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5 Steps to Protect Your Business Amid Economic Uncertainty

A comprehensive risk strategy can help companies respond quickly to, and mitigate the pain from, events like the Covid-19 pandemic.

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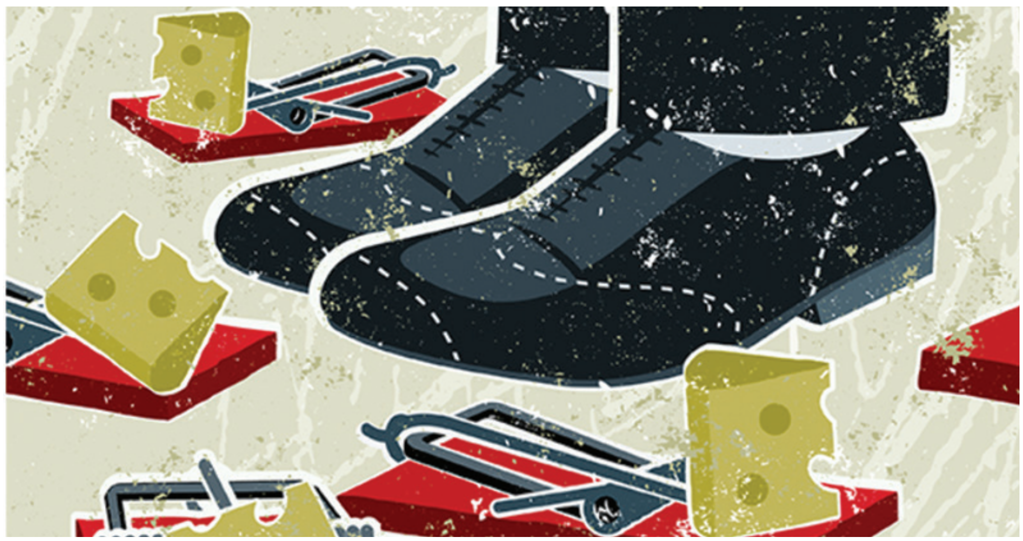

How will your business react—not if, but when, unexpected events occur? Business resiliency plans are rapidly changing from hypothetical situations to practical actions, as leaders respond in real time to the Covid-19 pandemic.

Although it's impossible to completely eliminate risks, an organization can minimize them. Companies that don't have an appropriate risk framework in place should create one now. For those that do, this is a good time to evaluate how well that risk strategy has bolstered performance through the Covid-19 crisis, and whether it needs any modifications to keep the organization strong through the challenges coming on the horizon.

These five practical steps can help any business establish or improve its risk strategy.

1. Create risk scorecards for counterparties.

Every business works with many counterparties. Banks may be the first that come to mind, but customers and vendors are counterparties, as well. Reputation and past experience may inform these relationships, but it's important to use research and data to develop a metrics-based risk profile.

Create a scorecard to assess each counterparty's risk to the business. Be sure to incorporate both quantitative and qualitative measures into the scoring system, and consider the following questions:

For banks:

- What is the market's confidence in this bank's ability to meet future obligations?
- Does the bank have an adequate capital structure to withstand an adverse stress scenario?
- Is the bank profitable and investing in its technology infrastructure?
- Does the bank offer electronic payment and collection services that can operate even if mail or physical facilities are disrupted?

For customers:

- What is our organization's risk tolerance toward customers' inability to provide full payment, or ability to provide only partial payment, of the invoiced amount due?
- How profitable is the relationship?
- Are the products and services tied to any single customer, creating a concentration of risk such that our business would

experience a significant disruption if the customer decided not to continue doing business with us?

For suppliers:

- What level of security does this supplier use to protect our confidential data from cybersecurity threats?
- Does the company accept check payments exclusively? If so, we could face challenges making payments in times of unexpected events, when it may be difficult to physically print checks on site or mail may become unreliable.
- To what degree would our own production be affected if this vendor experienced interruptions to its supply chain?

2. Analyze data to anticipate future risks.

The next step is to examine objective risk indicators and financial ratios for businesses similar to each counterparty, in order to determine how your banks, customers, and vendors stack up to their peers. The data to build out benchmarks can come from sources including Standard & Poor's, Bloomberg, and The Hackett Group, as well as in companies' 10-K and 10-Q filings and Investor Day presentations.

This benchmarking analysis can help a risk management team anticipate future risks by illustrating patterns and trends that are present in the industry, blind spots for which the target company and its competitors are not yet prepared, and emerging gaps for the target company relative to its peers that will require action and improvement.

When building such a peer assessment, consider the following key components.

- Cash conversion cycle: Calculate the number of days the organization requires to obtain liquidity through its operating cycle. (For benchmark data around the cash conversion cycle, see: "Strengthen Your Cash Position in the Covid-19 Crisis.")
- Liquidity risk: Examine available cash balances vs. used bank facilities.
- Financial risk: Measure capital structure costs and any foreign exchange (FX) exposure that puts the counterparty's financials at risk.
- Operational risk: Calculate the company's employee turnover rate, information that can usually be found in company 10-K or 10-Q filings or Investor Day presentations.
- Compliance risk: Look at reported breaches and events that have received negative press coverage.

3. Reduce liquidity risk by increasing visibility and identifying available sources of primary and secondary funding.

Many treasury teams have to determine their strategy for managing liquidity exposure with only limited visibility into the organization's global cash. Rather than relying on intuition-based decisions, implement end-to-end technology, optimize the business's global liquidity sources, and rationalize the organization's account structure to enable real-time visibility into liquidity at the domestic, regional, and global levels.

Forecasting global cash flows continues to be an important tool to evaluate access to primary and secondary liquidity sources.

Incorporating stress testing and scenario planning further helps treasury and finance teams achieve data-driven insights into future liquidity needs. For example, model the potential effects of FX and interest rate shifts; a delay in accounts receivable of 30, 60, or 90 days; and significant and unexpected outflows. Determining the effects of such surprises will help establish a diverse, well-developed contingency funding plan.

4. Reduce operational risk.

From people, processes, and technology to market volatility, a wide range of factors can drive operational risk. That's why it's critical to establish:

- A robust risk-mitigation framework with standard enterprise-wide policies and processes, including a dedicated cross-functional response team that can provide real-time internal and external communications in case of an adverse event.
- A strong internal accountability structure clarifying roles within the organization and team, individual ownership of tasks, and expectations around disruptive events.
- A business resiliency plan covering management, communi-

cations, and procedures, plus tests and reviews to ensure your organization is operational again as soon as possible following a crisis.

Concentrate on initiatives that provide high value not only to customers and vendors, but also to your internal organization. Prioritize efforts that increase efficiency and savings. Focus on freeing up working capital and streamlining processes and systems so that the organization can be agile and resilient enough to adapt to rapid market shifts.

Then, commit to long-term strategies that will make the business more resilient. The current crisis is worrisome, and the knee-jerk reaction of many treasury teams has been to tighten discretionary spending amid the uncertainty. However, it's important to keep in mind the long-term business value of everything from employee training and professional development to upgrades of software and hardware systems. Continue to evaluate long-term investments, even while focused on short-term performance.

5. Leverage big data to monitor risks.

Big data analysis can help a business predict and plan for disruptive events that traditional processes cannot identify. For example, some big data tools replicate specific scenarios to analyze the potential impact of disruptive events ranging from natural disasters to military conflicts. Likewise, these platforms can help the treasury and finance teams develop better business continuity plans by identifying operational inefficiencies, issues with internal systems, and cybersecurity and fraud threats. Big data analytics enable organizations to make thoughtful, data-driven decisions, rather than relying on intuition.

Look Ahead

Building a comprehensive risk strategy is always critical in minimizing the exposures an organization faces and increasing the business's stability. The strategy is more important now than ever before, given the impossibility of confidently predicting what the near future will hold for financial markets, supply chains, customer demand, interest rates and FX, and many other factors. The anticipated uptick in merger and acquisition (M&A) activity as economies come out of the Covid-19 crisis will further necessitate a strategic approach to risk management.

Organizations that successfully navigate this challenging time period can emerge stronger. To do so, they need to look toward the examples of companies that have successfully grown during difficult times and follow suit, taking proactive measures rather than waiting until the dust settles to assess growth opportunities. These measures may include performing due diligence on potential M&A targets and creating day-one go-forward planning that integrates operational and strategic aspects. These efforts will be core to your M&A strategy, and they will position your organization to grow into a market leader.

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