RISING BUSINESS RISK IN A CONNECTED WORLD

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RISING BUSINESS RISK IN A CONNECTED WORLD: THE THREAT TO SHAREHOLDER VALUE

Ask a corporate risk manager if they understand the risks facing their business and chances are that the majority will express cautious optimism that they have most, if not, all the bases covered. Operational Risk? Tick. Financial Risk. Tick. Enterprise Risk. Tick. In isolation, the rules of the risk game are widely understood and mitigated. As is becoming increasingly clear, however, the rules of the game are changing rapidly as our understanding of modern exposure drivers is clouded by the nature of connected risks in the globalizing world of Industry 4.0. The picture is further complicated by two other key points, as follows:

1. More stringent regulatory oversite should be driving companies to more transparency. The way it should be seen is that managing business risk drives shareholder value. Yet it is our opinion that many organisations are, afraid of truly reporting business risk and would not be comfortable in proactively communicating their business risks to shareholders. Why not? In simple terms, the truth hurts. In other words, tangible business risk doesn't get enough of a mention when communicating potential exposures to shareholders because the perception is that it might destroy shareholder value in the short term.

2. At the same time, under a capitalist system, the market is used to communicating the delivery and achievement of Quarterly Results and sales targets even if it means that in the long-run the brand is damaged e.g. product recall or customer churn increases. This is what can happen when obtaining maximum shareholder value is a legal requirement for company directors, however it doesn't always translate into optimal business performance and effective risk management. Insurers also face a very similar problem. Organisations that do not confront connected business risk head on - in what we describe as the Corporate Accountability Deficit (CAD) - are fooling themselves, as we discuss in this white paper.

Point 1 might seem like a contradiction in terms. Surely the Boardroom and their risk managers are employed to manage their risks proactively at all times? Of course, but a number of recent studies have identified common causes of a kind of "risk blindness" linked to boardrooms across the corporate spectrum. Information flows to Boards are often defective and the rise of new technologies and the current methodology for "just in time" product delivery threatens to create a new crisis of complexity that is difficult if not impossible to manage in neat vertical silos. Ultimately, this results in the increase of business risk and the loss of brand and shareholder value.

These are not the only problems confronting Boardrooms and financial services providers such as insurance companies and banks. Financial services organisations underwrite risk but have in-built flaws that can fatally undermine their ability to manage their own risks. As recent news headlines have shown there appears to be a gathering popular will to moderate the excesses of 21st Century capitalism particularly in the wake of the Lehman crisis when incentives were seen to have played a part in finishing off financial businesses. Flawed leadership, a skewed ethos and poor-quality information all play a part in modern-day risk mismanagement.

These themes are examined in the paper Deconstructing Failure: Insights for Boards — by Anthony Fitzsimmons and others and published by Reputability, a boardroom governance consultancy of which Fitzsimmons is chairman. Fitzsimmons was also involved in a project with the Association of Insurance and Risk Managers in Industry and Commerce (Airmic) and Cass Business School, which produced a study called Roads to Ruin looking at corporate collapses seeking to discover if there are common themes.

As we examined in Point 2, these issues can often be behavioural-led rather than accounting-led. Some commentators believe that companies behave and evolve in an almost biological way rather than mechanical way. As we know, biology is essential for reproductive purposes but it often fails to lend itself to rational business decision-making! So the problems described by Fitzsimmons are behavioural but even he does not go far enough in that he is looking at problems at the enterprise-level.

In my view, the behavioural problem is industry wide and cuts across other connected sectors. There is corporate information disconnect, which suits the purpose of some market protagonists, but in the long term is not a viable recipe for sustainable success in today's linked global economy.

In the context of connected risk, it is vital that boards know their risks and are able to name their risks. This seems obvious at first sight but the reality is that this simple aim is not being achieved by the vast majority of corporate entities operating in the world today. As Russell Group Limited has been arguing for some time, the (re)insurance market is hardly immune from these problems. To help with the better understanding of insured risk Russell has devised a universe of companies which contains 20,000 companies, representing 67% of global revenue as reported in 2015. This universe of companies contains the top 1,000 companies and half of their supply chains.

The intention of this universe would be to provide a known sample of the global economy in terms of exposure profile, sector and geography. By linking to this known universe (re)insurers will avoid the time consuming names matching issues, and be able to understand relationships between companies, sectors and geographies, as well as knowing true market share.

The next step to achieving a better understanding of risk is to pursue and adopt a more collaborative approach that connects industries and removes silo-based thinking. Collective risk management becomes far more important in today's networked global economy.

As I have outlined previously, organizations are more connected to each another, and to "crowds," than ever. In today's connected eco-system, enterprises not only share data, technology and other resources, but also more exposures. According to The Future of Risk: New Games, New Rules, a report from Deloitte & Touche LLP.

"Increasingly, organizations are managing risk in a manner that reflects this new reality—transforming their risk processes through more open, collaborative approaches that address the challenges of a networked economy, and working together to identify, manage and reduce risk," says Mr. Saia. Organizations might also form alliances with risk experts, researchers and academia to stay abreast of the latest threats and mitigation approaches, and also consider forming industrywide partnerships and consortiums."

Corporates are now increasingly integrated across industrial sectors and geographies, and are operating sophisticated supply chains and/or delivery systems to end clients and markets. This exposes companies to a network of connected risk as each company's business becomes more related to the next, thus generating systemic risk.

Klaus Schwab, Founder and Executive Chairman World Economic Forum, outlines the importance of a new collaborative approach to integrated risk management in the preface to WEF's recently released Global Risks Report 2017 report. He concludes that: "The threat of a less cooperative, more inward-looking world also creates the opportunity to address global risks and the trends that drive them. This will require responsive and responsible leadership with a deeper commitment to inclusive development and equitable growth, both nationally and globally. It will also require collaboration across multiple interconnected systems, countries, areas of expertise, and stakeholder groups."

In my view, a "less co-operative, more inward-looking world" doesn't really create an opportunity to address global risks, quite the opposite, people will focus on local issues! The point about corporates and insurers needing to engage in collaboration across multiple interconnected systems is spot on, however, and is a theme I will continue to explore in 2017.

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 sbasi@russell.co.uk or rborg@russell.co.uk