



Stress Testing: A Smart Way to Manage Today's Business Risks

Business owners today face no shortage of uncertainty. Persistent inflation, evolving trade policies, cybersecurity threats and ongoing geopolitical tensions have made planning challenging. Although it's impossible to predict every disruption, you can better prepare by evaluating how your business would respond under adverse conditions. One proven approach is stress testing, which helps organizations identify vulnerabilities before they become costly problems.

Some background

Stress testing gained widespread attention in the banking industry following the 2008 financial crisis. Regulators continue to require large financial institutions to evaluate how they'd perform under severe economic scenarios.

However, for most businesses, stress testing doesn't need to be as complex as a bank regulatory model. Approach it as a practical planning exercise that uses realistic financial assumptions to answer questions such as: What would happen to operating cash flow if a major customer left, borrowing costs rose or a key supplier increased prices? By modeling the financial impact of potential disruptions, you can make more informed decisions and improve long-term planning.

Identify major risks

To launch your own stress-testing initiative, identify your business's primary risk factors in the following categories:

Operational. These affect the day-to-day functioning of your business and may include supply chain disruptions, technology failures, cyberattacks, natural disasters, employee shortages and human error.

Financial. Risks related to cash flow, access to capital, interest rate fluctuations, fraud, customer credit issues and changes in borrowing costs all deserve attention.

Compliance. Such risks stem from evolving tax laws, industry regulations, data privacy requirements, labor laws and other government mandates.

Strategic. These relate to competitive pressures, changing customer preferences, market disruptions, technological innovation and broad economic shifts.

As you evaluate each risk category, be specific. The more realistic your assumptions, the more valuable the exercise will likely be.

Meet with your team

Once you've identified the most significant risks, meet with your leadership team and trusted professional advisors to discuss each scenario. Consider not only the likelihood of each event but also its potential financial impact and your business's ability to respond.

The goal is to develop practical strategies to reduce exposure and improve resilience. For example, if your business operates in an area susceptible to natural disasters, a comprehensive disaster recovery and business continuity plan is essential. Other vulnerabilities may be less obvious. If your business depends heavily on a single executive with specialized knowledge, stress testing can highlight the importance of succession planning.

Value of continuous improvement

Risk management isn't a one-time exercise. Economic conditions, customer behavior, technology development and regulatory requirements continue to evolve, creating new challenges and opportunities. So review your stress-testing program at least annually and update it whenever significant changes occur within your business, industry or in the broader marketplace.

Although stress tests won't eliminate uncertainty, they can help your business respond more confidently when unexpected events arise.