KAGE STRATEGY

RISKS, WASTED?

How well does your longer-term viability statement process illuminate strategy and risk at your firm? How do you know?

EVALUATING YOUR LONGER-TERM VIABILITY STATEMENT PROCESS, ITS RESULTS, EFFICACY, RELIABILITY AND UTILITY

EXECUTIVES' SUMMARY

Your longer-term viability statement is more than just a compliance requirement; it can – and should – form the nexus of your strategy, your risk management and your capital and risk-financing programmes. It's <u>that</u> important; it can also be <u>that</u> useful. Research conducted for FRC shows that most firms are not making the most of the process of preparing their viablity statement. Are you? How do you know?

Our review will evaluate your existing approach and show you how to realise the full potential of your viability assessment process while cutting radically your 'analytic load' – the effort required. The resulting process will be so efficient, you'll easily be able to use it to support rapid on-going decision-making around issues like strategy, M&A, capital projects, performance and risk transfer. Now, <u>that's</u> useful.

Using a purpose-built and proven analytic tool (technically, a stochastic engine) and relying on your current loss analyses, we can quickly model and aggregate your risks and compare them to your existing analysis. By analysing your balance sheet, your debt tranches and your net income forecast variability, we can provide a rapid comparison of your analysis of viability over your chosen horizon. And we'll do it in two weeks flat! That makes it quick *and* cost-effective.

To find out how, read on . . .

ARE YOU MAKING THE MOST OF YOUR LONGER-TERM VIABILITY STATEMENT PROCESS? REALLY?

You've implemented the requirement. But how well? Is it reliable? Is it efficient? And do you make the most of your process? How do you know?

Most firms required to do so have by now implemented the FRC's requirement from 2015 to produce a longer-term viability statement. However, significant questions remain over the quality of many firms' statements. Research conducted on behalf of the FRC suggests that most firms have a long way to go in joining up their analysis for the viability statement with their strategic decision-making and even their broader risk programmes. But this is where the real benefits lie, both to the firm and to its institutional investors. Why put in the effort without giving yourself the opportunity to reap the rewards?

At Kage Strategy, we can reduce your **analytic load** – the time and effort required to analyse and combine different loss scenarios. We understand how a corporate firm can 'sweat' its analysis for its longer-term viability statement – how strategically and tactically you can make the most of the work you undertake to produce the statement. By applying easy-to-use, purpose-built tools that are state-of-the-art, we can also validate that programme quickly and, if you choose, simplify it considerably. The simpler the programme, the easier it is for you to use and the more likely you are to reap the real benefits from doing so.

We make your analytic risk programme simpler and help you to join up your thinking and action. We make your risk effort more **useful**.

Kage Strategy – putting you in the driving seat of your risk analysis and how to use it. And we can do it in just two weeks!

USING A COMPLIANCE REQUIREMENT TO IMPROVE YOUR BUSINESS.

Just as with the logic of financial regulation on which it is based, the real test of impact of the longer-term viability statement is the 'use test' – not just the analysis, but what you do with it.

In terms of corporate risk, these new requirements, with which many corporate firms have struggled, are best thing since the proverbial 'sliced bread'. They represent an attempt to translate the best aspects of prudential regulation of capital in financial firms in to non-financial sectors. They make sense. And they represent an unparallelled opportunity to improve corporate risk management. But implementing them is neither quick nor trivial. At least, not until now.

In just **a couple of weeks**, using leading-edge analytical tools and knowledge, and drawing on your existing assumptions, we can complete a rigorous evaluation of your longer-term viability statement, the process for completing it and its utility. Our review covers:

- an independent analysis of viability using your existing assumptions
- the replicability of the result
- how you accumulate risk across different risk classes or entities and how risks combine to produce your corporate position
- the coverage and efficiency of your statement process, and
- the utility of your process and results to contribute to your strategic understanding of risk and uncertainty.

We are confident our approach to evaluating your viabilty statement process will **simplify** and **transform** your firm's understanding of the relationship between strategy, risk and uncertainty and how they link to your balance sheet, risk-bearing capability and risk appetite. A compliance requirement today will be a source of understanding and **competitive strength** tomorrow.

HOW? SIMULATION REQUIRES THE RIGHT TOOLS.

We use tools developed for rapid application to risk in financial services to solve the problem of analytic load.

Many – no, most – financial services firms struggle with complex risk requirements; non-financial corporates, no less so. To solve this problem, our risk technology partner, MonteCarloPlus or **MC+**, has developed a rapidly-deployable risk simulation tool that retains the sophistication of complex stochastic processes without requiring the heavy lifting those tools imply. It uses advanced statistical techniques to 'parameterise' plausible risk scenarios then applies Monte Carlo simulation to determine loss estimates and capital requirements – exactly what is required under the new FRC Guidance. But, rather than taking weeks to define and hours to run, **MC+** can be parameterised in hours and runs in a couple of minutes – revolutionising analysis of risk.

We can work with your firm over days – not the usual weeks or months – to translate your existing insights in risk in to this form of analysis. Then, using our knowledge of corporate finance and management of risk in your balance sheet, we can assess your risk position and longer-term viability rapidly and effectively. By reviewing relevant documents and reporting and with a handful of interviews of key people, we can produce a **comprehensive evaluation** of your longer-term viabilility statement, the process for preparing it and how – and how well – you use it in your business.

And that's just the tip of the iceberg.

But before looking at other applications of this knowledge to improve your firm's strategy and risk programmes, let's look at a practical example. We need to start by understanding how the firm's liability structure reveals its risk-bearing capacity.

EVERY FIRM IS DIFFERENT.
BUT CORPORATE FINANCE STAYS THE SAME.

All corporate firms face the same financial challenges – illiquidity and risk of insolvency. And credit ratings matter.

We use standard corporate finance techniques to understand risk on your balance sheet; ultimately, it's your liabilities that drive the twin dangers of illiquidity and insolvency. Typically, a solvent firm holds three levels of protection against loss:

Level	Name	Description
1st	**Liquidity Headroom**	cash and cash equivalents available
2nd	**Revolving Credit Facility**	pre-arranged working credit line
3rd	**Financial Covenant-Free Facilities**	facilities that can be drawn on without impacting debt covenants

As putative losses increase, these buffers are increasingly eroded. The losses the firm may plausibly experience at various levels of probability of risks manifesting and combining – and, thereby extinguishing each tranche – reflects the **risk-bearing capacity** of the firm. Various levels of probability can be related to those used by credit rating agencies to determine the firm's probability of transition between credit ratings at escalating levels of loss. The firm's **target credit rating** under these loss scenarios, therefore, reflects the firm's **risk appetite**.

But risk appetite only tells half the story – i.e. how much risk you want. How much risk are you really taking? And what are you getting for that risk? Is it worth it? Properly structured, your longer-term viability statement process provides answers to these questions by combining your plausible losses in to a distribution of probability of aggregate loss levels. And that informs every area of your strategy – as long as you are looking at the right things.

Now let's take a look at a real example.

CORPORATE-LEVEL RISK ANALYSIS IN PRACTICE.

To tie together the firm's risk picture, we use existing information to generate and to combine a set of plausible risk scenarios.

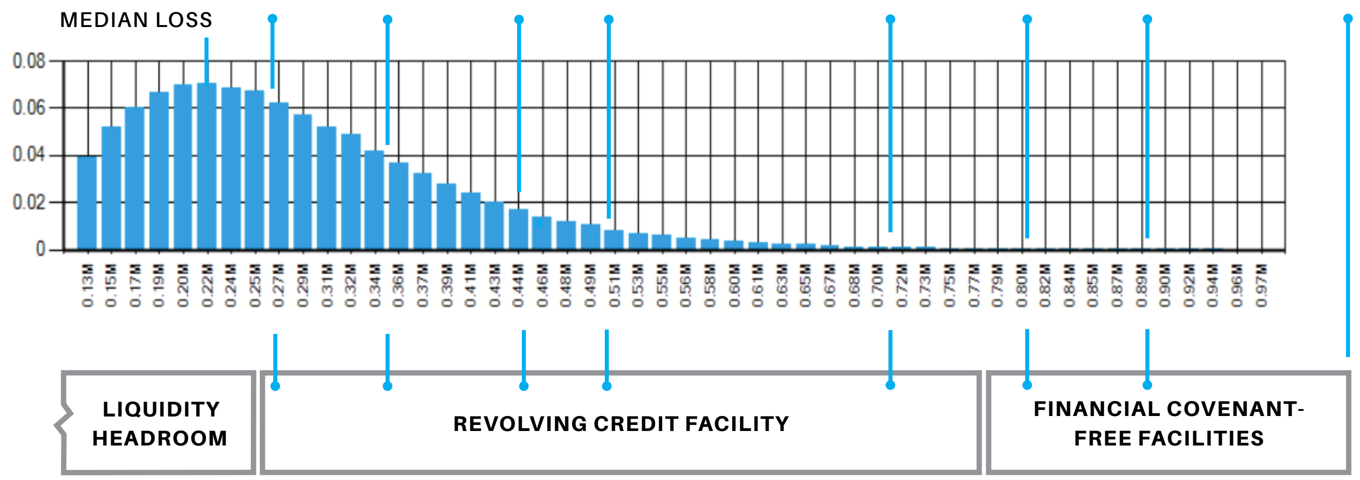
We have undertaken this form of analysis for a FTSE 100 firm. From its balance sheet:

Level	Instruments	Risk-bearing capacity	Total
1st	**Liquidity Headroom**	£250 million	£250 m
2nd	**Revolving Credit Facility**	£525 million	£775 m
3rd	**Financial Covenant-Free Facilities**	£250 million	£1,025 m

By analysing its identified risks, and combining them using realistic (correlation) assumptions about how likely the risks are to coincide, we can define a probabilistic distribution of aggregate losses. This shows the impact at differing levels of probability of combinations of risk effects manifesting and their impact on the firm's capital – exactly the insight you need to assess your actual risk-bearing relative to your risk appetite and to complete your longer-term viability statement.

EXAMPLE FTSE FIRM: DISTRIBUTION OF PROBABILITY OF AGGREGATE LOSS

VALUE	£265M	£349M	£440M	£506M	£708M	£802M	£891M	£1,025M
PROBABILITY	@50%	@25%	@10%	@5%	@0.5%	@0.017%	@0.007%	
IMPLIED RATING					'BBB'	'A'	'AA'	



INTERPRETING AND APPLYING THE RESULTS.

Analysis is just a beginning. To be useful, the analysis must link to actual decisions the firm takes and their effects – in use.

To generate the results above, we analysed **16 risks** across all classes of risk confronting that firm – from performance variability to projects and new initiatives to mergers and acquisitions to regulatory risk to reputation to market value of pension-fund assets to technology-related risk issues and operational control. The **'plausible-scenarios' approach** draws in existing knowledge and experience within the firm, as well as external information sources and insights. Our reporting covers all material aspects of the firm's risk appetite, risk-bearing capacity, liquidity and solvency. **Regulatory problem sorted**.

More usefully, this form of analysis of risk also allows you to zero in on the key strategic issues you face in which risk is material; and that is **every strategic issue**. Using **MC+**, we can identify rapidly – sufficiently rapidly to support real-time decision-making – how different assumptions of risk drive different levels of risk-adjusted performance and the capital needed to underwrite that performance; this is, **real economic rates of return.** From there, it is a short jump to understanding risk and economic performance by business line, geography or subsidiary.

Because our approach focuses on risk as a strategic and economic issue, it links directly to the firm's **financial and operational decision-making**, By reducing **analytic load**, our approach offers firms a feasible analytic engine to target strategies – to understand the impact on capital required to underwrite the firm's risk-taking under different assumptions of financial performance, how well you implement projects or integrate acquisition targets, different levels of disruption from technology or market entrants; and to optimise your financial strategies and risk transfer arrangements to reflect the risks you take. **Now that's knowledge worth having.**

Proper analysis. Not subjective rankings or guess-work. That's what makes it useful.

WHAT WILL THE EVALUATION INVOLVE?

Our approach involves combining information you already publish with insight from your experts. As it should.

Because we use senior and experienced personnel, using **MC+** we can complete a powerful and comprehensive analysis of your strategic financial risk at corporate level **in just two weeks**. That means that you get a rapid, informative and strategically-focused result that will change – and certainly improve – your perspective on your risk. Our rapid corporate risk evaluation has three stages:

1.

We review your published accounts and extract from there all salient information about your corporate financial position, liquidity and debt facilities, your performance and your current analysis of your risks.

2.

We talk with your senior people in strategy, risk, finance and planning; internal audit also, if you want us to do so; we review key risk reporting, how you include risk in your strategic financing decisions, capital budgeting and project selection. From this, we re-work your existing assessment of your major risks to increase analytic depth.

3.

We produce a clear, comprehensive and analytically-robust report summarising **graphically** your corporate financial position from a risk perspective covering your liquidity under stress, your key risks and how they combine. Our report will tell you **how well you are preparing and using your longer-term viability analysis** and what you do – **and could do better** – with your risk knowledge**.**

All in just two weeks.

TO FIND OUT MORE . . .

Talk to us. Just because we're acknowledged as experts doesn't mean we can't have a sensible conversation about your corporate strategy & risk .

We will seek to meet you shortly. Or you can contact us to arrange a meeting.

Our Managing Partners are:

Peter Bonisch
e. peter.bonisch@kagestrategy.com
m. +44 7974 168 559

Mustafa Cavuş PhD
e. mustafa.cavus@kagestrategy.com
m. +44 7432 633 984

. . . and you can find out more about Kage Strategy online at

kagestrategy.com

Kage Strategy
Kage Bailey Mayer LLP
34 Ely Place
London EC1N 6TD
United Kingdom

t. +44 20 7060 7475

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