

RSM Tenon



Global strategic risks
A brave new world

A simple transaction?

One of our US-based media clients recently acquired a company with interests across the Americas, Asia and Europe. This is a significant acquisition in terms of value and global reach and is a 'game changer' in terms of strategic direction and global risk and reward.

Five years ago this would have been treated more as a transaction than a strategic global risk. The focus would have been on the synergy obtained from the transaction, the opportunity to expand into new markets and products, increased efficiency and effectiveness and economies brought by scale. These considerations are mainly operational and financial by nature.

Times have changed. In considering this 'transaction' the likelihood and impact of global strategic risks are now very much front of mind. Our client has had the foresight to take a very strong global governance, risk management and assurance approach to this deal and as a result has a high chance of making it a success.

Figure one: What's below the tip of your iceberg?



Global strategic risks

Geographic, political and social unrest need to be factored into the strategic risk assessment.

Social unrest

Recent events have shown that we must 'expect the unexpected', everywhere. From regime change in Libya to the London riots, social unrest can suddenly require Boards to re-examine the stability and attractiveness of their chosen geographies, anywhere in the world.

Public sector austerity

Austerity measures around the world include significant cut backs to the front line and the back offices of essential services such as police and defence, as well as other important government services and programmes. New risks are emerging as accountabilities are moved closer to the public through social enterprise-based initiatives.

What are the real risks to public safety, security and wellbeing? Will these unprecedented measures unravel the fabric of our society?

Continuing fall-out from the financial crisis

The world financial crisis has changed both the economic landscape and the regulatory regime. The issues are almost incomprehensibly vast, but companies must consider their response to the domino impact of EU countries' economic failure, credit downgrading of the US and concentration of wealth heading eastward and in oil-rich sovereign wealth funds. Breaking it down into smaller issues can help.

For example, one result is the ring-fencing of banks in terms of investment and retail banking. If this is an over-reaction by the regulators, it could significantly undermine the rebuilding of our banking system and in turn impact the ability for companies to access and invest capital. Should such a scenario be included in the sensitivity case for your strategic plans?

Disasters

Disasters, natural or otherwise, can also require a rapid response. Companies with supply chain partners in Japan, which has recently suffered an explosion at a nuclear power plant, an earthquake and a tsunami, will have been wondering how to respond both on a human level and as a business. When supply and demand is so significantly affected, Boards need to consider developing contingency plans in 'safer' geographic areas.

I was in New York during the recent tremor. Thankfully it was minor but there was still significant business down time as companies and staff assimilated what was happening, with memories of 9/11 firmly etched in the minds of New Yorkers. This was quickly followed up by Hurricane Irene. What if these two consecutive events were much worse? How would that impact on global business via one of the financial centres of the world?

Cyberthreats

E-commerce, cloud computing and global data transfer have left companies vulnerable. Invisible attacks can emanate from sources as varied as individual 'geeks' in their bedrooms, organised groups of hackers bent on corporate disruption for fun, and major western powers and terrorist sects allegedly searching for economic and defence data with a view to causing damage.

Resilience of information systems is the technical and operational risk but the plethora of high and low profile international system security failures demonstrate that this risk is not fully mitigated. Public reputation risk management when resilience fails remains important.

Our Business Barometer survey of more than 300 SMEs in May 2011 showed that many organisations have yet to take even basic steps to protect themselves from cyber attacks. 16% say they have not even installed anti-virus software. Consumers, regulators and the large corporates that many SMEs supply simply will not tolerate this laxity in the future.

People risks

The introduction of the UK Bribery Act with its international reach has brought organised global crime such as illicit trade, bribery and corruption into much sharper focus. Overseas and UK clients are equally interested in managing the risks associated with the UK Bribery Act and protecting their company and employees. Interest in the American version of the act, the Foreign Corrupt Practices Act (FCPA), has been reinvigorated. Oil, gas and defence companies are particularly concerned because of the nature of their global and high capital investment businesses.

Criminality and unethical behaviours are far from the only sources of risk. The banking industry was reputed to have the most sophisticated risk management system and processes available, yet it failed. Originally seen as a systemic failure, attention is now increasingly turning to human behaviour. Individual bonus incentives may have had more influence on individuals and teams than the real and inherent risks of their activities. Some of our clients are looking closely at the psychological traits of individuals and team dynamics as part of a cultural risk assessment and audit process. This will impact on all aspects of human resource management including recruitment, retention, reward, training, personal development, and nominations at Board and non-exec level.

Figure two: The three dimensions of risk

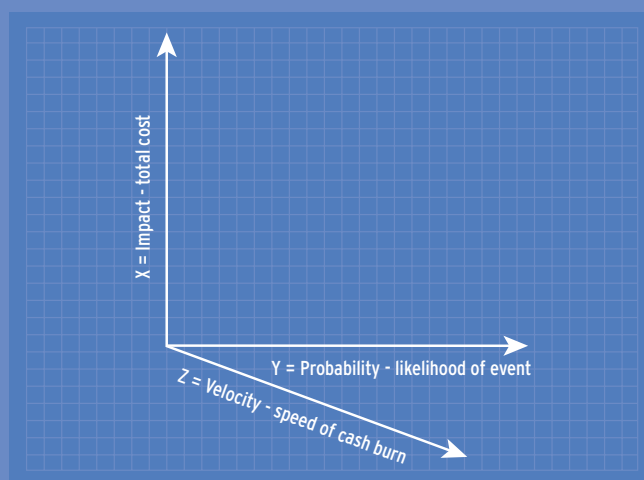


Figure three: Which, if any, of the following precautions has your business taken to protect itself against cyber attacks? Please select all that apply.

	Base: all	(All)	(North)	(Mids)	(South)	(Scot)
Installed anti-virus software	84%	86%	83%	81%	86%	
Conducted a risk audit	27%	30%	23%	28%	27%	
Brought in outside consultants	19%	15%	18%	20%	24%	
I have a cyber security professional on my team	15%	11%	16%	17%	16%	
Purchased dedicated software	38%	42%	40%	30%	41%	
Other	4%	4%	3%	5%	6%	
No provision made	6%	5%	7%	5%	8%	

Reputational risks

Your reputation is only as strong as the weakest link in your global supply chains. If one of your components is made in a 'sweat shop' or one of your suppliers leaks harmful chemicals into the atmosphere, you cannot risk being the last to find out. There are plenty of people and organisations dedicated to finding and exposing human rights and environmental abuses and in the age of social media, negative publicity can sweep around the world in a matter of hours.

Public reputation and environment protection risks are now as important as the efficiency and quality of the production process. Companies need to contractually oblige suppliers to be compliant, and also have a mechanism to monitor on-going compliance in far-off lands to ensure these types of risk are covered.

Leading change in the brave new world of risk

Approaches to risk management are quickly adapting, moving from an operational, compliance and financial bias towards a more balanced consideration of global and strategic risks. The former remains extremely important as the fundamental basis of good risk assessment. The latter, however, increasingly will help determine the sustainability of a major business change.

Figure four: This shift in risk management has forced our clients to reconsider many aspects of the traditional approach to risk management:

What strategic risks should now be included?

How do strategic global risks inter-relate?

How do you evaluate the consequence and likelihood of these risks?

How many risk dimensions should we consider?

How do we recalculate the total company cost of risk and controls, and sensibly reduce it?

How will the balance and cost of risk avoidance, risk transfer and risk mitigation change?

Can risk appetite ever be fully understood and defined in such an environment?

How important are the behavioural aspects of risk compared to the systemic aspects?

Addressing these questions has led to the growth of approaches that help support companies to assess and manage global strategic risks. Scenario models run by senior and international executives can provide strategic geopolitical risk assessments of individual countries, regimes and industries. Advisors can use public information, and perhaps informal data, to profile key foreign business and political leaders and appraise their good standing. Lawyers and forensic accountants increasingly focus on global corruption prevention, detection and investigations. IT specialists, including 'controlled' hackers, can test the vulnerability of IT systems security. Access to these types of skills and experience will become increasingly important to address global strategic risks.

So what does this all mean? Does risk still equal opportunity? This debate reminds me of a presentation I did at the Toronto Stock Exchange on risk management in the mining industry. It was a 'traditional' type presentation focused on the old world order of risk management before global strategic risks appeared to be so relevant. At the end of the session a very experienced mining company Director gave his view: "I don't really understand all this. We put a cross on a map, go to hostile countries, drill a hole, hope to find some oil and then work out how to make everyone some money."

I sincerely hope that this brave and entrepreneurial spirit can still prevail in our new world.

John Abbott

Head of Corporate Risk Advisory Services

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RSM Tenon Limited (No 4066924) is registered in England and Wales. Registered Office 66 Chiltern Street, London W1U 4GB, England.

32022009(11) M2229011

For further information please contact:

John Abbott, Head of Corporate Risk Advisory Services

Mob: +44 (0) 7837 641 542 **Email:** john.p.abbott@rsmtenon.com

Web: www.rsmtenon.com