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property risk and insurance solutions for a complex world

## Chain Management

Managing Business Risk Through  
2009 and Beyond: A Special Report

**FM** Global<sup>®</sup>



# CHAIN MANAGEMENT

## Managing Business Risk Through 2009 and Beyond: A Special Report

**I**n business, risk lurks at every turn: competitor innovations that threaten the viability of your products or services; new players in your market space; adverse trends in commodity prices, currencies, interest rates or the economy. Throw in potential disruptions to supply chains that have been stretched across thousands of miles and country borders by globalization, and the opportunity for something to go wrong is, to say the least, worrisome.

It could get even more challenging. FM Global's recent study of 500 financial executives in North America and Europe—the data for which was collected by Opinion Research Corporation—found that the vast majority expect the severity of their most prevalent business risks to remain the same or intensify through 2009. These executives also identified a wide range of emerging classifications of risk that, although not among their primary concerns today, look to become more troubling in the years ahead.

“This year's study results are a forceful reminder that manag-

### KEY FINDINGS

Competition is viewed as the biggest risk to revenue, followed by supply chain disruption and property-related risk.

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The most broadly cited consequence of disrupting a top revenue driver is loss of competitiveness

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The biggest challenge to implementing a strong risk management program is finding enough time, budget and people.

ing business risk is a continuous, dynamic process, and not something a company can afford to be complacent about,” said Ruud Bosman, FM Global executive vice president. “Successful organizations proactively identify and address the threats they face today, while never losing sight of emerging risk on the horizon.”

For financial executives, the study’s findings suggest a compelling imperative: that companies that have not done so already should begin to develop a holistic risk management program, that is, one that allows them to mitigate and manage risk on a broad front. “As the financial executives interviewed for this study warn, the price of a major business disruption can far outweigh the

drivers for their business; what risk poses the greatest threat to those revenue drivers; what risk consumes the greatest percentage of their time and attention; how those types of risk can affect their business when left unchecked; and what the biggest hurdles are to managing risk. Taken together, their insights can serve as a road map for companies seeking to manage risk successfully in the 21st century.

### Top revenue drivers involve people and processes

Today’s most successful organizations are often those with the most valuable intellectual property, the latest and most sophisticated information technology, and the fastest communication between company, customer and vendor—in

### Competition, supply chain and property risk pose top revenue threats

Most financial executives view the variable risk of competition—a competitor’s groundbreaking new product, for example, or the entry of a new and powerful player into their market space—as the biggest specific threat to their revenue. However, they consider the downside risks of supply chain disruption and property damage to be almost as worrisome. After all, disruptions to a company’s supply chain can bring production and sales to a halt. And a factory or office building rendered unusable by fire, flood or other disaster provides neither a place for employees to service customers nor a space for them to build or assemble goods.



**This year’s study results are a forceful reminder that managing business risk is a continuous, dynamic process, and not something a company can afford to be complacent about.**

Ruud Bosman, FM Global executive vice president

cost of effective risk management,” said Bosman. “Organizations that may be tempted to shortchange their risk management efforts face potential consequences ranging from the severe, such as a loss of competitiveness, to the catastrophic—having to cease operations altogether.”

This report explores how financial executives in North America and Europe perceive revenue and risk—what they see as the top revenue

short, those whose financial strength and physical assets outstrip those of their competitors. But the top revenue drivers for financial executives in this report are far less trendy: people and processes. Their companies’ revenue, they say, is driven primarily by how well their employees support and service their customers, and by the quality, reliability and efficiency of their manufacturing operations and processes.

A majority of financial executives report downside risk, overall, is more likely to threaten their top revenue driver than a variable risk by a margin of 53 percent to 45 percent. Financial executives in North America and the United Kingdom, it seems, are particularly concerned with downside risk. Respondents in those locations were more likely to cite property-related risk among their top threats than their counterparts in France and Germany.



## Variable vs. Downside Risk

Why one should be managed differently than the other



Not all risk is created equal. Some types of risk, such as that related to supply chain or property, have only downside consequences. There's never a benefit to running out of a key component because your supplier can't get his or her hands on critical raw material, or losing a manufacturing facility to a fire or flood. Other types of risk—the economy, competition, currency trends, client demand—can best be described as variable, because they may have positive *or* negative consequences. The economy can reduce demand for your product or service during a recession, but it also can stimulate demand during an expansion. Similarly, a new technology could either threaten the viability of your business model (if you're one of the last to embrace it) or give you an advantage over the competition (if your company is an "early adopter").

Downside risk, while seen by a majority of financial executives in this report as the most likely to affect their top revenue driver, tends to be easiest to manage, because companies can take proactive measures to minimize or mitigate it, such as building redundancies into their supply chain or installing fire protection systems in offices and manufacturing plants. Conversely, companies have little control over variable risk. That doesn't mean companies shouldn't attempt to manage variable risk—indeed, successful organizations often get that way by using their skills in forecasting, planning, marketing, and research and development to leverage variable risk to their own advantage. What it does suggest, however, is that companies should focus on eliminating as much downside risk as possible so they can maximize the time spent managing and exploiting variable risk—work that adds real value to the business.

The importance that financial executives ascribe to supply chain risk reflects the significant changes companies have made, during the past few decades, to the way they procure raw material and produce goods. Where many companies once operated principally in their own country, with highly vertical business models, companies today outsource non-core activities, locate facilities in distant countries, and rely on just-in-time inventory and other lean manufacturing techniques—all of which make the margin for supply chain error significantly smaller.

### Top risks seen rising, new threats on horizon

Financial executives are keenly aware that competition risk is not only here to stay, but also likely to intensify. According to this FM Global study, fully 62 percent of executives surveyed say they expect competition risk to increase during the next three years (see Figure 1), while only 4 percent expect it to decrease. They are nearly as concerned about the outlook for supply chain risk: 24 percent expect it to increase during the next three years, and only 8 percent expect it to decrease. And, while property risk ranks as one of their top three concerns, only 7 percent of financial executives expect it to increase during the next three years; 10 percent expect it to decrease.

When asked to identify the emerging risks they believe will threaten their business during the next three years, financial executives again cite competition as their biggest concern. Beyond that, they cite government and regulatory developments (downside risk), pricing volatility and variable client demand (variable risk),

and political threats (downside risk) as likely to come to the fore during the next three years.

### Risk forecast grim for financial executives

The Internet, e-mail and instant messaging have dramatically increased the speed at which people communicate and, therefore, do business. That means competition could spring up in new and unexpected places—a fact many makers of portable music players, cellular telephones and portable Internet devices can attest to, having seen computer manufacturer Apple Inc., with the announcement of its iPhone, become capable of taking on competitors in all three of those markets simultaneously.

By contrast, the rather benign outlook for property risk, while encouraging on the surface, is out of sync with actual developments in the property insurance marketplace. This is especially true for companies that have been outsourcing manufacturing activities or acquiring manufacturing operations in other parts of the world. Companies based in North America, for example, operate in an environment where public expectation and law have made some property risk control methods, such as the use of fixed sprinkler systems and adherence to building codes, common practice. When such companies move offshore, by contrast—either through acquisitions or joint ventures—they can find themselves in locales where the idea of taking proactive measures to prevent property loss is far less ingrained than it is in Canada or the United States, possibly putting them at a competitive disadvantage in that local market.



## Pump Up Your Program

If you intend to build a strong risk management program, it needs to be:

- 1 Championed.** As with so many business initiatives, the success of a risk management program depends greatly on the active support of senior management.
- 2 Inclusive.** Effective risk management programs do not rely on the work and resources of any single person or group within the organization. While often led by a risk management officer, the best programs draw on the input and cooperation of every part of the organization.
- 3 Transparent.** Risk management programs work best—and companies reap the greatest possible benefit from them—when their goals, processes and results are shared with all stakeholders involved.
- 4 Holistic.** The best risk management programs not only address all the risks to which modern corporations are susceptible; they also consider how these various risks can affect the companies' stakeholders and operations.
- 5 Proactive.** Effective risk management programs do not merely insure companies against downside risk; they also include proactive systems and processes to minimize or eliminate downside risk, and to maximize the opportunities presented by variable risk.

This can be true not only in developing countries in Asia, Latin America, Eastern Europe or Africa, but also in some Western Europe countries. For example, while most supermarkets or factories in Canada or the United States have fixed fire protection systems, outside those countries it is rare to find commercial, industrial and institutional buildings protected by automatic sprinklers. Expanding a company's operations into certain developing countries also can bring with it increased legal and political risks, not to mention increased exposure to natural disasters. Taken together, these factors are affecting the risk profiles of many large companies seeking to reap the benefits of globalization.

Unfortunately, companies that are willing to relax their property-related risk management standards also run the very real possibility of increasing their supply chain risk. After all, offshore facilities knocked out of commission by fire, natural disasters or other destructive events will not be available to help meet production goals. Perhaps if financial executives knew just how much their moves to offshore locations were increasing their property risk, more than the reported 7 percent would be expecting property risk to increase during the next three years; and perhaps more than the reported 24 percent would be looking for increased risk on the supply chain front.

### Taking a closer look

One reason financial executives are not unduly concerned may be simply that they just are not looking hard enough. In a recent survey of 443 manufacturing executives by consulting firm Deloitte Touche Tohmatsu

**Figure 1**

Top Five Business Risks Through 2009				
	Increase	Remain the Same	Decrease	Don't Know
Competition	62%	33%	4%	1%
Supply chain	24%	64%	8%	4%
Property (fire/explosion, mechanical/electrical breakdown, natural disaster)	7%	83%	10%	0%
Economy	31%	55%	12%	2%
Pricing and currency	38%	53%	6%	3%
Miscellaneous	34%	57%	7%	2%

(*Innovation in Emerging Markets: 2007 Annual Study*), only about one-half said their firms conduct a "very rigorous" risk review before entering an emerging market. While 57 percent assess security risks, only 51 percent consider geopolitical risks, and just 30 percent look at terrorism and the impact of natural disasters. Among those that do conduct "very rigorous" risk assessments, the Deloitte survey shows 86 percent are highly confident in their ability to manage that risk. Where risk assessments are less rigorous, only 68 percent of respondents felt highly confident in their risk management abilities.

### The impact of risk realized

Financial executives at companies that fail to appreciate and prepare for increased risk facing their top revenue driver concede that, if those threats materialize, the consequences could be significant. Beyond the obvious hit to revenue, 54 percent of financial executives warn of a loss of competitiveness, which can translate into both a loss of market share and a reduction in their company's valuation. Another 23 percent report that disruption of their top revenue driver could result in the laying off of employees and/or

an adverse impact on the local economy. Other leading potential consequences they cite include having to exit a line of business (or cease operations altogether), undergo leadership changes, see their company's credit rating downgraded, or face regulatory scrutiny or legal action.

### More challenges abound

Whatever the potential benefits of a strong risk management program, many financial executives see plenty of challenges to implementing one. During the next three years, the biggest risk management challenge expected, by far, will be obtaining adequate resources; 56 percent (see Figure 2) of financial executives cite it as their top concern. After that, they worry about attaining organizational consistency—being able, that is, to apply the same risk management standards and processes across the enterprise. They also expect new types of risk may be introduced to their enterprises through the development of new products, the introduction of new technology, and changes attributable to merger and acquisition activity. Not surprisingly, more than one-third of financial executives say getting senior management

Figure 2

Top Risk Management Challenges Through 2009						
	Overall	North America (United States, Canada)	France	Germany	United Kingdom	
Obtaining adequate resources (time, budget, people)	56%	72%	50%	36%	66%	
Attaining organizational consistency	43%	59%	46%	23%	44%	
New product development	42%	49%	39%	30%	51%	
New technology	39%	57%	34%	18%	48%	
Mergers and acquisitions	39%	53%	40%	29%	34%	
Making it a top priority for senior management	35%	54%	29%	18%	38%	
New geographic expansion	33%	42%	28%	26%	35%	
Miscellaneous	4%	0%	1%	4%	9%	
Don't know	2%	0%	5%	2%	2%	
None	2%	3%	1%	2%	0%	

to make risk management a top priority is a significant challenge. Experience has shown that, when leadership at the top of an organization does not embrace a culture of risk management, risk improvement initiatives can be doomed from the outset.

### Charting a course for responsible risk management

Even after bringing together the requisite resources, companies need to make sure they develop risk management programs that work. Beyond addressing both variable and downside risk across the enterprise, such programs should incorporate systems and processes for preventing, not just insuring against, common risk factors.

Financial executives broadly agree that the consequences of risk management failure can be dire. Given that they expect the severity of their companies' most prevalent business risks to either remain at current levels or increase during the next three years, there is a clear imperative for many such organizations to develop

a strong, consistent, enterprise-wide risk management program.

But how to make the case for a strong risk management program? How much value should be placed on preventing loss from a disaster that might never happen?

Companies would do well to begin by identifying their top revenue drivers. Next, they should pinpoint the top threats to those revenue drivers, and categorize each threat as either a downside risk or a variable risk. As it happens, the type of risk that can be most directly controlled is downside risk—the very risk, the study data shows, that financial executives collectively consider most likely to threaten their top revenue drivers. When downside risks are dealt with first, through prevention and control, it enables senior management to deal more aggressively with variable risk—in other words, to take a more strategic approach to risk management.

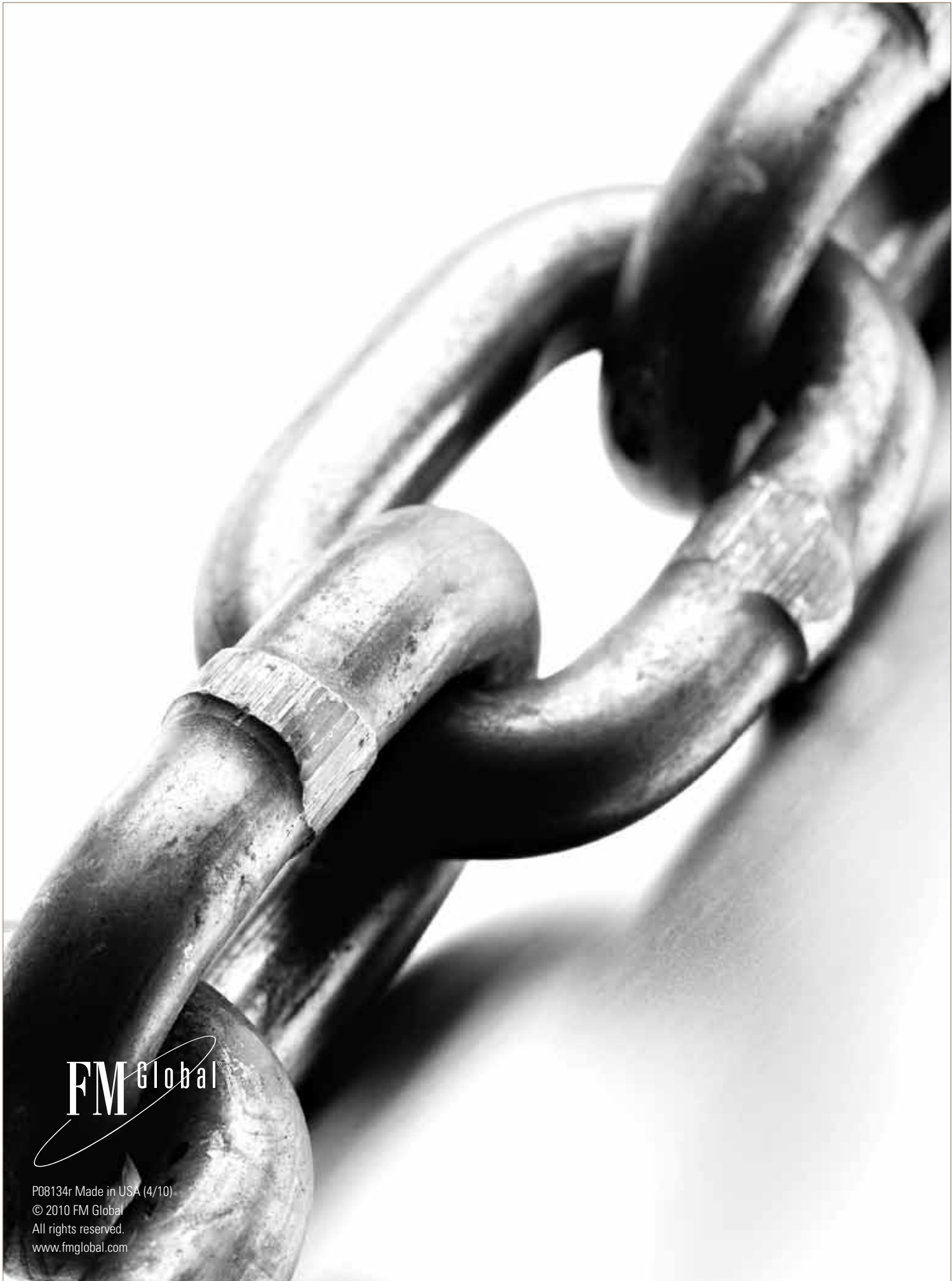
Finally, because today's financial executives indicate they expect to have trouble finding the time, budget

and people necessary to implement or maintain a strong risk management program, senior management must demonstrate leadership in championing—and funding—this initiative. Justifying the commitment should not be difficult. As the financial executives surveyed for this report agree, the number one consequence of poor risk management is loss of competitiveness. By implementing an effective risk management program, companies protect their ability to compete. Nothing is more fundamental to business success. [1]



To read the full-length *Managing Business Risk Through 2009 and Beyond*

study, complete with additional charts, plus a look at how views of risk vary throughout the world, please visit [www.protectingvalue.com](http://www.protectingvalue.com).



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