StrategicRISK

THE KNOWLEDGE

TOP 10 EUROPEAN RISKS

For Europe's risk professionals, the 10 most likely threats include four related to economic factors – but technology and geopolitics are big concerns too

Europe versus the world

A *StrategicRISK* survey shows European risk managers have a different outlook to their Asian, and global, counterparts

Increased competition is the biggest risk facing European businesses in the coming year, with a combined risk score of 3.53 out of a possible five. That's the headline finding of a straw poll conducted by *StrategicRISK*.

A close second on the top 10 risk list for Europe is economic conditions (combined score: 3.51), followed by failure to innovate (3.27) and damage to company reputation or brand (3.22). The risk of a targeted cyber attack (3.19) rounds off the top five.

Nearly 50 European risk managers responded to the exclusive survey, ranking the risks of both likelihood of occurrence and financial impact.

Of these, 25 said increased competition was likely or highly likely to occur. Meanwhile, 24 said economic conditions were likely or highly likely to have an adverse effect on their business in the coming 12 months.

"IT IS NOT NECESSARY FOR MOST BUSINESSES TO ANALYSE THE RELATIVE PROBABILITIES OF VARIOUS EXTERNALLY TRIGGERED RISKS, PROVIDED THAT THEY KNOW HOW TO REACT SHOULD THEY OCCUR"

John Hurrell, Airmic

GLOBAL DIFFERENCES

Damage to company reputation or brand topped the list when it came to financial impact, with failure to innovate in second place.

By and large, economic risks keep European risk managers up at night (see page 28). The risk landscape looks different, however, from a global perspective.

Research from the World Economic Forum (WEF), *The Global Risks Report 2016*, found that large-scale involuntary migration and extreme weather events were the most likely to occur, while failure of climate change mitigation and adaptation was deemed to be the top risk in terms of impact.

Margareta Drzeniek-Hanouz, lead author of the WEF report, told *StrategicRISK* that economic risks were still a concern on the global scale, but that other societal considerations were pushing risks such as migration and climate change further up the risk agenda.

"Economic risks generally remain high on the agenda, albeit not as the top risk," she says. "But they should not be underestimated as they remain very important and impactful. There is definitely an underlying long-term concern about economic risk.

"This has been the case over the last few years since the global financial crisis. There is a sense that we are not really addressing those the way we should and they are therefore persisting in one way or another."

She adds: "Asset bubbles have shot up considerably compared to two or three years ago, and that is clearly another concern."

Airmic chief executive John Hurrell says risks fall into one of two categories: internal risks resulting from the failure of company processes and external risks that are the result of unforeseen occurrences.

"The first category will be managed to the best of the ability of the board and management of the company in the light of their (hopefully well-informed) market intelligence and the deployment of their own resources," he says.

"However, the second category requires analysis and intelligence (a good risk radar) but, most of all, the ability to respond effectively and rapidly. It is not necessary for most businesses to analyse the relative probabilities of various externally triggered risks, provided that they know how to react should they occur. Crisis planning will be more effective in practice than risk analysis."

To help ensure internal processes are suitable for the business's needs, and to ensure it is prepared for any unforeseen circumstances, FERMA president Jo Willaert says companies must ensure risk managers are properly embedded within the organisation.

"It is really important that the internal structure of an organisation defines who the risk manager is working for," he told *StrategicRISK*.

"A risk manager should be high-level enough to be part of, or at least support, the decision-making process of the company. He should be there when the strategic options are set out and to give his technical opinion like other disciplines such as financially responsible senior executives.

"It is obvious that these senior executives are close to the decision-making process and that when they say something, it is taken into account. It is often not so obvious for the risk manager."

THE VIEW FROM ASIA

In 2015, *StrategicRISK* conducted a survey of more than 145 of Asia's top risk professionals to get a view of the biggest risks facing organisations in Asia-Pacific.

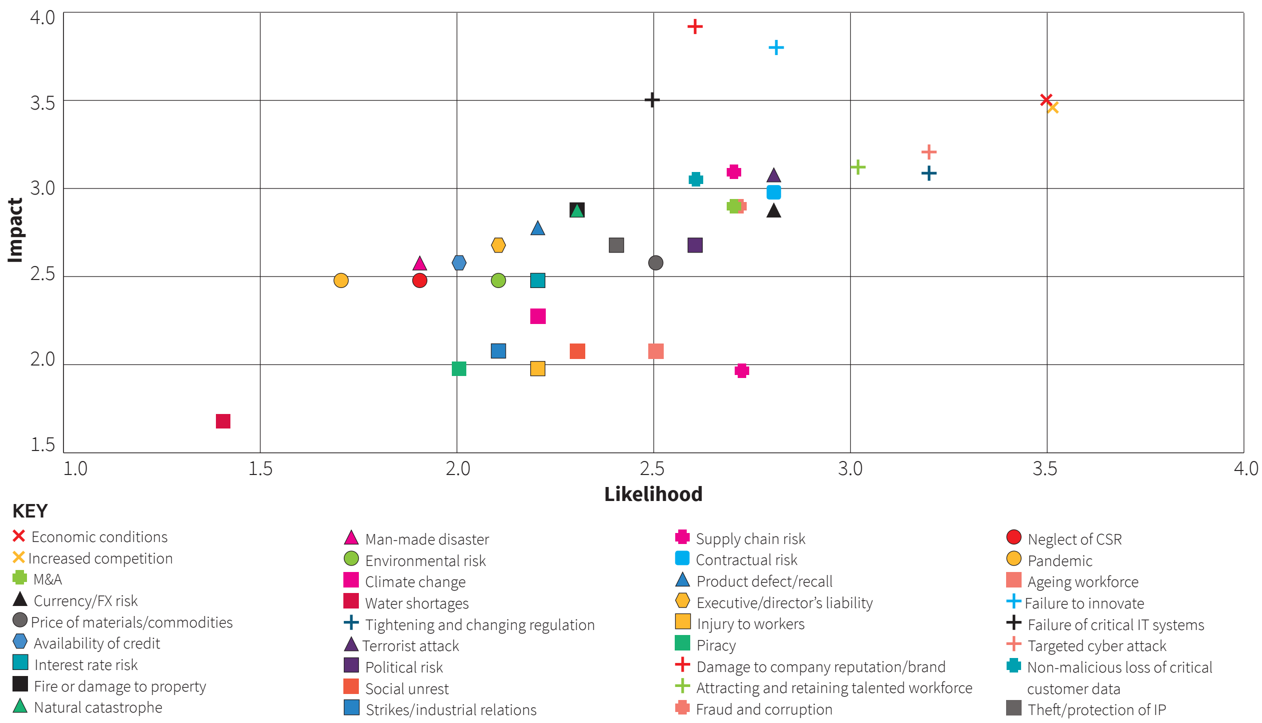
Top of the Asia-Pacific risk agenda was the economic landscape, with a combined risk score of 3.45. While this is lower than the 3.51 score for European economic conditions, it is still enough for it to take the top spot in the Asia-Pacific survey, with

TOP 10 RISKS – FINANCIAL IMPACT

Damage to company reputation/brand	3.9
Failure to innovate	3.8
Economic conditions	3.5
Increased competition	3.5
Failure of critical IT systems	3.5
Targeted cyber attack	3.2
Tightening and changing regulation	3.1
Attracting and retaining talented workforce	3.1
Terrorist attack	3.1
Supply chain risk	3.1

ECONOMIC AND COMPETITION RISKS TOP THE EUROPEAN RISK AGENDA

This chart correlates the financial impact and likelihood of 35 risks



the second and third spots going to, respectively, attracting and retaining a talented workforce (3.09) and increased competition (3.06).

A targeted cyber attack, which was the fifth-biggest risk in the European survey, was of increasing concern for Asian risk managers, climbing from ninth spot in 2014 to fifth in 2015 with a combined risk score of 2.84, compared to 3.19 in the European survey.

Another threat climbing the risk ladder in Asia-Pacific was a company's failure to innovate, breaking into the top 10 for the first time with a combined risk score of 2.84.

Daniel Tan Kuan Wei, second vice-president of the Risk and Insurance Management Association of Singapore and convenor of Singapore's National Risk Management Working Group, says he was surprised that the risk manager community had taken so long to appreciate this risk.

It should have already been in the list, he says. "This is absolutely critical for organisations to constantly produce new products or services that meet customers' needs or innovate internal processes to be more efficient and agile."

Interestingly, European risk managers ranked failure to innovate much higher on the risk spectrum, with a combined risk score of 3.27 taking it to third spot on the list of Europe's biggest risks for 2016.

The risks that least concern Asian risk managers coincided with the European view of the risk landscape. Water shortages and piracy made up the bottom two of both *StrategicRISK* surveys, with likelihood risk scores of 2.0 or less. **SR**

"IT IS REALLY IMPORTANT THAT THE INTERNAL STRUCTURE OF AN ORGANISATION DEFINES WHO THE RISK MANAGER IS WORKING FOR"

Jo Willaert, FERMA

TOP 10 RISKS – LIKELIHOOD

Increased competition	3.5
Economic conditions	3.5
Tightening and changing regulation	3.2
Targeted cyber attack	3.2
Attracting and retaining talented workforce	3.0
Contractual risk	2.8
Terrorist attack	2.8
Currency/FX risk	2.8
Failure to innovate	2.8
M&A	2.7

TOP 10 RISKS – COMBINED

Increased competition	3.5
Economic conditions	3.5
Failure to innovate	3.3
Damage to company reputation/brand	3.2
Targeted cyber attack	3.2
Tightening and changing regulation	3.2
Attracting and retaining talented workforce	3.1
Failure of critical IT systems	3.0
Contractual risk	2.9
Terrorist attack	2.9

It's more than just the economy, stupid

For Europe's risk professionals, the 10 most likely threats include four related to economic factors – but technology and geopolitics are big concerns too

"THE PERCEPTION IS THAT WE ARE FACING MORE AND MORE NEW RISKS BUT OFTEN IT IS THE SAME RISKS, WEARING A DIFFERENT HAT"

David Howells, Tetra Laval International

Economic risks rank among the biggest concerns for European risk managers over the next 12 months, according to a 2016 survey conducted by *StrategicRISK*.

The survey of almost 50 leading risk managers found that four of the top 10 most likely risks were related to economic factors: increased competition, economic conditions, currency and foreign exchange risk, and mergers and acquisitions.

Other categories in the top 10 risk list for Europe include technological risks (targeted cyber attacks and failure to innovate), geopolitical risks (tightening and changing regulation and terrorist attacks), societal risks (attracting and retaining a talented workforce) and contractual risk.

Overall, economic risks had a likelihood risk score of 2.8, compared to 2.7 for technological risks and 2.6 for geopolitical.

Tetra Laval International's director of group risk management and insurance, David Howells, says the globalisation of the marketplace means that businesses now face an increased exposure to economic risks as they enter into new and emerging markets.

"The core risks like damage to assets and supply chain disruption remain, but the economic landscape often changes their location," he says. "As organisations seek growth, their sales become focused on their emerging markets and their manufacturing base moves to contain or reduce costs.

"Doing business in new markets brings new exposures, be it credit risk, country risk, security risk or economic risk. The perception is that we are facing more and more new risks but often it is the same risks, wearing a different hat."

TECHNOLOGICAL CHALLENGES

While economic threats topped the list of most likely risks to affect businesses over 2016, respondents said technological developments were likely to have the biggest financial impact, should they occur.

The results of the survey gave technological risks a financial impact risk score of 3.3 out of a possible five, with economic risks (2.9) and societal risks (2.8) rounding off the top three.

Speaking to *StrategicRISK*, the World Economic Forum's (WEF) director of the Centre for Global Competitiveness and Performance, Margareta Drzeniek-Hanouz, said companies are often ill-equipped to cope with technological risks, despite improvements being made in the private sector.

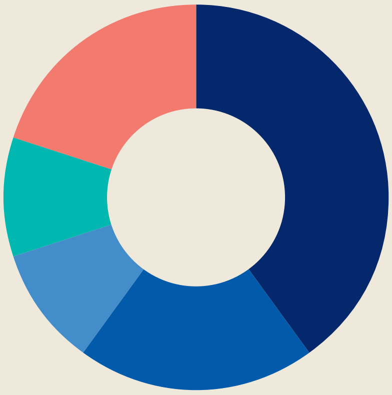
"We do not have mechanisms in place to deal with many of those [technological] risks," she says," but the private sector is advancing very quickly in terms of adjusting to those risks.

"[The problem is that technological] risks also spill over into security and societal questions. Technology empowers people at the same time as governance structures look to disempower them – so new tensions are being facilitated by technology.

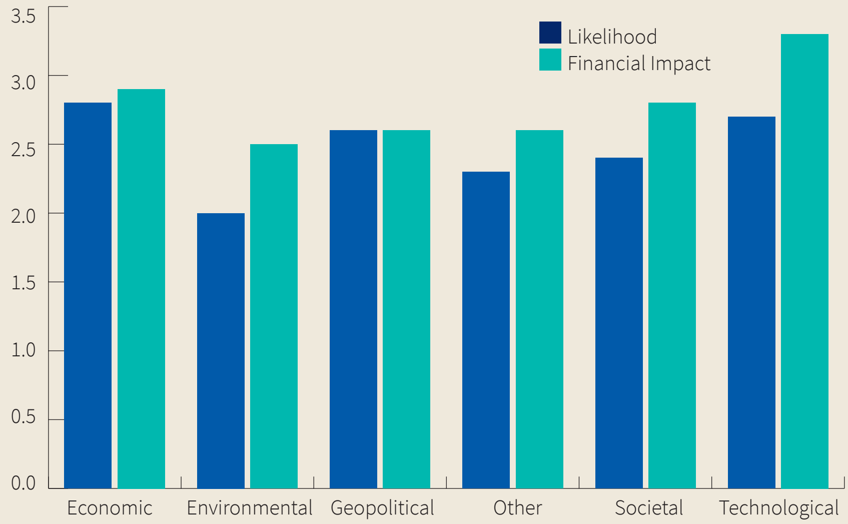
"As a result we will see, through those interconnections and the application of technology in different areas of risk, an amplification of risks [across the spectrum]."

THE EUROPEAN RISK LANDSCAPE

TOP 10 RISKS BY CATEGORY



TECHNOLOGICAL RISKS DEEMED COSTLIEST THREAT



LIKELIHOOD VS IMPACT

Economic risks such as increased competition, currency and foreign exchange risk, and mergers and acquisitions account for

40%

of the top 10 risks in Europe

Technological risks such as targeted cyber attacks, failure of critical IT systems and non-malicious loss of critical data accounts for

20%

of the top 10 risks in Europe but it is deemed the most costliest risk

To combat this, Howells says it is vital for risk professionals to carry out thorough risk analyses and ensure business practices are kept up to date in the face of constantly evolving technological threats.

"Changing and developing threats are the reason we regularly review our risk assessments and mitigation plans," he says.

"We assess technological and cyber risks by considering information confidentiality, privacy, information integrity and availability.

"So while the threats are constantly changing, so are the strategies used to address them. By reviewing the threats against each of these categories, we can better ensure we remain focused, ahead of the threat, and that our mitigation strategies are effective."

The latest research from the WEF, however, shows that classification of risks by categories can have its limitations.

Drzeniek-Hanouz, who is also lead author of the WEF *Global Risks Report 2016*, says risk managers are now seeing a range of different risks rise to the top of their agenda, rather than have a concentration of particular types of risk as their main concern.

"Until 2008, we saw a clear dominance of economic risk, then we had the emergence of environmental risk between 2008 and 2014, and then over the last two years we've seen other risks move up [the risk agenda]," she says.

"This year was the first year we had four out of the five risk categories represented in the top-five risks. Previously it's been more dominated by one category, so it is visible that risks are increasingly coming together – we cannot think of it in terms of categories any more.

"The risks for today are becoming more about how they are connected and how they play into each other."

What is more, this interconnection of risks requires risk managers to react differently to the risks their organisations are facing, as more risks are introduced that businesses may not have otherwise been exposed to.

"These interconnections can give rise to cascading risk factors," Drzeniek-Hanouz says.

"Risk managers should think about those cascading effects more seriously, rather than thinking of risks as individual events, because it's not about individual events any more.

"It's really about the trends that drive long-term risks and the cascading effects between interconnected risks." **SR**

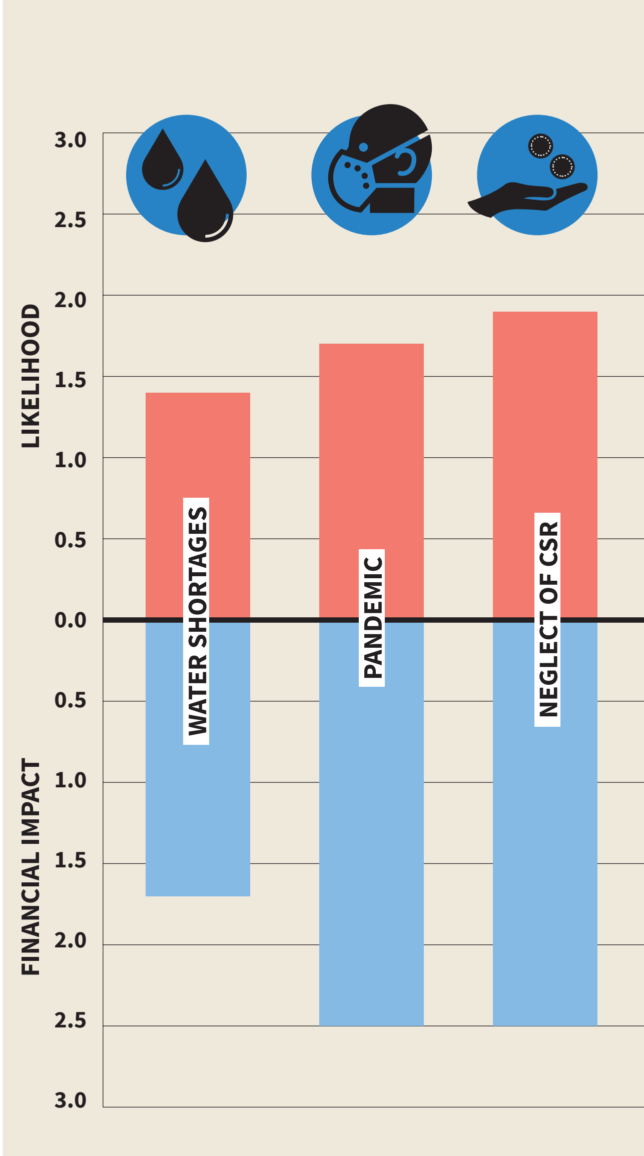
"RISKS ARE INCREASINGLY COMING TOGETHER – WE CANNOT THINK IN TERMS OF CATEGORIES ANY MORE"

Margareta Drzeniek-Hanouz, World Economic Forum

Don't rule out an unforeseen calamity

Unlikely they may be, but hidden risks and 'black swan' events can be extremely damaging. So, how do you prepare for the unexpected?

HIDDEN RISKS



The economic downturn and increased competition may be topping the risk agendas of Europe's risk managers, but a failure to address the unexpected risks lying beneath the surface could be just as calamitous. This was one of the key findings of a European risk management survey conducted by *StrategicRISK*.

The failure of critical IT systems, failure to innovate and damage to company reputation or brand are risks with a low likelihood of occurrence but a high financial impact, should they take place.

Speaking to *StrategicRISK*, FERMA president Jo Willaert said businesses must conduct a proper assessment of the risk landscape they are operating in before they make any strategic decisions.

"It is crucial that when you set up the strategy of the company, you are aware what all the risks are and that people are taking care of those risks," he says.

John Windsor, head of insurance at Marks and Spencer, says organisations can prepare for these unexpected events through the use of traditional risk management techniques, to assess the risks, and through careful crisis management planning.

"The most important thing is to know what your risk is – quantify and identify the risk and make sure you understand it," he says. "Your business continuity plan must involve the physical part of your business, but the IT guys and insurers must also be included from day one, as should the press office to ensure you all speak with one voice. You don't want to have people going off and saying things they don't have enough knowledge of to discuss."

COMMUNICATION IS KEY

He adds: "Reputational risk in any event, whether it be cyber or fire, is hugely important. You have to maintain the support, loyalty and confidence of your customers. The most important thing when something does happen is to make sure you've got a tried and tested response to these things.

"Communication is key – it has to be confident communication to make sure your customers realise you do know what you are talking about and you are trying to address the situation."

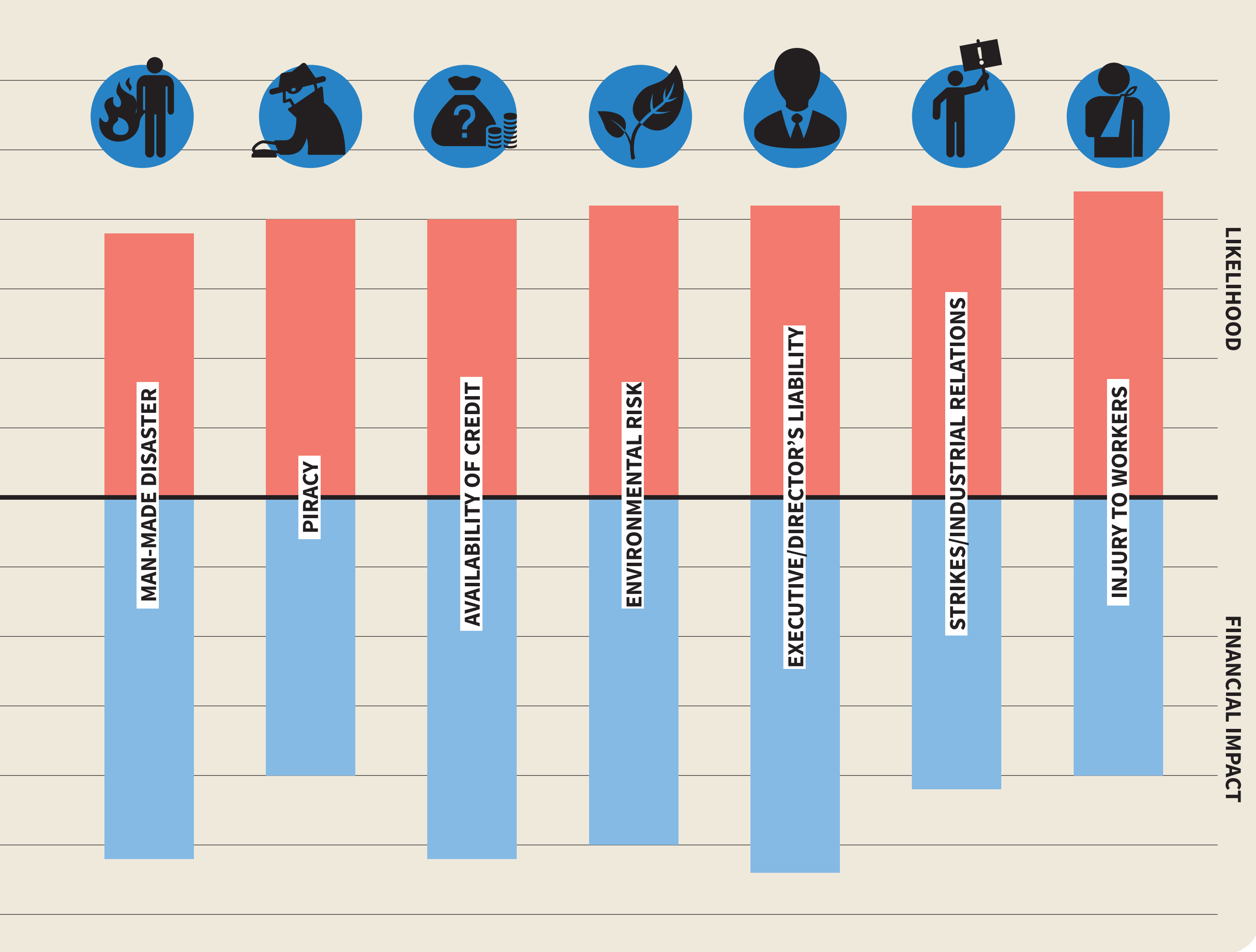
Margareta Drzeniek-Hanouz, director of the Centre for Global Competitiveness and Performance at the World Economic Forum, notes that companies must also be aware of the costs of risk mitigation and make sure any measures are proportionate to the risk faced.

She adds: "It's really about a cost-benefit assessment and each will be very different depending on the

10 HIDDEN RISKS (LOW LIKELIHOOD, HIGH IMPACT)

- Damage to company reputation/brand
- Failure to innovate
- Failure of critical IT systems
- Terrorist attack
- Supply chain risk
- Contractual risk
- Non-malicious loss of critical/customer data
- M&A
- Fraud and corruption
- Currency/FX risk

Some risks may have a low likelihood but if they occur, they could cost companies dearly



"YOUR PLAN MUST INVOLVE THE PHYSICAL PART OF YOUR BUSINESS, BUT THE IT GUYS AND INSURERS MUST BE INCLUDED FROM DAY ONE, AS SHOULD THE PRESS OFFICE"

John Windsor,
Marks and Spencer

operations [of the business] and economic exposure of those risks [to the organisation].

"Proper assessment of that exposure and the potential impact is needed; there's no silver bullet or miracle solution."

As well as the risks highlighted by the survey, Tetra Laval International group risk management and insurance director David Howells says risk professionals also need to be aware of the threat of black swan events. "These 'hidden risks' or 'black swan' events, are considered to be so unpredictable that they cannot be measured or modelled," he adds. "But that doesn't mean they should be ignored.

"While they may seem to come as a complete surprise, it is generally accepted that they can be rationalised afterwards. Risk managers can prepare; using previous events we can develop scenarios to test our resilience.

"It is a challenge to motivate an organisation to consider events that are, by definition, so unlikely to occur that they cannot be modelled, but the use of examples helps. The organisation's strategy will have considered these scenarios and without even identifying the event, it will have considered how diversified it is, it will monitor performance across a multitude of areas and use key indicators to determine when it is necessary to rebalance and realign operations."

BOTTOM 10 RISKS – COMBINED

Water shortages	1.6
Piracy	2.0
Pandemic	2.1
Injury to workers	2.1
Strikes/industrial relations	2.1
Social unrest	2.2
Neglect of CSR	2.2
Climate change	2.2
Man-made disaster	2.3
Environmental risk	2.3

But Windsor says it is important for risk managers not to overlook the more old-fashioned threats. "Yes, you do have to look at the emerging risks, but you can't forget about the traditional risks that have been around for many years," he says. "For me, the three main threats would be the traditional perils, fire and flood, because of the effect they can have depending on where and when they hit, as well as terrorism and cyber risks." **SR**

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