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Growth Strategy

How to Succeed in an Era of Volatility

by Dunigan O'Keeffe, Karen Harris, and Austin Kimson

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Azuma Makoto

Summary. Over the past 30 years we've lived through a remarkable era of macrostability, characterized by largely peaceful geopolitics, generally falling interest rates, expanding credit markets, and moderate inflation. The landscape has shifted, and we've now entered an era of volatility in which new rules apply and the intuitions that leaders... **more**

One cold, hard truth laid bare by the pandemic is how vulnerable a business can become when strategic foresight and operational flexibility are low on the list of priorities for boards and leadership teams. Many companies were caught flat-footed when the number of Covid-19 cases in the United States began to mount, but H-E-B, the Texas-based regional supermarket chain, was a notable exception. In mid-January 2020, H-E-B began putting out feelers across its network of global suppliers, and it reached out to retailers in China to learn about what the early weeks of the pandemic looked like there and what lessons they had learned.

H-E-B quickly recognized that the pandemic would require a full-scale response. Fortunately, the company's director of emergency preparedness (yes, H-E-B already had one) was experienced in crisis management, having overseen emergency plans to keep stores open during hurricanes to support shoppers. H-E-B even had a playbook for managing through an influenza outbreak, refined after the swine flu was detected in Cibolo, Texas, in 2009.

Within a few weeks of the first U.S. Covid case, the company was running tabletop simulations of how a large-scale pandemic would affect its employees, supply chain, and operations overall. Early on, the supermarket trimmed daily store hours to provide more time for stocking shelves, which were sometimes empty by the end of the day. H-E-B, which has its own meat plants, quickly pivoted to 24/7 operations for its top 50 meat products, allowing the company to ship significantly more meat to its supermarkets. Eggs were in short supply, so H-E-B worked with one of its beer distributors to pick up eggs from a wider geographic area and deliver them to H-E-B stores along with its regular cargo. By all accounts, H-E-B employees remained committed to hard jobs in a very challenging time. When shopper volume just kept climbing, H-E-B asked employees on its corporate teams if they would pitch in and take shifts in stores and warehouses—and 800 people signed up.

The way this regional supermarket confronted the pandemic isn't just a bit of business heroism—it's also an illustration of how strategy needs to change as the world does. Over the past 30 years we've lived through a remarkable era of macrostability, characterized by largely peaceful geopolitics, generally falling interest rates, expanding credit markets, and moderate inflation. During that time, five new trends in the business landscape emerged: globalization, capital superabundance, the declining cost of distance, labor superabundance, and, underlying all those, technology-led innovation. Winning companies adapted their organizations to the trends, embracing such mantras as “Move fast” and “Adapt or die” to create enormous amounts of value.

We’ve now entered a new era in which new rules apply. It’s a time of post-globalization, capital rationalization, spatial dispersion, shrinking workforces, and dependence on automation. Meanwhile, technology-led innovation is only accelerating and compounding. In this environment, the intuitions that leaders have developed over the past few decades will cease to be useful—and the shape of opportunity and risk will be entirely different.

If leaders want to continue creating value in the era of volatility, they must still focus on adaptability. But they’ll also need to revive strategies that boost investment in two other capabilities that have fallen out of favor in recent years: resilience and prediction. Ultimately, every company will need a strategy that allocates time, resources, and energy to all three capabilities.

Over the past few years, we’ve had strategy dialogues with leading companies around the world, during the course of which it became clear that conventional strategic formulations aren’t well suited to the disruptions of the era we’ve entered. One source of inspiration for leaders? The world’s financial investors, who are free of the obligations of managing individual businesses day-to-day and can take a broad perspective on major shifts in the economy and adjust their portfolios accordingly.

The starting point for such a perspective is a sharp appraisal of where you are today. What are your various exposures—that is, the risk and reward potential—of key investments in your portfolio? Where are you long, with bets on rising value, and where are you short, betting that less value will be generated because of limited opportunities? Are these positions deliberate and consistent with your predictions about the future, or have they built up over time without intention or focus? To navigate the uncertain landscape and continue to generate sustainable growth, business leaders will need to develop growth strategies that are both pragmatic and powerful.

A Three-Part Approach

The era of volatility requires that companies integrate capabilities for prediction, adaptability, and resilience in a manner uniquely tailored to their circumstances. Let's consider each capability in turn.

Prediction. This capability involves generating beliefs about the future of your industry with enough precision and conviction to create opportunities for competitive advantage. For example, leaders may not know the full contours of the coming geopolitical landscape, but they're sure to face a more fractured world of sharper rivalries, and that reality will shape parts of the macroeconomy. Companies must constantly work at developing scenarios, testing them against their risk and reward potential, and selecting a strategy that will adjust their exposures over time. The more asset-intensive a company is or the more fast-paced its competition, the more it will need good predictive capabilities.

Private equity firms, for example, need superior prediction capabilities to generate detailed investment theses: A particular investment will produce a specific rate of return if and only if A, B, and C are all true. Most energy companies also require strong prediction capabilities, as do some leading telecom companies.

Consider the case of Reliance Jio, which accurately predicted the shifts in India's mobile-phone-services market toward ubiquitous smartphones and high data consumption. In 2016, having recognized the potential for greater smartphone penetration despite a landscape crowded with well-established and well-funded incumbents, the company predicted that demand would increase if smartphones were made more affordable. As a result, it launched a series of budget-friendly smartphones, targeting the mass market and offering Indian customers features they were keen to have but often couldn't afford. Jio also had the foresight to invest strategically in building a robust 4G network across the country ahead of the incumbents. By offering customers high-speed and affordable voice and data connectivity, including in rural areas not served by incumbent companies, Jio was able to disrupt and capture a significant share of the market. It also anticipated the growing importance of digital services and content consumption on mobile devices and developed an ecosystem of news and entertainment offerings that helped further differentiate it from competitors.

Adaptability. Being adaptable means changing the business faster than competitors are changing. Most companies developed this capability during the recent era of macrostability, but they now need to refine it in key ways to grow in the era of volatility. By understanding where their current business has long or short exposures, for instance, leadership teams can track signals related to critical bets that might trigger a shift in strategy. Shockingly, financial investors often work harder to track such signals than corporations do. Many leaders also fail to recognize and capitalize on the signals coming from their front lines that only they have the ability to discern.

For dynamic early-stage industries, adaptability is required to survive; the most nimble companies can sometimes rely on adaptability rather than prediction to navigate through changes in the environment. Large companies should be able to use adaptability to reap advantages at scale, but too often their size creates complexity that makes it hard to pick up important signals. Tuning in to these signals is the first step in identifying where you need to double down, initiate fresh innovation, or simply cut losses.

The Japanese artist Azuma Makoto photographs his 50-year-old bonsai tree in an open steel frame in locations around the world to explore the idea of beauty and vitality in unexpected landscapes.

Satya Nadella famously demonstrated adaptability when he decided to commit Microsoft to cloud services. When Nadella became CEO, in 2014, going all-in on cloud services was far from the obvious move, but he saw signals that the company needed to adapt: Amazon's AWS was already moving forcefully to a business model anchored in cloud services and the underlying technology, and other enterprises, Netflix among them, were reshaping their respective industries by capitalizing on their own services.

Early on, Nadella committed the company to Microsoft Azure, its cloud-computing platform, which enables companies to build, deploy, and manage applications for services and provides developers with an array of powerful tools and resources. Office 365 was a key part of the strategic shift. Even though the company's desktop and enterprise business models were well-developed, with huge installed bases, Nadella chose to pivot to the cloud, which required enormous new investments in complex product engineering and architecture. That shift brought the company up against brutal new competitors and new dynamics, but getting ahead of the market has paid off for Microsoft: More than half of its revenue now comes from cloud services and properties, up from about one-third in 2020, amounting to $31.8 billion in the first quarter of fiscal year 2024. And cloud-based subscriptions for Office 365 deliver more-predictable recurring revenues than Microsoft earned using its previous business model. Microsoft has been able to diversify and expand into new sectors, including health care, finance, and manufacturing, where Azure is hosting advanced technologies such as AI, machine learning, and IoT.

Resilience. Companies with superior resilience survive shocks better than their competitors do. Many shocks that companies should prepare for (perhaps even most) are known to them, but too often leaders don't do the work of pressure-testing their chosen strategies and business models. During the past three decades of macrostability, companies were insulated from damage from shocks, and it became far too easy for them to optimize for short-term profits and avoid investments in resilience. That's partly because resilience can have deleterious effects on efficiency: It takes time and money to make the investments in redundant capacity, alternative supply chains, and critical inventories, all necessary to weather shocks.

Southwest Airlines has adopted a notable approach to resilience, with a target of hedging at least 50% of its fuel costs each year. The program hasn't changed Southwest's fundamental exposure, but by using financial instruments such as futures contracts and options to lock in prices for specific time frames, the company mitigates the risks to its business from spikes in jet-fuel prices. In 2022, as the battered airline industry began to return to profitability, Southwest's hedging saved the company $1.2 billion, according to industry analysts, boosting its operating margins above those of three major competitors. Investing in resilience takes commitment, a focus on the long term, and an ability to weather short-term turbulence: For example, when oil prices plunge, as they did from 2015 through 2017, Southwest risks losing money on its fuel-hedging program.

Where to Start

How can leadership teams prepare for the new era? It's not an environment that favors small moves and a test-and-learn mindset. Instead, it requires that companies adopt an approach to strategy that integrates bold investments in the three capabilities of prediction, adaptability, and resilience. In determining how best to allocate your resources across the three capabilities, the following steps can help.

Map exposures. Companies can learn from hedge funds to simplify their understanding of their exposures and where they have long positions (where they've made larger and more strategic bets) or short positions (fewer and smaller bets or even none at all owing to limited opportunities). To determine where they are long, companies typically examine the concentrations of revenue, direct costs, and suppliers in their current business.

Consider a hypothetical agricultural equipment company we'll call AgEquip. Looking at revenue concentrations across its core customer segments and channels in various geographies, the company might quickly identify that it is long on Brazil, a key market for its equipment. Looking at exposures from a demand perspective, it might recognize that it is also effectively long on China, given the importance of that market to Brazilian farmers, who use the company's equipment to produce soybeans largely exported to the Chinese market as feed for pigs.

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Mapping exposure also means identifying where the business is short and then deliberately placing smaller strategic bets or choosing not to play. For instance, AgEquip might believe that innovation in data-analytics services for farmers is moving too slowly to become a high-growth area of its business anytime soon. The result of this mapping would be an integrated picture of exposures that provides an explicit view of how the company currently makes money for its shareholders and how it will do so in the future.

Develop scenarios. It's not unusual for an initial mapping effort to uncover dozens of exposures, but typically no more than eight to 10 merit strategic debate, because of the uncertainty that surrounds them and their potential to greatly affect financial performance. So define a disciplined, manageable set of variables, and ask yourself: What are the extreme but plausible scenarios? (If none of the scenarios you've come up with change the decisions you would make, then they aren't extreme enough.) From those scenarios, companies can develop three buckets of activities: "no regrets" moves (those that can be made with a high degree of confidence and that apply across all scenarios); options and hedges (to mitigate the risks from a changing environment and capture emerging opportunities); and big bets (the moves that are going to reposition the company for the future). Leading auto manufacturers, for example, have developed in-depth scenarios around autonomous driving that lay the foundation for creating proprietary strategies in the long term while identifying options should autonomous vehicles take hold sooner than anticipated.

Allocate capital. This step uncovers the investments companies should make in adaptability and resilience—and reminds leaders that resilience can be expensive. The classification of no-regrets moves, options and hedges, and big bets is the basis for shaping capital allocations. Recently, for instance, the surge in generative AI has convinced some companies of the need to reshape their strategies and significantly increase their no-regrets investments in specific applications of the technology that could transform internal productivity. Big bets often revolve around M&A, either to consolidate a market by doubling down on an attractive exposure (as with Microsoft's acquisition of Activision Blizzard) or building scale in an entirely new market where the company wants to shift from short to long (as with Amazon's decision to become a major player in the retail grocery business through the acquisition of Whole Foods).

Track signals. In an era of greater volatility, it's also crucial to develop a capability for monitoring potential disruptions and opportunities. Some of these will come from changes to the macroeconomic environment: developments in labor markets, capital markets, broadly disruptive technologies, or economic cycles. Others will be more industry-specific, from new entrants to substitutes for products and services, and some, such as labor needs, may be company-specific. Ask yourself, What is our ongoing capability to monitor these trends? Who is in charge, what are the key inputs from different sources and constituencies, and how can we ensure that a change in these inputs triggers quick actions with conviction? This is also where M&A scouting kicks in: What potential acquisitions would allow your company to adapt the business and balance overall exposures? For example, the 2020 surge in demand for food delivery during the pandemic caused Uber to acquire Postmates and extend its core business from rides to meals.

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There's no single intervention you can make to modify your company's strategy as we move into the era of volatility. The key, instead, will be to develop a rhythm of awareness, experimentation, and execution that will help you prioritize conflicting demands and allocate resources appropriately to the three key capabilities—prediction, adaptability, and resilience. This approach is geared to action, as every winning strategy must be: It helps you predict which exposures will be most profitable, adapt your portfolios to shift exposures, and protect against surprises that could make those exposures a liability. That's the new formula for growth in a volatile world.

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Dunigan O'Keeffe leads the global strategy practice for Bain & Company and is a Bain partner based in San Francisco.

Karen Harris is the managing director of Bain's Macro Trends Group and a Bain partner based in New York.

Austin Kimson is Bain's chief economist and a vice president based in Dallas.