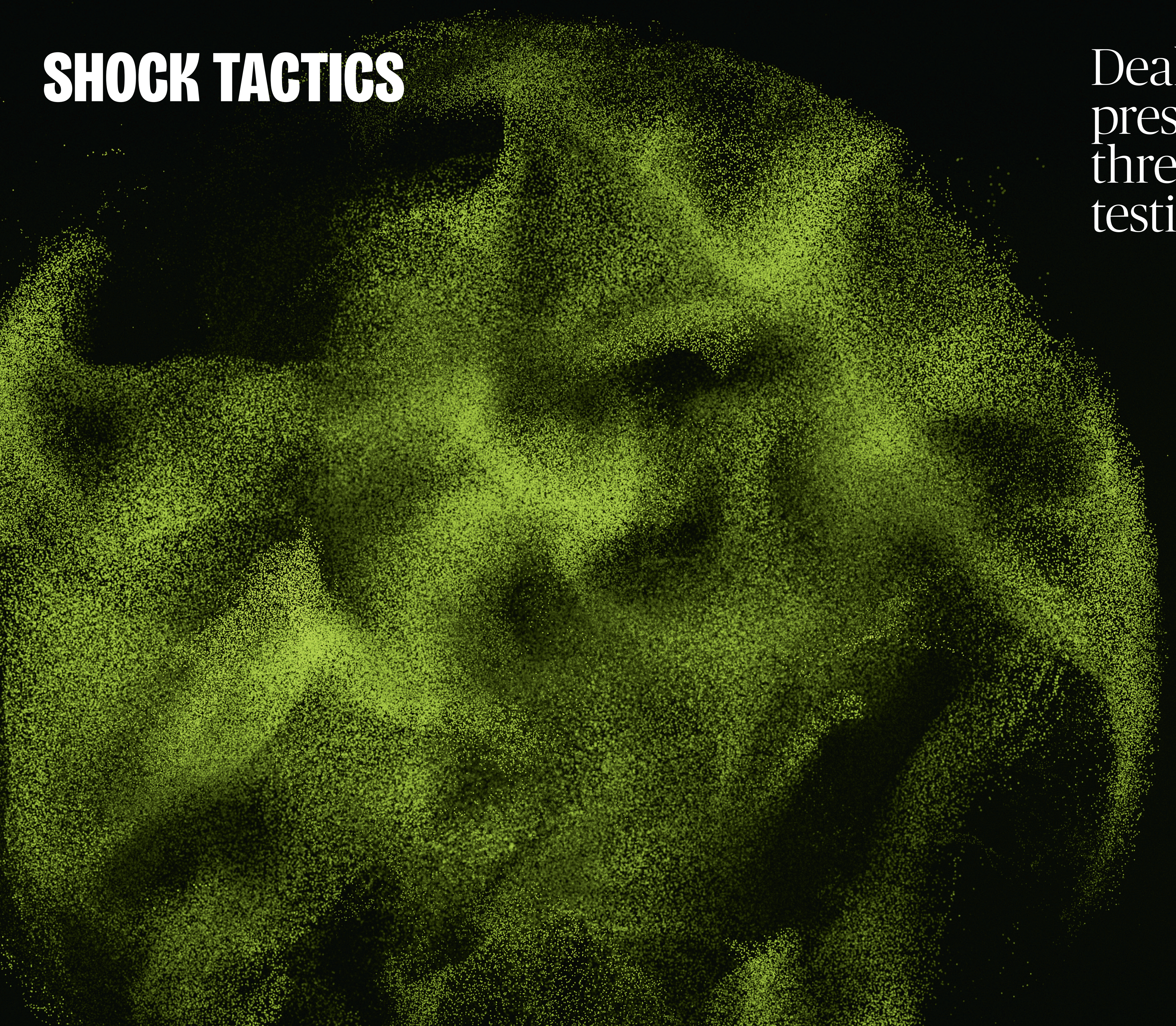
Story by Domini Stuart

SHOCK TACTICS



Dealing with ongoing financial pressures, global uncertainty, cyber threats and pandemic after-effects is testing business resourcefulness.

A resilience rethink is required.

High interest rates, inflation and lingering pandemic effects are driving persistent financial strain and mounting cost pressures on Australian businesses.

The road ahead could be bumpier than many Australian boards are used to, according to John Park, senior managing director and head of Australian corporate finance and restructuring at FTI Consulting. "They're facing higher inflation, rising interest rates, supply chain disruptions, global unrest and fundamental changes to the demands and wants of consumers," he says. "Further, the emergence of new challenges such as cybersecurity, AI and big data have increased the workloads and mandates of directors and management alike."

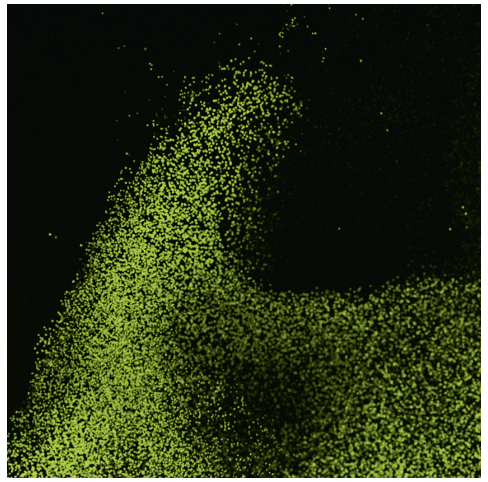
For some, insolvency is looming as a real – if shocking – possibility.

"If the threat of insolvency is immediate, it's vital you engage advisers who can consider all available options such as safe harbour and the prospects of a restructuring plan," says Matthew O'Keefe, managing director at FTI Consulting. "If the threat is emerging, remember that as you progress along the solvency curve from performing, to underperforming, to stressed then distressed, your attention and resources are increasingly diverted from core business operations and risk management. Catching the falling knife early will be a lot less painful, so act quickly to engage trusted advisers, gain clarity on your forecast liquidity, identify and interrogate potential options, and quantify the financial, operational and human resources you'll need to carry them out."

Develop a system

For some, the pandemic has already tested resilience to its limits.

Martin Reeves is chair of BCG Henderson Institute and an author whose books include *The Resilient Enterprise: Thriving Amid Uncertainty*. He believes resilience requires a fundamentally different mental model of business – one that embraces complexity, uncertainty, systems thinking, interdependence and a multi-timescale perspective. "During COVID, every business was forced to adjust and most businesses eventually returned to previous levels of performance, but it would be misleading to interpret this as success," he says. "The real questions are, how prepared were companies relative to the competition? How quickly did they adjust? Did they seize the opportunity to create advantage and improve their position? And did they learn to be more prepared for the next shock?"



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Keri Pearlson, MIT Sloan

Reeves suggests that while most business leaders understand the idea of resilience and appreciate its importance, at an operational level, fewer understand how to create, measure, manage and systematise resilience.

"Resilience is really about the application of six principles (redundancy, diversity, modularity, adaptation, prudence and embeddedness) on four timescales (anticipation, shock, adjustment and reimagination)," he says. "Essentially, having no slack means you have no ability to buffer shocks, but building redundancy requires a short-term trade-off between efficiency and resilience. The same is true for diversity. It takes time to change your business model so that you're not dependent on one way of doing things or one set of suppliers."

Plan ahead

Ralph Khoury, Australian expat and Nissan United CFO for the AMIEO region, believes resilience is connected to long-term strategic planning. Based in Dubai, Khoury has spoken regularly on the importance of strong finance leadership in times of crisis, including a keynote at November's World Finance Forum in Dubai. His vantage point is unique at Nissan United, a multidisciplinary marketing and communications unit for the auto manufacturer that sits within global advertising firm TBWA. Khoury leads financial and operational strategic leadership for the unit across Africa, the Middle East, India, Europe and Oceania.

"Many companies were caught seriously off-guard when COVID struck," says Khoury. "They've seen the impact it had on their business and they're wary of when the next crisis will materialise. Now it's time to focus on business fundamentals, in particular what you can control, rather than spending endless time worrying about what you can't control. It sounds simple, but when you adopt it as a principle, it can make the right decisions a whole lot clearer."

Cash flow and liquidity can deliver a healthy balance sheet for any business.

"Focusing on these will strengthen a company's overall financial position, improving working capital and insulating the business against further crisis impacts and potential relapses," says Khoury. "Today, you have time to try to get this right. Once a new crisis hits, then it's too late. Everything becomes short term-focused in a crisis, with the decision-making becoming very tactical. In the midst of a crisis, you're forced to consider your clients' challenges and look at ways to cater for them."

Longer-term, he believes many companies will continue to benefit from the changes triggered by the pandemic. "The crisis forced many of us to rethink our business models by using ecommerce, automation and technology to drive efficiency," he says. "Those who haven't embraced technology will likely fall behind or suffer a slow death."

Resilience in smaller businesses

Most customers of business management software provider MYOB are businesses with fewer than 1000 employees. According to CEO Paul Robson GAICD, many are adopting financial prudence as a way of shoring up their resilience.

"These smaller and mid-sized businesses are also finding ways to access extra funding if they need it, but it's even more important for them to be tuned into to the macroeconomic conditions limiting disposable income," says Robson. "For example, if your business model is geared to a strong sales period, such as holiday season sales or tourism, you can no longer predict the future by simply looking to the past."

Technology can help by providing real-time insights. "If you know how you're doing today, you can make decisions for tomorrow," he says. "But, in these economic conditions, it's wise for smaller businesses to take a conservative approach to, for example, hiring casual labour or ordering extra stock. It's far better to end the year with excessive demand than with excessive inventory or falling short of expected revenue."

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Cyber protection is not resilience

Park has seen numerous examples of otherwise financially resilient corporations being affected by the emergence of new threats, especially cybersecurity breaches and hacks.

Keri Pearlson, executive director of cybersecurity at MIT Sloan, believes boards could achieve better outcomes by adopting a different investment strategy.

"Most companies spend all their cybersecurity resources on protection, but we can see from the number of cyber incidents that protection isn't enough," she says. "Instead, the board should be focusing on resilience – how they can prepare the organisation to respond and recover when a cyber incident occurs. Imagine if an attack had no financial impact, if it had no organisational or operational disruption and caused no reputational damage. It may not be possible now, but if we don't put that vision out there, we're never going to try to achieve it."

Along with protection, she recommends boards invest in things like tabletop exercises – simulated scenarios designed to test the organisation's response to various cyber threats.

"Regular practice sessions will ensure everyone in your team knows the role they need to play and have the right tools to do the job," says Pearlson. "You also need a communication plan so you know who you have to talk to and what you're going to say. Of course, the board plays an important role in establishing a culture of cybersecurity throughout the organisation."

Pearlson would also like to see changes in how cybersecurity is reported to the board. "It's nice that a cybersecurity manager reports on how many people failed a phishing exercise, or what their identity and access management tools look like, but this is focusing directors' attention on much too narrow an area," she says. "I propose a 'balanced scorecard', built on work carried out by Kaplan and Norton some years ago. This combines financial, technological, organisational and supply-chain risk indicators with an aggregated indicator of resilience in a way that makes complex information easy for leaders to understand."

While it would be unrealistic to expect the whole board to understand the technicalities of how encryption works or what the company's different layers of defence are, Pearlson believes at least one director should have a cybersecurity perspective. "This is someone who understands what a cybersecurity expert is saying and who has the confidence to question an expert if something important is being overlooked," she says.

"Board members aren't generally shy about asking questions, but neither do they want to feel exposed by revealing things they don't know. Having at least one director who brings foundational cybersecurity knowledge to the board is just good resilience planning." ■