CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

BRIEF 1

Embracing Uncertainty

PLANNING FOR RESILIENCE IN A POST-COVID-19 WORLD

MAY 2020

We are living amid one of history's worst pandemics, broadest economic contractions, most significant government interventions, and deepest oil price declines – all at once. The unprecedented circumstances are forcing many organizations to face existential challenges. The pace of change and scope of its impact may not wane, even when restrictions lift. Wise leaders know that the time to start planning for the post-COVID-19 world is now.

The trajectory of the virus and its knock-on macroeconomic impacts remain unknown and are sure to vary by region and industry, meaning there is no perfect solution or one-size-fits-all approach. Yet, certain critical business themes and structural shifts are becoming evident. While worker safety and business continuity are paramount in the immediate term, company leaders need to begin looking forward and planning durable strategies for both the changing dynamics to come and for what next "black swan" event may follow.

Note: The outbreak is moving quickly, and circumstances surrounding the themes herein may change. This article reflects our perspective as of May 2020.

This brief is one in a series.

- **This document (Brief #1) describes the circumstances faced by Canadian organizations during the height of the COVID-19 crisis, and the mounting focus on organizational resilience arising from the economic disruption and recovery efforts. It serves to introduce high-level considerations for businesses to reflect on today as they assess the strength of their business model in a post-recovery environment.**
- It will be followed by a collection of thematic focus pieces describing, in greater detail, key business considerations and practical recommendations, both for achieving medium- and longer-term resilience as a competitive axis and for traversing the macroeconomic themes shaping the post COVID-19 world.

These briefs are intended for executives of Canadian corporations and their CPA partners or advisors.

This is a time of unprecedented change, where intersecting shifts in human and economic patterns are transforming the world we know. Right now, company leaders are concentrated on keeping their teams safe, reducing the probability and impact of disruptions to their businesses, and determining how to continue delivering to clients amid interruptions and uncertainty. In this survival mode, it is easy to lose sight of the planning and actions that are needed today to adapt to the next phases of change and re-emerge in a position of strength.

Perhaps the most valuable lesson to arise from the COVID-19 crisis is that when lockdown restrictions ease, businesses will still need to understand how to operate in fundamentally new ways. The immediate path to reopening doors has its own set of risks, opportunities and decision points centered around workforce fragility, cash management and asset impairment. Yet, the events have also uncovered deep structural vulnerabilities across traditional business models – ones which do not correct as the curve flattens. This discussion – and the deeper dives to follow – narrow in on the fundamental shifts to consumer and commercial patterns that may shape the post-COVID-19 economy and the steps businesses should take today to ensure that they adapt to any eventual outcome and align with a sustainable future.

Step 1. Examine the Business Model in Great Detail

Prepare for Stages and Layers of Impact

COVID-19 is not just an economic and healthcare shock. It is a shock to industry structures, consumer behaviours, market positions and sector attractiveness[1] that is revealing systemic exposures across the global value chain to both financial and non-financial factors.

1 Ken Sneader and Shubham Singhal. The future is not what it used to be: Thoughts on the shape of the next normal. (McKinsey and Company, April 14, 2020)

While there are varying estimations of the totality of the damage and the trajectory forward, companies should prepare for stages of economic recovery that may result in a new playing field. The passage will be non-linear and peppered with fits and starts: The recession may deepen; regulations may change; credit markets may seize up despite stimulus; asset values and investor sentiment may shift; margins may shrink; supply chains may move closer to home; R&D priorities may need to pivot; online retail and remote working patterns may stick; the fallouts from broad-based unemployment and deliberate economic constriction remain to be seen; and the list goes on …

If we can take anything from this global financial crisis, it is that we should not assume a quick recovery; we were still in a "low for long" rate environment when COVID-19 hit. Every variable – and the interplay between them – presents business risk and opportunity; the distinction comes down to strategic focus and controlled agility in the face of change.

Understanding Risk Exposures – Opportunity to Leverage Climate Tools?

As organizations struggle to "right the ship" in the face of the human impacts of COVID-19, it is hard to know who to turn to or where to begin. Information and estimates continue to amass from all directions, with varying degrees of authority.

While the two are disparate in terms of timeframe and impact, one could draw meaningful economic parallels between the climate and COVID-19 crises. Each is a highly uncertain, rapidly-evolving global disruptor with multiple orders of impact over various horizons. Both are shaped by daily actions, with no historical precedent or data set against which to shape our responses – thus traditional metrics and assumptions apply to neither.

The recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) were commissioned by the Financial Stability Board to help organizations (of every kind) improve transparency to stakeholders on the risks and opportunities they face. While the recommendations are disclosure-based, their implicit impact is assisting companies to:

1. decode climate-related business impacts
2. understand their degree of exposure to those impacts
3. assess whether the organization has the necessary structures, strategies, tools and capabilities to manage material risk impacts and capture key opportunities

This bottom-up transparency is essential for businesses trying to make informed decisions about the security of their critical functions and assets. It is noteworthy that the TCFD reporting requirement was attached to the Canadian federal government's Large Employer Emergency Financing Facility (LEEFF).[2]

The TCFD model is robust, and it could offer a useful starting place for organizations to explore how they are uniquely exposed to the systemic risk factors uncovered during the pandemic and what potential gaps exist across their crucial business functions. Its four pillars (bolded below) represent core elements of how organizations operate and are designed to interlink and inform one another:

2 Justin Trudeau, Prime Minister of Canada [website]. **Prime Minister announces additional support for businesses to help save Canadian jobs** (May 11, 2020)

Governance – What is the company's overarching point of view on – and vision for – the post-recovery economy? What oversight mechanisms are in place to ensure incremental decisions steer the organization toward the desired end goal?

Strategy – What are the most significant financial threats, risky dependencies, sensitivities or opportunities to the business today, when restrictions lift, and over the long term? What is the likely timing, sequencing and magnitude of those impacts on financial planning and critical business services? Looking into the future, what potential circumstances will the business need to operate in? What tail risk events might it face? How does the company's position stand up across those scenarios?

Risk management – What are the company's structures, processes and roles for systematically identifying, assessing and managing critical risks and vulnerabilities across the enterprise?

Metrics and targets – Are there directional metrics that would help guide the business down a critical pathway, or trigger points that would help flag a key decision or time to take action?

The prevailing themes from climate economics – transparency, risk mitigation and adaptation – may become focal points in a post-COVID-19 world. In relatively short order, climate-related factors have permeated the supervisory ecosystem, from macroeconomic forecasting to credit ratings. If resilience becomes a hot topic on the regulatory radar, businesses will need to be ready to demonstrate that they have the people, processes and structures to manage uncertain, evolving risks and opportunities and keep their stakeholders apprised along the way – the TCFD framework is structured for exactly that purpose.

Step 2. Assess Organizational Resilience

"For some organizations, near-term survival is the only agenda item. Others are peering through the fog of uncertainty, thinking about how to position themselves once the crisis has passed and things return to normal. The question is, 'What will normal look like?' While no one can say how long the crisis will last, what we find on the other side will not look like the normal of recent years."[3]

Rethinking Business Continuity

> While some companies will have faced prior hardships (cyber-attacks, floods, fires) and enhanced their crisis management capacity as a result, COVID-19 is revealing that even the best-prepared organizations have room to re-examine their risk tails and level of agility in a shifting competitive and risk landscape.

Traditional discussions around business continuity start with whether a key process or piece of business infrastructure will or won't fail. Businesses devise solutions to mitigate the effect of a potential failure and identify their operating priorities if a disruption occurs. Moving forward, investors, clients, suppliers and regulators will want to know not only how a company plans to self-preserve when a critical system or process has failed, but

3 Ian Davis, The new normal, (McKinsey, 2020)

also how it plans to ensure continued delivery to its stakeholders. The question is no longer “Will a disruption occur?” but rather, “What have you done to ensure I can continue to rely on you when it does?” Companies without an answer risk losing valuable partners and clientele to better-prepared competitors.

Businesses should review their portfolio of strategic responses, risk hedging solutions and back-up plans under a broader array of potential events (was a global healthcare-based supply chain shock on the radar?) and ensure it still performs relatively well, as a whole, across all likely scenarios.

Resilience = Flexibility

We do not know how this crisis will unfold, how long it will take or what next major event to prepare for. Business as *un*usual is the new norm, whether due to disruptions from increasing climate events, market shocks or the unprecedented COVID-19 pandemic. All of these disruptive influences confirm that business leaders must become adept at operating in extreme uncertainty. That ability – the essence of resilience – is not a business characteristic; it is an evolving skillset.

> Resilience is the ability of an organization to quickly adapt to disruptions while maintaining operations and protecting people, relationships, assets, brand equity and cash flow.

> We saw glimpses of supply frailty during the Fukushima tsunami disaster in 2011, when shortages of integrated circuits from Japan impacted the technology products market. Because the repercussions were sector-specific, the lessons were perhaps not fully appreciated nor applied toward avoiding the worldwide supply chain disruption that occurred when China halted production.

Take global supply chain management, as it may be one of the most transformed elements in a post-COVID-19 world. For decades, we have designed business approaches like Moore’s law[4] – optimized primarily for cost and speed to market. The acute focus on system efficiency was not wrong. Still, it was imbalanced, and the measures that enabled an ultra-efficient supply chain (outsourcing, just-in-time inventory management) also introduced inflexibility into the system. When COVID-19 forced manufacturing halts because critical components sourced from China were no longer available, the value of supply chain continuity came into glaring view.

Clients may be willing to pay higher prices in the future to ensure continuity of supply, realizing that saving pennies on inputs could impact their ability to support customers and generate higher value revenues in times of disruption. The challenge for company owner-managers is balancing the cost of resilience without compromising on efficiency or value.

4 Carla Tardi, Moore’s Law (Investopedia: Sept. 5, 2019)

Understanding Points of Failure

Resilience requires a keen understanding of where the business is most at risk, and where its strengths are, under normal and stressed scenarios. Sensitivity analysis of critical business components helps understand what triggers, interdependencies and impacts to plan for – and whether the organization is structured to enable an agile response to disruption.

Think of your company's critical components: suppliers, customers, employees, lenders, shareholders, partners, facilities, equipment, infrastructure or other. For each of these, ask:

1. How would a sudden change or loss of a critical component ("x") affect the ability to run the business and generate returns?

   The driver could be environmental (market-based, regulatory, technological or societal) or business-specific (a failed supplier, the loss of a key customer or employee, damage or lack of access to a facility, or divestment by a major shareholder).

2. What would happen if a second component were to fail ("x + y")?
3. Now, what if it were happening to everyone?
4. Does my business model need to change to minimize and withstand the impact of those losses over the short, medium or long term?

The solution depends on the vulnerability, but the essence of resilience is moving from "What should I do?" to "What will I have done **today** to ensure that a sudden change or interruption across key components is not life-threatening to the business **tomorrow**?". It might mean diversifying or reintroducing operational and financial depth that the business had invested heavily in eliminating. Depth comes with a cost; it is more expensive to have multiple sources of supply, to cross-train employees, to set aside contingency funding or to hold inventory. Businesses should take stock of what has worked well since the onset of COVID-19 – and what has not – and overlay that context onto a cost / benefit review of potential resilience measures.

Every business has its blind spots. Preconceived notions about "the way things are" can get in the way of revealing very real weaknesses or opportunities. Unfortunately, it can take a disruptive event to trigger reflection. But even with the best intentions, it is hard to objectively analyze from the inside. To conduct a thorough analysis of potential vulnerabilities, businesses should engage skilled advisors who will analyze the business in depth and without bias.

Once baseline sensitivities are understood and planned for, companies can begin exploring the opportunity in disruption and whether or how they will position themselves to take part in (and advantage of) the revolution. Does the business house the intellectual capital or innovative capacity to help identify or execute solutions that will differentiate it from its competitors? Structural market changes often make way for new markets and business models – is the company equipped to align itself with the future-makers of its industry and contribute in shaping the next ecosystem? Resilient companies will play a lead role in designing – and thriving in – new circumstances, while others weather the storm.

Every business assumption should be open to question and the "materiality test" should go beyond predictable costs, all with a line of sight to evolving near- and longer-term industry trends and market patterns. As McKinsey warns, "The pendulum might not swing back fully once the outbreak has relented."[5]

> Organizational responses will impact the company's ecosystem of suppliers, customers, employees, competitors, lenders, owners, agents and partners. Enhanced resilience requires many groups across a company (and across reporting lines) to align on priorities and operate in a more cohesive, integrated way. The first step is identifying those closest to the work and then spelling out who will be involved, and to what extent, in making and communicating key decisions. Likewise, the evaluation of resilience risk and opportunity should consider the company's integration with clients and other market participants; one partner or link along a value chain would be challenged if left to drive transformative change alone.

Do Not Let Perfection Be the Enemy of Progress

There will be many unknowns in the weeks and months ahead. In the end, resilience is about having the organizational processes and discipline to develop (and continually enhance) the strategies and capabilities to deliver in calm and in crisis. The point is not to build concrete, detailed plans but rather to begin a dialogue on big themes and material business impacts over the short, medium and long terms. Use your mission and corporate vision as beacons, even if they evolve. Revisit plans as new intelligence becomes available.

> Companies may face pressure from stakeholders to quickly become fluent in resilience and build it throughout the enterprise. Much like other transformative themes of the past – the transition to IFRS, cyber-security, climate change – the business advisory ecosystem is adept at cutting through complexity and guiding companies through new and evolving circumstances.

Step 3. Practice Discretion in Accepting Stimulus Support

The Canadian government, and others worldwide, are currently injecting massive sums of emergency financial support into all parts of the economic system. We are experiencing economic intervention on an historic scale; as of April 10, governments across the globe had announced stimulus plans amounting to $10.6 trillion.[6]

Support will come in phases, each with its own considerations and dynamics.

5 Matt Craven, Linda Liu et al., COVID-19 – Implications for Business (Mckinsey & Company: March 30, 2020)

6 Ken Sneader and Shubham Singhal. The future is not what it used to be: Thoughts on the shape of the next normal. (McKinsey and Company, April 14, 2020)

Phase 1 – Emergency Recovery

> Companies should consult their business advisors on which of the available stimulus packages are right for the organization and how to navigate eligibility and reporting requirements.

Right now, the government is extending an assortment of quick emergency provisions to bridge the road from relief to recovery. The measures are designed as a temporary splint to help the companies and citizens most in need to stay afloat, keep their workforces intact and prepare for a managed return to business. Though targeted fiscal policy is most effective, the necessary speed and scope of delivery has limited the government's ability to introduce controls; the onus is on recipients to practise discretion when accepting the limited funds. Emergency stimulus is not a source of "free funds" for functioning companies to collect as a safety net. In fact, some healthier organizations are refusing or returning the support. Company leaders should be thoughtful in aligning available government provisions with the entity's unique corporate strategy and needs.

Phases 2, 3, and Beyond – Scaled Co-Investment in Economic Growth

At a reasonable point, governments will turn their attention to economic rebound and growth, and will require significant private sector partnership in their pursuits. Canada's private sector leaders in all industries should take a vested interest in where stimulus investments flow and how to apply those investments toward a smart, competitive and resilient economic system and society. Decisions today will shape our country for decades to come.

Weighing Canada's climate commitments

Knowing that major economic decisions made in the wake of COVID-19 will have lasting effects, the IEA has urged worldwide governments to focus their economic stimulus on measures that revive the economy while reducing carbon-intensive investments. In line with the call, Canada's minister of finance is working with provinces to apply a rigorous climate lens to recovery efforts. This month, the newly announced Large Employer Emergency Financing Facility (LEEFF) came with the condition that recipients commit to future climate disclosures and environmental sustainability goals.

Meanwhile, a new independent Task Force for a Resilient Recovery led by prominent financial, political and sustainability figures will deliver recommendations in the coming months on how governments can use a range of tools to support the "jobs, infrastructure and growth that will keep Canada competitive in the clean economy of the 21st century."[7] If other countries follow suit – and it appears they will – the low carbon transition could gain renewed momentum in the post-COVID-19 economy, and it is an important macro theme to consider in assessing future businesses models.

7 Taskforce for a Resilient Recovery (2020)

Stay Tuned for Next Steps

In the coming months, CPA Canada will issue a series of follow-on focus pieces examining the themes of this briefing and associated strategic initiatives in greater detail, with practical recommendations for companies to consider in developing their post-recovery resilience playbooks. Examples of focus topics include:

- assessing and reinforcing organizational resilience in line with national goals
- retooling Canada's supply chain of the future
- reshaping industries and harnessing innovation in the new context
- the financial sector's role in fostering sustainable development and economic regrowth
- striking the balance between privacy and the protection of public health
- the future of work from a business and employee perspective

The guiding principle and overarching objective of CPA Canada is enabling Canada's accounting profession to serve and protect the public. To meet that objective, it consistently develops and promotes programs, and advocates for public policy that serves consumers, businesses and organizations. As Canada looks to restart its economy post-COVID-19, CPA Canada commits to its role in promoting a more sustainable and resilient economic system and society.