COVID-19 Pandemic: The Catalyst for Business Innovation?

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The novel coronavirus (COVID-19) pandemic has resulted in a terrible human toll and seen economies wobble. It has highlighted a significant lack in global trust, issues with global interdependency and problems around state capacity in the provision of essential health services and around governance. As economies across the world continue to reopen, it is important to take stock of the situation and identify trends that could affect economic activities in the months and years ahead. Recovery is expected to be gradual as households and firms remain cautious, but should improve in 2021 as fiscal and monetary policy remain loose and the possibility exists of a vaccine being found.

With a lower-scale shutdown and strong government support, Japan is expected to be comparatively less affected than many other developed economies. Low unemployment and strong corporate balance sheets should mean relatively little permanent damage. Japanese companies are potentially better placed than others to ride the wave of global economic recovery in the next twelve months.

Governments have never had to shut down economies to save lives, nor reopen them still in the midst of a pandemic. Similarities are found with businesses' plans to close and reopen. Where a rigorous policy response was deemed necessary, businesses will unavoidably be impacted, with both near-term effects and less-expected longer-run consequences. Each company is implementing its own plans and identifying useful strategies taken by peers to adapt as necessary; many companies are suffering and in extreme cases even shutting down. Travel restrictions and quarantines have, for example, left manufacturing firms short of both labour and parts, which in turn has caused continuity issues across industries and stalled plans for investment and M&A activity. Mobility and social-distancing measures have led to enforced changes in social-economic behavior, hitting the aviation, tourism, hospitality, entertainment and luxury goods sectors especially hard. Businesses must navigate the financial and operational challenges ahead whilst ensuring the needs of their employees, customers and suppliers are met.

With crisis there is often opportunity. A new age of issues and events exists that may be regional or global in nature and may have direct or indirect implications to business operations and the meeting of strategic business objectives. We live in a VUCA (Volatility, Uncertainty, Complexity and Ambiguity) world. In these uncharted waters, the need to adapt a more holistic approach to risk-proofing business organisations becomes more pressing than ever. Business decision-making has always required access of reliable and timely information, and the pandemic has exposed how unprepared many companies are in their collection, collation, analysis and dissemination of actionable intelligence, and in managing 'extraordinary risk'.

Many business leaders continue to be preoccupied on the 'now', which has included the support of their employees, customers and suppliers and focusing on liquidity. These immediate needs are logical and necessary.

However, business leaders need to start focusing on the "next" and preparing their companies for change. Going forward, there will be a period of uncertainty with slow economic recovery in some areas, stronger competition and changes in consumer confidence which will require courage from business leaders. The 'new normal' will be challenging for companies that are conservative in their thinking. Companies must have the courage to examine their strengths and weaknesses critically, develop new competitive advantages and position themselves better in this 'new normal' world. Waiting is no longer an option.

One of the most direct business impacts of the pandemic has been a significant disruption to supply chains. For example, China was forced into quarantine which led to shutdowns of factories. Compounded by the US Trump administration's increasingly hostile rhetoric and rapidly shifting geopolitics, much subsequent discussion has taken place regarding the prudence of maintaining a sizeable portion of the Japanese supply chain in China. Within the post-pandemic new normal, companies will be operating in such a VUCA environment, and strategic decisions have to be made with available information at hand. Unfortunately, many companies are behind their western peers and competitors in integrating a sufficiently a robust 'intelligence' system in identifying, monitoring and assessing these macro changes, 'extraordinary risks' and new opportunities in the world. As we enter this new decade, this is an opportune moment to sharpen our perceptions and observe beyond the obvious.

David Teece, professor in Global Business and director of the Tusher Initiative for the Management of Intellectual Capital at the Haas School of Business at UC Berkeley and chairman of Berkeley Research Group, developed the concept of Dynamic Capabilities to account for a "firm's ability to integrate, build and reconfigure internal and external competences to address rapidly changing environments". Dynamic capabilities is distinct from operational capabilities, which pertain to the current operations of an organisation. In contrast, dynamic capabilities identifies "the capacity of an organisation to purposefully create, extend or modify its resource base": the fundamental assumption of this framework of thought is that core competencies can and should be used to modify short-term competitive positions and build longer-term competitive advantage.

From this standpoint, the coronavirus will likely have a major impact in three important ways. First, it highlights developments that may have gone largely unnoticed previously. For example, shifts in the global political landscape and the way in which China has already established areas of influence in some parts of the world become more apparent. Second, it demonstrates how companies need to be more alert to the alignment of their global operations and strategic partnerships, as they will inevitably be operating within fluctuating geopolitical conditions, notably the growing tensions between the US and China. Finally, it catalyses changes whose ultimate outcome and impact are difficult to predict currently, including the future of the EU and Japan's response to handling changes in workforce demographics. Again, this is further evidence that businesses must review their strategic priorities regularly and put in place tools that can identify and interpret the changes and meaning of seemingly discrete developments.

Risk management departments need greater recognition within the C-suite to allow business leaders to make critical decisions with all available information. The traditional role of risk management departments will become more important, but it will need to evolve to meet its expanded remit. The culmination of these events will challenge business leaders. Several areas should be addressed which are both proactive and reactive in nature. Examples include:

a. **Geopolitical risks**: These need to be assessed independently and monitored regularly. There is often too much reliance on 'off-the-shelf' reporting or use of internal resources. Whilst useful as background, it is critical that a tailored approach be developed to identify risks for specific operations and actioned upon quickly.

b. **Market-entry risks**: As companies continue to invest overseas, market-entry risks should be gathered carefully, assessing the risks specific to an industry and company. Whilst important to understand current government regulations in a particular country, of more value is assessing likely changes to future regulation and how that could affect an investment. Intelligence is therefore key to this understanding.

c. **Due diligence**: To ensure high corporate governance standards are met, due diligence on potential partners, acquisitions and/or suppliers should be enhanced and is appropriate to both country and industry risks. Often, financial information of companies operating in emerging markets is unreliable, and therefore relying just on legal and financial due diligence is not advised. Desktop research alone to identify off-balance-sheet risks such as corruption, government relationships, etc. is no longer sufficient, especially in opaque markets. It is critical to have a robust system to allow the collection and assessment of intelligence related to investments.

d. **Regulatory, fraud and corruption risks**: Post-coronavirus, there are likely to be increased issues affecting firms, especially related to regulatory changes, fraud, bribery and corruption particularly in emerging markets where internal and other controls are weak. Therefore, businesses must review their exposure, especially in emerging markets, and monitor and assess these risks continually. From an internal control and governance standpoint, business leaders should ensure their structures are in place and effective. This applies to not only their own operations, but also those of their key partners, suppliers and other significant third parties. Better use of technology and analytics can support in this.

e. **Company-wide risk assessment**: Overall, undertaking a company-wide risk assessment that identifies, assesses and prioritises business risks is a key element to mitigation. A risk assessment should consider country risks and risks related to industry, customer and supplier mix, products and services, third-party relationships and financial transactions. Companies also need to have in place an effective whistleblower mechanism, governance framework and internal controls to identify and mitigate instances of fraud, bribery and corruption when they occur.

In conclusion, this pandemic has highlighted the need for senior executives to assess their organisations' future business outlooks more critically, to include breaking down the traditional siloes governing risk assessment which tend to prioritise on operations and compliance. Speed of innovation is critical in these unprecedented times. We hope that JOI members recognize the pandemic as a stage for growth and change, and prosper and develop organization which nurture business innovation while enhancing resilience to risk. We are also happy to support members in the process of advancement of dynamic capability.

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