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Coping with an unpredictable world *More sophisticated risk management and scenario planning could be the antidotes to growing unpredictability, writes Cécile Fresneau*

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More sophisticated risk management and scenario planning could be the antidotes to growing unpredictability, writes Cécile Fresneau

Whether it's an unexpected election result or an extreme weather event, businesses are clearly operating in unpredictable times. However, periods of change can create opportunities for companies, especially if they are able to think strategically and manage enhanced levels of risk and increased volatility.

According to QBE's Unpredictability Index, the world is a less predictable place for businesses. Almost all of the 'least predictable years' in the Index have occurred in the past 20 years, with the majority during the past 10 years. This increase in unpredictability is largely driven by deterioration in political stability since the Millennium, compounded by the economic and political fallout from the 2008 financial crisis.

Companies have been saying for a number of years that the business environment is becoming more unpredictable, and this perception would appear to be supported by the findings of the Index. Political uncertainty from Brexit and global trade wars are creating substantial uncertainty for companies today, but longer term, climate change, an ageing population and the implications of emerging technologies are likely to be sources of unpredictability for some time yet.

Tracking uncertainty

Perceptions of predictability no doubt change over time and differ from one generation to the next. They may also be influenced by topical issues or

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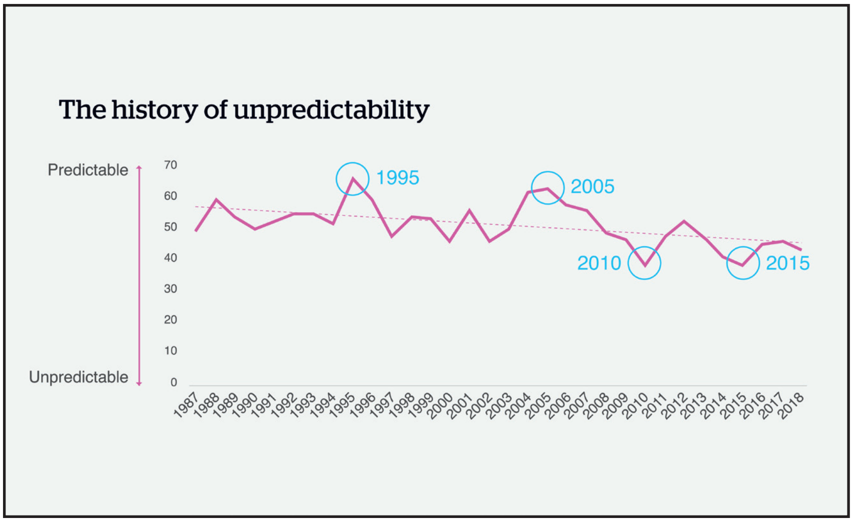


The majority of the 'least predictable years' in the QBE Unpredictability Index have occurred in the last 10 years

While political and economic factors are front of mind, there is considerable interplay between the five drivers in the Index. Globalisation, technology, climate change and demographic trends, like migration, urbanisation and the ageing population, are all feeding through to the political sphere.

Societal issues and globalisation are a root cause of political and economic uncertainty – we clearly see that expectations are changing and people increasingly want their voices to be heard. However, while these are the most visible and the noisiest drivers of unpredictability, there are multiple drivers at play that are interlinked.

heightened media interest. For example, a survey of business leaders that accompanies the Index found only 42 per cent of businesses in the UK feel the business landscape for the next 12 months will be predictable – compared with two-thirds (68 per cent) of all businesses – most likely a reflection of Brexit.

However, the Unpredictability Index is built on empirical data – it compares actual results against expectations, such as GDP growth vs forecasts, volatility of election results, or rainfall against historical norms. The Index tracks a set of indicators between 1987-2017 across five pillars: business, economic, environmental, political and societal.

Of the five pillars tracked by the Index, politics stands out as the biggest driver of unpredictability. Political instability started to rise following the 2001 terrorist attacks in the US and has continued over the last decade with a huge rise in electoral and policy-related instability. Mirroring the Index, the survey found political risks are of most immediate concern and are perceived as the most unpredictable area at present by the survey participants.

Economics, however, is the other main cause of unpredictability in the Index, in particular following the global financial crisis in 2008. The survey found that economic factors are the biggest concern for businesses when looking ahead three to 10 years, and the measure considered the least predictable over this timeframe.

The Index findings strike a chord with recent high-level risk surveys, which show increasing concern among business leaders for political and social developments, as well as broader technological changes and climate. Political and economic risks dominate global risk rankings, including those conducted by the World Economic Forum, PricewaterhouseCoopers and the Federation of European Risk Management Associations (FERMA).

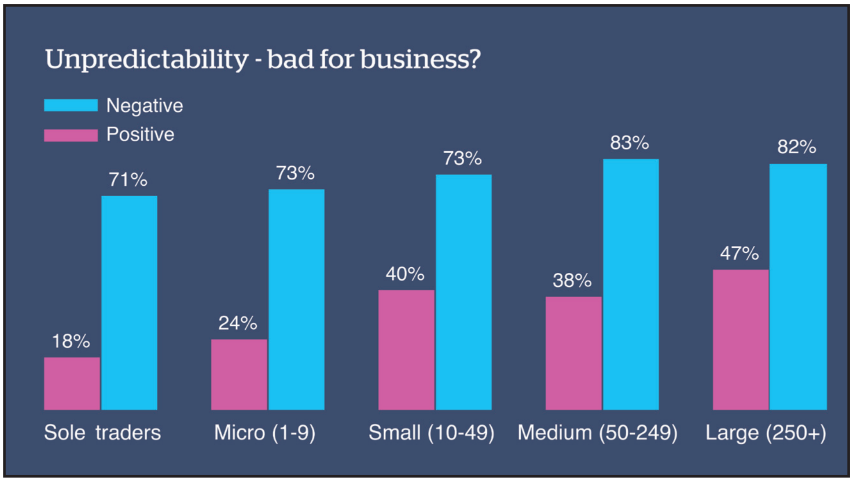
"Smaller companies are most vulnerable to periods of unpredictability as they are less able to absorb shocks"

Cost of volatility

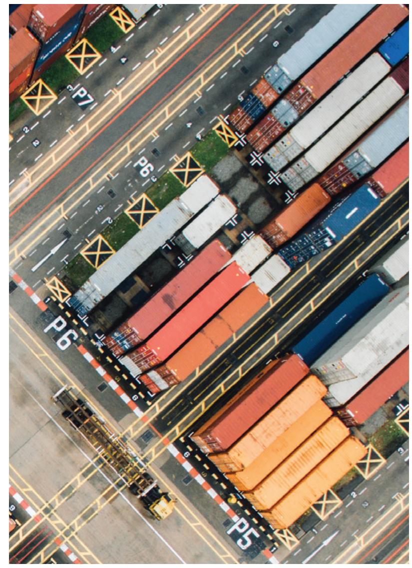
Unpredictability affects companies differently, varying by size of company, location and sector. Manufacturing companies and retailers, for example, are vulnerable to disruption in trade or their supply chains, while service companies are more likely to be concerned with regulation and cyber.

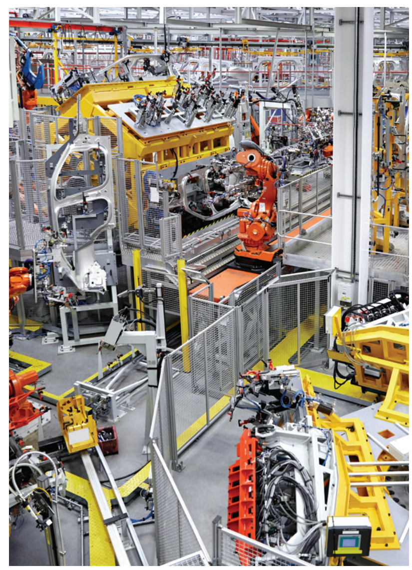
Many firms are already operating on squeezed margins and are particularly vulnerable to a significant increase in exposure, disruption or volatility. According to the Index, the biggest impact of unpredictable events is loss of revenue, unexpected costs and decreased demand.

Smaller companies are most vulnerable to periods of unpredictability. They may be more nimble and quicker to leverage opportunities, but they are typically less able to absorb shocks than large companies. They also often lack the resources and influence of large multinational companies, which are able to invest in business intelligence, sophisticated risk management, scenario planning and business



Less than one in five businesses carry out stress tests for the unforeseen
Less than a third have developed risk management plans





continuity planning.

Companies are under increasing pressure to manage or eliminate volatility and be prepared for the unexpected. Uncertainty and volatility increases costs while disruptions to supply chains or changes in consumption make it harder for companies to hit forecasts and meet investor expectations.

Delivering on promises

An increase in short-term and long-term unpredictability is problematic for businesses large and small, whether it is setting strategy or delivering on their promises. Boards are under pressure from shareholders to meet targets and reliably deliver against strategy, as well as consider the impact of their business on customers and wider society. Companies must also meet the expectations of consumers and regulators, which increasingly look to hold companies and their directors to account.

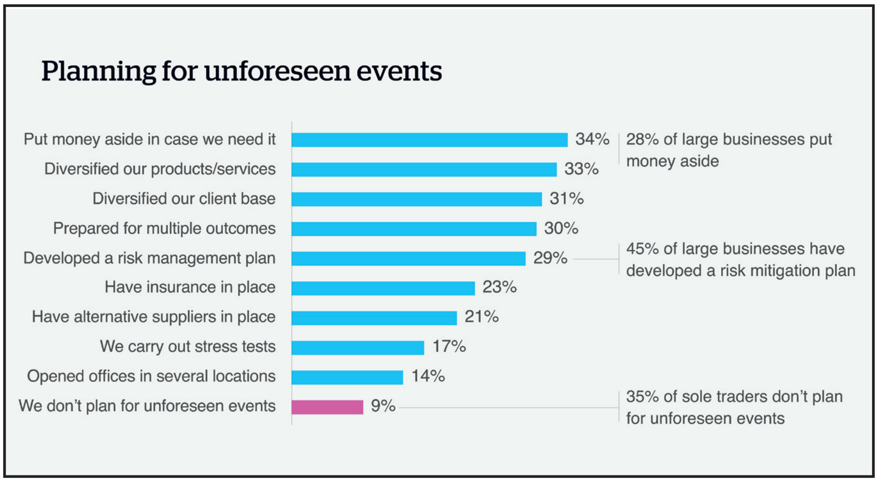
Planning for the future is likely to be more challenging against enhanced levels of unpredictability. Over two thirds (68 per cent) of those surveyed for the Index felt that the business landscape for the next 12 months is predictable, but confidence levels fall to 50 per cent when looking at the next three years. Just 37 per cent say the next five years are predictable, falling further to 29 per cent for the next 10 years.

Many businesses have to think five, 10 or more years ahead. Big investments in plant and infrastructure or new markets can take many years to execute and come to fruition. However, companies may have to invest in new business models at a time of fast changing technology and consumer trends. Artificial intelligence and automation, for example, will have huge implications for the workplace and wider society, while political and environmental factors could lead to big changes in demand for goods and services. Yet predicting the how and when is beyond most companies.

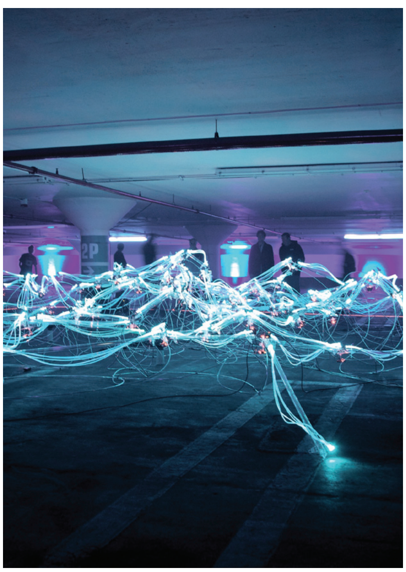
"AI will have huge implications for the workplace and wider society, while political and environmental factors could lead to big changes in goods and services – but how and when is hard to predict"

Increased unpredictability compounds the problem of business planning and strategy setting, but organisations would do well to focus on the most critical factors for their business.

There is a lot of noise surrounding important issues like Brexit and global trade disputes, and this is likely to continue for several years



The Brexit Effect: The next 12 months will be predictable: 42% of UK businesses agree, 68% of all businesses agree



to come. But companies should step back from the media headlines and not get bogged down with the issues of the day -there are likely to be long term trends out there that are more relevant to the future success of a business.

Creative preparation

The antidote to unpredictability is likely to be found in the development of risk management and scenario planning. As the size and complexity of risk grows, risk management and governance frameworks are becoming more sophisticated, and boards are increasingly demanding better information on risk.

Information is likely to be key to managing unpredictability in the future. We already see an increasing number of companies spending time on risk modelling and scenario planning, thinking about unexpected or difficult to predict events. However, the collection of risk data is often not as comprehensive and as structured as it could be. According to the survey accompanying the Index, 64 per cent use some form of economic data to help plan for their future.

Planning and preparation will also be important. The Index survey found that the majority of businesses (77 per cent) feel prepared for unforeseen events in 2019 – although a fifth (20 per cent) of businesses do not. To help plan for the future, businesses are most likely to use industry experts (40 per cent), internal forecasts (39 per cent), industry bodies (33 per cent) and peers in other companies (32 per cent). Two-thirds (66 per cent) subscribe to some form of business intelligence report to help them plan.

"We are seeing companies spending time on risk modelling and scenario planning, thinking about unexpected or difficult to predict events, but the collection of risk data is not as comprehensive as it could be"

Unpredictability is here to stay, and the speed of change does not look like it will slow any time soon. But businesses can get better at preparation and planning, which should improve our ability to cope and adapt. What-if thinking can identify risks to critical services and supply chains, and help organisations prepare for the worst.

Organisations that survive and succeed in an environment of enhanced unpredictability will be those that are best prepared. It is important to build resilience, but also challenge long term business models.

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