



## Strategic Stressing

As many boards think ahead to their strategy away day, they may be looking for different ways to liven up the discussion and get new insight. So it's perhaps a good time to think about what you can do to consider different scenarios and the "what ifs?". Financial institutions are used to stress testing – but even there it may not reach the boardroom, being seen as a regulatory response rather than a strategic tool. And other types of business can also benefit from "kicking the tyres" of different short and longer term scenarios. If done well it provides a very useful backdrop to the strategic review. But it's quite easy to do it badly, dragging the board into too much detail and making it all seem a bit pointless. Here are a few points on what can be helpful...and what to avoid.



### Good practices to consider...

Aim for a few scenarios only. The idea isn't to arrive at a likely scenario or to anticipate every eventuality. Instead it's to provoke debate, make sure the big issues and the big risks get an airing and to provide a framework for long-term strategic development and risk management.

Make sure the main assumptions are clear and understood – and not too clever or over-engineered. Stick to just a few that are the main drivers for your industry or your model. And be rigorous in asking "do they make sense?"

Be comfortable with ambiguity. You can't know with any certainty what's in the future but you can identify the things you and management need to watch out for – and maybe react to.

### Things to avoid...

Trying to flex too many assumptions. That way you end up with too many scenarios. And there's a danger of the exercise being dismissed as valueless because it's seen as all too hypothetical.

Being told – or letting yourself be told – that "it's all too complex to explain". The main assumptions should be clear – and if they're not and can't be explained, that should mean you need to start asking more questions not fewer!

Aiming for precision. It's an art, not a science. It's not there to be audited but to provide a basis for discussion and strategic debate – at board level at least.

## Good practices to consider...

Make sure you're told how far the main assumptions underlying the business model are based on fact - and which are best guesses.

Think about contagion and interconnections. When things out in the marketplace start turning in the wrong direction (financing availability, economic growth, consumer spending, commodity prices, regulatory change...) how are you likely to be affected? Or look at a core part of your business: what happens if it turns down?

Ask about the controls around your modelling. As a Board you don't need to know the details but you do need to know that there are quality checks in place to make sure your model is sound. Have Risk Management and/or Internal Audit taken a look?

Try a bit of "reverse stress testing". It's now used by financial institutions as standard but it can be used by others too. It involves working out what it would take to "break the bank". How much of a decline in your main drivers would it take to mean you're in a spot of bother - or worse? That way you can start to get a feel for how unlikely it is.

If you have any questions on the issues covered here, please contact Richard Sheath at [richard.sheath@independentaudit.com](mailto:richard.sheath@independentaudit.com)

We are leading specialist advisors on corporate governance. We assess the effectiveness of boards, committees, internal audit, external audit and risk management.



## Things to avoid...

Assuming that the key assumptions and estimates used are more solid than they in fact are. Check how far management have confidence in their soundness.

Developing scenarios and modelling in a bubble. Management will of course know that you have to take into account external dependencies. But they can be especially hard to pin down so there's a tendency to look inside at the more knowable and controllable factors.

A model containing big mistakes is not much use. By the time forecasts and scenarios have reached the Board, they should have been picked up. But those responsible for the model may be too close to it - fresh eyes may be better at spotting weaknesses or illogicalities.

Trying to imagine scenarios which might be threatening, or testing random scenarios might not get you very far - or lead to madness. Working backwards by testing what would need to happen to the main drivers to cause major problems helps by narrowing it down.

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