The Year Ahead: Risks and Opportunities in 2018

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Russell

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A New Year for many promises a fresh start. Yet, if you are a (re)insurer or a risk manager, then 2018 promises a continuation of the new and emerging risks that have emerged over the last few years.

January is also the time when organisations and corporates indulge into a bout of crystal-ball gazing as they seek to try and predict the trends and risks that will dominate the year. Yet, as 2016 showed, reality has a funny way of making its own mind up.

Russell Group enters the fray in a slightly different manner. For, we are not going to focus too much on the big questions but rather the less discussed trends that in the long term will become critical risk drivers. Trends that if not managed in a correct way, will create potential challenges and opportunities for corporates and (re)insurers. In other words, to quote UK Environment Secretary Michael Gove, "In this unfrozen moment, new possibilities occur."

It is often these lesser spotted trends that emerge to be the most dominant theme for an era. For instance, in the early 1990s and 2000s, cyber insurance was a relatively new concept, pioneered in Lloyd's of London in 2000. Yet, according to many predictions, cyber insurance premiums are expected to hit $20 billion by 2025 and is now a must-have insurance cover for many corporates.

Looking ahead 10 years is something we will leave to Science Fiction writers and film makers – for now – so in this new Russell Group white paper, we look at the top connected risks in 2018. Risks, that we will be exploring in more-depth over the next 12 months.

Theme 1: Public capital, Private Capital

Economist superstar, Thomas Piketty, author of *Capital* identified that today's economic debate is being determined by two realities that are connected, more than we think. That is the relationship between public capital and private capital.

On one hand Piketty points out we have the steady rise in public debt and, on the other, the prosperity of privately owned wealth. The figures for the level of public debt are well known; almost everywhere the level approaches or exceeds 100% of national income as compared with barely 30% in the 1970s.

The most recent data available for 2015-2016 shows that net public capital has become negative in the United States, Japan and the United Kingdom. In all these countries, the sale of the total public assets would not be sufficient to repay the debt. In France and in Germany net public capital is only just positive. But this does not mean that rich countries have become poor: it is their governments, which have become poor, which is very different. The fact remains that private capital grew much faster than the decline in public capital, and that rich countries themselves hold even a little more. The power of private capital is increasingly in conflict with public capital depending on which side of the debate you stand on, but the risks and opportunities cannot be ignored.

Global multinational corporations are entering a new phase in their development. The race is on for a Google, Amazon or Facebook to become the first trillion-dollar enterprise. At the same time, public debt has increased sharply in many countries in recent years, particularly during and after the Great Recession. Globally, the total amount of government debt now exceeds **$63.1 trillion**, according to a Pew Research Centre analysis of International Monetary Fund data. Which way will the scales tip? Whichever way they rise or fall, risk managers need to be aware of the risks and opportunities - and adapt.

Theme 2: $74 Trillion Global Economy

Currently, World GDP stands at $74 trillion according to the *World Bank.* A visualisation from *HowMuch.net*, in the form of a Voronoi Diagram shows the $74 trillion global economy in nominal terms. Each country's segment is sized according to their percentage of global GDP output. Unsurprisingly, the USA generates a quarter of global at 24.3%, 10 percentage points ahead of China (14.8%). China is, in turn, 18 percentage points ahead of Japan (4.5%).

Yet, as both 2016 and 2017 showed, this wealth can be

disrupted by external shocks ranging from NatCat disasters to political shocks.
2018 promises no let ups. Geopolitical tensions on the Korean peninsula, UK's fraught Brexit negotiations with Europe, an embattled Trump administration are some of the many potential crisis points on the horizon in 2018. Saying that, the U.S., which is the benchmark and driver for global investment recently announced a once in a generation tax cut that many economists predict will fuel a boom in demand with its mature economy touching 4.0% annualised growth.
The flipside is $1.5 trillion added to the U.S. deficit.
The macroeconomic risk and opportunity will need to be monitored carefully by risk managers across the corporate spectrum.

Theme 3: The World is Not Global, It's Local

At the turn of the 21st century, historians, politicians and commentators believed that the world was entering a new era of globalization like

that of 18th and 19th centuries. An era of mass movement of people, goods, capital and services moving across borders seamlessly.

That era came to a shuddering halt in 2016, with political earthquakes in the UK and USA determined to reverse this trend. So, are those who view themselves as globally minded 'Citizens of Nowhere' as UK Prime Minister, Theresa May put it?

Well, the reality is more complicated than that. Back to 2013, a DHL Global Connectedness Study pioneered by Pankaj Ghemaway, argued that since 2007 the world has become "less connected" each year. This is not to say organisations

do not have global operations or that people do not communicate with people from different nations. Rather, it is saying that local countries have their own economic conditions, cultures and values.

Ghemaway adapted these ideas in a book, *World 3.0*, in which he argued for "rooted cosmopolitanism". This called for business leaders to respect and understand not just the economic interests but cultural interests of each country that they sell or operate in. The two major growing powerhouses of China and India are perfect examples. Both have unique labour markets with a younger workforce and different regulatory and cultural environments. Succeeding in any market not just India and China, will require an adjustment of a company's product, channel and marketing strategies.

Theme 4: Data Privacy: GDPR

With just over four months to go before the GDPR goes live on 18th May 2018, later in

the year we will study the implications for international data protection standards and potential threats posed to business resilience, national security and critical infrastructure in today's connected digital age. In the meantime, most top UK and US firms are still overestimating their state of readiness, a study by international law firm *Paul Hastings* suggests.
Although 94% of FTSE 350 companies and 98% of *Fortune 500* companies believe they are on track to comply with the GDPR by the May deadline, the report suggests that levels of readiness may not be so advanced. In reality, less than half of firms (39% in the UK and 47% in the US) have set up an internal GDPR taskforce, only a third are hiring a third-party to conduct a GDPR gap analysis, and roughly only a third are hiring a third-party consultant to assist with compliance, all of which suggests many companies are not as well-prepared as they think.
Failure to comply by any company anywhere in the world that does business with Europe and holds personal data about EU residents – for purposes such as profiling and big data analysis – could result in fines of up to € 20m or 4% of its global turnover, whichever is the greater.
Another survey published in November 2017 by cloud security firm *HyTrust* revealed as little as 22% of US organisations are concerned about the GDPR and have a plan in place. The survey included respondents from key industries, including government/military, financial/insurance, healthcare/biotech, manufacturing, transportation/shipping and technology.
More than half (51%) of respondents said their organisation is either not concerned about GDPR or is unaware of its relevance to their business. That's all very well from a business point of view. Fines will be levied, reputations will be sullied when regulators intervene and the ensuing publicity hits the media. What is also interesting, however, are the potential geo-political implications of the EU inspired regulation.
In theory, the EU regulator has the power to levy huge fines on U.S. (or other regions) businesses, healthcare providers, charities, individuals and other institutions that fail to comply. It will be interesting to see the reactions of the current U.S. Government administration if/when the fines land on corporate America's CEOs desktops in 2018 or more likely 2019.

Theme 5: The New Protectionism

In 2017, many feared that the world was slipping into an era of Protectionism, with the retreat of the US from the global stage under the banner of 'America First'. Yet, the term 'Protectionism' for many still means what it meant in 1930: tariff and quotas.

Protectionism in the Connected World is radically different. For it incorporates not just free trade but areas such as data, environmental and geo-political hazards:

Data Protectionism. The pending introduction of the General Data Protection Regulation (GDPR) by the European Union will force companies to accept a 'tariff' on their data or lose their European business.
Environmental Protectionism. America's retreat from the Paris Climate agreement in 2017 has forced regional powers like Europe and China to take leadership on climate issues.
Political Protectionism. The rise of populist politics across the West has forced companies to change how they invest in western economies.

Economic Protectionism. Governments use Monetary policies to deliberately devalue their exchange rate.

Theme 6: The Future's Bright. The Future is Online.

The working title of June's *Airmic* Conference is "The Future is now." Russell Group will be working with *Airmic* on the conference report, *Roads to Revolution*, which promises to be a groundbreaking analysis of the world of connected risk. Yet, any discussion of the future raises the biggest questions: How will (re)insurers and corporates respond to the rise of Millennials and technology change?

Millennials, are arguably the most influential generation since the Baby-Boomers, and like the Baby-Boomer generation, are living through profound social, economic and political change. Most Millennials have grown up with *Playstation, iPhone* and *Facebook*, all concepts that place a strong emphasis on personalized user experience. Coupled with this experience is Millennials' belief in activism. In previous times, Corporate and Social Responsibility used to be a tick-boxing exercise for many companies. With the rise of Millennials' influential voice powered by Social Media, companies now have to actively take a stand on issues that they would not have done previously. For instance, when President Trump introduced a visa ban in 2017, many CEOs such as Tim Cook of *Apple* and Satya Nadella of *Microsoft* condemned the measure.

Now more than ever, brands are aligning with causes that people - and Millennials – believe in. It's not only Millennials, of course.

Groups across society defined by age, gender, race, ethnicity, political persuasion and even Presidents of the United States are joining the social media clamour in great numbers. The great disintermediation of the political and mainstream media class is well under way.

Behind the rise of Millennials and activist groups in society is their ability to exploit the new digital revolution. A revolution that is asking profound questions about the way all these tribes are governed, cared for and sold to. As a result, this shift is leading to changes in buying patterns and is re-shaping the world of bricks and mortar.

The most obvious changes are being seen in the retail space where we see smart phone emporiums replacing clothes shops, independent boutiques – like a small music shop business previously frequented on a regular basis by one of the authors of this report – as well as giants of the music trade such as HMV.

The question for risk managers, CEOs, marketing departments is: "How do we protect, consolidate or change our business model in such an environment?". One thing is for certain, it is not business as usual.

Theme 7: Are you at risk of being trapped in an uncompetitive business?

Chances are the strategies that worked well for you even a few years ago no longer deliver the results you need. Dramatic changes in business have unearthed a major gap between traditional approaches to strategy and the way the real world works *now*.

In short, strategy is stuck – or frozen. Most leaders are using frameworks that were designed for a different era of business and based on a single dominant idea—that the purpose of strategy is to achieve a sustainable competitive advantage. Once the premise on which all strategies were built, this idea is increasingly irrelevant.

Now, Columbia Business School professor and globally recognized strategy expert Rita Gunther McGrath argues that it's time to go beyond the very concept of sustainable competitive advantage. Instead, organizations need to forge a new path to winning: capturing opportunities fast, exploiting them decisively, and moving on even before they are exhausted. She shows how to do this with a new set of practices based on the notion of *transient* competitive advantage.

One way of doing it is to incorporate the name Blockchain in your brand overnight! According to *The Financial Times*, investors were warned against "potential scams" following a surge in stock prices of previously obscure business that announce abrupt changes of strategy into crypto-currencies.

The FT reports that: "shares in Long Island Iced Tea Corp, a maker of soft drinks, leapt as much as 500 per cent...after it announced it was changing its name to Long Blockchain Corp. The Nasdaq-listed company, which has never reported a profit and two weeks ago struck a distribution deal for cold-pressed juice, said it was "shifting its primary corporate focus towards the exploration of an investment in opportunities that leverage the benefits of Blockchain technology".

The FT notes that this sudden embrace of Blockchain makes the company only the latest in a number of small U.S. stocks that have more than doubled their value in a day by adding it to their names, bringing back memories of the wildest days of the late 1990s technology bubble.

Theme 8: What is Risk Culture?

The last theme we will be exploring this year is that of risk culture. In today's interconnected world, boards are taking more of an interest in their company's internal risk management systems. Yet, despite this interest, the most crucial aspect of any risk management is being ignored, that of risk culture.

What is risk culture, exactly? Is it top down or bottom, inside out or outside in? Before, any developed risk management program can be implemented, risk culture needs to be defined first. Risk culture can be defined as a system of values and behaviours within an organization that forms the

risk decisions of the senior leadership and employees. Risk culture plays a key role in an organisation's drive to name and know your risks. For risk culture, can help an organisation's employees develop a collective understanding of the enterprise, its corporate purpose and risk and compliance rules. An understanding that signals to all employees "to do the right thing", which is fundamental to good Enterprise Risk Management (ERM).

The themes mentioned in this report will no doubt evolve over the year ahead. The pace of modern change and business transformation is startling and discombobulating. What is clear is that the status quo is melting. One question to ask might be:, "is this unfrozen moment melting or transforming into a new state entirely?" The other question to ask is "can we adapt and are we aware?"

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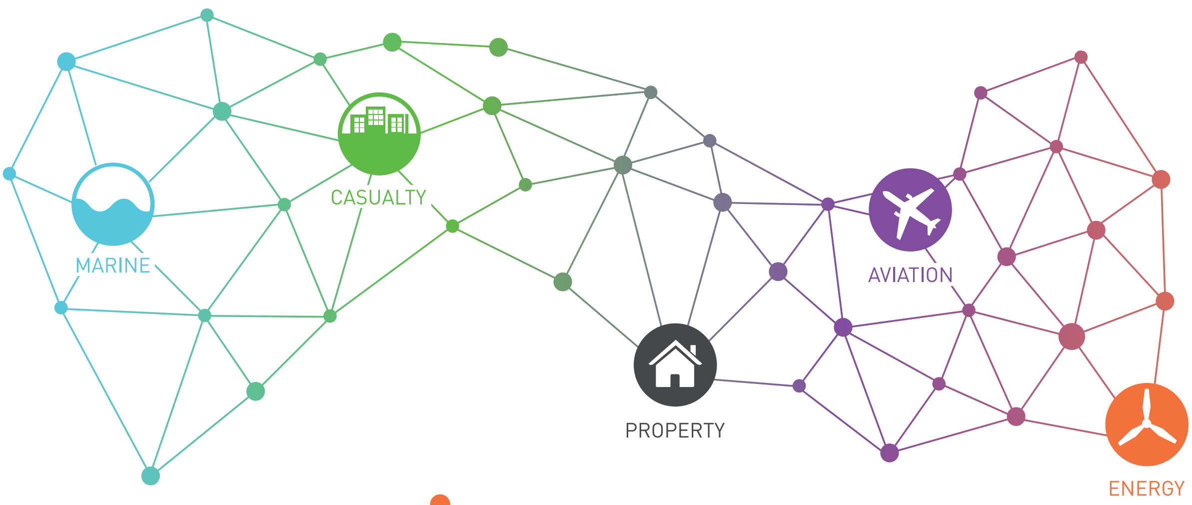
Russell Group is a leading risk management software and service company that provides a truly integrated risk management platform for corporate risk managers and (re)insurance clients operating in an increasingly connected world.

Connected risk refers to the growth in companies which are increasingly integrating across industrial sectors and geographies, and creating greater levels of risk. This exposes corporates and (re)insurers to a broader range of inter-related perils, which requires a risk management approach built upon deep business intelligence and analytics.

Russell through its trusted ALPS solution enables clients whether they are risk managers or underwriters to quantify exposure, manage risk and deliver superior return on equity.

If you would like to learn more about Russell Group Limited and its risk management solutions, please contact rborg@russell.co.uk or visit www.russell.co.uk/contactus

Managing Risk
in a Connected World



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