



January
2013

Allianz Risk Pulse

Focus: Business Risks

Fire risk burns brighter for companies

Business interruption, natural catastrophes and fire represent the top three risks for companies in 2013, says a new global survey by Allianz

→ Increasingly high-tech and ever more interconnected, the global business landscape fears a broad variety of risks, from the traditional to the ultra-modern. A recent survey of more than 500 Allianz corporate insurance experts from 28 countries placed business interruption, natural catastrophes and fire and explosion at the top of the agenda. A range of different legal and economic risks form major areas of concern, while cyber crime and IT failures or power outages remain underestimated.

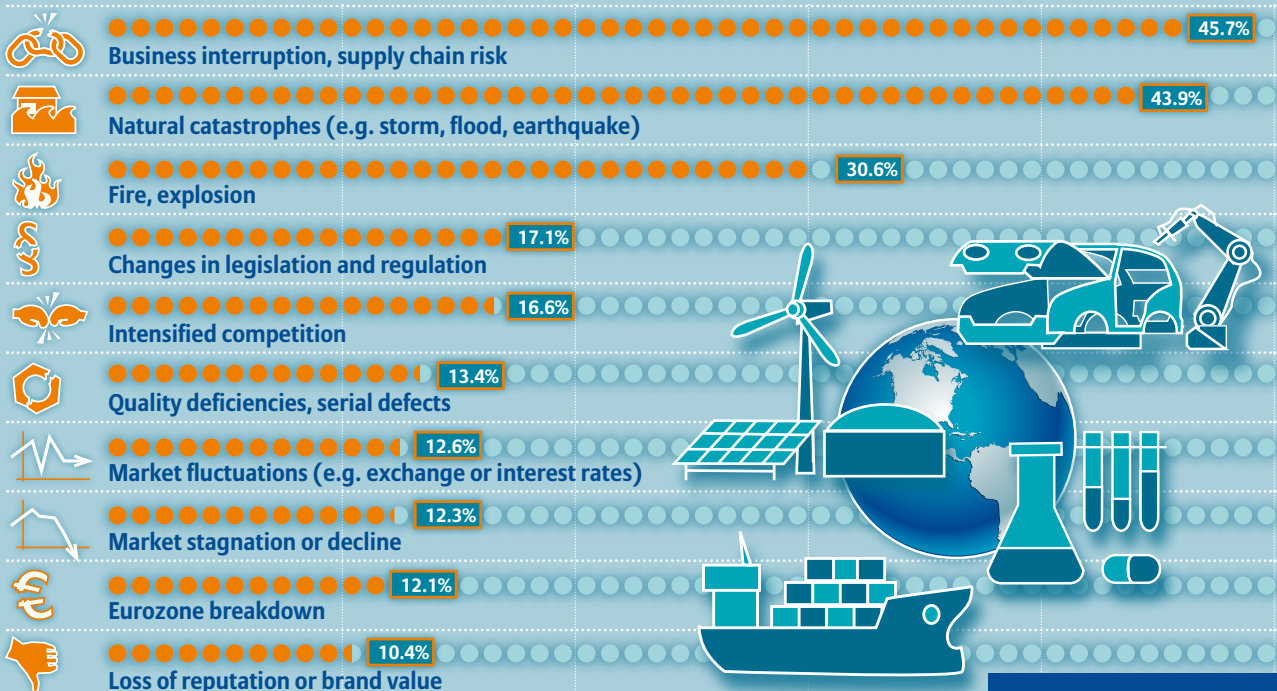
The Allianz "Risk Barometer" survey was carried out in late 2012 by Allianz Global Corporate & Specialty (AGCS), the center for corporate and industrial insurance at Allianz, and gathered opinions from Allianz risk management and underwriting professionals on today's most

important business risks. It follows a similar survey conducted in 2011, which identified economic risk as the most pressing concern, followed by this year's top two: business interruption and natural catastrophes. In the current study, economic risk was replaced by multiple financially-oriented categories, including market stagnation, market fluctuations and Eurozone breakdown, explaining the change in results. Summed up, economic and market risks continue to be seen as high risk priorities for companies globally.



"Allianz has been a reliable partner to businesses all over the world for many years. We have in-depth knowledge about the risks that businesses face and we also know which issues they may be underestimating." Clem Booth, Member of the Board of Management of Allianz SE

Top 10 global business risks for 2013



The Allianz "Risk Barometer" survey was conducted among risk consultants, underwriters, senior managers and claims experts in the corporate insurance segment of both Allianz Global Corporate & Specialty and local Allianz entities. Figures represent the number of responses as a percentage of all survey responses (843).



Supply chain vulnerability

Business interruption and supply chain risk ranked as the top risk, with almost half (46 percent) of the responses ranking it as one of the three most important risks for their clients. With many businesses choosing to run lean supply chains to reduce costs, business interruption at a key supplier can cause a ripple effect felt across an entire industry. The flooding in Thailand in late 2011, for example, caused a shortage of hard-drives impacting PC manufacturers globally, triggering contingent business interruption claims far outside the flood zone itself. "The flexibility that provides a modern supply chain with its cost advantages has also created its inherent vulnerability," says Paul Carter, Global Head of Risk Consulting at AGCS. Today, companies are increasingly re-examining the trade-off between efficiency and operational redundancy.



"The risk landscape for global companies includes traditional risks like natural catastrophes and fire as well as modern ones such as business and supply chain interruption that are closely linked to increasing economic interconnectedness." *Axel Theis, CEO of AGCS*

To improve supply chain resilience many companies consider adding back some redundancy into lean supply chains, even if this reversal of widely used single-supplier sourcing incurs additional costs, adds Carter. Checking a supplier's own business continuity planning should also be embedded in the supplier selection process and ideally include even the suppliers of the primary suppliers.

Insurance companies are also interested in receiving more information about their clients' supply chain risk management as a way of better managing their own portfolio. They are particularly concerned about supplier clusters in the automotive and semiconductor industries. "A natural disaster could hit many of our policyholders in terms of

Allianz "Risk Barometer" survey: participants and methodology

- The Allianz "Risk Barometer" survey was conducted among risk consultants, underwriters, senior managers and claims experts within both AGCS and local Allianz entities in October 2012, with a focus on the corporate insurance sector for both large industrial and mid-sized companies.
- There were 529 respondents from a total of 28 countries. As multiple answers for up to two industries were possible, 843 answers were delivered.
- Participants were asked to name industries about which they are particularly knowledgeable and then name up to three risks they believed to be of most importance for their clients within each industry. In addition, they identified risks they thought their clients significantly underestimate.
- The survey is a follow-up to a first "Risk Barometer" from 2011/2012 which was conducted among AGCS experts, referring only to large corporate businesses. As the base of participants and the methodology have evolved slightly, the results cannot be compared directly. However, major trends can be identified.

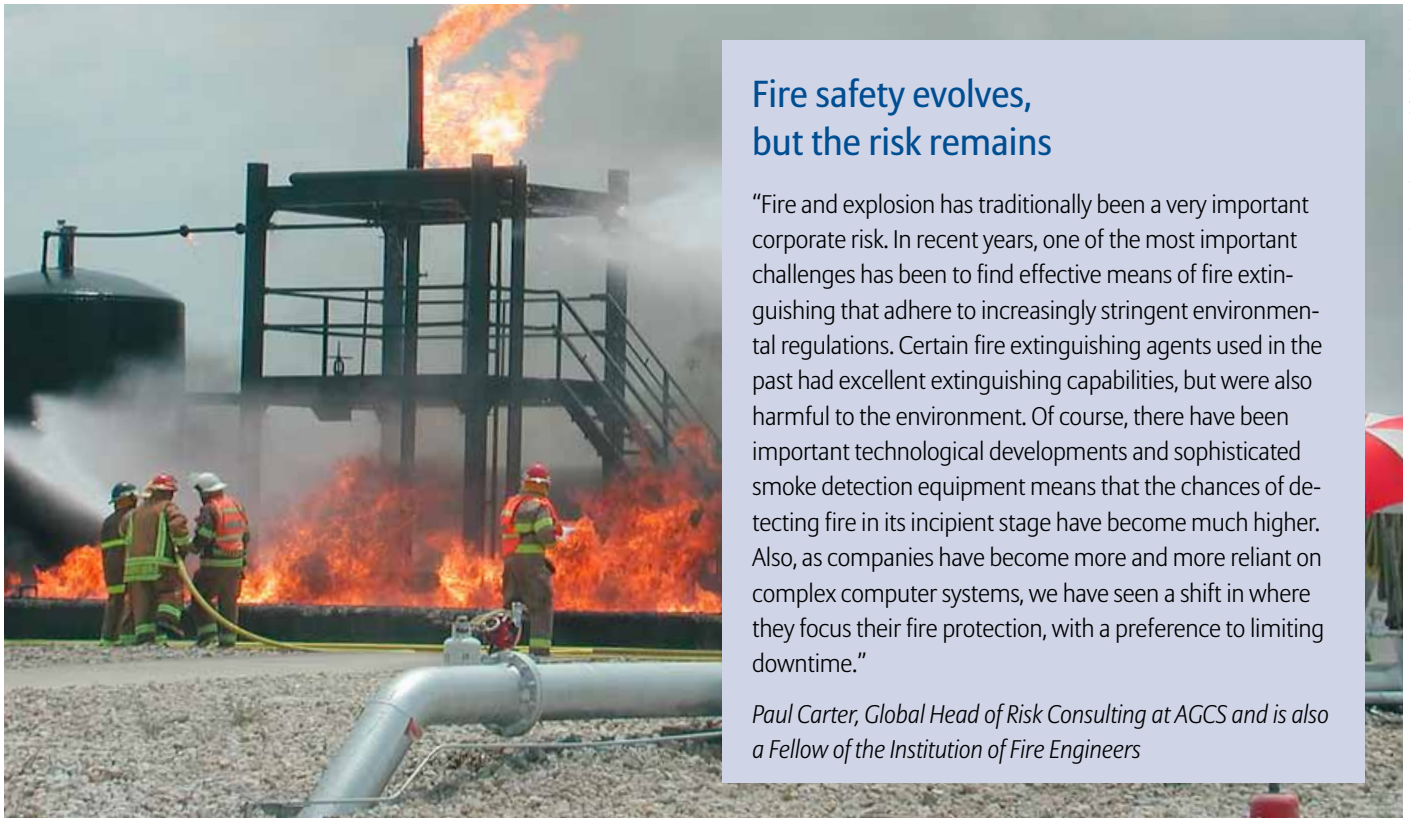
business interruption," AGCS property expert Volker Muench explains. "With global supply chains and production networks, assessing the accumulation of risk is a lot more complex than it used to be."

→ [See report "Managing disruptions".](#)



Photo: Shutterstock/Leonard Zhukovsky

Hurricane Sandy hit the US east coast in November and severely damaged thousands of buildings. For businesses, material damage is only one element of the loss; financial losses following operational disruptions and production shutdowns can far exceed those amounts.



Fire safety evolves, but the risk remains

“Fire and explosion has traditionally been a very important corporate risk. In recent years, one of the most important challenges has been to find effective means of fire extinguishing that adhere to increasingly stringent environmental regulations. Certain fire extinguishing agents used in the past had excellent extinguishing capabilities, but were also harmful to the environment. Of course, there have been important technological developments and sophisticated smoke detection equipment means that the chances of detecting fire in its incipient stage have become much higher. Also, as companies have become more and more reliant on complex computer systems, we have seen a shift in where they focus their fire protection, with a preference to limiting downtime.”

Paul Carter, Global Head of Risk Consulting at AGCS and is also a Fellow of the Institution of Fire Engineers

Fire and explosion continue to be a major hazard for companies. Due to technological progress, chances of detecting fire in its incipient stage have become much higher, but tremendous losses still occur in manufacturing industries.

A quieter year for NatCat, but for how long?

At first it seemed that 2012 was a moderate year for natural catastrophes. Insured losses for the first six months of 2012 only amounted to US\$12 billion, compared with a 10-year average of US\$19.2 billion. However, Hurricane Sandy reminded everyone of the devastation natural disasters can cause when it hit the US east coast in November. A number of cities, including New York and Washington D.C., ground to a halt. A total of 44 percent of Allianz responses named natural catastrophes as the second-most important corporate risk – a long-running trend that looks set to continue. Overall, insurance claims caused by weather incidents have risen 15-fold over the past 30 years.

Dr. Markus Stowasser, meteorologist at Allianz Re, says the trend is attributable first and foremost to the increase in insured assets worldwide, as well as the ongoing shift towards settlement in high-risk coastal regions. The Pudong area of Shanghai, for example, was a little-developed agricultural area until the early 1990s, but has since grown to become China’s financial and commercial hub. “Many of the world’s million-strong cities are not sufficiently equipped to cope with storms, as the impact of Sandy on New York has shown,” says Stowasser. “What is more, as global warming progresses, there is a risk that sea levels will rise in the future. This means that in the worst-case scenario, the potential economic damage caused by a very strong hurricane in the New York metropolitan area could rise to trillions of US dollars by 2050 without mitigation measures.”

→ [See Allianz research on natural catastrophes.](#)

Fire risk getting hotter

If the top two results were to be expected based on the results of last year’s survey, the risk of **fire and explosion** has rocketed up the corporate agenda and was named third-most significant risk, compared to tenth just one year ago. It was nominated as a top risk across all regions and is seen as slightly more important for mid-sized enterprises in comparison to larger companies, which are likely to have greater fire protection resources. “Fire risk is certainly no ‘known unknown’ in the world of corporate risk but it continues to be a major hazard for companies which shouldn’t compromise on high protection standards due to economic pressure,” Carter says. “Risk managers should always have it on the list of top risks even if some current risks seem to be more complex.”

→ [See expert article on fire suppression technologies.](#)

Fire and explosion represents an important risk in both established and emerging markets. Losses can be tremendous in terms of physical damage and can also be a significant business interruption if the affected location is a crucial link in the company’s own network or an important supplier for others. This is underlined by the AGCS loss statistics: In 2012, AGCS experienced seven large property losses exceeding 10 million euros each, with six out of seven caused by fire. In emerging markets in particular, there is also the added risk of large loss of life. Over 250 people died after a fire in a textile factory in Pakistan in September 2012, while in November, over 100 died in a similar incident in Bangladesh. In areas such as this, lack of basic fire protection standards often plays an important role.

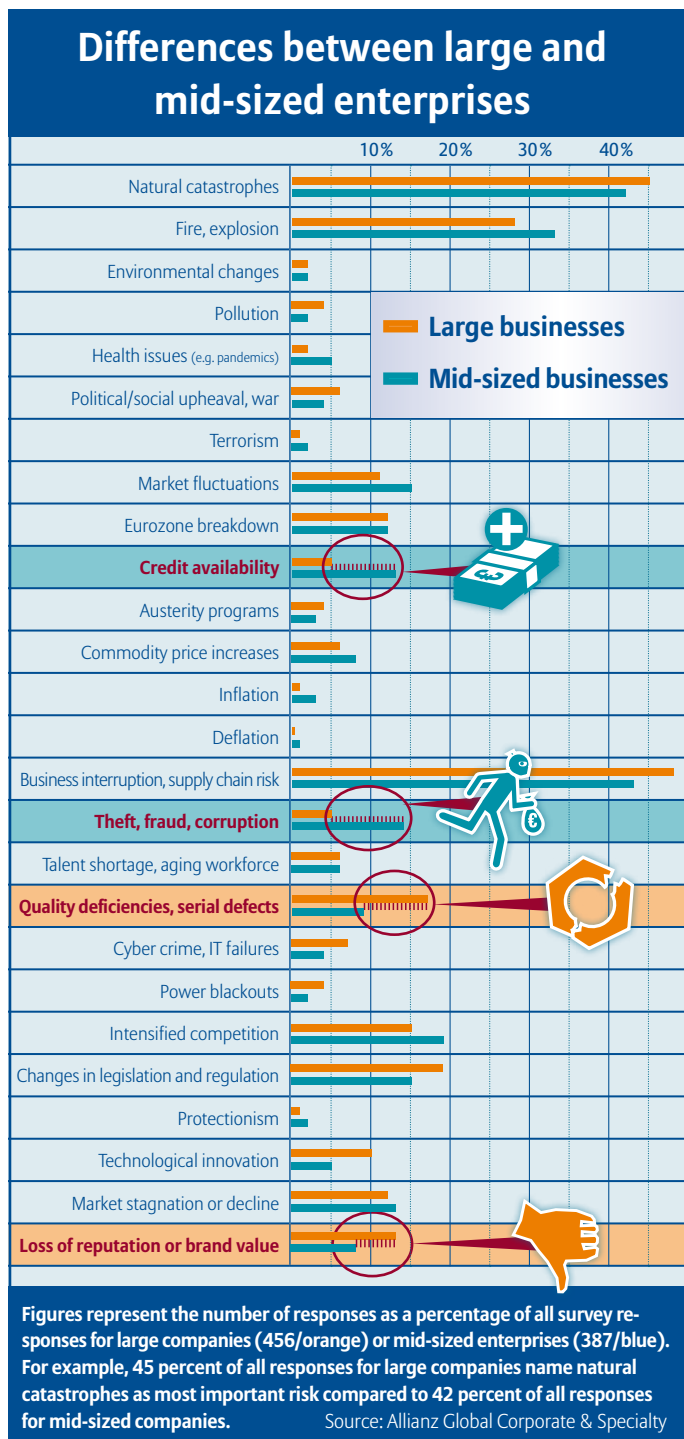
Risk profiles of large and mid-sized companies differ strongly

While certain similarities can be identified between large and mid-sized company risk portfolios, the survey highlighted a number of key differences. In terms of the top three risks, business interruption and natural catastrophes were slightly greater concerns for large enterprises.

Credit availability shows a larger discrepancy between the two, proving to be twice as important for mid-sized enterprises. As Michael Krause, who is responsible for corporate liability at Allianz Versicherungs AG explains, "Mid-sized companies are generally not listed on the stock exchange, which means they have no access to the capital market. This is certainly a reason for worrying about credit availability. In addition, they are also more vulnerable to market fluctuations than larger companies which have a bigger capital base." Mid-sized companies are also more concerned about theft, fraud or corruption, which may



Quality problems or design defects affecting large production series could pose a serious risk for carmakers or other high-tech companies.

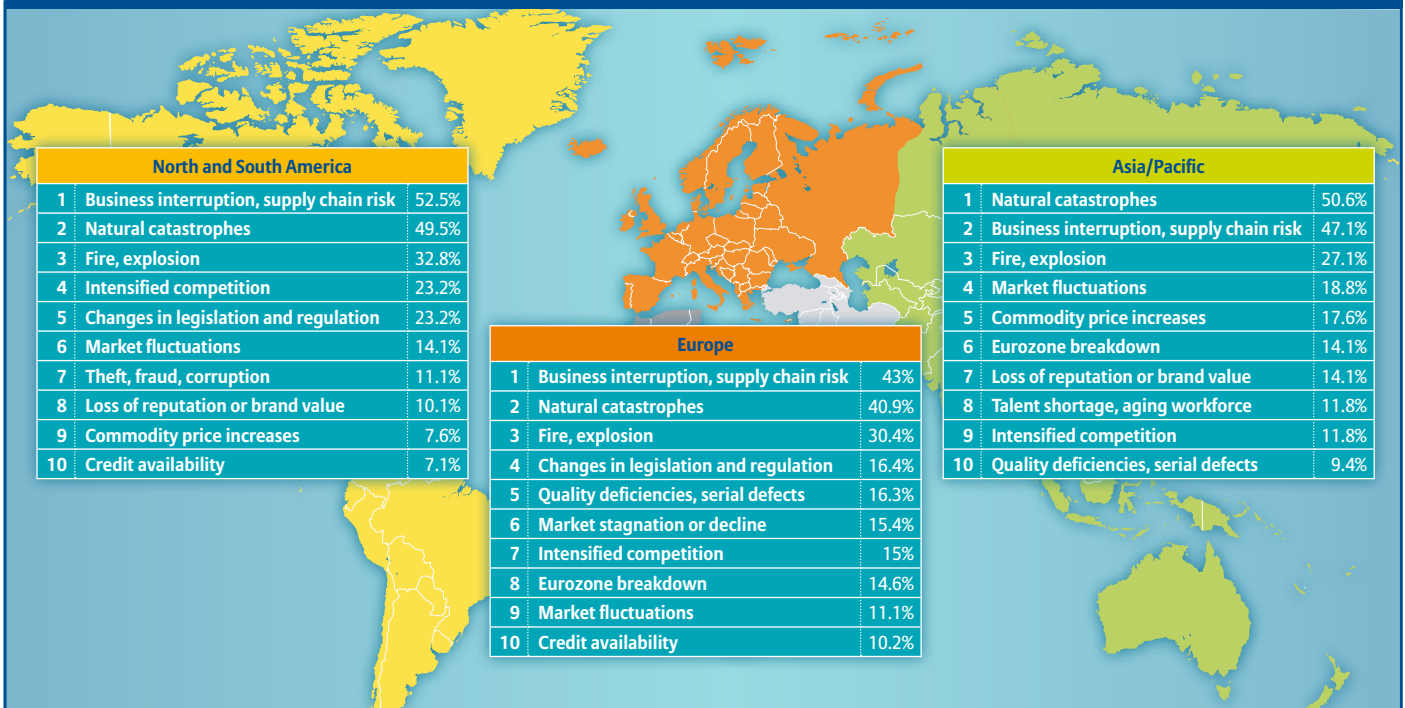


be due to a lack of consistent compliance schemes or the necessary resources to enforce them.

Large enterprises are concerned about the risk of quality deficiencies and serial defects as well as the loss of reputation or brand value. For many manufacturers it may well become a critical issue to their survival if the quality of design, manufacturing and maintenance of their equipment is not satisfactory to their customers. "Substantial faults are often hidden in the final industrial product and manifest themselves years later," says Ahmet Batmaz, Global Head of Engineering Risk Consultants at AGCS. Quality problems and design defects affecting large production series could pose a serious risk for carmakers or other high-tech companies. Within engineering, the off-shore windpark industry can be particularly sensitive. Market pressures mean new innovations, such as larger turbines, modified drive technology or larger blades are put into operation after just a short development period. A serial failure at such a park would affect around 100 turbines at once.

Any product recall or doubt about functional performance will undermine trust of customers and may result in decreased brand value or financial losses. And in an age of instant social media coverage, companies that fail to deliver what both the public and customers expect of them can be global headline news in a matter of minutes. A single blogger in China gained national attention recently when he highlighted certain quality deficiencies in one company's kitchen appliances. For less renowned mid-sized enterprises operating on a smaller scale and with reduced exposure, this risk is less pronounced.

Top 10 business risks by region in 2013



Figures here represent a percentage of all relevant responses. Responses for Europe: 560 (Europe also includes Middle East and South Africa, however, EU-origin responses strongly dominate); North and South America: 198; Asia/Pacific: 85.

Source: Allianz Global Corporate & Specialty

Regional analysis: Asia fears aging society, US concerned about intense competition

As Allianz respondents represent major countries and regions, the survey helps to assess and compare regional differences in risk assessment throughout the world. The three main risks of business interruption, natural catastrophes and fire hazard are identical across all regions, but there are a number of differences elsewhere. After the

debt crisis in the last two years, it comes as no surprise to see Eurozone breakdown as a major risk feared across Europe, Middle East and Africa (EMEA). One risk that is of particular importance for EMEA in comparison with other regions is quality deficiencies and serial defects. For Europe, which has a high proportion of export-led high-tech, manufacturing and engineering businesses, this risk is especially significant.

In Asia-Pacific, market fluctuations and commodity price increases came in just behind the top three risks. Higher commodity prices could impact on the rapid growth currently being enjoyed by countries such as China and India. Another risk rated as particularly relevant for the region was talent shortage and an aging workforce. While population aging may be a global phenomenon, Asian countries in particular are set to experience a drastic increase in elderly citizens over the coming decades, which will have a serious impact on its workforce.

The fourth-most important risk for the Americas was intensified competition, a sign of the increasing pressure the United States especially is coming under from emerging markets, particularly in manufacturing and technology industries. The Economic Policy Institute estimates that between 2001 and 2011 2.7 million manufacturing jobs in the US were lost or displaced by trade with China alone. Due to slow growth in their home markets, American manufacturing and technology companies are increasingly forced to look for new revenue sources and ways to cut costs, for instance by sourcing in emerging markets.

Factory workers in Shenzhen, China: Talent shortages and an aging workforce are important business risks in Asia.



Photo: Shutterstock

Different industries, different risks

The top three risks rank consistently highly across the majority of industries, with only a few exceptions. Fire and explosion is a far less important risk for industries with little or no production sites, such as professional services (e.g. lawyers) or telecommunications and IT.

A clear risk profile can be identified for a number of industries.

- Consolidation in the **Aerospace, Defence and Aviation** industries sees intensified competition named as a major risk, ahead of market fluctuations.
- For **Pharmaceuticals and Chemicals**, changes in legislation can heavily affect their business. Fire and explosion is another major risk in these industries that often process highly inflammable substances.
- For **Financial Services**, the top risk is Eurozone breakdown, closely followed by natural catastrophes and regulatory changes.
- For **Marine and Shipping**, theft, fraud and corruption was identified as the number one risk. Theft in particular has long been a problem for cargo insurers. Both the number of incidents and the amount of losses have substantially increased every year since 2006, according to Freight Watch International. In the European Union alone the cost to businesses is estimated to be 8.2 billion euros a year (Transported Asset Protection Association). Emerging markets such as Mexico, Brazil and South Africa currently rank highest in terms of cargo theft. During the first six months of 2012, 881 cargo thefts were registered in Mexico. High-value goods such as consumer electronics used to be particularly sought after, but pharmaceuticals have become increasingly targeted in recent years.

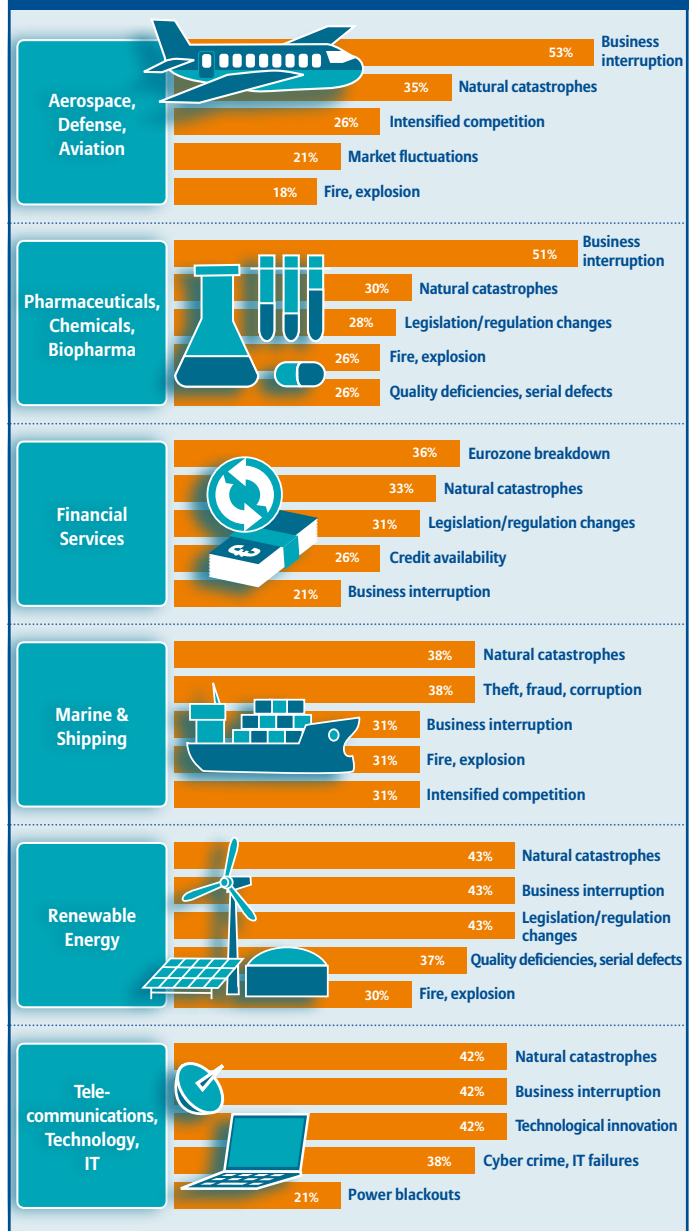


“Cargo theft is a low-incident/high-impact event that usually has a major effect on our clients’ supply chains. We work closely with the companies and their transport providers to put deterrents in place to minimize theft and hijacking exposures.”
Tim Donney, Global Head of Risk Consulting Marine at AGCS



Quality matters in the renewable energy sector with its short development cycles: Serial defects could damage multiple turbines of an off-shore windpark at once.

Top business risks in 2013 by industry

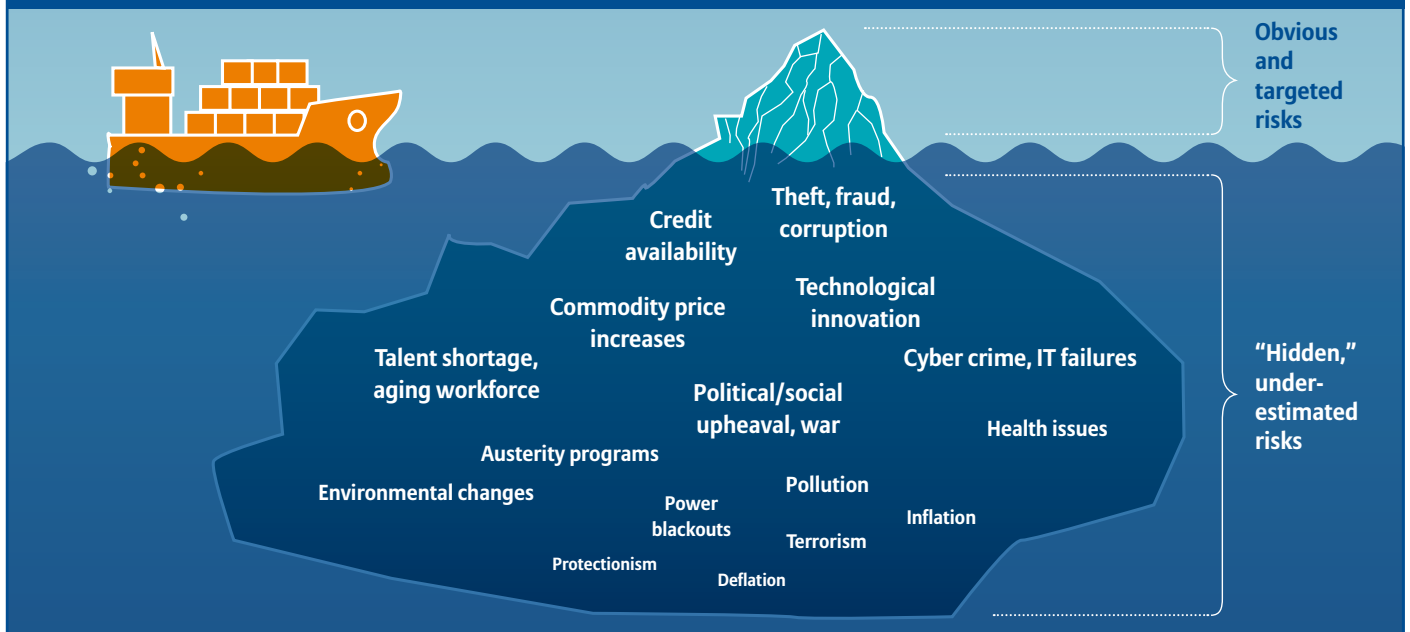


Figures here represent the number of responses as a percentage of all relevant responses (between 43 and 24 responses per industry).

Source: Allianz Global Corporate & Specialty

- Legislation and regulation is a major risk in the **Renewable Energy** sector. In Germany, for example, the government is addressing off-shore liability and has developed plans for a compensation scheme for delayed off-shore wind farm grid connections. Quality deficiencies or design defects are also critical in these young high-tech industries with short development cycles.
- For the **Telecommunications, Technology and IT** sector, technological innovations, cyber crime and IT failures or power blackouts are important risks. There is a high awareness for cyber risk in particular. “IT and telecom companies understand the enormous importance of their systems in today’s connected world. They are under constant threat and observation by the community and can be sure that each leak will be highlighted,” explains José Fidalgo, Deputy Global Head of Risk Consulting Liability at AGCS.

The most underestimated business risks for 2013



The "hidden" risks shown were identified by Allianz experts as most underestimated by businesses. All of these risks received less than 10 percent or even less than 5 percent of the overall responses (843).

Source: Allianz Global Corporate & Specialty

Underestimating cyber crime

Despite being taken seriously in the information and communication technology (ICT) sector, the risk of cyber crime seems to be underestimated in many other areas. Only 6 percent of the Allianz experts think that their corporate clients are really aware of this risk. Insurance policies covering property and liability often provide no cover for cyber risks, while the percentage of companies that do take out specific cyber cover remains low, particularly in Europe.

➔ [See expert article on cyber risk.](#)

While ICT companies are used to being under the constant threat of hacker and malware attacks, industrial companies should not underestimate the risks. The Stuxnet attacks have moved IT systems of industrial facilities, production lines and power plants into the spotlight. Security experts watched with concern as Internet connections for data transfers were added to previously isolated Scada systems used to control industrial facilities. "This theoretically opens the door for hackers, especially as Scada systems' security functions lag far behind those of commercial IT systems," Fidalgo says.

Power blackouts on the rise

Beyond IT there are also a number of other risks with low importance across all industries such as environmental changes and terrorism. In addition, many companies in Europe and the US generally underestimate the risk of supra-regional power blackouts with high economic losses. "Reliability of power supply will decrease in the future due to aging infrastructure and the lack of substantial investments," explains Michael Bruch, Head of R&D Risk at AGCS.



"If a blackout occurs, the impacts are much higher today than 10 to 15 years ago due to the high dependence on information and communication technologies and the lack of preparedness on the part of businesses."
Michael Bruch, Head of R&D Risk Consulting AGCS

It will be necessary to expand and to link decentralized sources of power generation – especially renewable energies – and to enable cross-border trading of power and grid services. Smart grids with metering, communication and control technologies and new storage and transport capacities are needed to handle the growth of renewable energies."

➔ [See expert article on power blackouts.](#)

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