Executive Level Education

BY DAVE MCINTYRE

An Education *in the* Value of Value

With an active storm season bearing down on us and the danger of violence from abroad remaining high, what do you think is the biggest barrier to American companies adopting viable Business Continuity Planning (BCP)?

Well according to one expert in both business and risk, one major reason that businesses are caught napping by disasters is that executives fail to understand the enterprise value of their own endeavors – or how quickly that value can be destroyed if they do not take reasonable measures for preparedness and response.

Peter J. Leitner is the Founder and Managing Partner at Waterford Advisors, a corporate finance advisory firm that focuses on the healthcare and technology sectors. In one chapter of the newly released text, Business Continuity and Homeland Security, he lays out his case for why managing enterprise value is the key to preparing for and weathering a corporate disaster. (Full disclosure: this author is co-editor of the volume, but receives no remuneration from sales.)

While many leaders think of their firm's value purely in terms of assets, Leitner defines Enterprise Value as the sum of Debt and Shareholder Value (based on both tangible and intangible assets). This is a clever way of focusing executives on the reality that operating capital has a cost, debt must be repaid, and perceived value can disappear quickly. Hence the need for BCP.

Assets, after all, may appear stable, and some businesses may run so smoothly that they give a false sense of permanence and reliability. But from the perspective of debt and capital, business is always in motion. In fact, a company can only stay in business over time by maintaining a positive cash flow despite the pressures of competition and economic realities beyond its control. Some part of every business is always dying. As equipment ages, processes become obsolete, new ideas emerge, and tastes change. Thus some part of every business must always be growing so that innovation, efficiency, and effectiveness offset these losses and create new value.

This, at its core, is the business of business, regardless of the product or service produced. Ensuring and revitalizing this changing balance of value within acceptable risk is what owners, boards, executives, and managers do for a living, regardless of the type of business in which they are employed.

This is a challenge in the best of times, as anticipated cash flows are disrupted by competitors, the cost of capital fluctuates, and the firm's value is assailed by changing trends. Disruptions from intentional attacks, hazards, and natural disasters may be even more sweeping, rapidly imperiling cash flow, enterprise valuation, or even survival. Additionally, according to Leitner, special considerations may include:

- The Speed with which connections between customers, employees, vendors, and debt holders fray and unravel following a major event.
- The Isolation business leaders will feel, as the normal support system of federal, state, and local government is interrupted, and the presence of consultants, lawyers, and lenders is reduced.
- The Confusion that accompanies the absence of large numbers of employees and supervisors, as well as the unavailability of physical resources (like a building to work in).
- The Interruption of the Supply Chain that connects vendors and services to the processes and production means of the firm.
- The Distress of lenders who suddenly find themselves over exposed, and counter by modifying the availability of loans.
- And finally the Absence of customers who provide the life blood of business, and may hold the company's long term destiny in their hands as they make short term post-event decisions.

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If all these factors are included in a solid risk analysis, a sobering picture of what happens to those who ignore BCP emerges. And some interesting ideas about preserving enterprise value – different from the traditional list of planning models, frameworks, and standards -- emerge.

True to his argument about the importance of considering enterprise value (including debt, intangibles, and cash flow) rather than just asset value, Leitner begins his look at Business Continuity from the perspective of Value-at-Risk (VaR). That is, how much of the Enterprise Value (Debt + Shareholder Value) is actually at risk, given the likelihood that a particular threat, hazard, or national disaster comes to pass?

This is simpler than it sounds. Leitner offers the convenient example of a Category 5 hurricane striking Long Island. Understanding how such an event would destroy facilities, interrupt cash flow, and disrupt the systems and relationships that create value, his mythical company leadership can develop a more business-like and financially sound course of action than traditional approaches to securing physical assets might suggest.

Of course, none of this is to argue that traditional continuity planning, training, and exercises be ignored. Whether a company relies on the concepts of the National Infrastructure Preparedness Plan, the annexes of the National Response Framework, the structure of NFPA (National Fire Protection Association) 1600, the considerations of appropriate ISOs (International Standards for Organization), the guidance of federal Sector Specific Plans, the recommendations of industry groups, the content of FEMA training courses, or the products of contractors and subject matter experts, the detail and discipline imposed by proven BCP approaches is essential. Leitner is offering a philosophical approach, not an alternative mechanism that will build a plan, test it against reality, and make it available in an emergency. Value based perspective is intended to focus traditional BCP, not replace it.

But the need for new perspectives is made evident by his final point – the impermanence of Knowledge Based business. While industrial age value was based on physical resources, Knowledge Based value is based on a constantly changing "combination of employees, vendors, customers and financiers" that fits a constantly changing niche. Significantly interrupt this connectivity and continuous evolution, and the firm may not be able to recover.

Educating leaders to this fact and motivating them to actively plan for and manage through disastrous discontinuities in company value is what enterprise value planning is all about.

ABOUT THE AUTHOR

DR. DAVE MCINTYRE is VP for Homeland Security Programs at the National Graduate School of Quality Management, and is a Visiting Fellow at both the Homeland Security Institute and the WMD Center. He is co-editor with Bill Hancock of the book Business Continuity and Homeland Security, recently released by Edward Elgar Publishers.