respondents were also asked the main reason they are reacting and making change (see Figure 3). The top reason ought to make many companies nervous. Remaining relevant was listed as the number one reason companies are making a change (76% chose this answer). Another 52% listed the reason for the change as following best practice. Revealing a chance of serious business trouble, 47% of the respondents suggested that old ways of doing business just may not be able to continue. **That disrupt or be disrupted headline may be truer than ever**. Pressure is also showing up from stakeholders as evidenced by the 36% that agreed that stakeholder pressure was their reason for change. Board and C-suite requests for changes were noted by 20% of the ERM leaders.



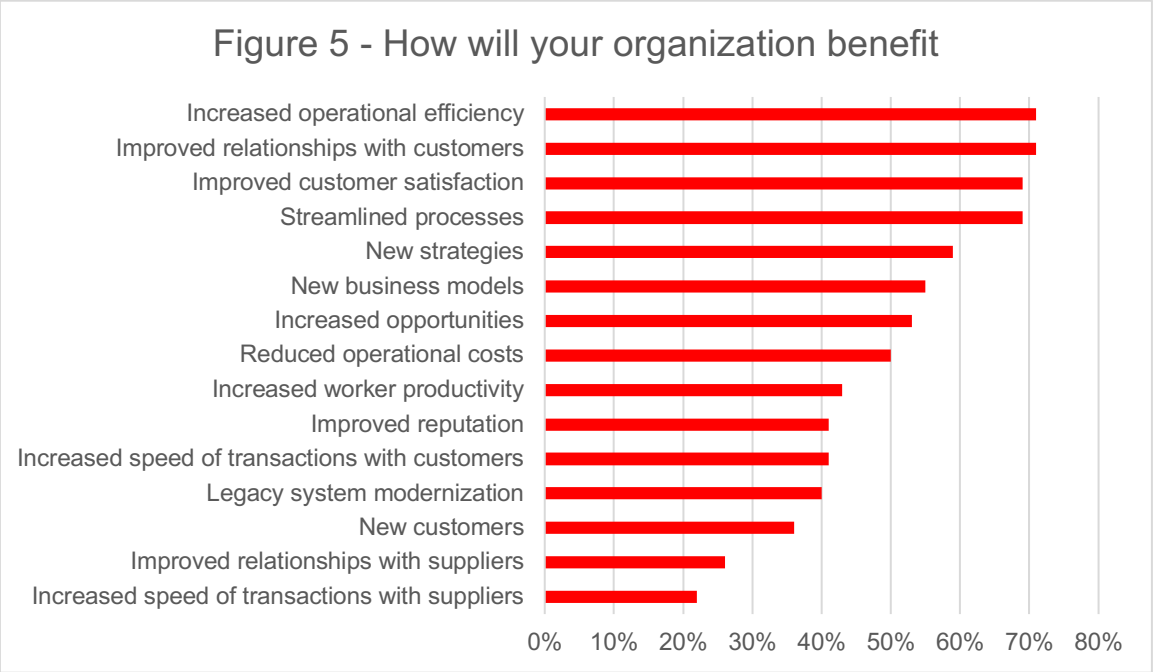
Organizations are Responding

Given the significance of the risk and the business model pressure it is not surprising that companies are taking a lot of action. The top specific actions are listed in Figure 4). The pattern and responses above can be interpreted in several ways. One simple way is "take action." There is no single solution for everyone, but companies must respond or risk remaining relevant. Monitoring trends appear to be a method by 65% of the organizations and another 42% say they are increasing IT budgets. Three of the answers address employees: asking them to do more, retrain, or go out and hire new ones. A related answer popular among many innovation thinkers is to create a new division within the company. Another three actions look outside the organization: get vendors, get advice, or engage in M&A transactions. Again, the big picture is "take action."



Much is Expected

Organizations have high-hopes/expectations for the actions too. Each ERM leader was asked what benefit they expect from their increased investments over the next 24 months. The replies are noteworthy and hit key buzzwords for running companies: efficiency, streamlined, reduced costs, improved worker productivity (see Figure 5). **Other expectations include new business models, new strategies, increased opportunities, and improved reputation.** The most frequently listed benefit and expectation was improved relationships with customers. Those are changes that all of the C-Suite and board members desire.



Testing and Readiness

The bad news is that although companies are responding and doing so in a variety of ways, very few are testing enough. Not one single organization agreed with the statement, "Our testing, adoption, and implementation of these digital disruptions is too much, or far too much." **In other words, no one felt ahead of the game. Although 46% did state that their testing was "about right," that left 54% acknowledging that their testing, adoption, and implementation was "too little" or "far too little."** Given that companies are concerned about their old business model being at risk, that they are feeling pressure from stakeholders, that they see changes in interacting with customers, and that customer use of data is changing, it would seem that companies would be aggressively trying to get ready. Perhaps they are pushing the readiness buttons but currently only 32% agreed that they are "ready" to address these changes and 48% are "undecided." **Another 20% disagree – meaning, they believe they are not ready.**

Measure the Results or a Leader Mandate?

Given the headlines and acknowledged high risk it is important to understand how companies will measure the success of their responses and efforts to react. But it's the "how" they judge it that's surprising. Although 47% agreed that they'd use traditional measures such as ROI or NPV to measure their effort's success, many took a different view. For example, **63% checked that they will measure their efforts by**

how it impacts the business model and 37% checked that they'll judge their effort by whether they meet a target set by leadership. Is this a "just do it" or a "we're in trouble" response? It appears it is, and likely reflects the pressure that companies are feeling and that shows up in the other survey questions. Even more surprising, another 17% said they were not going to worry about how to judge the project. Just do it, indeed! In spite of the lack of wide spread agreement on metrics, 82% agreed that "we are confident these digital transformations will benefit the organization."

Too Much Optimism

The high level of confidence may not be completely justified when a few other answers are factored into the equation. First, **only 33% agreed that the CRO or ERM leader has been involved at the appropriate level in the efforts.** Using the ERM leaders to help identify the risks post hoc does not seem wise given what's at stake for companies. The ERM team should be used up front, especially when so much is in play and the field is moving so fast.

Another reason the optimism might be too high is that adoption of these new approaches carries risk – **68% agreed that the risk in adopting and implementing is significant. Additionally, 55% agreed that digital transformation is one of their "top risks."** And although 43% agree they have identified the new risks, only 38% were confident they had done so.

The highest rated potential risks in these new efforts were:

- Falling behind (87%)
- Increased data privacy exposure (85%)
- Increased cyber security exposure (84%)
- The changes do not improve the business model (72%)
- The company loses its competitive advantage (72%)
- Uncertainty in how to extract value (70%)
- The organization loses control of the data (72%)
- The organization chose the wrong digital transformation (70%)
- The changes do not deliver as promised (70%)
- The changes do not keep up with regulations (65%)

- Insufficient funding (63%)
- Overspending (61%).

Despite the fact that companies are responding, they may not be responding fast enough or wisely enough. As noted above, there was large agreement about risk related to still falling behind, losing the competitive advantage, choosing the wrong transformation, and not improving the business model. Surprising, but consistent with the large number that said they are not necessarily judging these projects with traditional financial metrics, insufficient funding was the second lowest ranked risk and overspending was the lowest ranked risks.

There appears to be great concern about increased cyber and data privacy risks (and significant but less concern about regulatory risks). One can only hope that the push to get better business models and improve customer relationships also clearly and smartly factor in cyber and data privacy related risks up front. Again, this reinforces the importance of having the right SMEs and ERM team involved early.

Challenges Ahead

As noted above, many companies acknowledge that digital disruption and transformation is a significant risk and they expressed serious reasons for pursuing change and adoption. The reasons included fear of the old business model not being relevant, fear of losing their competitive advantage, and fear such as losing touch with customer. Although a lot were testing and adopting, and a lot expected great benefits, very few seemed actually ready. One final question revealed the spotlight on the overall feel of companies. When asked if they were ahead of their competitors in these areas, only 20% said they were ahead, leaving 80% feeling behind. Everyone involved has more work to do and many expressed the challenges going forward. The challenges are listed below in ascending order.

- Lack of leadership support
- Company resistance
- Knowing when to invest
- Difficulty in seeing the value
- A need to the see the business model impact
- A budget to adapt/train

- Talent shortage
- Complexity
- Speed of change.

Perhaps the two highest ranked challenges should spur companies to step it up even more. Given the complexity and speed of change, there is no time to lose and much to dig into and begin to understand. The risks should be identified and the journey should be accelerated. Below is a list of the top things ERM leaders should do in this area.

TOP ACTIONS ERM LEADERS CAN TAKE

1. Managing digital disruption and transformation must start from the top. Get leadership and the board involved in the risk and the solutions.
2. Build your digital mindset (upskill yourself). Invest in developing a deep understanding of digital concepts, transformation, and risks.
3. Know your digital landscape, what you currently have.
4. Help management understand what disruption means to the company and the form it could take.
5. Identify the digital drivers that are influencing your business (changing customer preferences, large amounts of data, etc.) and assess how they'll change your business model in the near future.
6. Examine trends in customer, suppliers, etc. to determine how that trend might impact your need for digital disruption and transformation.
7. Identify the potential risks for each step of your business model. Isolating steps can make it easier to identify such risks. Ask, "how could this disruption impact this part of the business model?"
8. Determine the most significant risks. Consider traditional ERM dimensions such as impact and likelihood but also consider the strategic position of the business as a dimension.
9. Get creative when determining the biggest risks. Consider mapping the risks on some new perspectives such as the following. New growth (low to high) and Company Transformation (low to high). Again, the upper right quadrant represents the disruptive responses that could create the greatest revenue and the greatest transformation. Ensure the transformation is the strategic position you want and accelerate.
10. Use the critical success factors associated with the disruption adopted as prompts to identify the associated risks. For example, if improved customer relationships are critical, then test that factor. Finding data to support the factor de-risks the project at the right stage.
11. Identify how the disruption creates other risks. For example, new disruption might create a serious talent shortage risk.
12. Work closely with the product or innovation teams. Build that relationship.
13. Help management and leadership think through how the company can exploit the risk, be the disrupter, and get ahead of the competition.

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