Operational risk management and your competitive advantage

Brand (noun)
A particular identity or image regarded as an asset[1]

Introduction

Much has been written about the speed of disruption in business today. Basic principles, assumptions, and business strategies are being challenged. Technology is enabling new businesses and dislocating current operating models.

The list of real-world business stories that justifies these trends is long. Most "top risks" lists will usually include business disruption—and rightly so.

What, then, is the moat that protects current businesses from being dislocated? In our experience, firms with many of the following characteristics generally do better over the long term:

- Institutionalized innovation, in which innovation is ceaselessly encouraged and pursued across the organization and not left to individual lone ranger efforts
- Products or services offerings that are simple and frictionless in their use or consumption
- A focus on the customer and providing a distinctive customer experience that's steadfast and relentless
- Implementation of proprietary leading-edge technology and the ability to monetize data
- Possession of a global reach with state-of-the-art logistics and distribution network
- Willingness to disrupt themselves
- Business leaders who recognize the success born of the above and build a culture that rewards forward-looking thinking

Firms that live by these mantras stand to reap positive long-term benefits, as they develop an identity and image that becomes synonymous with the company and the quality of products and/or services that they provide. They derive value from this behavior and leverage their reputation to enter new markets and introduce new products and services. This identity or image is commonly defined as "brand."

We might suggest that it is this brand, a significant corporate asset, which allows great companies to remain great. An organization's brand and reputation give it license to enter new markets, introduce new and adjacent products and services, and—most importantly—provide an audience receptive to trying the next product or service innovation. This receptive audience is the result of brand loyalty or the willingness to try a related product or service again. We don't suggest this is the only factor in the success of product innovation and introduction, but we do think it makes capturing growth opportunities a whole lot easier.

Brand protection

If a company's brand is so important, it is crucial to understand what affects and influences it. There is no singular answer for what influences a brand. The traditional view of brand has been that it is strengthened by what consumers experience through advertising, marketing, product positioning and pricing, and interactions with representatives of the brand. In addition, many of the characteristics that we noted—a consistent offering of leading products and services, providing a distinctive customer experience—certainly help.

More recently, however, many organizations are considering the connection between brand and their underlying business operations and business practices (that is, how they do business, with an emphasis on how the effective performance and delivery of the promise can have an impact on brand health).

Aside from brand-enhancing strategies to create value, preventive measures are necessary for protecting the brand. Staying out of the news for the wrong reasons; focusing on product quality through operations excellence; and having the capability to respond, timely and appropriately, when crisis events do materialize are crucially important, as well.

Without a doubt, there's benefit to the above. But how do you articulate the value of these brand-protecting, risk management measures? How do you quantify the cost and benefit and make them measurable enough to invest in capabilities to become resilient? And finally, how do you calculate the return on investment you expect on the cost to build that capability?

At Deloitte, we think of business practices and operations failures that cumulatively affect a brand as operational risk events. And we think of the resiliency and capabilities you build to protect your brand and your franchise as operational risk management.

Decomposing brand

Brand differentiation can happen at any point in the supply chain, from procurement, production, and distribution to marketing, sales, and post-sales support. In both regulated and less-regulated industries, organizations should be sensitive to the vulnerabilities that could potentially hurt their brand. How, then, should a company ensure processes, procedures, and controls are built to prevent or reduce operational risk incidents from occurring, and that when they do occur, the brand will be resilient enough to recover?

One approach may be to start with a deeper understanding of what makes your company distinct among its peers. What is it about the products or services offered that illicit a positive response from consumers—the experience or the emotions that are evoked from the use of the product or service that makes a customer choose your product or service over that of your next direct competitor? Whatever that may be, it is a big part of your competitive advantage.

Next, consider everything that should go right across all business operations—through product creation, manufacturing, production, marketing and positioning, point of sales and fulfillment, and postsales service—that will continue to reinforce and even build your competitive advantage. Or stated differently, what could go wrong and what is it that you should protect against to maintain your real or perceived competitive advantage? This consolidated list is your risk inventory or risk register.

After you have articulated your competitive advantage and started to build your risk inventory, consider other mandated requirements (for example, safety standards or regulatory requirements). These help you ensure that your risk register is complete, that it includes all risk management expectations—internal or otherwise—and that it becomes the golden source of your operational risk requirements.

Risk identification is a critical step in building your operational risk program. There is likely a long list of risks that can be identified and, therefore, an important lens to use in building the inventory is understanding the potential impact to your brand should that risk materialize. If the inherent impact of the risk to your brand is not significant, you might want to move ahead and only identify those risks—material risks—that have an outsized impact to avoiding building a bloated operational risk management program.

Once you have understood and assessed your material risks, and in advance of any of these operational risks actually occurring, you should now design your risk response. What protocols—policies, procedures, and standards—will you design and implement to protect your franchise from the consequences of the identified risks materializing? These are your key controls and, together with the identified material risks, they form the bedrock of your operational risk management programs.

Additional considerations as part of the build-out of an operational risk management program include:

- Articulating your tolerance for those risks that you will accept, mitigate, or transfer
- Developing risk monitoring and reporting mechanisms
- Implementing technology solutions to help ensure sustainability and efficiency of risk management efforts

Brand risks

Across industries, there are multiple vulnerabilities that may have a significant impact on a brand. Although these vulnerabilities may appear as normal elements of business operations, they can manifest into risks that hinder brand longevity. A few of these vulnerabilities are discussed below:

- **Customer experience** can be described as the emotion attached to the assistance and advice provided by a company to those people who buy or use its products or services. This encompassing emotion associated with the brand is amassed through every step of the solicitation, buying, and servicing processes. Whether it be the ease of access to a company's website or the sensory associated with setting up a product for first-time use, a quality customer experience is arguably just as important as the quality of the product or service itself. Perhaps most crucial in the retail industry, outstanding customer service can create brand loyalty and trust in an ever-changing consumer base. Following the emergence of e-commerce platforms and dissipation of brick-and-mortar locations, many retailers lost touch with their customers. As retailers attempt to take control of their data and go direct-to-consumer in a competitive marketplace, customer experience is of the utmost importance in obtaining and retaining customers.

- **Supply chain** is the sequence of processes involved in the production and distribution of a commodity. Organizations today face multiple risks as they diversify their supply chain and globally outsource production to third parties that have better economies of scale. Attributable to the complexity and size of supply chains today, managing supply chain risk becomes crucial in an environment where there might be multiple suppliers tied to the design and manufacturing of a product. Besides the actual quality and timing of input delivery, businesses are subject to geopolitical risks, trade disputes, capacity limits, supply shocks, and other industry forces that affect proper delivery of manufacturing input and end products to the consumer.
- **Resilience** is the ability of an organization to quickly adapt to disruptions while maintaining continuous business operations and safeguarding people, assets, and overall brand quality. Businesses should have continuity planning in place to prevent and recover from potential threats while continuing ongoing operations before and during the execution of disaster recovery.

An all-too-common example of this is cyber risk. There is a broad consensus that cybersecurity is the risk type increasing the most in importance, with 67 percent of respondents to a recent Deloitte Touche Tohmatsu Limited survey naming cybersecurity as one of the three risks that would increase the most in importance for their business during the next two years, far more than for any other risk.[2]

What's next?

The majority (79.2 percent) of C-suite and other executives recently polled by Deloitte say significant operational risk events have an impact on shareholder value over the long term.[3] Specifically, a company's ability to leverage its brand may be limited following an adverse operational risk event.

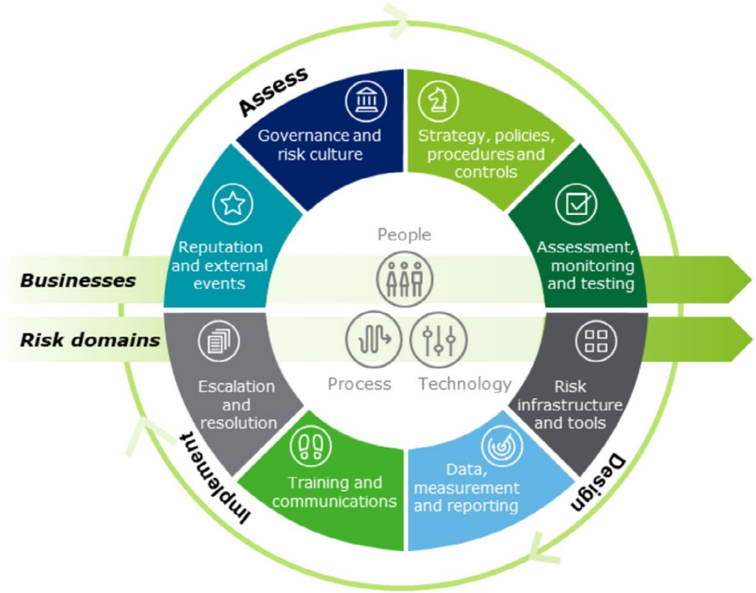
It may sound trite to say, but you will want to build an operational risk management capability before you need it the most. Certain industries, most notably banking, require rigorous programs as part of capital adequacy directives and safety and soundness standards. Beyond financial services, it is a sliding scale of regulatory requirements. Though there might not be explicit regulatory requirements to establish operational risk programs in all industries, exposure to various operational risks and the upside to proactively managing them should prompt companies across industries to consider establishing mechanisms and capabilities to manage operational risks in a programmatic and coordinated way to protect their brand and build competitive advantage.

A programmatic, enterprise-wide operational risk management framework (figure 1) commonly includes eight components and can be tailored to specific risk areas. Putting governance in place over the management of risk; understanding and assessing the sources of risk; articulating your tolerance for those risks that you will accept, mitigate, or transfer; putting in place controls; risk monitoring and reporting mechanisms; and technology solutions to ensure sustainability and efficiency of risk management efforts are all areas of an operational risk management capability to develop.

Conclusion

An effective operational risk management program can enable you to manage risks to protect value for your organization. It can also help you to find the optimal balance to make risk-intelligent business decisions. But you should recognize that risk management is a journey. It is important to understand your current capabilities; however, it is more important to understand where you would like to be and the specific milestones on the journey to getting there.

Figure 1. Deloitte's Operational Risk Management Framework



Notes

Want to learn more? Let's talk.

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Endnotes

1. "Brand: Definition of Brand in English by Lexico Dictionaries." Lexico Dictionaries | English, Lexico Dictionaries, www.lexico.com/en/definition/brand.
2. Deloitte's *Global risk management survey, 11th edition* is the latest edition in the ongoing survey series that assesses the industry's risk management practices and the challenges it faces. The survey was conducted from March 2018 to July 2018 and was completed by CROs or their equivalents at 94 financial institutions around the world that operate in a range of financial sectors and with aggregate assets of $29.1 trillion.
3. On March 28, 2019, a Deloitte Dbriefs webcast, titled "Operational risk management: Implementation, data, and analytics," polled more than 955 C-suite and other executives online about operational risk management. Answer rates differed by question and respondents differed by webcast poll.

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