# CHAIN REACTIONS

In today's complex world, one risk leads to another. So, how should businesses deal with these knock-on effects? *StrategicRISK* sought the views of senior executives at Airmic's annual conference

Russell

**EMBRACING FEROCIOUS TECHNOLOGICAL** change, engaging inert boardrooms and honing the skills sets of future risk managers all came to the fore at a *StrategicRISK* roundtable discussion.

Held in association with Russell Group at the International Convention Centre, Birmingham during the annual Airmic conference, the discussion focused on specific risk exposures and how they relate to each other.

The event brought senior executives from the agriculture and chemicals, automotive and utilities industries together with risk managers, leading insurers and consultants to assess how companies are coping with the increasingly complex risks to supply chains, business interruption, their boardrooms and overall reputations.

With Sophie Roberts, associate publisher at *StrategicRISK*, managing the roundtable, the initial, fundamental question was one of definition. Colin Barker, deputy company secretary at Bayer PLC, defined interconnected risk simply. "To me, it's like the domino effect," he said, "so one impact will cause a reaction to something else, so therefore it's interconnected. Any contingent risk from one action into another is a connected risk."

Group risk manager at engineering consultancy Ricardo, Andrew Swayne, concurred. Noting his firm's tendency to collaborate inter-departmentally, he said: "The way we structure our risk register and our risk thinking is we don't put things in silos. We obviously have to have a label, but there is a lot of cross-referencing going around and we sort our risks by type and the drivers going around them so we can see the actions, put them together and review them as a package."

For general insurer RSA's Neil Strickland, director, global consulting, the complexity of supply chains was instrumental in understanding the meaning of the issue. He said: "If you look at the industry as a whole, the supply chain's becoming much more complex because boards are demanding we operate just-in-time, which plays out to the same but more complex risks. It's very difficult to nail it and therefore to insure it, but it brings us back down to basics: any risk is just risk and is all around your business continuity. If you have it in a broad enough sense or plan, you can respond to any risk. With interconnected risk, you don't know where it is coming from, or what it will be, so it's all about the basics."

Allianz Global Corporate & Specialty's UK chief executive, Brian Kirwan, thought the essence of the issue was correlations. He explained: "We are looking at correlations between particular events. For us, that's what the interconnectivity of risk is. It's

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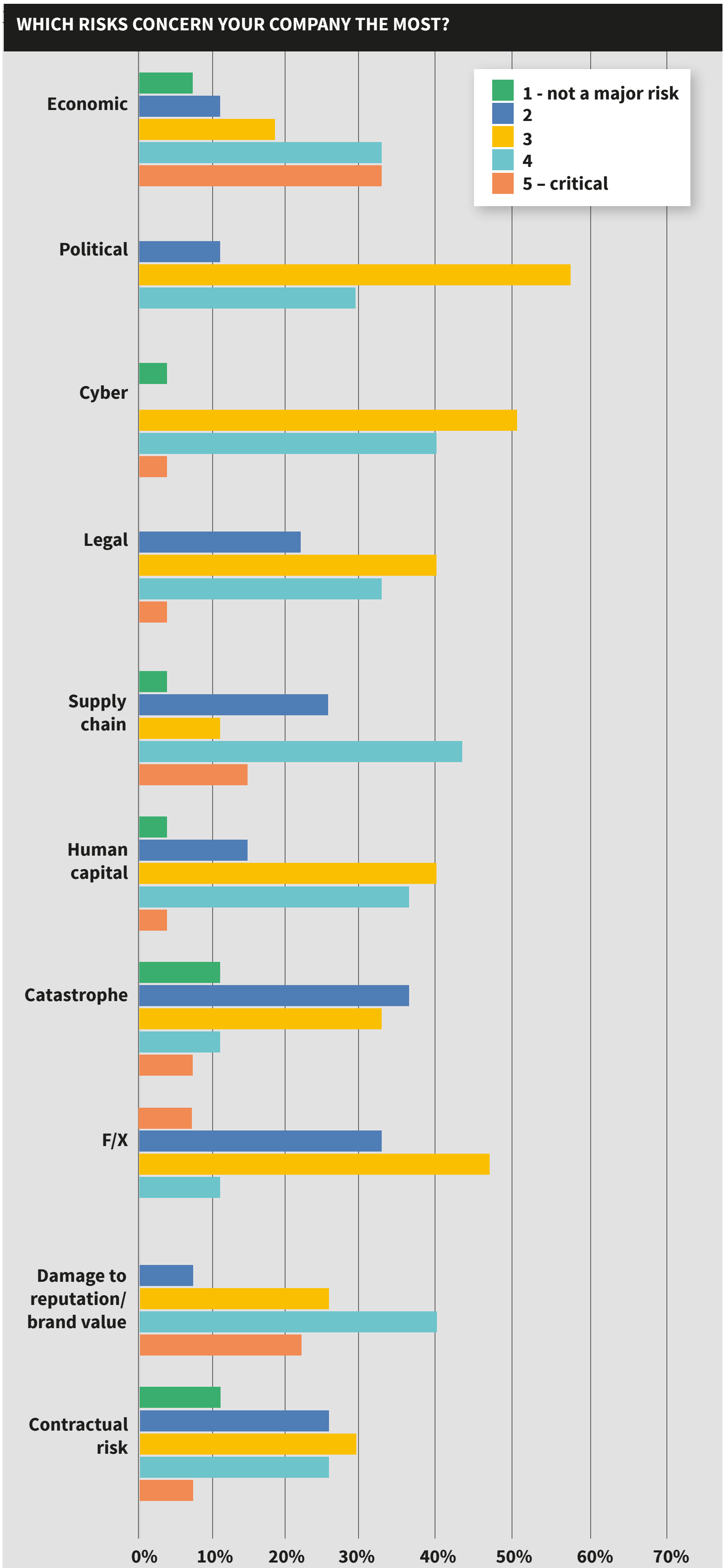
## WHICH RISKS CONCERN YOUR COMPANY THE MOST?



**Source:** StrategicRisk Interconnectedness of risk survey

creating a much greater loss than the individual loss. What's changing for us is before, where loss would be looked at from a physical location point of view so you could correlate your potential losses per event/per location, software and technology moves that in a much broader way, so we have correlations within and across companies. Software is changing the way we have to look at correlation and interconnectivity."

XL Catlin's head of property engineering, Jonathan Salter, said there is a real need to understand the connectivity of the risk. To illustrate his remark, he said: "In automotive, there are, constantly, examples where the lack of, say, a piece of kit in Italy from a supplier means production grinds to a halt in four or five countries. There's lots of high-profile ones that make the media, but I guess the good news is there's lots that don't make the media. People understand the value of connectivity, but also the risk of disruption. They are investing a lot of time in understanding business continuity and resilience.

"It's very difficult to know where these things are going to come from because of the nature of these 'four-dimensional' dominoes. It could be that there is a natcat event somewhere that leaves a business with a production challenge on the other side of the world."

For event sponsor Russell Group's managing director, Suki Basi, PR, brand value and reputation are all intrinsic to the concept of interconnected risk. As he averred: "You're getting into the interplay of events with intangible assets where brand value and reputation are big. To some extent, we are in uncharted territory. To say [interconnected risks] are new – well, they've always been there. They are now amplified by the environment we're in, which is faster-moving. It is how you react to this rather than the actual risk, such as how you react that forces the share price in one direction or the other, which is the biggest measure for brand value and reputation."

## BORED ENGAGEMENT?

There was consensus around the table that the average board cannot look at 25 risk issues at the same time, but typically focus on three priorities that they then instruct their risk managers to stress-test. This has proven inadequate, according to Julia Graham, deputy chief executive and technical director at the UK's risk management association, Airmic.

"There's an assumption that boards get involved with this. Our experience of talking through the Chairman's Forum is they don't," she said.

"Research that people like McKinsey have done shows how much time boards spend looking at risk – it's about three-and-a-half percent of their time. And it's not changing, even though the governance demands on risk are increasing."

She went on to identify some salient new operating trends. "One is a new type of governance, where the board can look to people who operate at an integrated level, maybe the level that sits beneath them – because the whole concept of connected risk means you need connected management.

"With the domino-effect scenario [mentioned earlier], I think it's a case of four-dimensional dominoes because they don't go in a straight line, they go all over the place. The difference with connected risk is that it doesn't work laterally. They're like an amoeba. They go in all sorts of directions, they go in all sorts of dimensions. What you therefore need is not only connected risk assessments, you need connected risk controls."

Graham stressed the need for new tools and techniques. "If you look at the FRC code, they ask companies now to list their top-ten principal risks. That almost encourages people to think in a linear way, in a list: 'List me your top ten.' That doesn't encourage companies to think in an interconnected way. There is something awry with the governance

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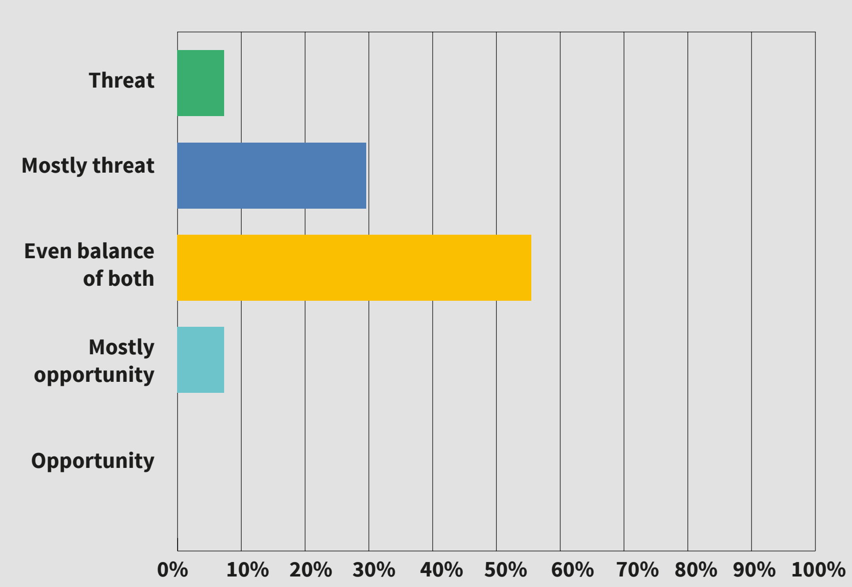
WHAT IS THE PERCEPTION OF RISK AT BOARD LEVEL WITHIN YOUR COMPANY?



**Source:** StrategicRisk Interconnectedness of risk survey

process, albeit it's quite new on the code having only been out a couple of years."

For Graham, interconnected risk itself is not novel, but its velocity and viral nature today are. "Connected risk isn't new. What's new is the context and the environment are much more sophisticated. It's harder. It's more complex. And it's faster and harder to understand."

The Warranty Group's managing partner, Patrick Smith, said finding the tool that tests the engagement of the board was critical.

"In my experience, finding a tool that worked was due to a Solvency II implementation. I was really struggling with stress-testing and modelling. I wasn't struggling to do it – I know how to do it. But emotionally getting engagement from the board, that was really hard. What really worked was stress-testing. I had to ask the question about 12 times before they understood the question, but we got there."

He added: "It's not: 'How likely are we to go wrong?' It's: 'We've gone wrong. How did it happen?' Once they understood that question and addressed that, we didn't really have to talk about risk whatsoever. I just made notes. They were connecting. They were building the scenario of the demise of the organisation. The network of interconnected risk simply emerged. The engagement was triggered by the board believing that was a legitimate question to ask. The tool was the question: 'You're bust. How did it happen?' Emotionally, that made the board turn the corner."

Basi was reminded of the ripple effect of last September's collapse of South Korea's Hanjin Shipping, where vessels were seized by authorities and creditors, while others were denied entry to ports when the company lost the support of its banks.

"At the time of their bankruptcy, there was obviously cargo shipping all over the planet," he recalled. "There was no knowledge of where the ships were and in some cases, the ships with perishable goods couldn't enter the harbour because the company was in administration pending insolvency.

"Obviously, shipping's a big part of global trade. That was an example of something that is so key in the global system, its failure caused so many gaps in information, that in itself is a demonstration of the era we're now getting into.

"As we get more interconnected, these situations are going to become more common. Part of this is that we're cost-driven and are trying to keep things moving and keeping low inventory levels."

## FUNCTION OVER FORM

Inter-departmental collaboration is a critical method to combat the silo mentality in companies that can lead to blind spots in which interconnected risk lurks, participants of the roundtable agreed. Although it is often a challenge to work collaboratively with everyone, it's the way to move forward.

Christopher Palm, chief risk adviser at the Institute of Risk Management South Africa, told how he had learnt the hard way, over a decade, how to bring the board onside. "My background is in the biggest electricity supply network in South Africa. We told the board: 'But we told you about the risks. Why have the 'top-ten' risks materialised?' They replied: 'Maybe it's about the way you told us about the risks.'

"So, we started reverse-engineering the idea of risk being a linear or a chronological flow of events that you look at from either a process perspective or a functional perspective, instead of a value chain, or from a 'systems thinking' perspective."

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Palm challenged the methodology, management and board mentality when it came to interconnected risk. He said: "We have dominoes that fall from five different angles. How do we respond to that? If you have risk affecting finance, but don't have finance expertise around the table, you lose interconnectivity and the whole thought of interconnectedness across the value chain right there. We've learnt that we could get it wrong, that we got it wrong. If you get it wrong at the source, you get it wrong straight to the top. So, we fixed it at the methodology level."

Risk managers are never the experts, Palm maintained. "They are enablers and they have credible processes that can be put in place. They can put forward subject matter experts across the value chain, but if they're not there from the beginning, this can make it very hard."

## SKILLS SHORTAGE

Julia Graham pressed the need for a new, bolder type of risk manager. "I would argue that tomorrow's risk managers need different knowledge, different skills, they need different abilities to use data. We've got many members who could use a spreadsheet the size of this table and not bat an eyelid. We've got to be prepared to think of technology in a similar way. It's inexcusable in the future to say, 'We don't know anything about these new issues,' because that's the world we live in."

Tomorrow's risk manager needs to be a lot less risk-averse and more of a risk-taker, so they can look at opportunity as well as risk, added Graham.

"They have to be much more willing to work in teams. They have to be great collaborators, negotiators. There's a skilling-up of the profession – which is already happening – so we can have the conversation with insurers. I have a lot of sympathy with insurers because we don't know how to articulate the problem."

## AN ASTONISHING PACE

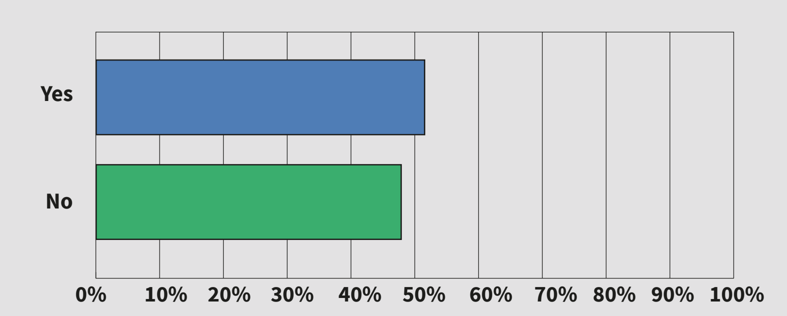
Every panellist agreed that the pace of – especially technological – change is relentless and accelerating. As Kirwan at Allianz commented: "Our business models are changing dramatically fast. The last conversations I've been having are about big data, data leaks, correlations, mathematical modelling and modelling interconnectivity.

"We're moving at an astonishing pace as an industry with digitalisation. We see most of our customers' business models changing dramatically fast as well. The biggest risk to all enterprises at the moment is technological change. You can talk about all the other bits, but your business can go out of business within months of a significant technological change. If you're not adopting the right technology fast enough, you're not going to survive."

In encapsulating the challenge confronting the risk management community in terms of interconnected risk, Basi gave the most telling caveat. He said: "In terms of modelling that aspect, how can you possibly model the world? Well, you start with the data you need and try to build it layer by layer. You supplement this with good techniques to model those parts of the environment you can model and take it from there."

As Basi concluded: "We're picking up more unknown liabilities in business and the best way is orientating towards a culture that's more responsive and reactive to change and views risk as an opportunity rather than as a threat. That needs to be the baseline; without that you're always fighting against the ingrained culture. Risk managers are looking at virtual reality now. In terms of role-playing and simulations, imagining a virtual reality is perfect because it puts you in the situation. That's a great way of getting management into the situation." ■

**DO YOU PERFORM ENTERPRISE-THREATENING SCENARIO MODELLING?**



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