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Risk Angles

Five questions on business risks related to water and other critical resources

An interview with William Sarni, director and Enterprise Water Strategy Practice Leader, Deloitte Consulting LLP.

Water is something most of us take for granted. However, as demand for water continues to rise, more and more companies are learning that water is a finite resource and that water scarcity may have a big impact on the bottom line. In some cases it can even threaten a company's ability to operate, as well as its reputation.

In this issue of Risk Angles, William Sarni, director, Deloitte Consulting LLP, offers his thoughts on some questions commonly asked about water-related business risk. Then, Christopher Park, principal, Deloitte Consulting LLP and leader in the area of Enterprise Sustainability, adds his perspective on the broader issue of risks related to sustainability and resource scarcity.

Question	Will's take
What does water have to do with business risk?	Without water it is virtually impossible for businesses to do anything. Food and beverage companies face the most obvious challenges — but they're not alone. In India and the U.S., for example, some leading beverage companies have had their social license to operate threatened or even revoked because their water usage directly conflicted with the needs of the public. Other industries that rely heavily on cheap plentiful water include apparel, utilities, energy, technology, and manufacturing. Also, for some sectors water is a critical resource for product manufacturing and product use. As a result, there is increased focus on agricultural supply chains and consumer products such as personal care and cleaning.
Why is this an issue I should address now?	Demand for water is rapidly outpacing supply in many regions, driven by economic growth, urbanization, rising populations, and expansion of the middle class — particularly in emerging economies. These trends, coupled with droughts in certain regions, are forcing businesses to compete for water. The impact of water scarcity on businesses is being felt now. According to the recently released Carbon Disclosure Project (CDP) Water Disclosure report (www.cdproject.net), 53% of respondents have experienced detrimental water-related impacts over the past five years and 68% believe water is a substantial risk to their business. Of these risks, 62% have the potential to impact business now or within the next five years.
What are the risks of ignoring the problem?	The business risks associated with water generally fall into three categories: • **Operational.** Not having enough clean, affordable water — when and where you need it — to run your factories and business. • **Regulatory.** Current and future laws and regulations that affect the availability and price of water. • **Reputational.** The positive or negative brand impact that stems from how your business uses and manages water.
Water scarcity has yet to affect my business or customers. Do I still need to take action?	Water scarcity is a global problem that varies by locality. In some watersheds, demand for water already far exceeds supply. In other watersheds, supply is sufficient to meet demand (at least for now). Either way, companies should take a hard look at their future water requirements and sources to see if any risks need to be addressed — especially when deciding where to establish new operations.
What's the best way to get started?	Businesses can start to develop an understanding of water-related risks by scrutinizing how their internal operations use and manage water compared to current and projected water availability. But in order to see the true picture, companies should analyze their entire value chain. *How much water do suppliers use? How much do customers use when consuming their products?* Also, it's smart to translate the potential impact of water-related risks into dollars and cents. A bottom-line perspective provides the CEO, COO, and CFO with a tangible understanding of the business value at risk and how best to allocate capital to mitigate any current or projected risks.

A closer look: Ways to manage risks related to resource scarcity and sustainability

Chris Park, principal, Deloitte Consulting LLP and leader in the area of Enterprise Sustainability

Water scarcity is part of a larger risk management challenge that includes other critical resources such as energy and materials. These risks — along with broader business issues such as sustainability — can have a significant impact on shareholder value and the bottom line. Here are three tips for managing them:

- **Expect the unexpected**. These days, it's hard to predict the price and availability of critical resources with any level of certainty. Over the next few years, will a barrel of oil cost $50 or $150? Who knows? Maybe both. Will we face droughts or floods? Again, the answer could be both. An effective way to manage resource risks in an uncertain environment is to analyze and plan for a wide range of scenarios. Scenario analysis is a common strategic planning tool and businesses in resource-intensive industries such as airlines and energy have long used it to hedge their resource bets. But in a world of increasing price and supply volatility, even companies in non-resource industries may find scenario planning useful for managing resource and sustainability risks.
- **Scrutinize risk across the entire supply chain.** Everyone knows a chain is only as strong as its weakest link. Yet most companies continue to operate with only limited visibility into the resource and sustainability risks within their supply chains. They might have a pretty good idea of the resource risks within their own four walls. And some even understand the risks presented by their direct suppliers. But what about their suppliers' suppliers? The tsunami in Japan provided a vivid illustration of how a third- or fourth-tier supplier can bring an entire global supply chain to its knees. To manage risk effectively, you should understand the extent to which all of your supply chain partners rely on critical resources. And while you're at it, make sure they are operating efficiently and behaving responsibly, since there's a chance your brand can end up taking the hit for any problems that arise.
- **Strive for transparency.** Issues such as resource risk and sustainability may have a significant impact on shareholder value. That's one reason more and more companies are starting to address these topics in their formal reporting. Although integrated reporting standards have yet to emerge, companies with a good story to tell should not be shy about blazing the trail. Moreover, even companies with less than perfect records might benefit from opening their books and fully disclosing their risks and challenges. After all, problems that are out in the open can be actively managed and treated, while those that remain hidden are more likely to fester into life-threatening wounds.

Whether your top priority is on sustainability or boosting the bottom line, managing resource risk should to be part of your thought process. A risk management strategy that doesn't address resource risk can be dangerously incomplete.

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