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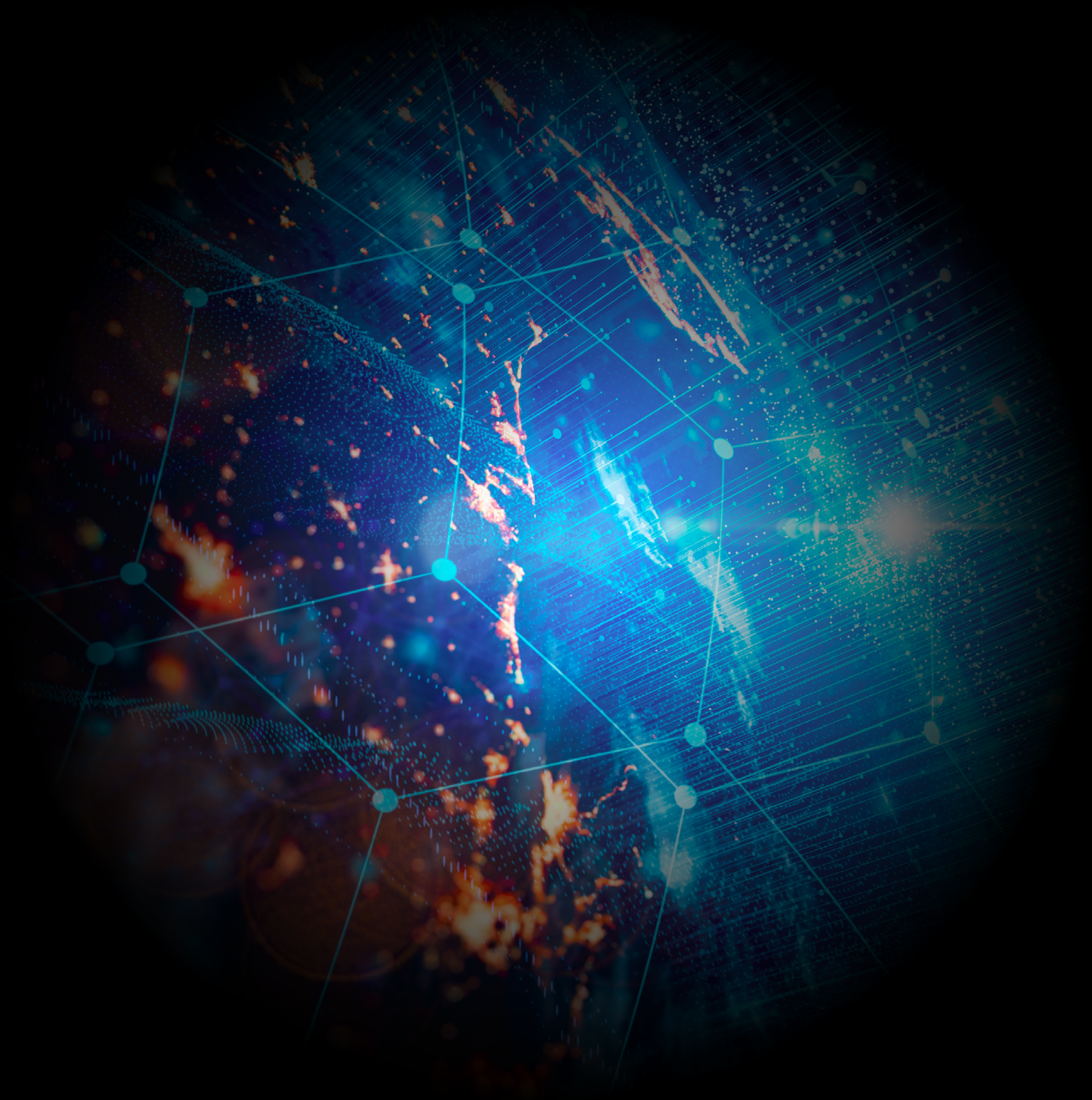


Strengthening private company risk resilience

Introduction

What does it mean to be resilient? One common definition is "to be able to withstand or recover quickly from difficult conditions." For most, it helps to frame resilience as a question planned ahead of time, along the lines of, "What are we going to do if…?"

That's the way the National Aeronautics and Space Administration (NASA) tends to think about it, and it's in the business of resilience. The agency launches equipment worth billions of dollars into the depths of space, but not without a complex network of sensors to detect if something is wrong, along with a contingency plan for every error code.

The stakes might not be quite as high, but every day private companies and family enterprises have to grapple with a wide range of "what ifs." Our prior chapter detailed a litany of operational risks that confront them today, originating from sources as diverse as cyberattacks, artificial intelligence, or new competitors created through industry convergence. Being resilient in the context of running a successful enterprise means not only having a playbook for the material disruptions and threats that could impact the business but also cultivating a culture of resilience so that every meaningful decision is viewed through this lens.

This is ultimately the goal of any successful enterprise risk management (ERM) program. It does little good to identify, assess, and prioritize risk if you don't then follow through with a plan of action for defending the enterprise from harm. Over the years, ERM has evolved from a focus on ensuring business continuity to helping organizations build the capacity for agility, adaptation, learning, and regeneration to ensure they are able to deal with more complex and severe events and be fit for the future.

Deloitte Global's latest *Global Resilience Report* outlines the importance of organizational resilience rather than a narrow focus on operations, extending ERM's reach to people resilience, reputational resilience, financial resilience, and environmental resilience, in addition to operational resilience. This has helped business leaders to predict and plan for a broader array of problems, quickly pivot to address issues, and strengthen their ability to thrive in the face of disruption.

The postures of resilience

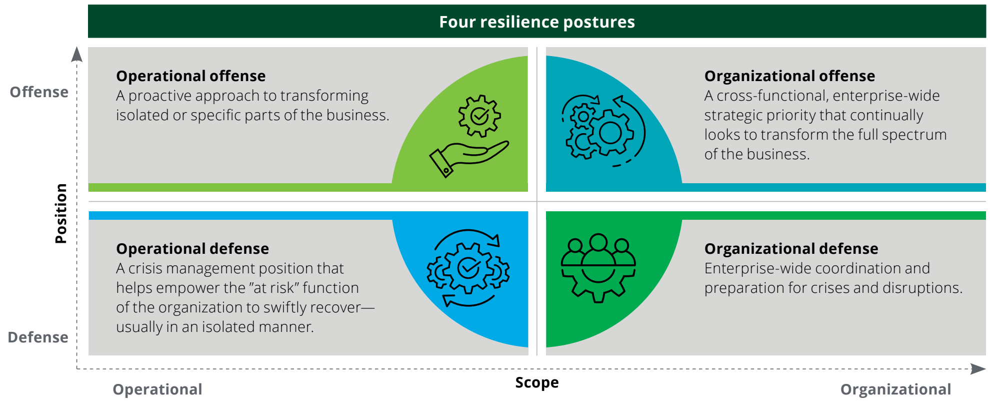
Put simply, every company's value has a numerator (cash flow/earnings) and a denominator (cost of capital). One way to boost the value is to increase the numerator, while the other is to reduce the denominator.

ERM has long been used to tackle the denominator, since managing risk can effectively reduce the risk-adjusted cost of capital. But, increasingly, ERM can help companies shift from defense to offense and support the numerator as well. It accomplishes this by moving organizations from a reactive to a proactive stance by maximizing the value they realize from taking risks that they can control and limiting or mitigating those they cannot.

Private companies and family-owned enterprises have an inherent advantage in this respect. Since they aren't under quarterly pressure to deliver results for shareholders, they have more room to resist the temptation to retrench when risks mount. Keeping a focus on their business's long-term viability means they can take the time to invest in the quality and availability of information and data at their disposal, helping improve their decision-making abilities during an event.

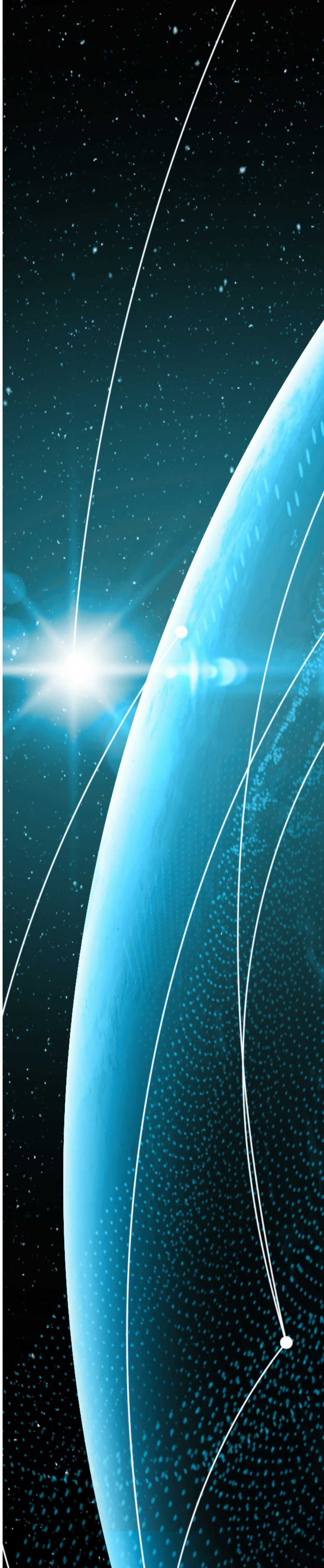
But every disruption that a business might face or attempt to engineer is unique, necessitating that its leaders match the posture of the disruption. How a business marshals resources to help address a natural disaster, for instance, is quite different from what it will need to do to adjust its innovation strategies in a world of increased climate- and privacy-related regulations. In other words, context matters greatly when it comes to resilience. A one-size-fits-all approach won't work.

ERM programs can help organizations assume or pivot to one of four resilience postures, depending on the nature of the threat or opportunity and whether it calls on leaders to play offense or defense:



How do you know which posture is right for the moment at hand? Sometimes the solution is obvious—product innovation isn't going to appear at the top of the agenda when your main production facility is flooded or on fire, as one clear-cut example. Most of the time, though, deciding which posture your organization should assume doesn't immediately reveal itself.

Over time, many private companies and family-owned enterprises will likely take turns adopting all four of these postures. Which posture is right for the current time often depends on many factors, including prevailing market conditions, the nature of competitive threats, the depth and breadth of internal and external resources, and the state of the business overall.



Two questions organizations should be asking

When deciding which posture to assume, start by plugging two critical questions into your ERM planning and discussions: 1) *What are the severe but plausible risks or disruptions that could affect us?* and 2) *What is our ability to respond and adapt to that situation?*

On the first question, it's important not to get caught up trying to predict the scenario itself. What could matter far more is identifying which company capability, resource, or cash flow stream would be most harmed if disrupted.

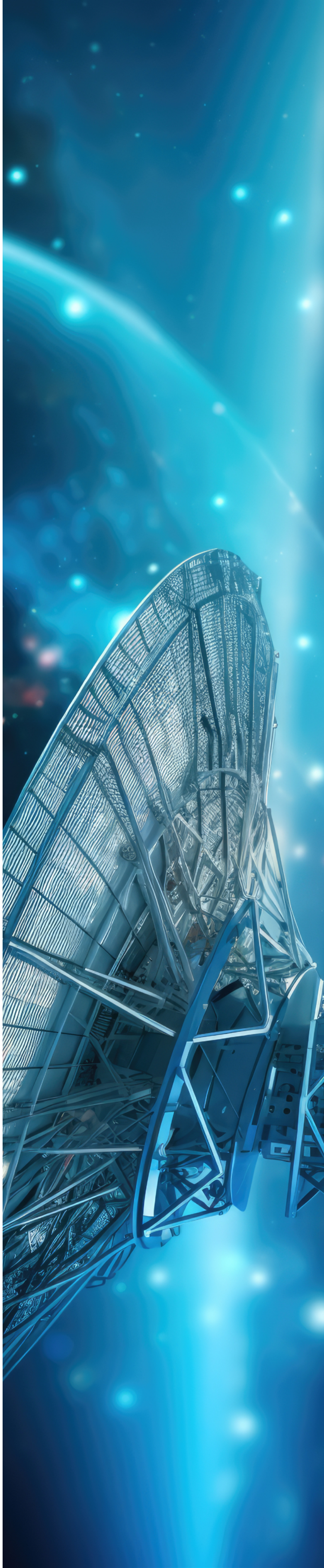
Consider the example of a hospital system engaging in scenario planning around a hurricane. That's not the right risk to prepare for—it's the risk of your basic operations being brought down that puts human lives in jeopardy, or the loss of the system that stores electronic health records or losing internet access for a week. A hurricane might cause those things but so could a lot of other events. In other words, emulate NASA: plan for the error code, not what triggers it.

As we covered in our first chapter in this series, risk assessments play a vital role in identifying which assets are the most critical to the company's performance—in other words, the "heartbeat" of the organization. What's the most important thing to protect? What drives our reputation, our brand, our revenue or profits?

Once you know the answers to question one, you can begin to figure out where you should invest to address your deficiencies and work to prevent those risks from coming to fruition or mitigating their impact. You're searching for resilience confidence—an objective, risk-based measurement specific to your organization—which provides a clear sense of your ability to respond to disruptive business events while also offering clear guidance on correcting underperforming assets.

This can involve not only assessing risk but also determining what should be required to cover, replace, or rebuild critical business processes in the wake of business disruption and the ability to meet recovery objectives. For example, a business focused on operational defense should prioritize investment in the financial, operational, and stakeholder sentiment metrics that can help keep them on the right path, particularly during times of crisis. But a company more focused on operational offense might be better served by strengthening the ways it measures the pace of innovation, such as looking at the share of growth coming from new products and new service launches. If that key performance indicator is low, or slowing, then it's likely further investment or reorganization may be necessary.

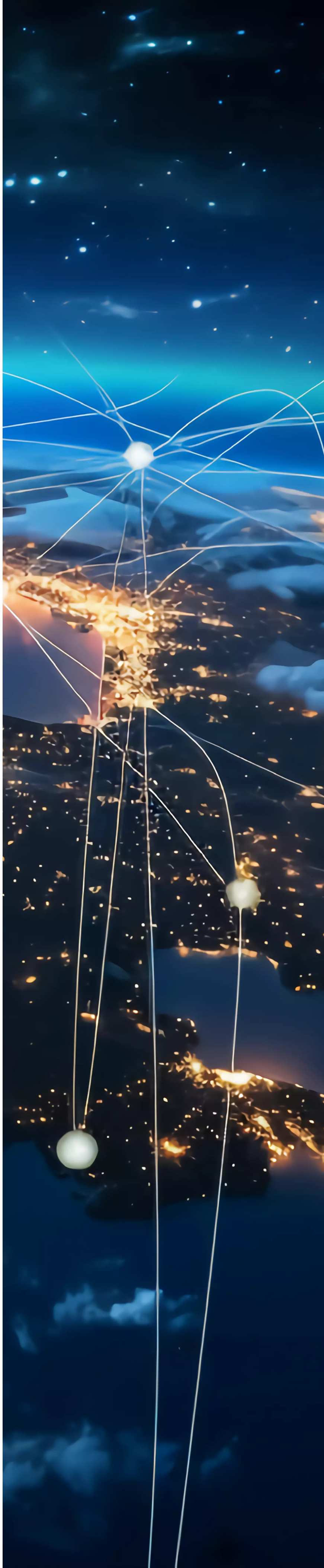
By working out in advance how you plan to recover critical capabilities, resources, and cash flow streams, your business can have a plan of attack on the shelf to activate if the disruption occurs. Getting to resilience confidence can start with a simple checklist approach, but it should mature to include planning and discussion about potential risks. The exercise of getting senior leaders together to walk through these disruptions provides value on its own, since it aids their understanding of the business's relative strengths, risk aversions, and capability gaps. Once your team accomplishes that, you can install internal controls that notify and activate the organization when those risks are triggered and ultimately decide how you should respond.



Conclusion

Resilience isn't a process or a topic of this time—it's a way of being. Remember back in the late 20th century when the quality movement took over corporate America? Everyone was focused on discrete initiatives to build quality, such as Six Sigma or total quality management. Today, quality is virtually assumed for any company doing business nationally and globally. Those discrete programs have likely been embedded in the fabric of successful companies, becoming part of their culture and mindset.

Much in the same way, resilience can evolve and emerge to the point where it's embedded in all business operations. We're just scratching the surface of what it means to build resilient organizations, but all that scratching can give businesses harder shells. Through greater risk intelligence, organizations can build confidence in their ability to deal with the next evolution of risks, no matter what may come.



THANK YOU FOR ENGAGING WITH THIS SERIES

We hope you have found this series on enterprise risk management a helpful conversation starter to begin making or advancing improvements within your private company or family-owned enterprise. As we said at the outset, every organization has room to improve in this critical aspect, especially at a time when competitive and other threats continue to expand. There are many things business leaders can do to strengthen their risk intelligence and boost the ability to respond in the moment. But it's also the case that new threat vectors may emerge that require a change of course within your ERM program. Deloitte Private stands ready to help you and your business boost the reach and effectiveness of your risk monitoring, plan for the possibility of those risks surfacing, and build your organization's capabilities to recover and thrive.

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