CNA

Establishing Strategic Business Resilience

Position your organization to endure and thrive through adverse business conditions.

The Value of Preparedness

Recent business disruptions, from the global pandemic to extreme weather events - underscore the value of establishing and maintaining a holistic risk management program that is anchored in preparedness. To grow and thrive in an uncertain risk environment, business leaders need to continually examine potential disruptions, prepare to absorb the shockwaves of disruptions, and quickly adapt their operations to be resilient to many different situations. CNA's 2021 Establishing Strategic Business Resilience report provides suggestions to business leaders on how to develop a resilience culture and a sustained ability to endure disruptive events.

Three considerations to help business leaders manage a disruptive incident regardless of how, when, and where a disruption occurs:

Step 1: Understand the Changing Risk Landscape

Step 2: Advance Resilience Capabilities

Step 3: Implement Strategic Insurance Coverages

Step 1: Understand the Changing Risk Landscape

As we continue to work in an interconnected risk landscape, business leaders consume the news daily to understand the events happening in their local community as well as what is occurring across the world. Awareness helps business leaders better prepare for emerging risks and potentially disruptive events. Scenario planning requires one to imagine what lies ahead, considering how to deal with a variety of uncertainties. For example, what are the next unprecedented events that could severely damage the business? Will the risk be a slow and steady rise providing the company time to adapt or is it more likely to be a sudden disruption? The past year has presented many changes in the risk landscape, challenging businesses to think both proactively and reactively.

Advanced Robotics and Automation

Technology advancements are transforming how businesses produce, manage, and govern in almost all industries. The result of this revolution has produced impactful innovation, including robotics, automation, the Internet of Things (IoT – sensor technology), autonomous vehicles, 3-D printing, nanotechnology, biotechnology, materials science, energy storage, and quantum computing. Many experts anticipate that these advancements will exceed the scale and impact from previous industrial developments.[1]

These advances will also spawn new vulnerabilities. The energy, network, and computer systems required to operate these developments are susceptible to cyberattacks. They are also more sensitive to utility outages, such as water, power, and internet – all which are needed to maintain an efficient operating environment. While automation can increase efficiency and output to manage costs, the skilled workforce requirements along with extended replace and repair times following disruptions will need to be incorporated into insurance coverages as well as business recovery and restart plans.

[1] Klaus Schwab, The Fourth Industrial Revolution: what it means, how to respond, January 14 2016, (link)

Cyberattacks

Geopolitical action will be required to stem the volume and severity of cyberattacks. In the absence of global collaboration, attacks requiring increased payments are expected to continue. Artificial intelligence will likely be leveraged by both attackers and defenders as malware continues to evolve. Quantum computing may also threaten the vital encryption capabilities that businesses rely on to secure network data protection as it is known.

Environmental, Social, and Governance (ESG) Expectations

Investor, customer, and workforce interests continue to grow and favor companies that provide information on how they are managing risks and developing business strategies to address ESG issues. These issues include:

- **Environmental** topics describing how an organization manages carbon emissions, natural resources, pollution, waste management, and makes use of green technology and construction.
- **Social** topics, such as sharing how in- and out-sourced labor is managed, how supplier labor standards are managed, how human health and safety (employees, consumers, communities) is provided and how the company engages in supporting local and global health and nutrition.
- **Governance** topics, such as sharing how organizations support diversity, ethics, compliance, anti-corruption, tax, and accountability.[2]

EU and US government agencies are considering regulatory mandates to standardize reporting and support for environmental and social initiatives. A new proposal for a Corporate Sustainability Reporting Directive (CSRD), which could take effect in 2023, may require extensive ESG reporting by large companies operating in Europe. These new requirements extend the current Non-Financial Reporting Directive, and they are proposed to include additional disclosures on strategy, governance, and resilience as well as forward-looking sustainability targets that can be included in annual progress reports.[3] The US Securities and Exchange Commission indicated in March 2021 that it will also consider ESG disclosure regulations. It will take considerable time to determine whether disclosures will be mandated or if self-disclosure will continue to be organically driven by shareholder and stakeholder demands.[4]

Supply Chain Challenges

Business leaders who decreased inventories during the pandemic will continue to face considerable supply barriers as they compete to meet the spikes in demand for products and services in the coming years. Extended lead times, delayed deliveries, and increased freight costs are expected to continue due to bottlenecks at major cargo ports, truck driver shortages, and equipment shortages (e.g., chassis for transporting cargo containers via truck and train). Logistical issues, along with the shortages of vital chemical and raw material supplies, will have to be monitored across the supply chain to manage customer expectations.

As a result, many business leaders may be forced to adjust inventory strategies from "just-in-time" purchases to "just-in-case" inventory methods. Increases in materials and finished product warehouses could introduce additional risks and loss exposures.

For example, high freight costs and extended lead and delivery times can create vulnerabilities for businesses over the next few years, considering any shifts in natural disasters, political tariffs/sanctions, accidents, or a pandemic resurgence that could extend the period of supply disruptions.[5]

Weather and Climate

The impact of anthropogenic climatological changes will present growing risk for businesses in various regions across the globe. The influence of these changes on weather events may stress even well-prepared organizations. As noted recently by researchers at the University of Colorado, factors like population densification in urban centers and expanding suburban growth as well as socioeconomic dynamics will continue to increase the number of buildings being constructed in hot spots known for wildfires, floods, earthquakes, and convective storm events like tornadoes.[6] More simply, the more buildings that we construct in previously undeveloped areas or the greater the population growth in already dense urban centers,

[2] ESG oversight: The corporate director's guide: PwC
[3] Proposed EU Directive on ESG Reporting Would Impact US Companies (harvard.edu)
[4] A Response to Calls for SEC-Mandated ESG Disclosure (harvard.edu)
[5] Shipments Delayed: Ocean Carrier Shipping Times Surge in Supply-Chain Crunch, The Latest Supply Chain Disruption: Plastics, Harvard Business Review
[6] Iglesias, V., Braswell, A. E., Rossi, M. W., Joseph, M. B., McShane, C., Cattau, M., et al. (2021). Risky development: Increasing exposure to natural hazards in the United States. Earth's Future, 9, e2020EF001795. https://doi.org/10.1029/2020EF001795
[7] Rapid growth of the US wildland-urban interface raises wildfire risk Volker C. Radeloff, David P. Helmers, H. Anu Kramer, Miranda H. Mockrin, Patricia M. Alexandre, Avi Bar-Massada, Van Butsic, Todd J. Hawbaker, Sebastián Martinuzzi, Alexandra D. Syphard, Susan I. Stewart. Proceedings of the National Academy of Sciences Mar 2018, 115 (13) 3314-3319; DOI: 10.1073/pnas.1718850115

the greater the risk becomes that buildings and businesses will be impacted by weather events.

Nowhere is this clearer than in areas known for wildfires, where rising housing costs and other factors continue to drive communities and businesses closer to the wildland urban interface. Research published in 2018 found that between 1990 and 2010, the number of homes in the wildland urban interface grew by more than 41%, and the vast majority of homes were new construction.[7]

Recent flooding is another tragic example of the impact weather events can have on businesses and surrounding populations. In the US, urban flooding causes more than $9 billion in damages annually.[8] These events can be exacerbated by deteriorating infrastructure. In many countries, including the US, storm water systems were built with theoretical capacities based on storm probabilities at the time of construction, often many decades in the past. Based on continuing densification and regional changes to rainfall patterns, these systems may no longer be suitable for actual storm water management needs. This can lead to flooding in areas where such events have not previously occurred, including areas not identified by traditional flood maps.

While the connection between droughts and increased wildfire risk is well known, droughts can exacerbate existing water scarcity, requiring local governments to take significant measures to restrict or prohibit water use to conserve resources for essential functions, such as firefighting, healthcare, and drinking water. In many cases, local jurisdictions will restrict the testing of fire protection equipment, such as fire sprinkler systems and booster pumps, which are critical to maintaining reliability and identifying problems in these fire and life safety systems.

Weather events – with or without sudden and immediate impacts - can test an organization's resilience as well as the reliability and performance of systems and protections that businesses leverage to minimize everyday risk.

Workforce Shortages

As nations and public health officials continue to battle the COVID-19 pandemic, one of the aftereffects on businesses in the years ahead is the change in how and where we work as a society. The introspection brought on by quarantine and the extended periods of remote work have likely spawned a significant increase in employee attrition in businesses across various industries as well as workforce shortages in many segments.[9] For example, the healthcare industry is managing a chronic shortage of nurses throughout the US in hospitals and aging services. This pressure point is directly impacting patient care and putting more stress on the existing workforce, which is resulting in higher rates of burnout and staff loss.[10] Employee staffing struggles can also impact processes like incident response and preparedness.

Human Resource departments are reviewing and, in some cases, altering employee benefits to ensure employee retention and support recruitment.[11] When an organization is losing staff, it is losing human capital and organization intelligence as well. The same can be true in many specialized industries. If companies cannot find the needed skilled workers, it will be difficult for businesses to grow, compete and innovate.

[8] Insurance Information Institute, "Facts + Statistics: Flood Insurance."
[9] Roy Maurer, Turnover 'Tsunami' Expected Once Pandemic Ends, March 12, 2021 (SHRM.org)
[10] The 2021 American Nursing Shortage: A Data Study, University of Saint Augustine for Health Sciences, (link)
[11] Attracting Talent During a Worker Shortage by Tino Sanandaji, Ferdinando Monte, Alexandra Ham, and Atta Tarki, June 14, 2021, https://hbr.org/2021/06/attracting-talent-during-a-worker-shortage

Step 2: Advance Resilience Capabilities

The structure and method for implementing a business resilience framework will vary across organizations. The key is to ensure that the core management disciplines are fully coordinated and integrated with proper insurance coverages - regardless of how reporting is structured in the organization. It is important to focus on building and maintaining a company's resilience framework.

Business Resilience Program

Resilience Framework

Establishes four integrated management disciplines to enable your organization to effectively respond and adapt to business disruptions.

Build the Resilience Framework

- The **Risk Management** function typically considers current and emerging risks, working with appropriate business functions to implement mitigation plans to avoid an impact or loss. Business resilience is a component of enterprise risk management and often oversees risk transfer strategies (e.g., insurance, contract indemnification clauses) to minimize the impact and loss for a physical disruption.
- The **Incident Management** function is responsible for implementing strategies and plans at each site where the organization operates to reduce the impact or loss. The key is to prepare a controlled response to quickly address life safety issues and enable local response agencies to fix the problem (e.g., put out the fire). Every second matters, and failing to develop this response capability for operations can significantly affect the severity and impact of a disruption.
- The **Business Continuity Management** function is charged with developing strategies and plans to ensure business recovery teams have the resources needed to continue critical processes impacted by a disruption. This includes developing strategies for both internal production elements, such as workforce, equipment, facilities, and materials, technology plus supply chain elements, including suppliers, distributors and customers. While insurance coverage decisions can positively affect continuity plans, they often are arranged and developed separately. For example, extra expense coverages may provide the funds needed at time of disruption for additional workers and/or workspace requirements when a property loss for a covered cause of loss occurs as defined in the policy.
- The **Crisis Management** function is authorized to coordinate and issue all internal and external communications surrounding a disruptive event. Some policies include coverages to support the use of public relations firms, which can be engaged at the time of disruption.

Positive change starts with an honest assessment of an organization's current position or identifying where an organization falls in the program maturity scale with regards to establishing a holistic, coordinated resilience framework.

Advancing an organization's position can take multiple years. The timeline for achieving an established maturity level is subject to the understanding and priority placed on progressing this capability. Functional and site leadership participation is paramount. Outside support and systems for managing risk assessments, strategy, and plans may be advantageous to jump start a program.

Define a Resilience Program
Develop clear and concise enterprise business resilience policies. These policies describe an auditable structure, key requirements (e.g., plan updates, exercise, and training), and the leadership roles for implementation across the organization. Internal and external audits should be periodically performed to confirm the health of resilience capabilities.

Establish Resilience Response Teams
Establish the policies, procedures, and resources needed to implement the resilience framework for each organization. Two structures are enabled to minimize the impact and loss across the operational footprint – a response structure as well as a recover and restart structure. Keep in mind that for less complex single site operations, plans may be combined.

The Response Structure

Corporate Crisis Management
- Site Incident Plan #1
- Site Incident Plan #2
- Site Incident Plan #3

Incident Escalation Process

The Recovery and Restart Structure

Business Continuity Strategy
- Business Recovery Plan #1
- Business Recovery Plan #2
- Business Recovery Plan #3

Tactical plans to recover and restart operations to minimize the business impact at time of disruption.

The **Response Structure** is anchored by Site Incident Response plans to manage local emergencies and disruptions where they occur.

There should be one plan per site and escalation procedures, if not already in place, need to be defined to notify and obtain support from corporate leadership as noted in the Corporate Crisis Management plan.

The **Recovery and Restart Structure** is based on an enterprise level business continuity strategy created from an analysis of what is required to continue critical operations through a disruption. Each business function leader is responsible for the continuity of their operations.

A plan sponsor and plan owner should also be assigned for incident and recovery plans, as they will be accountable and responsible, respectively, for ensuring plans are regularly updated and exercised.

Step 3: Implement Strategic Insurance Coverages

Insurance is a vital component of an effective business resilience program. An established business resilience strategy for a company's operations allows an organization to better design insurance coverages that directly support the successful implementation of an organization's response, recovery, and restart plans following a disruption. This report is an overview of potential coverages, but only the insurance policy an insured selects will provide the actual terms, coverages, amounts, conditions, and exclusions that apply.

Property

When companies think about protecting property assets, such as buildings and equipment, one area that is often overlooked is the true replacement cost of these assets when a disaster strikes. Equipment assets in particular are often treated as depreciating assets, but it is equally important for a business to understand true replacement costs and the impact of marketplace factors and trends on those estimates when considering property insurance coverages. Companies should also consider rising fuel prices, cargo container costs, raw materials shortages, and other supply chain disruptions.

For example, prices of certain materials, such as lumber, steel, and PVC, have increased dramatically over the past 12 months, with lumber prices increasing 42% YOY as of March 2021. When considering these factors and inflationary pressures, even recently appraised or updated valuations on some buildings and operations are likely to be insufficient, in some cases, dramatically so. In the years ahead, it will become even more important for companies to critically review the schedule of property and building assets to ensure insurance coverage is sufficient, accounting for these global impacts.

Business Interruption

Based on the severity of impact and the complexity of operations, the time to rebuild, repair/replace, and restart affected operations could take weeks, months, and, in some cases, years. Business Interruption (BI) coverage is an essential element to enable financial resilience. This coverage provides the insured with the opportunity to maintain their financial trajectory and enable the insured to pay continuing expenses through the period of restoration. Core elements of this coverage, per the policy terms and conditions, typically include the following:

- **Business income** coverage helps to recover the net income loss plus continuing expense (e.g., payroll, rent, utilities, etc.) during the period of restoration.
- **Extra expense** coverage is used to mitigate/minimize a loss during the period of restoration (when possible).
- **Extended period of indemnity** coverage provides further financial relief for a stated period of time beyond the period of restoration, for continued business income loss, supporting the organization's return to production and sales levels.

Whether a company has one or hundreds of covered properties and suppliers, there are important considerations when determining business interruption values for an organization:

Frequency of Business Income Projections

A realistic assessment is needed of how revenues and expenses will change over a 12-month and 24-month period. Annual review and updates are recommended to ensure coverage levels are adequate. Fast growing businesses may need to review exposures and coverage levels more frequently.

Ordinary Payroll

Ordinary Payroll is an integral component of continuing expenses covered in BI insurance. Coverage may be limited to a certain number of days or excluded entirely, reducing the insured's recovery in the event of loss. Given the forecasted workforce shortages, it is important to retain a knowledgeable and trained workforce during the period of restoration. Continuing to pay ordinary payroll will help the company keep the employees needed to run the business when operations are able to resume.

Blanket vs. Location BI Structure

Blanket limits of insurance are beneficial when the insured has multiple interdependent locations where financials are accounted for under one profit center for all covered locations. Separate BI limits may be needed when the covered locations are not under one legal entity to provide adequate financial support for recovery efforts following a disruption.

Business Income Limits

In order to calculate the necessary limits for business income coverage, the key is to start at the enterprise level and consider how revenue is generated and the recovery time required to restore operations for each scheduled property. Analyzing the impact using a "complete loss" scenario for each location will help to understand the potential financial impact. This analysis will also highlight locations where business recovery strategies can be aligned and/or improved to enable business resilience.

Equipment Breakdown

As the reliance on complex computer-based machinery and robotics expands, the need for contingency planning and insurance coverages also grows. Robust preventive and predictive maintenance remain the first line of defense to ensure continuity of operation for critical machinery. The development of continuity strategies and plans to provide for redundant machinery, where possible, and providing for multiple skilled operators also helps to minimize the impact of downtime. Equipment breakdown insurance (as part of property coverages or as a standalone policy) can also provide coverage for physical damage repair/replacement and associated business income loss from mechanical and machinery breakdown based on the policy terms and conditions.

In Summary

Business leaders continue to face challenges as organizations continue to evolve and innovate amidst an emerging risk landscape. A strong resilience framework with incident, crisis, and continuity teams will help ensure leadership is prepared to make thoughtful, fact-based decisions in response to disruptions at the local and enterprise level. Business leaders that focus on preparedness, considering current and future challenges, learning from every disruption, and working with insurance brokers and carriers to develop strategic risk transfer solutions, can help ensure that organizations are both financially and operationally resilient.

To learn more about managing your risk and increasing efficiency, visit cnacanada.ca.