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Embracing opportunity in a new world of risk

The rewards of being risk confident

Are you risk confident?

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Contents

Not if, but when: The changing risk landscape

For organisations worldwide, the concepts of 'catastrophic risk' and 'likely worse case scenarios' have moved decisively from theory to everyday reality. With global trade, financial markets and supply chains increasingly interconnected across borders, and rapid technological advances reshaping every facet of business, the question is no longer *if* a damaging risk event somewhere in the world will impact your company, but rather *when* this will happen. At that point, a further question will come to the fore: is your organisation sufficiently aware and agile to respond to these impacts quickly, confidently and effectively?

The risks facing today's organisations range across known, emerging, and 'black swan' scenarios. In each case, recent events indicate that as companies expand into new markets and progressively globalise their operations, they become increasingly vulnerable to events that are less predictable and more far-reaching in impact. As PwC's *Black swans turn grey: The transformation of risk* (January 2012) points out, high-impact 'black swan' risk events should only occur at unpredictable intervals, but they're now taking place with rising frequency. Equally worrying are organisations that have blind spots where such risks may be lurking undetected.

"The stories of businesses grappling to navigate through and recover from volatility in financial markets, the unknowns of doing business cross borders, natural disasters, increasing regulation and the like are well-documented," comments Marco Amitrano, Head of UK Risk Assurance Services and PwC Risk Assurance Services Global Chairman. "Moving forward, organisations need to be better prepared to manage those risks, and, as importantly, to seize the growth opportunities they present."

Can businesses achieve these two imperatives? According to PwC's *15th Annual Global CEO Survey* (January 2012), their leaders believe the answer is 'yes'. Despite the challenges and the complexities they face, the CEOs interviewed in the survey were more confident than in the previous year about their businesses' growth prospects, and also over their ability to avoid the jagged rocks of risk. In fact, some 40% were 'very confident' in the growth of their company over the coming 12 months. However, other findings underline that today's increasingly unpredictable risk landscape can run counter to the current business mandates to grow the organisation, expand its bottom line and drive industry innovation. Even CEOs who are shaking up their current strategic models to undertake more complex transactions, spin off business units, adopt new sourcing models or ensure compliance with new regulations, said that the steps to execute these moves were becoming increasingly difficult.

The organisations that succeed in today's environment do so because they are future-focused, innovative, and capable of making bold and practical business decisions that keep their assets safe and secure. As the *CEO Survey* confirms, these organisations have learned that being prepared for uncertainty means focusing on the consequences of business disruption – a perspective that enables them to discuss risk at a more strategic level. And they attribute their own market sure-footedness to proactive risk management practices, a determination to stay ahead of their competitors, and thinking long-term to ensure their business model remains relevant and suitable for an ever-evolving global economy. In this context, PwC's *Project Blue* (July 2012) framework indicates that forward-looking organisations are actively taking advantage of the volatility in the financial markets over the past few years to leapfrog over slower-moving competitors. They have grasped the fact that these conditions present a once-in-a-generation opportunity to boost differentiation at a time when their industries' competitive structures are in flux, and the gap between high and low performers is widening.

Unfortunately, 'confident', 'proactive' and 'agile' are not words that describe all companies today; for many, the pursuit of these qualities is still very much work-in-progress.

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Head of UK Risk Assurance Services and PwC Risk Assurance Services Global Chairman

The risk of inactivity – the case for change

As the shifts we have described continue, what are the implications for risk management? Indicators, including our CEO Survey and a host of other studies, highlight that the risk landscape will continue to become more complex due to growing economic uncertainty, intensifying industry competition, increasing regulation and the escalating battle for talent and resources. But is risk actually increasing? Or are companies just more aware of risks these days? Does it really matter? There's no doubt that the uncertainties surrounding some very real risk factors present new challenges for companies. They also present opportunities. Either way, scenario planning and active responses are required.

PwC's *2012 State of the Internal Audit Profession* (March 2012) study confirms that risks are perceived as becoming more complex, less predictable and more diverse. However, while the respondents recognise this changing reality, only 45% think that most of their organisation's critical risks are being well-managed. In truth, many don't know how to fully articulate these risks, or how to address them. They need to learn fast.

To do this, we believe that companies need to look beyond traditional enterprise risk management (ERM) processes and evolve their frameworks for the new risk landscape. Some are starting to build competencies in identifying risk scenarios and, to varying degrees, are dealing with their consequences. However, this maturing of risk management needs to accelerate in order to enable companies to become more proactive in handing both risk and the opportunities presented to them. A failure to prepare for, predict, anticipate or build in the flexibility to adapt to various scenarios will potentially cost organisations, both in terms of quantifiable value creation and also in their relative competitive positioning in the marketplace. This imperative applies whether the uncertainty is on the downside or upside. For example, consider what would happen to a consumer technology company that finds customer demand for its latest product dramatically exceeds its expectations, resulting in problems in meeting that demand. How would this impact its brand and market share? What would its stakeholders say?

Achieving risk confidence

To be regarded by its stakeholders as forward-thinking and risk confident, it is critical that an organisation makes the transition from being subject to market unpredictability, to possessing swift, sure-footed strategic agility. Achieving this shift successfully requires a resetting of the organisational thinking about risk. Consider the following perspectives:

Risk planning is no longer just about asking what might go wrong.

As PwC's *Risk in Review: Rethinking risk management for new market realities* (March 2012) indicates, today's future-focused companies need to figure out what needs to go right in order for them to ensure their systems, processes and management focus remain aligned to achieve successful outcomes for their strategy. What's more, they need maintain this alignment in the face of a myriad possible situations and external scenarios. Against this background, employing a purely traditional approach to risk management is not enough.

Being prepared for risk events is not just about having plans in place to respond.

As PwC's report *Prospering in an era of uncertainty: The case for resilience* (May 2012) highlights, organisations must focus on resilience which we define as having the capacity to survive and thrive in times of uncertainty and turbulent business environments. Resilience is not just about being robust and able to bounce back from an incident. An organisation looking to be resilient over the longer term must also have agility to seize opportunities, a culture of learning from its mistakes and a willingness to transform itself.

Relying purely on a risk management approach that uses historical corporate data to predict future events and impacts is no longer enough.

To achieve sustainable risk resilience, boards must closely interlink their key internal processes risk management, strategy, performance management and reward, and so on and connect top management's agenda with experiences and perspectives from all segments of the organisation. With these linkages in place, they can start to change what they measure as key risk factors and look at more predictive indicators rather than just reactive or historical ones. When boards are more explicit about their organisation's risk appetite with staff, and connect individual behaviour with accountability, they can reduce the potential impacts of risk events. Consider the commercial, ethical and legal risks commonly faced by an employee negotiating a supplier or customer contract, or the data privacy issues that IT managers must keep in mind when choosing a third-party cloud service provider.

Going a step further, resetting their thinking about risk also enables organisations to quantify their risk appetite and tolerance more explicitly, and to cascade and clarify measures to the front line about behaviours, freedom, barriers and limits, alongside traditional management and financial delegation. However, to convert this approach into true competitive advantage in the marketplace, organisations will not only need the ability to react effectively to risk scenarios; they will also need to react faster than their competitors.

Nurturing a risk-confident culture

For the leadership of any organisation, rethinking traditional control-based approaches and connecting risk management with organisational strategy, culture and business decision-making is easier said than done. However, this new way of thinking needs to take root at the top of the organisation to be most effective.

At risk confident organisations, risk conversations have escalated to the C-suite and onto the Board agenda. Board members actively want to understand the risk potential of their organisation; not just whether the organisation is prepared for a risk event, or whether it can identify challenges early enough to respond quickly and ahead of its competitors.

Marco Amitrano comments: "We find that executives who bring risk discussions to strategic levels in their organisation achieve greater results and, therefore, risk confidence. When clients focus on preparing to respond to the consequences of business disruption, discussions take place across the organisation with people involved in strategy, operations, risk management, crisis management and business continuity planning. Doing otherwise–focusing only on 'what if' scenarios–simply keeps the discussion theoretical, and doesn't engage all the functions that will have to respond to the disrupting event."

"Organisations need to be well-rehearsed and more agile to better anticipate and manage the risks and opportunities presented to them. Not only will this future-proof their investments, but it will also inspire confidence in the eyes of their stakeholders"

Marco Amitrano

To build a sustainable risk confident culture, organisational discussions need to be about forecasting the consequences of risk events, as well as future-proofing against events that might hamper the achievement of strategic objectives. This means thoughtfully assessing a wide array of issues ranging from supply chain weaknesses, data breaches/security and corporate fraud/corruption, through to overregulation and the extreme conditions in local markets that can quickly escalate to the global stage. To improve these assessments, some leading organisations are adopting the practice of 'reverse stress-testing'–effectively preparing for consequences, not predicting causes. Having acknowledged that it is no longer possible to forecast events themselves, they are focusing instead on managing their impacts and knock-on effects.

A further development is that many CEOs and Boards are promoting risk-aware organisational cultures and setting the pace for establishing ethical and sound business behaviours. These efforts often include encouraging a culture of open communication and collaboration across the organisation, and seeking to improve the ability to define and communicate a clear, organisation-wide risk appetite.

Today's most risk confident businesses have taken an honest look at their business model and their balance sheet. They've asked themselves and have responded to the tough questions. As a result, they are in a better position to handle the complexities of doing business and are more agile and stable as organisations–meaning they can gain competitive advantage in their industry globally by building, investing and doing business in their traditional markets, cross-border, and in emerging economies.

Executives who bring risk discussions to strategic levels in their organisation achieve greater risk confidence.

Making business decisions with confidence

For business leaders, committing to achieve sustainable growth in challenging times is a bold move but also a business imperative in today's economic climate. Proactively managing your organisation's destiny today by future-proofing against an evolving risk landscape builds confidence and ensures your success and longevity in a changing global economy. Our experience shows that the key actions being taken by clients to improve their risk confidence include the following steps:

- Making changes to supply logistics, in order to improve contingency planning in supplier networks and manage future disruptions.
- Implementing new business models involving shared IT platforms and applications delivered as services, to help manage the complex interrelated issues of data management, capital investment in IT, and cyber risks.
- Improving the quality of management information by defining key performance and risk indicators that will enable the right business decisions.
- Improving transparency and visibility over processes, controls, and performance information; enabling companies to build trust with employees, customers, regulators and investors.
- Integrating strategic risk considerations into executive agendas: ensuring decision-making takes into consideration the impact of economic, social, political and environmental conditions. More importantly, utilising these discussions to develop sensitivity to subtle cues on how such factors shape the organisation's business environment.
- Capturing the learning from recent hard lessons in relation to conventional forecasting approaches. Organisations are expanding their repertoire of risk and forecasting techniques to include innovative tools geared to today's complexity and uncertainty.

Given all the potential risk factors they face today, organisations need to be smart in focusing their efforts to bolster their risk confidence and succeed in their markets. The path to building a risk confident business starts with an acute degree of self-awareness across a number of dimensions. We recommend you start by asking your executive teams some tough questions; their responses will give you the insight and foresight you'll need to assess how risk confident you really are.

How risk-confident is your organisation?

How confident are you in your organisation's ability to achieve future growth while navigating through today's changing risk landscape? To begin assessing how ready your organisation is for the road ahead, try asking the following questions about risk confidence:

Building your risk awareness

- What are some of the potential risks that could prevent you achieving your organisational goals over the next 3-5 years? Have you involved the right people in risk identification?
- What risks–known, emerging, and black swan events–might impact those goals?
- How does your organisation address those risks today?
- Are you fostering a risk-aware culture at all levels of your organisation?

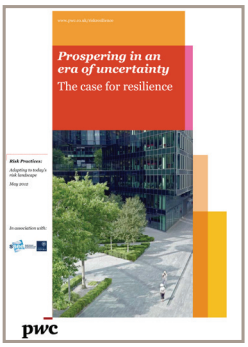
Gauging your risk competencies

- Does your organisation possess the right industry expertise to ask tough questions about executives' decisions, and develop the right risk management solutions?
- Are you thinking beyond traditional ERM frameworks and processes?
- What steps are you taking to improve your risk management approaches in these complex times?
- How effective are your governance frameworks (including corporate risk management and internal audit) in helping you identify and manage key risks to your organisational goals?
- Do your stakeholders trust you and do you leverage that trust to drive competitive advantage?

Related reading

Risk in review 2012: Rethinking risk management for new market realities

Project Blue: Assessing the future trends for financial services



Prospering in an era of uncertainty: The case for resilience

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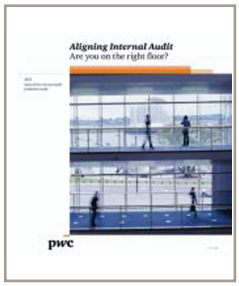

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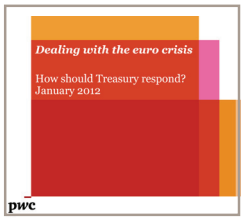


Dealing with the euro crisis: How should the Treasury respond?

About PwC Risk Assurance

From traditional financial controls and Sarbanes Oxley compliance to broader risk issues, PwC strives to inspire confidence in your business performance and reputation. Our Risk Assurance portfolio of integrated solutions can help you improve the resilience of your business. We bring together specialist disciplines and commercial expertise to give you insight, foresight and independent advice so that you are confident in building and safeguarding future value across your business. We can help you with:

Business Resilience
Helping you build a more risk-resilient business through better identification, measurement, and mitigation of risk– from assessing and implementing Enterprise Risk Management (ERM) frameworks and Governance, Risk and Compliance (GRC) solutions, through to assuring business continuity plans.

Business Controls Advisory
We help clients balance risk and control by designing, implementing, testing, optimising and assuring internal controls environments, ultimately providing advice to help you improve the return on your investment.

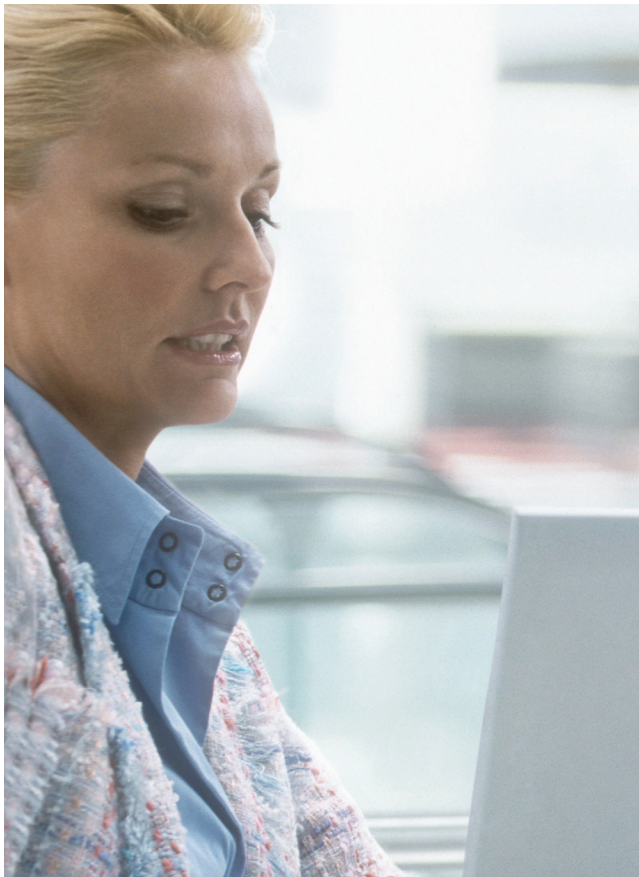
IT Risk Assurance
Developing IT risk and control solutions that keep pace with today's complex, changing technological landscape and ensure maximum value from the investment you've made in technology– whether it's securing your business from information leaks or security breaches, protecting your critical business systems from failure, managing complex projects or helping you safeguard your data's quality and reliability.

Corporate Treasury Solutions
Enhancing or transforming the treasury function or addressing specific accounting and reporting implications or cash and liquidity management concerns so that it creates the value you want.

Internal Audit Services
Helping you improve the strength and quality of your Internal Audit function, with services ranging from outsourcing and co-sourcing solutions, to independent assessments of function effectiveness and broader corporate governance advice.

Performance Assurance
Helping to build commercial advantage through reliable processes and trusted information across a range of financial and non-financial areas, from recognised third party assurance standards through to integrated reporting and independent assessments of commercial arrangements.

This is the first in a series of thought leadership papers produced by PwC's Global Risk Assurance practice on building risk confidence. Subsequent papers will look more closely into key risk areas and explore the tools and approaches that will help organizations achieve their risk management objectives.



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