EXPECTING THE UNEXPECTED

When businesses plan for both known and unforeseen risks, it's possible to turn lemons into lemonade without missing a beat

Volcanic ash from Iceland shrouded Europe last spring, too far from the headquarters of Kenyan food exporter Vegpro Ltd. for its managers to see the haze. But they could smell 200 tons of produce spoiling in their warehouse as transport planes observed a flight ban. Had business been proceeding normally and the Vegpro warehouse caught fire, or if one of its trucks had been damaged by collision, traditional insurance would cover the losses. Suspension of operations due to a natural or geopolitical disaster is different, however, and falls under the heading of enterprise risk and strategic risk, a broad realm of adverse events and conditions that organizations are building new tools and systems to effectively manage.

The ever-evolving concept of enterprise risk management (ERM) has pushed the attention of insurers and their clients far beyond basic insurability and underwriting. Samir Shah, Chief Risk Officer of insurance heavyweight Chartis, calls ERM a "fundamental change for the long term." In search of best practices, Shah studies the business sectors where early successes have been achieved.

"Companies that embrace ERM principles are looking beyond the management of market risks, such as foreign exchange, interest rates and commodity prices, and traditionally insurable property and casualty risks," says Shah. Forward thinkers now apply disciplined analysis to areas such as supply chain management, strategic expansion into new products and markets, outsourcing, and mergers and acquisitions. Shah notes, however, that this increase in "demand" for management of broader business risks needs a matching "supply of innovative solutions for risk transfer and risk capital, to get these risks on par with financial and property/casualty risk management."

It is human nature to treat fire, flood and accidental death as risk hazards to be mitigated via some deliberate investment, but what

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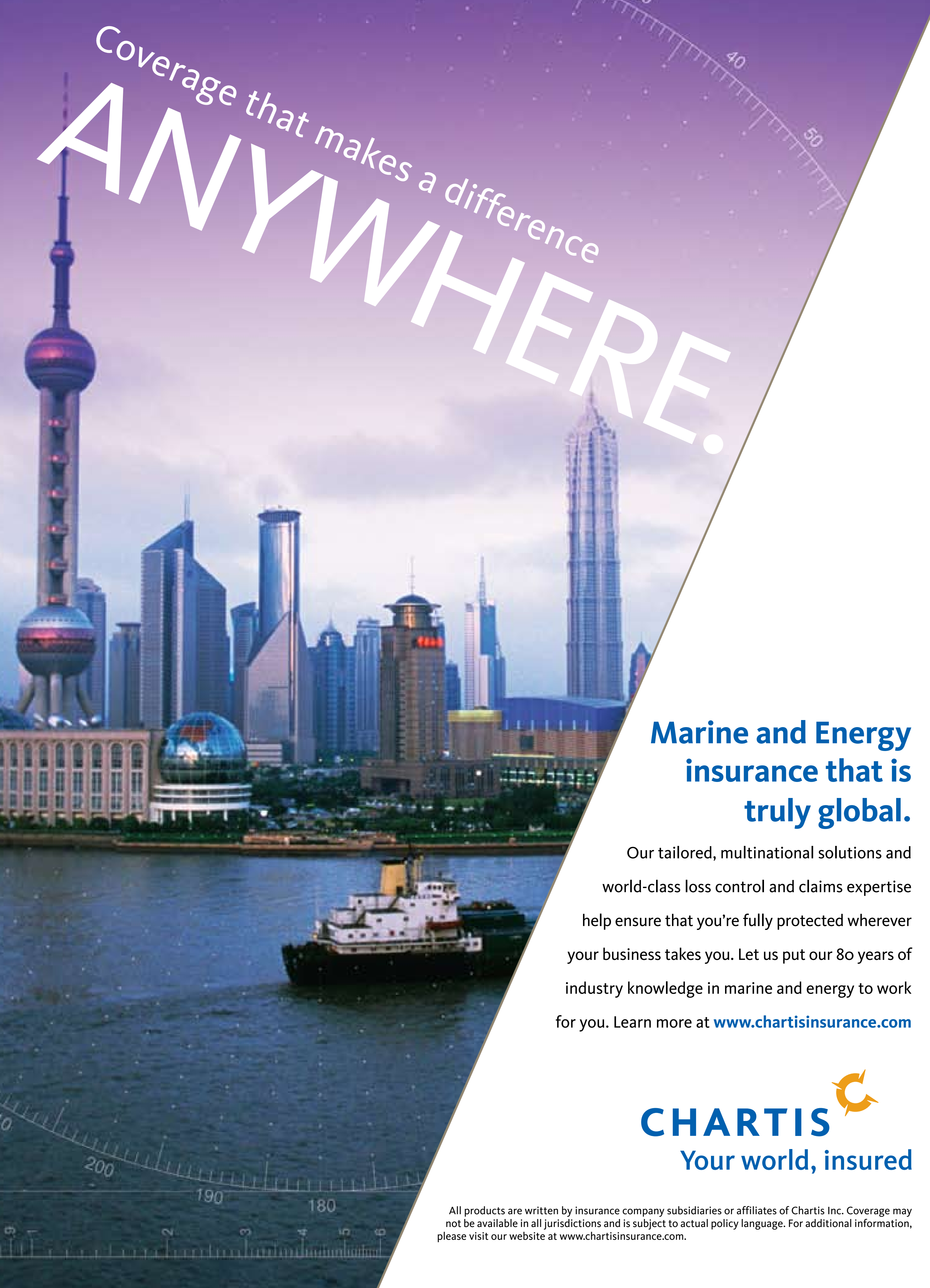

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about a failed IPO? Samir Shah describes a medium-sized California healthcare company as it prepared to go public and use the new capital for acquisitions. "The CEO and his team created a comprehensive plan and executed it flawlessly," says Shah. "Then the Russian government defaulted on its debt and the IPO market suddenly shut down. The CEO viewed this as an event that could not be anticipated, so he felt he should be not held accountable for it—not unlike how many CEOs feel about the recent financial crisis. The principles of ERM contradict that view. Scenario analysis would have allowed the company to simply consider the possibility that the IPO market was shut down without attributing it to a specific cause. That would have allowed the company to develop contingencies for this scenario and possibly put the company at a competitive advantage over others who had not contemplated the scenario."

Scenario analysis is a discipline being practiced ever more widely. In a market-wide risk situation, such as the recent endowment reversals at nearly all universities—not to mention the reduced spending power of students' families—the competitive advantage of suffering least and recovering fastest is significant. That was the case at the University of Saskatchewan, where Nowell Seaman directs risk management and insurance services. The university had this potentiality "on our risk register," says Seaman. "We set up operational contingency funding, which bought us time before we had to contract budgets. Our cuts were only half of what comparable universities underwent."

Seeing the future through a new lens

Uniting the efforts of ERM practitioners is the nonprofit organization RIMS, the Risk and Insurance Management Society. Along with its 10,000 members, RIMS confronts the challenge inherent in the famous Peter Drucker observation that "what gets measured gets managed." In the hypothetical case of the fire-damaged warehouse, a paid policy claim is the factor that traditional risk management would deem the typical relevant metric.

"A loss transferred through insurance coverage will always be valued and necessary," says Carol Fox, RIMS Director of

> "Within integrated risk management, business disruption is an ever-present concern, whatever the source," says Carol Fox of RIMS.

Strategic and Enterprise Risk Practice. "ERM moves from that starting point to a wider spectrum of emerging events and obstacles. It applies the classic risk disciplines to an organization's full array of objectives as defined in the early stages of strategic planning." The implication is not that an African produce exporter would be expected to foresee lava bursting through glaciers. "Within integrated risk management, business disruption is an ever-present concern, whatever the source," says Fox.

Michael Kerner, CEO of Zurich Global Corporate in North America, a business insurance leader, defines the current and future risk-management challenge as a square-off between volatility and dynamism. "The business environment is more volatile—that's a global reality," says Kerner. "Meanwhile, our capacity to respond proactively is also expanding." The stakeholders are multiple and distinct, he notes. "Beyond the entity that's confronting the risk, you have investors wishing to avoid hits to balance sheets and earning streams, rating agencies evaluating stability and predictability and regulators that want to see the consumer protected," Kerner says.

When a company's approach is truly strategic, it becomes possible to view difficulties down the road in a dispassionate manner. "The more you see risk through a strategic lens," says Kerner, "the less likely you are to alter your plan purely on the basis of 'too much risk.' What you instead conclude is: 'We could certainly bear that risk, but not under these terms—they don't provide us a sufficient return in light of the risk factor.'"

Using Kerner's strategic lens, an airline enduring the Iceland volcano might have had a plan to use the flight ban period for upgrades, special training or aggressive cost conserving. And if the airline had been ready last spring with an accessible, second-option market for the transport of perishable produce, they could have made an unexpected profit—and new friends in Kenya, as well. ●

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