

Cybersecurity in Business Valuation: Addressing the Impact of Data Breaches on Value

A BVR
BRIEFING

EXCERPT



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PDF ISBN: ISBN: 978-1-62150-194-7

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Every company—large and small alike—now faces material risks related to data security and privacy concerns that need to be addressed when performing a business valuation. The evolving and increasing risk of data security and privacy is one that cannot be ignored in a credible business valuation. Addressing data security is a challenging area for valuation experts because it is a complex issue and there is little guidance or empirical data to help quantify these risks. This report presents some emerging ideas and techniques that are helping to pave the way to better understand and measure the impact of data security and cyber liability risks on the value of a business.

Introduction

Data security liability continues to grow in importance as the issue of data breaches and their impact on the value of businesses increases year by year. It is anticipated that global financial losses and costs attributed to cybersecurity will total \$2 trillion in 2019 and reach \$5 trillion by 2024. A breach of a company or organization now averages around \$8 million. In fact, data liability security failure may be the most existential threat to a business today.

This report reviews a number of specific cases where the impact of a cybersecurity or cyber liability breakdown led to a tangible, and, in some cases, catastrophic, change in the company's value. It also provides valuable insights and information for practitioners who are asked to testify on diminution of value cases and direct damages to a business.

Practitioners may be asked to consult on determining the appropriate level of cyber liability insurance coverage for a specific business. As part of making this determination, a client may ask the valuation expert to help him or her build models to figure out how much liability insurance he or she should purchase—a challenge that can be met through statistical modeling and simulation, also discussed in this report.

The client may be interested in learning not only how much coverage to purchase, but also what his or her exclusion is. What is the top end of that coverage? What might the deductible be? To help answer such questions, this report addresses how these damages arise and how they are quantified.

The ability of practitioners to offer such services can become an important part of a practice and contribute significantly to the bottom line of those who choose to offer them.

This report does not aim to make anyone an expert in every element of cybersecurity but rather to determine which critical questions need to be asked of the client in order to determine to what extent

cybersecurity should or should not impact an appraisal—and to pose the questions in a way that will not inundate the client.

Part I of this report focuses on the complex issues the practitioner should be aware of regarding the overall cybersecurity and cyber liability landscape. This includes how and why data security impact a company's value, an overview of common vulnerabilities, and the recent sea change in data security regulatory frameworks that have made data security into a compliance issue for every business.

Part II takes up how to determine whether cybersecurity demands special attention, or how much attention, in a specific valuation assignment. This section begins by providing practitioners with a valuable checklist of issues and additional questions to ask management, discusses how to quantify cyber risk, and proceeds to the all-important question of how to integrate the cyber risk assessment into the appraisal.

The issue of cyber liability is not going away. It will only become more important.

BVR would like to thank cybersecurity specialist Charles Hoff (Data Security University) and business appraiser Michael S. Blake (Brady Ware & Co.) for their invaluable help in creating this report.¹ Hoff covers the material in Part I of this report, and Blake takes over for Part II.

Charles Hoff, JD, MBA, is founder and CEO of Data Security University, an Atlanta-based company that delivers to enterprises, chains, and government agencies a proprietary online data security and privacy platform. Hoff is considered an expert in the field of data security and privacy and has devoted his entire career to this field from the start of his career at Equifax as senior vice president. HeCharles provided data and privacy security counseling to some of the largest companies and associations in the country such as the National Restaurant Association and has previously managed collective action lawsuits on behalf of organizations that sustained data breaches.

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¹ The material in this report is based on Don't Make Me Call Security! Considering Data Security Liability in Business Appraisals, a BVR webinar, Oct. 30, 2019.

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