



Allianz Risk Pulse

Focus: Business risks

“Big three” risks trouble companies

Allianz experts see economic risks, business interruption and natural catastrophes as greatest risks for 2012

→ An Allianz study has found that economic risks, business interruption and natural catastrophes are the most feared risks for businesses. These are the big three, all of which have been highly active in combination this year and will continue to do so in 2012. They are followed by legal and reputational risks. Currently the most underestimated risks are IT and cyber risks.

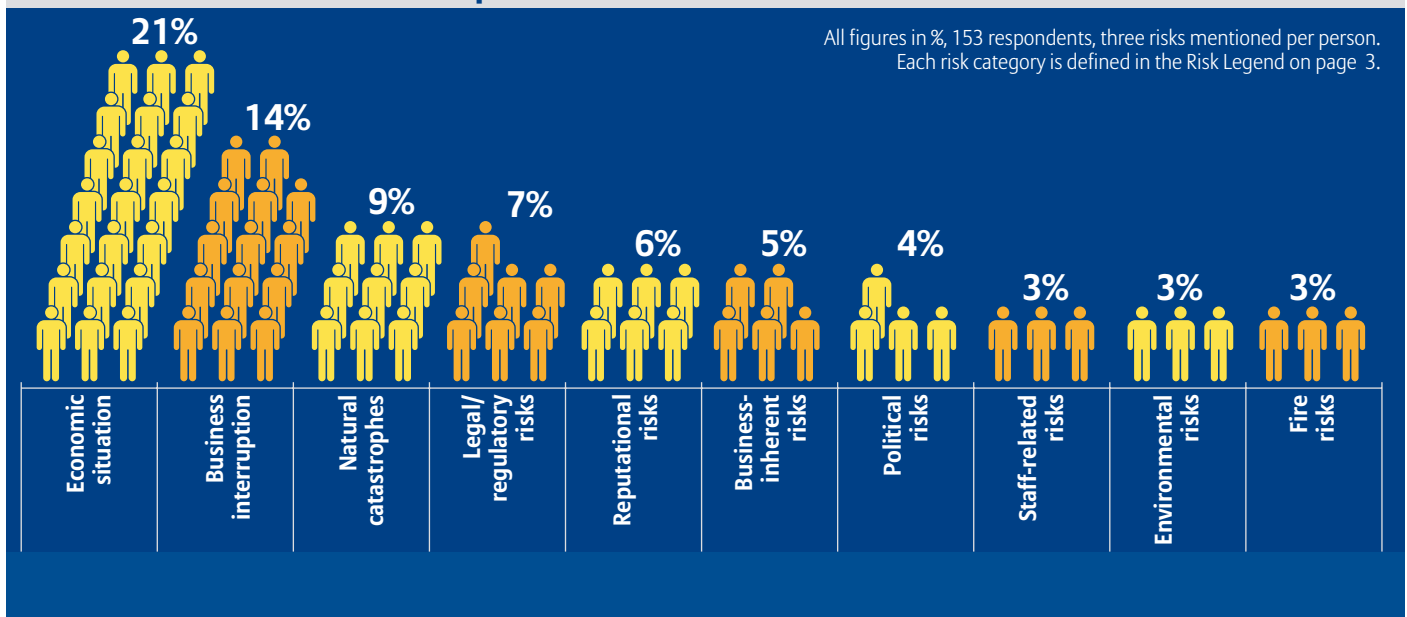


“As an insurer we are constantly looking at new, emerging risks that might become important for our clients,” says Axel Theis, CEO of Allianz Global Corporate & Specialty.

Allianz Global Corporate & Specialty (AGCS), the center of competence for corporate and industrial insurance at Allianz, has conducted a worldwide survey among its risk management professionals to identify the risks they see as most prevalent today and in the future.

By far the most frequently mentioned type of risk in the AGCS Risk Barometer is **economic risk**. 21 percent of all AGCS risk experts see it as the most pressing concern for their clients. Economic risk refers to a broad range of risks related to the economic climate. It includes commodity price increases, loss of key markets and, generally, economic recession, sovereign debt concerns and foreign currency fluctuations.

AGCS Risk Barometer: The Top 10 Business Risks



Source: Allianz / AGCS





“In the current climate we have all become acutely aware of the pervasiveness of economic risk,” says Allianz Group Chief Economist, Dr. Michael Heise. “Nervousness and volatility in the financial markets eventually undermine confidence and business activities in the real economy, which in turn further unsettles investors and the markets. Risk assessment is a crucial element in all our personal and business decisions.”

Vulnerable supply chains

The second most frequently mentioned issue is **business interruption**. 14 percent of AGCS experts see this as a major risk and mention it as their clients’ highest priority, especially those AGCS risk engineers who go out to their clients’ plants and see the production on site. This view is shared by their counterparts at the operational risk management level, who are responsible for seamless production. Business interruption refers to supply chain interruptions and the vulnerability of production processes through a concentration of suppliers. AGCS risk experts also point out the exposures created by “just-in-time” logistics, with pronounced knock-on effects when the supplier is not able to deliver within the tight tolerances of such processes.

“The past 20 to 30 years have seen the development of business strategies that promote the ideas of ‘lean manufacturing’ and ‘just-in-time’ supply. In reality this means rationalizing supply, centralizing distribution and, even holding virtual inventories,” explains Paul Carter, Head of Property Risk Consulting at AGCS. “In addition to these strategies there has been an increasing trend to source globally in order to reduce costs yet further, all along the chain. This has become the dominant economic model, but its success has been achieved at the expense of a significantly increased risk of disruption within companies’ overall supply chains. The very flexibility that provides the supply chain with its cost advantages has also caused its inherent vulnerability.”

➔ [See article “Supply Chain – a house of cards or a firm foundation?” by Paul Carter](#)

Natural disasters increase claims

Allianz risk experts see **natural catastrophes** (NatCat) as the third most feared risk. NatCat includes floods and landslides, storms such as hurricanes and tornadoes, earthquakes, tsunamis, volcanic eruptions and heat waves. For 9 percent of the AGCS risk experts NatCat risks are

of highest priority and they see them as important to watch in the future. This may seem surprisingly low considering the substantial impact on the entire insurance industry that the most recent natural catastrophes in Asia Pacific have had: for example, the Japan and New Zealand earthquakes and the Queensland and, more recently, Thailand floods.

Across the globe, trends like urbanization and coastal / flood plain development increase the overall loss potential due to the high risk of windstorms and floods. Socio-economic changes combined with rapidly developing technology and increasing global supply chains create growing potential for NatCat losses and a threat to business continuity.

“Despite extensive media coverage and the significant impact of natural disasters on people, organizations and economies, many businesses still do not address their vulnerability to natural perils adequately,” observes Tina Butzbach, Global Head of Cat Risk Management. “However, the ‘worst case scenario’ can happen, as we have seen in recent years. Therefore, thorough preparation and risk management is crucial.”

AGCS is seeing increased claims, not just from earthquakes but also from weather-related events such as flooding and hurricanes. Economic growth drives natural catastrophe claims, and insured claims have been increasing dramatically. The average cost of insured claims per decade from weather-related incidents such as flooding, hurricanes and typhoons, has increased eightfold since 1970, to over US\$40 billion in 2010 from some US\$5 billion in the 1970s and 1980s.

➔ [See article on “Natural Catastrophes on the rise?”](#)

2011: A perfect storm?

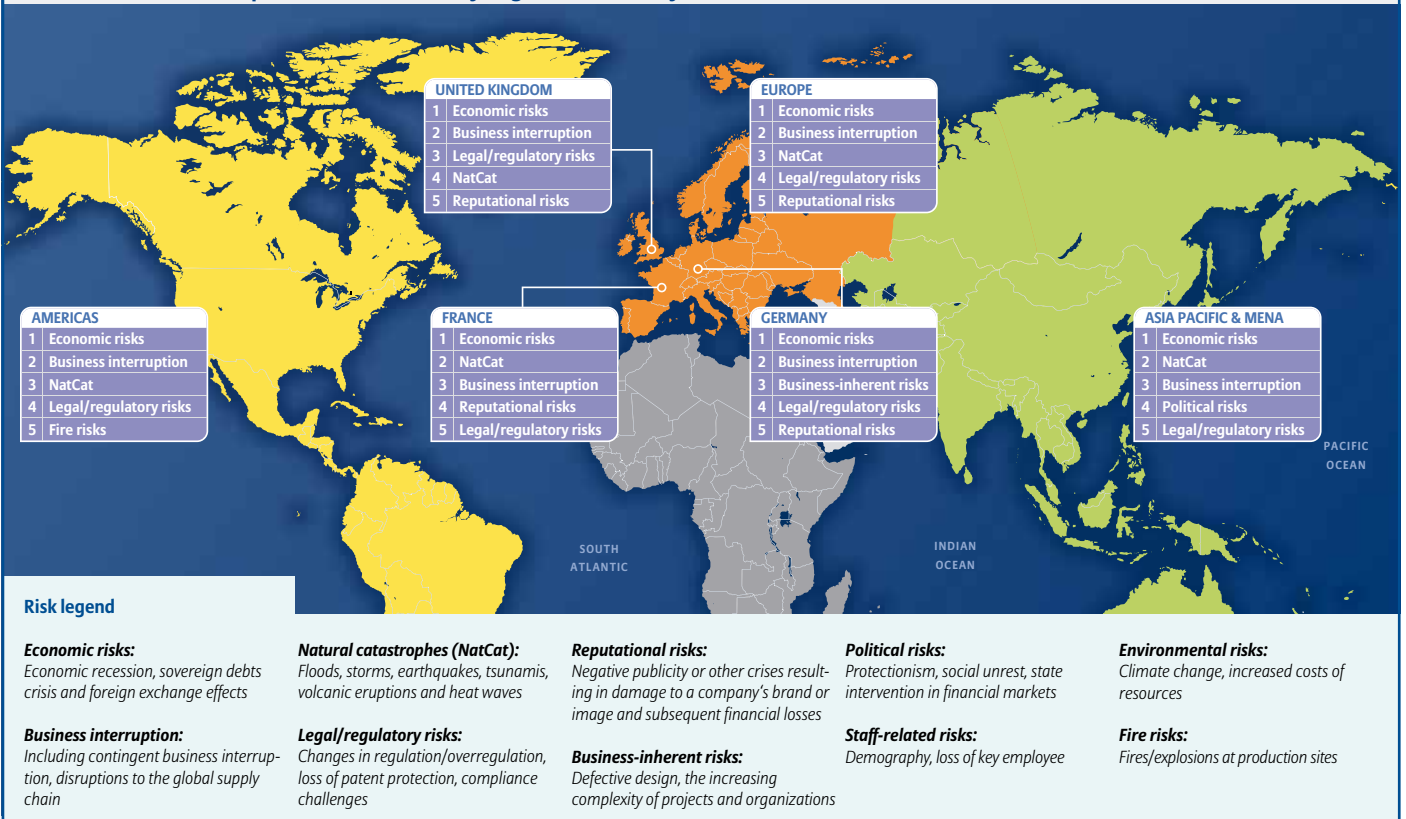
The AGCS Risk Barometer’s results also show the systemic interconnectivity of risks – a fact clearly demonstrated in 2011, when an extraordinary combination of extensive natural catastrophes caused business interruption on a global scale against a continuing backdrop of unprecedented economic challenges. In the globalized world economy, no risk stands on its own or can be seen in isolation. A combination of major events can come together in a “perfect storm” to compound the individual effects of each risk.

In 2011, contingent business interruption claims, arising from natural catastrophes (whereby a supplier failure in one country can have a



Airplanes drown in the water at Don Muang International Airport during the massive flood crisis on November 16, 2011 in Bangkok, Thailand.

AGCS Risk Barometer: Top Five Business Risks by Region and Country



direct impact on a third party manufacturer on the other side of the globe), have demonstrated the cumulative impact and interconnectedness of risks. These claims are all the more damaging to clients when they come in the midst of continuing economic crises, with rising inflation and falling demand challenging profitability from many angles.

Such risks are frequently linked to a greater or lesser extent, but their causes and effects are not always entirely clear. AGCS risk experts often stress the links between different risks in their descriptions of why they consider a specific risk important.



"In today's interconnected world we cannot see the risk of natural catastrophes in isolation but have to ask ourselves what happens when disaster strikes and what kind of knock-on effects this may have in other parts of the world," explains Michael Bruch, a risk expert from AGCS Risk Consulting.

For instance, those respondents who are concerned about changes of rules and regulations by authorities and growing compliance requirements are also concerned about the reputation of the brand and how a headline-making event can have an immense effect on reputation. In many countries, this may be due to increasingly regulated legal environments, which tend to have an effect on liability and financial lines (D&O) insurance and at the same time pose a risk to a company's reputation in terms of product recall or product tampering.

The risk of losing a good reputation is becoming more and more apparent not only to large corporations but also to mid-sized and smaller businesses. In today's information society the power of the

increasingly digitalized mass media and of the new forms of media that allow for much higher engagement by citizens (Web 2.0 / social media) is leading to a broadening challenge for corporate risk management. Speed has become an essential factor in terms of responding to news spreading within minutes on the worldwide web.

The AGCS Risk Barometer also reveals a close relationship between the risks that climate change and dependence on fossil fuels pose, and the risk of damaging the reputation of a business. One expert explains that the public in many countries expects companies to act in an environmentally conscious way and that not doing so is punished quite harshly by consumers, affecting sales figures. At the same time climate change may also have a direct impact on a company's economic situation. It may lead to water and energy restrictions, increased food and commodity prices and finally to an economic downturn that could directly affect a client's business.

Asia Pacific fears NatCat, UK overregulation

As a global insurer, AGCS is present all over the world to cover its clients' needs. Allianz risk consultants work with clients to deliver the best solutions in management, control and risk reduction. AGCS has questioned them all for the Risk Barometer – not only those from Europe, where AGCS has larger hubs (in Germany, the UK, France, Spain, Italy and the Nordic Region), but also from the Middle East (Dubai), the Americas (United States, Canada and South American countries) and Asia Pacific (Singapore, Hong Kong, Australia and Japan).

AGCS risk experts display some geographical differences in their responses. While the AGCS Risk Barometer results show that the economic situation and business interruption are global risks and concern

companies worldwide, other risks vary by region. For example, the risk of natural catastrophes is seen to be more prevalent in Asia Pacific.

Political risks are considered very important in Asia Pacific. Experts explained that these refer to protectionism evolving in emerging markets and to both social unrest and state intervention in the financial markets.

Businesses in the United Kingdom seem to be more concerned about legal and regulatory risks than other countries. These refer to changes in regulation by the authorities, loss of patent protection, growing compliance challenges or overregulation. Business-inherent risks play a large role in Germany. By business-inherent risks, AGCS experts mean issues such as defective product design or the increasing complexity of projects and organizations, which may lead to impaired effectiveness, or a series of losses, for example in the offshore wind industry where maintenance and reconstruction is time-consuming and expensive.

Cyber risks continue to be underestimated

The most underestimated risks, according to the AGCS Risk Barometer, relate to IT. Despite a broad awareness of the increasing risk, only 1 percent of risk experts say that their clients are concerned with cyber risks. Most experts feel that this risk is often underestimated. Cyber risks are characterized by constant innovation and change and are therefore difficult to control.



“We should not only focus on the IT systems. After a claim notification we see very often that we are not dealing with a pure system failure but that there was a lack of understanding around the entire process,” says Jose Fidalgo, AGCS Risk Consultant Liability. “We have to continue putting a lot of emphasis on education and know-how transfer. IT risks are quickly evolving and becoming more complex by the minute.”

➔ See interview with Jose Fidalgo: “How long can a company survive without a functioning IT system?”

Methodology

➔ In the second half of 2011, AGCS surveyed more than 150 risk experts from Singapore to São Paulo on their opinions on the most important current and future risks, based on their experience and discussions with clients. The sample of more than 150 experts included risk engineers, underwriters, key account managers, claims and other risk specialists from different levels of the organization. Not only did they state their three top risks from their clients’ perspectives but they also gave their assessment as to why and how these risks would affect their clients in the future. They were then asked to attribute their top risks to an industry and say which region/country they were based in.

Another risk that is not at the forefront of people’s minds is the risk of fire – perhaps surprisingly, as this was the risk that drove the initial development of insurance during the sixteenth century. As an insurer, AGCS sees the risk of fire as very important but, since it is such a long-established danger, many are under the impression (maybe the illusion) that they know how to deal with it. There are fire experts and sprinkler experts, and many of the AGCS risk engineers specialize in the mitigation of fire risks – but fire remains a key danger, especially as manufacturing and logistics processes are constantly evolving.

Insurance fosters dialog about risks

Allianz experts see economic risks, business interruption and the increasing number of natural catastrophes as the most serious risks that businesses need to mitigate in 2012 and beyond. Whatever the area of risk, continuing dialogue between insurers and clients will be crucial for dealing with problems before they arise.

Axel Theis, CEO of AGCS, explains: “Working with our clients worldwide we see that there is a high awareness of economic risks, but this does not mean that they have found the right way of dealing with them. Many companies seem to underestimate other risks that have been around for a long time, for instance property risks, relating to fire, but also new, emerging risks such as cyber risks or nanotechnology. This is where AGCS comes in and fosters an intensive risk dialogue in order to create more awareness of these important topics.”

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