The Effective Board

INDEPENDENT AUDIT
BOARD REVIEW

December 2017

De-stressing and Stressing

It's time to celebrate! We send all our readers warm greetings and wish you a Happy New Year. Forget the year end accounts, put the Annual Report draft to one side, let the December minutes wait and get as much rest as the smaller members of the family will let you have…because you'll be having to draw on all the calm you can muster in the year ahead. Next year is likely to be an unusually unpredictable one – so how can boards prepare for the unknown?

There's an understandable reluctance to spend valuable board time speculating about unknowns, but 2018 promises to bring particular uncertainty. So there's some point in doing a bit of crystal-ball gazing, if only to think through what "being prepared" might involve.

Good practices to consider...	Things to avoid...
Allow time to stand back and think through some different scenarios for the next few years. Put your Principal Risk lists to one side and look to identify the big uncertainties and risks that most of us will be having to manage in the future. Brexit, of course – but also growing cyber threats, increasing interest rates, exchange rate volatility (and possible weakness in sterling), stock market corrections, geopolitical uncertainties everywhere you can think of… It all adds up to a changing mix – and that's before you add in underlying shifts such as technology and customer trends.	Failing to stand back far enough. Boards often can get stuck in a bit of a rut with their Principal Risk discussions and find it hard to go beyond the risks that are more immediate or more knowable. (And even less usefully, many so-called Principal Risks are actually just routine things that need to be managed in the ordinary course of business.) Too much time on this means the board won't have time to look further ahead and bat around big ideas about what might be looming. Strategy days don't lend themselves to this, as management often has objectives for the session that mean you need to keep focused. So find a time to do some speculating – certainties will be unreachable but some ideas will be useful. And, besides, it should be a lively and enjoyable discussion!
Keep track of ideas – with the Company Secretary or CRO capturing and structuring what comes out of the discussion. The executives can then think through how far they might need to respond – whether in tweaking strategy, strengthening contingency planning or bringing decisions and actions forward.	Letting it be all too informal. Good ideas will come out – but they'll easily slip away or be lost in an unstructured discussion. Especially over dinner – this can be a very good format for a wide-ranging discussion, but you need to plan ahead and have someone present to take notes. (At this time of year, a teetotaller would be ideal.)

Good practices to consider…	Things to avoid…
Do some "reverse stress testing" and think about what it would take to get the business into trouble. It's standard in regulated financial services businesses where many have found it a useful discipline. And getting into trouble isn't just about going bust – there are plenty of other scenarios you'd rather avoid. Such as issuing successive profit warnings… performing at a level where the share price will drop significantly… becoming a takeover target… having to raise more equity at the wrong time… What would it take for any of the "big uncertainty" scenarios to get you into that sort of situation?	Dismissing downside scenario planning as a waste of time or the haunt of unduly pessimistic naysayers. Yes, positive thinking is indeed important. But boards need to help management think through how the present uncertainties might lead to things going wrong for the business. That helps identify what might be required to reduce the likelihood of damaging consequences if scenarios turn out badly. And then you're better placed to think through the risk-return angles of investments and mitigation strategies.
Think through the most likely Brexit scenarios. Of course there is no certainty for now, and probably not for many more months. But working out the possible implications of some different outcomes will help you at least get your head around the unknowables and enable you to start thinking about where it's safe to wait and see, and where you need to start making investments which might be money down the drain but could equally prove to be utterly invaluable.	Putting off thinking about it because of the uncertainty. Nothing's agreed until it's all agreed – so uncertainties will remain until late in the day, even if the negotiations' progress confounds our wildest expectations... and by the time outcomes are clear it could well be too late. Even if plans have to stay contingent, boards should have thought through the risks, consequences and opportunities of various scenarios – and identified which ones are too dangerous to be awaited without preparation.
Think again about the scenarios that might emerge from technological change. You've probably discussed these trends as part of your strategic thinking – but did you think through possible scenarios and the stresses that might result, especially if things happen more quickly than you've foreseen? Have you properly considered the possibility that technological change might make your existing business redundant?	Underestimating the pace and impact of change. You may be right that it will take longer – or that technical challenges and glitches will slow things up. But you might be wrong. And you don't want to wait until it's too late before you contemplate that possibility. Even if you're not wrong, the discipline of thinking through the impact of possible scenarios will throw up a few important questions to consider further.
Look at the financial models to anticipate the impact of increasing interest rates – whether on the financial model or on customers and debtors. And don't forget to consider the possibility of market upheaval affecting the availability of funding. We've got used to the markets being awash with cash, but that's not always the case and experience shows it can change dramatically very quickly.	Taking it for granted that the prevailing low interest rate scenario will continue and that any increase in rates can only have a marginal impact. A small change can have a big impact when people (finance managers, customers…) have had ten years of exceptionally low – or even negative – interest rates. NEDs are much more likely than most managers to have lived through turbulent times – so if anyone's going to prevent history being repeated, it's them.
Likewise, think through a higher inflation rate scenario – or deflation – or stagflation. None of these is out of the question – and all could have a significant impact on a wide range of economic variables and performance drivers: customers, supply chain, costs…	Failing to look over the parapet at changing macroeconomic conditions. Yes, the economists often get it wrong and there will always be speculation involved – but the economists are there to help you think though scenarios, not to give definitive answers.

Good practices to consider…	Things to avoid…
Watch out for political instability or flashpoints. It doesn't take much disruption in the Middle East to impact oil prices – so what would be the impact on you? How might volatility in Asian markets affect your business or growth plans? And of course there's closer to home as well, where the febrile political conditions mean all sorts of possibilities for 2018 – alarming or exciting according to taste.	Seeing macro politics as too distant and unpredictable. The last year has shown that very little is too improbable to contemplate… so it's best to think through the possible implications for your business. Then, if scenarios start to emerge, you've at least already done some of the thinking on how to respond.

Independent Audit can help with your individual director assessment. We have structured questions sets for executives and non-executive directors, which allow board members to review one another. We also have questionnaires for evaluating the Chairman and committee chairmen built into our online self assessment tool, Thinking Board®. And as part of our external board reviews, we can gather views on individual contribution and skills.

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