

Ready for risk?

By Jason Disborough, Managing Director, Global & Corporate, Aon Risk Solutions

- Local economic conditions have overtaken regulatory and legislative policies as the most prominent risk facing Australian businesses in 2014/2015.
- In contrast to other countries, only 13 per cent of risk managers identified cyber security as a significant risk in the local market.
- People risk and human resources ranked as the sixth and seventh top risks renewing emphasis on the challenges of attracting and retaining talent.

In the changing risk landscape, now more than ever, organisations are looking for ways to mitigate risk. They are also searching for guidance on identifying the practices and approaches to improve the effectiveness of their own risk management strategies.

Aon's *Australian Risk Management Benchmarking Survey* — now in its 13th year — offers key insights into how organisations measure and manage risk. The results provide Australian organisations with a snapshot of how their risk management practices measure up against industry peers and competitors. It can be used as a tool to help predict and manage their risk profiles more effectively.

Key findings

Creating the insight

Risks to businesses are constantly expanding and changing, and no business faces a fixed set of risks for more than a short period of time.

The 2015 survey attracted the largest sample size in the 13 years since we have conducted this research, with findings from 579 C-suite executives and risk managers — providing a detailed overview into meaningful risk management insights across sixteen industry sectors including energy, power, mining, health, construction and real estate.

From risk concerns to risk management trends, strategies to market commentary, the high level of responses we received from our survey provides powerful data and analytics about the current concerns of CEOs, CFOs, CROs and risk managers.

Practical application

This valuable feedback enables those working in risk management functions to better assess how their organisation manages risk compared to others, and to measure the costs incurred in delivering a risk management and financing strategy.

As the needs of organisations around risk and people expand and become increasingly interconnected and complex, it's critical that businesses routinely keep up to date with what the latest developments are around risk concerns. The survey results provide just that — in a digestible and easy to apply format.

The top risks facing Australia and New Zealand businesses

What has taken the number one risk concern spot? Local economic conditions have trumped regulatory and legislative policies as the most prominent risk facing Australian businesses in 2014/2015.

Local economic conditions have been on an upward trajectory through the top ten risks over the last number of years. However, its top position this year signifies a critical need for organisations to identify and confront local economic threats in order to

achieve sustainable growth and to better compete on a global scale.

While the current state of the market presents a very real challenge to Australian businesses, it is also an opportunity for insurers to innovate around these risks. With existing and new capital currently abundant, a focus on risk financing innovation is currently lacking in the Australian market at present.

Regulatory and legislative change, the top risk identified last year (2013/2014), still represents a key concern for business leaders across the region, ranking second in this year's results. Downbeat growth and inflation forecasts have elevated concerns of domestic economic slowdown as an obstacle to business growth and recovery (Figure 1).

Learning from the past, planning for the future

It's illuminating to see the trends around risk concerns over the past few years and to see a pattern emerging around the continuing and repetitive risk factors that build upon their significance each year.

Figure 1: Top ten risk concerns 2015

Rank	Change from 13/14	Risk Concerns
1	▲ 1	Local Economic Conditions
2	▼ 1	Regulatory & Legislative Change
3	▲ 2	Brand and Image
4	▶	Increasing Competition
5	▲ 1	Global Economic Conditions
6	▼ 3	People Risk
7	▶	Human Resources
8	▲ 10	Business Interruption and Supply Chain Risk
9	▲ 6	Property Damage
10	▲ 2	Corporate Governance

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The latest survey draws a strong parallel to findings over the last two years, with risk concerns centred on diminishing confidence and uncertainty.

As 'brand and image', 'increasing competition' and 'global economic conditions' round out the top five risk concerns, it is clear that an inability to grow underscores this year's rankings. As the magnitude and complexity of risk continues to rise, it's critical that businesses have access to information and analytics that can provide them with a fact base to make more informed decisions around their risk management and insurance strategies.

Preparation is key

How would you rate your organisation in terms of being prepared and ready to tackle risks? According to the survey, Australian businesses currently maintain a good level of preparedness against risk — partly driven by corporate governance regulations and particularly evident in listed entities.

However natural disasters in recent times, such as the Brisbane floods and North Queensland cyclone activity, have reinforced the need for planning ahead, scenario modelling, business recovery and continuity planning.

Our experience shows that the vast majority of our clients:

- know their risks
- understand their risks, and
- have mapped their risk profile and overlaid it with an insurable risk gap analysis, to determine what is and is not insured appropriately.

A focus on people

People are the engine room of any business — bringing to life the brand, products and solutions. Just as the risks affecting the physical assets of our clients have grown and evolved, so too have the issues impacting their people.

The survey results revealed that the use of risk transfer coverage has been applied to 'people risk' and 'human resources,' with these risks currently occupying positions six and seven in the top ten.

The presence of these two risks the top ten confirms the endurance of an industry-wide 'war for talent', renewing emphasis on the challenges of attracting and retaining talent as an organisational risk.

The need for innovation

Should more of the top ten risks be insurable? The majority of the top ten risk concerns are uninsurable, and while most businesses have some form of risk transfer coverage for risks such as people risk, business interruption/supply chain risk and property damage, when it comes to insurance policies for brand and reputational risk, there has been very limited adoption of this type of risk transfer solution.

This risk has been ranked number one more times than any other risk during the 13 years we have conducted this survey.

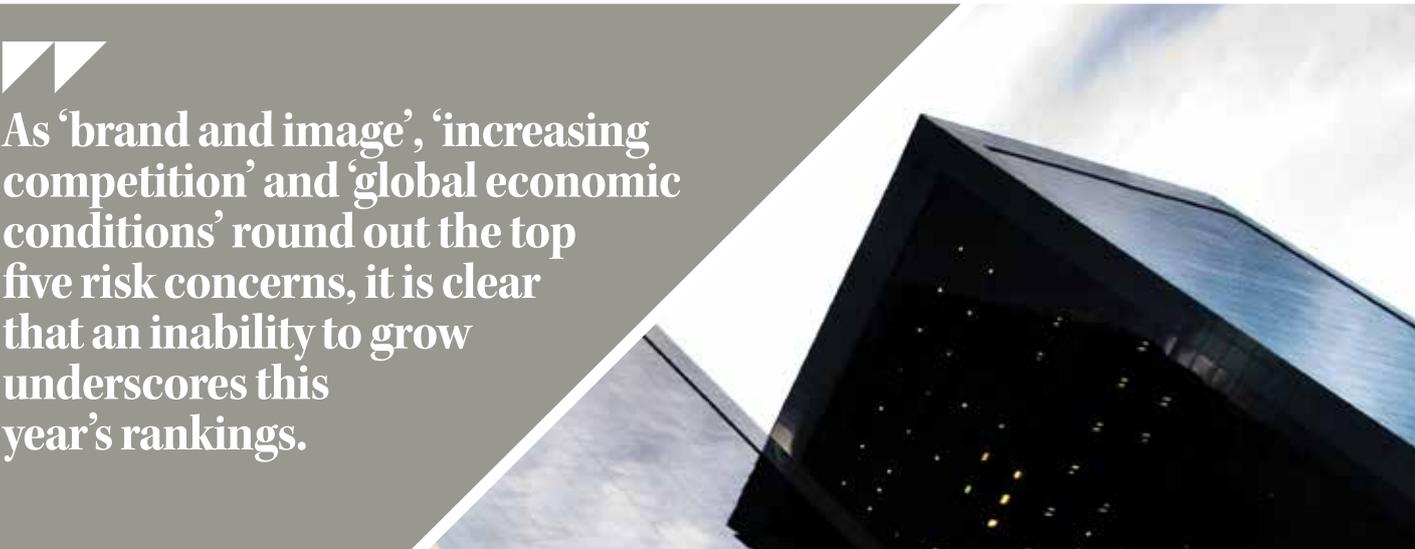
Never before has business operated in a world where brand and reputation face the potential threat of immediate and long-term damage from the online world. From corporate disasters to inter-office banter — the public impact of social media is building momentum with some sobering and cautionary tales highlighting real risks for corporations. Now is not the time to bury one's head in cyberspace and ignore the perils.

We believe there is an opportunity for insurers to innovate around these top risk issues and to develop new products for those risks that are currently uninsurable. There has never been a better opportunity for insurers to demonstrate what they are prepared to do to generate further premium in the current insurance market.

A framework for managing risk

TCOIR: You can't manage what you can't measure

The key to risk management is understanding risk needs and using insurance as a financial tool. This leads to the concept of 'total costs of insurable risk' (TCOIR) — the costs incurred by a business to deliver an effective risk management strategy.



As 'brand and image', 'increasing competition' and 'global economic conditions' round out the top five risk concerns, it is clear that an inability to grow underscores this year's rankings.

The TCOIR data gained from the survey continues to make this metric an extremely useful and valid benchmarking tool.

What are the benefits of TCOIR?

A TCOIR analysis provides a sound basis on which to manage, control, measure and compare insurable risk costs and performance.

While risk management was once regarded as a routine functional task of the risk manager alone — now CEOs and CFOs are under the spotlight and should be working with key stakeholders to target the lowest sustainable TCOIR.

When it comes to risk financing there is a gap that needs to be bridged — the gap between understanding what it means to buy insurance, versus what it means to look at insurance and risk within a broader financial management context.

Having an understanding of, as well as controlling and lowering TCOIR, can have a substantial financial impact. This means understanding how the different components both interact and contribute to the total.

Without an appreciation of your risk requirements, you are left buying an insurance product that the markets are prepared to provide, as opposed to taking charge and selling the insurable risk that you do not want to retain.

Being on the front foot with risk management

Risk maturity can vary greatly between organisations. Some companies have a robust risk management culture while other businesses might talk a lot about risk management but do not have the process and deliverables in place.

The survey reveals that Australian businesses have a mature and sophisticated approach to risk management. This is further supported by the findings of the Aon Risk Maturity Index, which demonstrates a strong correlation between risk maturity, return on equity and shareholder value.

The *Aon Risk Maturity Index* is an innovative risk management assessment tool developed in collaboration with The Wharton School of the University of Pennsylvania. It is designed to capture and assess an organisation's risk management practices and provide participants with immediate feedback in the form of a Risk Maturity Rating, along with recommendations for improvement.

The Aon Risk Maturity Index survey features a questionnaire on risk management processes, corporate governance and risk understanding. Questions align with the following ten characteristics of risk maturity:

1. Board understanding and commitment to risk management.
2. Executive level risk management stewardship.

3. Risk communication.
4. Risk culture: engagement and accountability.
5. Risk identification.
6. Stakeholder participation in risk management.
7. Risk information and decision-making processes.
8. Integrating risk management and human capital processes.
9. Risk analysis and quantification to understand risk and demonstrate value.
10. Risk management focus on value creation.

The top five characteristics of effective risk managers

In this constantly evolving risk landscape, it's critical that risk managers apply the skills needed to provide their organisations with the right level of advice and practical guidance.

What are the core attributes of an effective risk manager? Our survey reveals the following top five attributes:

1. Skilled at influencing and persuading others within their business.
2. Very good listening skills.
3. Are open and likeable.
4. Keep abreast of emerging risk issues.
5. Know exactly what to do when a crisis occurs.

Local and global insights: risk concerns and emerging threats

Aon also produces a *Global Risk Management Survey*, compiled from responses from over 1,400 risk management professionals in 60 countries. Overall there are very strong parallels between both the 2015 *Australian Risk Survey* and the *Global Risk Management Survey* findings

Findings reveal the same top four risks (albeit in a slightly different order) as: economic conditions, regulatory and legislative changes, brand/ reputation risk, and increasing competition.

The overall insights deliver one unified message: top risks are categorised by risk concerns beyond the business community's direct control (and are uninsurable).

It can be seen that businesses across the global landscape are experiencing the same challenges around the areas of economic, political and regulatory uncertainty. This in turn can cause diminishing business confidence, impeding the ability of these businesses to grow.

The ability to attract and retain the best performing talent makes the top ten in both surveys — however falls just out of the top five concerns for Australian businesses. This potentially indicates that people policies and talent strategies are more formalised in the local market.

The local and global findings indicate that it is now more critical than ever for organisations to develop efficient and effective risk management solutions. They must do this while remaining flexible to changes in both the local and global economies to successfully overcome the challenges ahead.

Significantly, where cyber security continues to be a key concern in other countries, only 13 per cent of risk managers identified it as a significant risk in the local market. Similarly, terrorism remains relatively overlooked locally, indicating that Australian companies consider themselves less susceptible in comparison to their international counterparts (Figure 2).

Figure 2: Top ten risks — Australia vs the rest of the world

Top 10 risk concerns 2015			Top 10 global risk concerns 2015	
Rank	Change from 13/14	Risk Concerns	Rank	Risk Concerns
1	▲ 1	Local Economic Conditions	1	Brand and Image
2	▼ 1	Regulatory & Legislative Change	2	Economic Slowdown/Slow Recovery
3	▲ 2	Brand and Image	3	Regulatory/Legislative Changes
4	▶	Increasing Competition	4	Increasing Competition
5	▲ 1	Global Economic Conditions	5	Failure to Attract or Retain Top Talent
6	▼ 3	People Risk	6	Failure to Innovate/Meet Customer Needs
7	▶	Human Resources	7	Business Interruption
8	▲ 10	Business Interruption and Supply Chain Risk	8	Third-Party Liability
9	▲ 6	Property Damage	9	Computer Crime/Hacking/Viruses/Malicious Codes
10	▲ 2	Corporate Governance	10	Property Damage

Source: Aon 2015 Australian Risk Survey

Changing trading conditions, the strength of the dollar and the evolving political landscape, aligned with relatively high unemployment and an on-going skills gap in some of Australia's most pertinent industry sectors, present an ever-evolving risk environment. While many of the risk concerns reflected in the survey are common across all Australian business, it is clear that the impact of various risk factors differs from one industry to another.

A focus on emerging risks

Compared to surveys conducted by Aon in other geographies, we were surprised to see that cyber, terrorism and pandemic risk did not rank in the top ten risk concerns for Australian business.

These three issues have the potential for serious business interruption and financial loss and, especially in the case of cyber, can also lead to catastrophic brand and reputation damage.

To put the concern regarding the low ranking of cyber into context, a 2014 report by the *Centre for Strategic and International Studies* estimates that cybercrime costs business approximately \$400 billion worldwide.

In addition, the potential ramifications of cyber breaches for directors and officers in terms of the *Corporations Act 2001* and the *Privacy Act 1988*, dictate that this is absolutely a board level issue.

On a local level, discussions around mandatory data breach laws potentially being introduced, signals that cyber-risk management is under the spotlight as a key focus area that businesses need to address around risk management, disclosure requirements and compliance related activities.

A closer look at cyber risk

Cyber risk (which includes network security and privacy), is an area that is creating worldwide headlines on almost

a daily basis. In the past year, the media, banking, retail and healthcare sectors were amongst those hit hardest by cyber attackers.

The Aon *Global Risk Management Survey* (referenced above) rates cybercrime in ninth position — the first time this risk has entered the top ten globally. This could be attributed to the heightened global media attention on data breaches experienced by large corporates. By way of comparison, cybercrime was cited number 16 in the Australian risk survey.

The key impacts of cybercrime on business include:

- business interruption due to network outages or data loss
- breaches of privacy legislation
- theft of business intelligence
- public release of sensitive material or business-critical information.

Importantly, a cyber attack has the potential to diminish brand and reputation, along with revenue and profitability.

The findings also draw a strong correlation with emerging risk concerns — with both terror and pandemic being underrated. Terror is number 20 in Australia and number 41 globally. Aon uses data and analytics through terrorism maps that may help organisations determine how they assess their risk exposures.

A risk roadmap for the future

Technology-fuelled disruptive innovations

On the topic of emerging threats, it is helpful to use the findings of the survey to consider what else might be coming along in our risk landscape future.

The pace of innovation presents constant new challenges and threats to business and risk managers. These could be in the form of disruptive innovations (3D printing, advanced robotics, nanotechnology, or the sharing economy typified by Uber and Airbnb) — shifting revenue and profits from traditional firms to innovators.

Findings reveal the same top four risks (albeit in a slightly different order) as: economic conditions, regulatory and legislative changes, brand/ reputation risk, and increasing competition.

The other concept to keep in mind is that of big data which provides deep insights, but raises huge risk concerns, especially when gathering and storage is outsourced to third party providers.

The role of predictive analytics might also give rise to the emerging role of the data scientist in risk management and articulating value.

Our reliance on the internet and the impact of increasing connectivity

With everything now connected, what happens if the internet — the central nervous system that supports the way we do business — goes down?

The scale and scope of the online world are changing so fast that business has even more to think about than ever before, as it moves forward in the face of a new era in risk.

Today there are billions of connected mobile devices, and this number is likely to increase exponentially over the coming years. With this in mind, it will become important for the risk, insurance, financial and professional services industries to consider how smart phone apps for example are changing traditional service delivery models.

Social media also provides the potential to amplify the reputational damage of operational risks (such as harassment or discrimination) and the 'golden hour' for preparing a response to a crisis has been reduced to just a few minutes.

Where to from here?

As the findings of the survey and commentary above emphasises, the risk landscape is constantly changing and evolving.

It is therefore, more critical than ever for organisations to develop efficient and effective risk management solutions, while remaining flexible and responsive to changes in both the local and global economy. ■

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