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Viewpoint

Assurance of your growing business

Are your new operations really as ready as you think?

As corporations extend their footprint into new geographies or new types of operations, they face many challenges, not least of which is the potential for unexpected losses that can damage operations, business performance, corporate reputation and brand. Establishing strong and safe operational performance in a new business from day one demands a focused approach to managing change throughout mobilization. This paper introduces some good practices which can be deployed in what is often a poorly managed process, to avoid unexpected losses and deliver a smoother start-up. These good practices leverage some recent developments in the rail sector, together with our own experience of supporting mobilization that can be applied pragmatically in any business.

Assurance over new operations

Starting a new operation presents myriad challenges to a corporation's overall operational and safety performance. New operations are often in less familiar locations, or with different regulatory frameworks.

There may also be cultural drivers that present challenges in new operations – governments operate at different speeds; in some parts of the world finding high-quality employees can be difficult, and there may be other local sensitivities to consider. The local culture will also impact your new operation, no matter how well designed the mobilization process is.

In the context of this paper, a "new business" could include:

- Taking over an existing business from another operator.
- Entering into a new partnership to operate a business.
- Creating a new business.
- Expanding existing operations into a new geographical area.

A pragmatic, effective and proportionate assurance process should be integrated into the mobilization plan so that potential weaknesses can be identified and corrected at an early stage, prior to start-up. The scale and complexity of the new operation will, of course, determine the level of governance and control, with larger or more complex operations often demanding executive and board involvement.

For a new operation it is often appropriate to appoint an independent reviewer to oversee the assurance process. The independence of the reviewer allows a different view on the preparedness of the new operation. If they are appointed by the final authorizer of the new operation (e.g. the group CEO), then the attention they can draw to problems can be critical in resolving them before it becomes too late.

The overall aim is to provide adequate assurance that the risks associated with any new or changed operations are identified and understood, and that suitable controls are put in place *prior* to the changes being implemented. Timing is critical; while early planning enables risk controls to be put in place in sufficient time, starting too early can mean there is too little real information to work with (and many key roles that will have important responsibilities may not be in place).

Managing uncertainty

The key drivers for managing risk of new operations align with those that are general to the business at all times, but are amplified because of the inherently greater uncertainties:

- **Financial** – reputational and brand damage from a poor mobilization can be significant and result in losses of revenue and profits.
- **Legal** – health and safety legislation that applies to established businesses will also apply to the new operation.
- **Moral** – new operations are often inherently less safe than existing businesses.

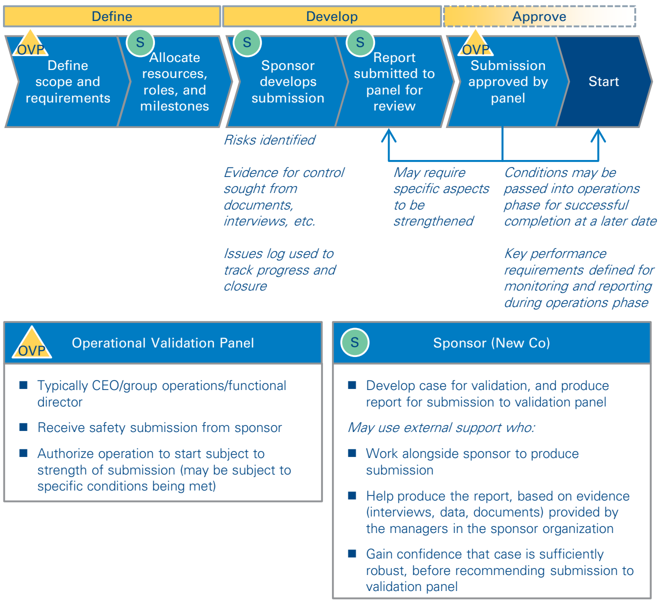
The most attractive business opportunities are often in markets that may have less mature attitudes to operational risk management systems (including quality, safety and reliability). Moreover, while local legal risks may be lower, the potential for reputational damage in a company's home market remains.

Effective preparation should highlight possible operational risks before new business activities begin – these can then be remedied more easily than they would be once operations have started. Appointing the right people to manage the mobilization of a new operation is critical to a successful Day 1 launch, as experienced leaders are more likely to know how to cope with the different challenges new businesses pose.

In the area of safety, a formal process, known as safety validation of change, is a legal requirement in some industries. The most mature example is the European rail industry, in which change is governed by EU regulation (the Common Safety Method for Risk Evaluation and Assessment).

A stepwise plan for gaining assurance

A typical process for gaining assurance over a new operation has five steps prior to start-up:



Essentially, the process involves initially ***defining*** the requirements, resources and work plan, then ***developing*** the case for validation, and finally seeking final ***approval*** prior to commencing operations. The person who will approve the new business to begin operations will often appoint an independent reviewer, experienced with the assurance process, to find possible areas of weakness and where focus should be applied.

Approval may be granted on the condition that certain activities are demonstrated after start-up, or that specific performance is achieved (such as accident or injury rates, financial performance, etc.). Importantly, the effectiveness of risk controls prior to start-up have to be estimated, and their actual effectiveness should be reviewed during the first weeks or months following start-up. As well as providing further assurance to managers over the new business, this can provide transferable lessons about what was most effective that can be used in subsequent mobilizations. If there are significant unmitigated risks that are not closed before Day 1 operation, then it may be necessary for mobilization to be delayed until these are corrected.

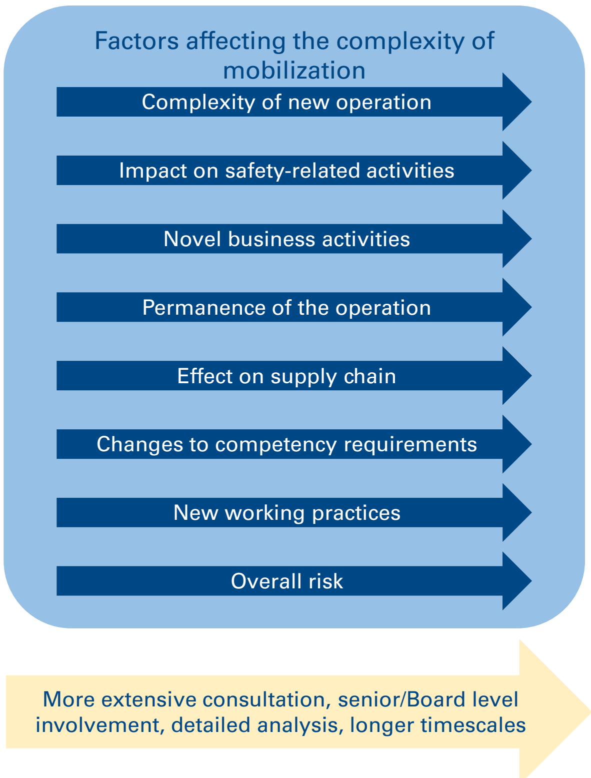
While the new business would be the main change in scope of the validation, there may be aspects of the existing business that could be impacted by the mobilization – for example, through reallocation of managers or changes in the supply chain. Defining the entire scope of these changes at this early stage and including them in the subsequent validation process is key to a smooth start-up.

Managing scale and complexity

The impact that a new business has on the corporation overall, or on other local operations, depends on many factors, such as the complexity in the new market, familiarity with the new business activities, depletion of valuable skilled resources from elsewhere to support startup, and disruption of the supply chain.

Our experience shows that it is worthwhile to define the nature of the change so that proportionate resources, time and budget are allocated. Taking resources out of the existing business to support the new operation is not a light decision, and skilled resources to provide on-the-ground support during mobilization are often scarce. Equally, the board itself is likely to be involved in approval processes, so early planning of key milestone dates is critical. Contingency should be allowed in both timescales and budgets, as there will inevitably be setbacks along the path to mobilization.

Factors that affect the complexity of mobilization are shown below. Where these are greater, there should be commensurately more effort put into the assurance processes.



Roles, resources and skills

Effective assurance over new operations requires careful management of skilled resources and careful allocation of roles – not only to start up the new business itself, but to run and govern the assurance process.

From an assurance perspective, the key roles in the process are a project sponsor, a reviewer/approver and an assessment team to check the robustness of arrangements.

Resources should be proportional to the level and complexity of change, and carefully consider the competence of the team as a whole. A common oversight is that the skills required to organize and mobilize a new business are quite different from those of running a "steady-state" operation. Businesses often appoint managers who have successfully run operations "at home", but fail to meet the often greater challenges of setting up a new operation.

Control of risks

During the development stage, potential threats to the new business need to be identified and assessed. There are many methods available, such as HAZOPs, comparisons with existing operations and industry codes of practice. We have observed that the best forms of risk assessment during this process involve the team systematically discussing what could go wrong from experience, but are also led by logical processes. External facilitation can be valuable to avoid defaulting to only what has been seen before. Clearly, there is substantial benefit in seeking to involve a wide cohort of people with skills and experience that cover a wide range of topics, including the operation itself, local external and political threats, human resources and engineering.

Good practice in risk tracking includes allocating a risk "owner" who is charged with closing the risk. Risk controls specified should be checked before Day 1 operations begin to ensure they are in place, but also reviewed shortly after Day 1 to confirm their effectiveness. This review can then be used to support future mobilization decisions, spreading accumulated good practice over time. A lack of incidents following start-up is no guarantee that risk controls are working or will continue to work. Our experience suggests that this review is one of the main differentiators of companies that are most successful at starting new operations.

Once risks are managed to an acceptable level, the final stage in the assurance process is for formal approval to begin operations. This will often be from the head of a BU or, in the case of new businesses that are large or complex, the CEO. Acceptability itself needs to be defined, and will depend on the corporation's own standards and appetite for risk, as well as those of other stakeholders.

The effect of insufficiently robust assurance over new businesses

There have been a number of instances in which a major change in a company's operations was a direct cause of events that resulted in significant damage to, or loss of, a company. Three notable examples are provided:

BP Texas City Refinery, 2005

BP acquired the Texas City Refinery as part of its merger with Amoco in 1999 – the refinery had suffered from under-investment, and there were safety issues at the plant known to Amoco before the merger. Once BP took ownership of the refinery, these issues remained uncorrected and contributed to a hydrocarbon vapor explosion that killed 15 people and injured over 100 others. BP has paid over 1.6 billion USD in compensation and fines. Had the safety issues been found before the merger and corrective actions put in place, the explosion may not have occurred – an affordable investment could have prevented this major incident.

Railtrack, 1994–2002

Railtrack, the group of companies that owned the UK rail infrastructure following privatization, suffered from a series of high-profile rail accidents. In an effort to cut costs, Railtrack contracted out track maintenance work in 1995, but the contractors found that they were losing money and were forced to raise prices when the opportunity to renegotiate came up in 1999.

Track maintenance suffered, and this was the main factor in the Hatfield rail crash that led to the government takeover. Speed restrictions were imposed across the UK, and extensive amounts of track were replaced, with many trains being cancelled. These led to an approximate 20% loss in revenue for passenger-train operators in the year following the accident. Combined with Railtrack's rapidly rising costs, the level of disruption was unsustainable and the government forced Railtrack into administration in 2001, before its assets were transferred to Network Rail in 2002.

London Heathrow Airport Terminal 5, 2008

Terminal 5 at Heathrow opened for passenger use on 28 March 2008, with British Airways aiming to transfer all of its flights at Heathrow to Terminal 5 on that same day. However, on the opening day 34 flights were cancelled and the baggage system failed, leading to around 42,000 bags being delayed. It took British Airways until 8 April 2008 to resolve the issues and begin operating fully from the new terminal. The disruption was so extensive that a UK Parliamentary investigation was launched. The report found that insufficient training and communication in the lead-up to the terminal opening were major factors in the operational failings that occurred.

Our recent experience

We have worked alongside a number of companies in both building corporate processes for assuring new businesses, and supporting new businesses in mobilizing.

During the mobilization of a high-profile new train-operating company, we provided assurance support for multiple aspects of the new business. As well as advising on the formal rail-safety validation of change process, we also acted as an interim safety manager and delivered senior leadership onboarding training. Our support strengthened their own preparation for operation. Both operational and safety performance have been demonstrably improved over the previous incumbent.

We have supported the mobilization of a new train company in Europe, including helping it to be granted its license for operation, which required overcoming significant cultural and political challenges.

For two major international transport operating groups, we have produced systematic processes for assurance of safety in new businesses. Both systems are embedded into the corporations' business processes and have been used effectively and extensively over their growing businesses. Our work has extended to safety validation of technical changes of existing operations, including train dispatch methods and changes to design of railway assets.

Conclusion

Our key conclusions on tackling the challenges posed by starting up new business are:

- **Clear requirements:** Setting clear, specific, measurable targets that are acceptable to the company for the new operation makes both the mobilization team's job and the assurance process clearer and simpler.
- **Key roles:** The key roles of the project sponsor and assurance panel need to be defined with sufficient authority. Skills required for effective mobilization are not necessarily the same as those required to run the business in the future.
- **Integration with mobilization plan:** Integrating the new business assurance process with the mobilization plan improves the chances of a smooth launch of the new operation – this may mean planning for the process during the bid phase.
- **Timing:** The process should be started early enough for issues uncovered to be corrected easily, prior to the start of operations, but not so early that resources are used inefficiently.
- **Invest to protect:** Budgeting for safety validation of change as part of mobilization activities may cost extra in the short term, but the spending can be recouped in the longer term as it facilitates smoother starts to operations.
- **Review:** Reviewing the effectiveness of implemented risk controls after operations begin supports organizational learning and spreading of good practice.

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Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

Our consultants have strong practical industry experience combined with excellent knowledge of key trends and dynamics. Arthur D. Little is present in the most important business centers around the world. We are proud to serve most of the Fortune 1000 companies, in addition to other leading firms and public sector organizations.

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