Navigating the new world of risk

The magnitude, complexity and speed of risk is increasing exponentially – and most companies are woefully unprepared to deal with it, says Greg Case, president and CEO of Aon.

Companies operating in today's global economy still face all of the traditional risks such as property, liability and compensation. However, those risks have been joined by a host of new, non-traditional risks such as cyber risk, disease pandemic and social media.

The interconnectedness of economies and people has enabled industries to become more efficient and faster at manufacturing and distributing products. A downside to that interconnectedness is that we are more susceptible to risks that can disrupt operations. A broken link in a global supply chain can have a material, almost immediate impact on a company's growth plans and the communities where its employees live. And those risks can often arise without warning.

Providing that predictability in an environment filled with risk is critical to the role of the broker in helping clients reach their full potential. Addressing these types of challenges can be incredibly daunting, but the companies that confront them directly stand to make tremendous gains.

It is clear from my meetings with leaders of large, mid-size and small businesses that managing risk is one of the biggest challenges they face. Our clients want to know where risk is coming from and more importantly, how it will impact their organisations and their employees. They know they must confront risk and understand its many dimensions so they can control their own destiny and feel that their future is secure. Providing that predictability is critical to the role of the broker in helping clients reach their potential. It is not an easy task.

Aon's 2013 global risk management survey revealed that risk managers are struggling to identify and manage the major risks facing their organisations; whether it is the economic slowdown and recovery, regulatory and legislative challenges, damage to reputation and brand, or the failure to attract and retain top talent.

More importantly, the percentage of companies that reported being ready for these risks dropped significantly; from 66% to 50% from our 2011 survey. Of the 28 industries surveyed, only three reported the same or improved level of readiness this year. That means four out of 10 companies feel unprepared for the risks they face.

One possible explanation for the decline in risk readiness could be that the prolonged economic recovery has strained organisations' resources, hampering their ability to mitigate many of these risks. Another theory would be that risk has been consistently harder to address, and even harder to address rationally.

Studies have shown that you are more likely to be killed by a falling coconut than from a shark attack. Nonetheless, many companies are nervously surveying the water, thinking about how to avoid the shark. All the while, they are standing under the figurative coconut tree, unaware of the real risk.

The Aon survey also uncovered several significant risks that are underappreciated compared with their likelihood: counterparty credit risk, loss of intellectual property and data, social media, pension plan funding, and cyber risks, to name a few.

Cyber attacks are becoming increasingly commonplace and preventing them has become a board-level issue. Hackers do not just target giant multinationals. Small businesses also have seen a dramatic increase in attacks by cyber thieves who break into systems to transfer money electronically.

The risk of a global pandemic has slipped from public view yet it remains very high on the list of concerns. It is a risk that is no less likely now than a few years back when it topped our survey list. The outbreak of human avian flu cases in China earlier this year is a disturbing reminder of the potential for a deadly pandemic. The March outbreak is estimated to have caused approximately $6.5bn in losses to China's economy. Imagine that scenario on a global scale!

It means a problem in one part of the world can set off a chain reaction with far-reaching implications. Last year a fire in a chemical plant in Mari, Germany had a huge impact in Detroit because the fire disrupted supplies of a nylon resin that is used in car fuels and brake lines. The 2011 earthquake and tsunami in Japan also created problems throughout the global automotive supply chain.

And the effects of these events did not take months to occur. Tightly managed logistics, common in manufacturing today, generally mean that there is little surplus in supplies. Downtime is costly.

The spread of social media and the democratisation of news have increased the sources and the complexity of risk. Companies face far more scrutiny than in the past. Average citizens, whether well-meaning or not, whether well-informed or not, have the power to broadcast information and opinion on even the largest companies. A small problem in a faraway place can become a big, global problem in minutes when magnified through the lens of social media.

Earlier this year, a teenager in Australia posted a photograph on Subway's Australia Facebook page showing that the company's "foot-long sandwich" was actually just 11 inches. Within days, Subway was flooded with complaints and faced with a $5m lawsuit, prompting the company to announce new quality controls on sandwich length.

This incident, while innocent on its face, is an example of the speed and magnitude with which a single risk, from one unknown person in a comparatively remote corner of the world, can impact a firm across the globe.

So how can companies deal with the increasing level of risk in today's world?

Insurance can be part of the solution. It is a response to risk and often a vital one, but while you buy it in advance, it is something that kicks in after-the-fact. So to that extent, it is only one piece of the puzzle.

Companies increasingly are aware that it makes just as much sense to assess risk and protect against it beforehand to make sure potential problems do not lead to a full-blown crisis. Stronger risk management practices can strengthen a firm's balance sheet and in turn free up capital that can help them grow their business.

Understanding how to measure and mitigate risk means using all of the information, technology and expertise at one's disposal. Having access to an expansive global network helps create a unique ability to connect the dots and recognise risk patterns across the globe, which allows companies to spot trends and stay ahead of emerging threats.

This is no small feat. Ninety percent of the data that exists in the world today was created in the last two years. Information is coming at us faster and from more sources than ever before, but that does not automatically translate into greater insight. Companies are finding that they have a surplus of information and a shortage of insight. Thus, there is a growing need for proprietary analytical tools that can transform that information into insight.

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For example, Aon's Global Risk Insight Platform includes data from more than 1,000 insurance carriers across nearly 170 countries. It leverages the world's largest international database of insurance placement information to provide clients with the most relevant and applicable data on market conditions, placements and rates to fit their needs. By monitoring that data and reporting our findings to clients, we can keep our finger on the pulse of the industry and the emerging risks that our clients face.

Companies need to think about risk in a different way. The desire to take on risk and the ability to understand risk, despite its increasing magnitude, scope and speed, are fundamental drivers for continued economic growth.

Acknowledging the reality of risk is not the same as saying the sky is falling. In fact, it is quite the opposite. When companies understand the impact of risk they are more optimistic about their position and better prepared to grow their businesses.

As the world continues to change, so does the face of global risk. Misunderstanding it can be fatal. The successful companies will be those who understand that risk is married to innovation, exploration and expansion. They will be the ones that understand that proper risk management provides an opportunity to grow and prosper.