



Softening the
BLOW

Risk management is about running faster – not simply dodging potholes. Kevin Kevany reviews the latest thinking in business risk management.

Most of us 'do risk management' intuitively, subconsciously, or in a way that has everything to do with our own survival. It's what you do. And we certainly don't relate it back (mostly) to our achieving success or even boosting the organisation we work for.

We largely think of 'risk' as only having a negative outcome. Wrong, say the experts!

You see, they reckon risk is "the chance of something happening that will have an impact on objectives" – which is a good deal more complex than looking right, then left, then right again on your way to crossing the street.

When the concept of 'risk management' first became popularised in the international corporate world just over a decade ago, we faced the new millennium and the notorious Y2K scam. It was largely viewed by sceptics as the redoubt of accountants looking to be more of a nuisance, or gouging more fees; another way for insurance sales staff to put the 'frighteners' on us; or a home for problematic and aging middle-managers, lacking in skills, but anal about administrative rules and 'regs'.

Today risk management qualifies as a management science, with New Zealand joining Australia in obtaining an ISO 31000 ranking, which presages the definition being taken a whole lot further. So, in the future, risk will be defined as "the effect of uncertainty on objectives" – the objectives of the individual or entity concerned.

The change in definition shifts the emphasis from 'the event' (something happens) to 'the effect' – which is the effect of the event on objectives. The 'risk' isn't the chance of having a fire (for example), but the chance that value will be destroyed and/or income-flow disrupted (assuming preserving value

and income flow was part of the objective), according to the New Zealand Society for Risk Management (NZSRM).

Because risk is directly linked to objectives, it is obvious that risk is not inherently 'bad'. Many objectives can only be achieved by someone being willing to accept at least some risk. If risk can be managed effectively, opportunities can be exploited.

Steve Vaughan, executive director and a founder of the NZSRM, is anything but the clichéd risk manager from the early days. For a start he has a doctorate in chemical engineering and avoided sales and accounting. "We are a cross-disciplinary body which has the goal of improving risk management in New Zealand. Put another way, we do not have an interest in taking one or other side on risk management issues, but rather we seek to make sure risk management is done well.

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Vaughan points out that if the resulting level of risk is either too high or too low for the entity at risk, then the risk can be treated so as to adjust the size of the consequences and/or the likelihood of experiencing those consequences.

"By managing risks – which is to say constantly understanding and then, if appropriate, treating the risks – an individual, organisation or society even, is more likely to achieve their objectives.

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Exploit opportunities

Vaughan is at pains to point out that risk management is more than insurance. Over the years too, the insurance industry has come to the risk management party by emphasising attention to detail, consistency and diligence in all processes – ensuring offsite backup of data, for instance, rather than using a 'loss of data' payout to fund a huge party, and then close the business.

Chris Peace, MSc risk management and

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former deputy chair of the NZSRM, is a lead consultant at Risk Management Limited and a senior associate lecturer in risk at Massey University in Wellington. “There is a saying that the financial consequences of perhaps ten percent of risks can be managed by insurance. Often the biggest risks are not insurable. And some risks can be insured, but the premiums are very high.”

So where does insurance fit in to risk management?

“To start with, you need to be clear that all insurance can do is help to put you back in the position you were in before the loss,” says Peace. “This tells us that insurance is only a help; you still need to do some work yourself to avoid a loss or get back to where you were.”

“Also, you should try to behave as if you had no insurance. Insurance is the ‘financial ambulance at the bottom of the cliff’. It is there just in case your fences at the top of the cliff don’t work. If risk management is about managing events or circumstances that could impact on objectives; insurance is about softening the financial impacts that loss-causing events could have on objectives.”

Enter insurance industry doyen, Roger Bell, CEO of Vero. “Many small businesses who suffer a significant loss never return back to business – even if all their assets are insured. The reality is that risk transfer (insurance) does not reduce the probability of an event happening and it may not cover

all aspects of the loss.”

Bell is also concerned about the ‘hidden costs’ – missed opportunities, lost customers, damaged reputation, staff turnover and costly delays – areas that have a downstream impact on the bottom-line.

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So there is some consensus there and the good news for SMEs is that by taking pre-emptive steps to identify risks and then reduce loss, there are many affordable and practical steps that can be taken to ensure the event never happens in the first place – and to minimise the visible and hidden costs after a crisis.

Transfer vs mitigation

“This move from risk transfer to risk mitigation is a critical one which should start long before a company considers insurance,” says Bell. “Start with assessing key risks within a company, and find ways to reduce them. Only where this is not possible, either because it’s too expensive or not feasible, should the risk be passed on to others.”

Finally, if a claim has occurred and the process to restore assets is underway, how a business deals with the wider impacts of this event can make all the difference in its ability to survive.

“The greatest tool for getting a business back on its feet will be a well-actioned continuity plan which sets out how a business will keep the most critical activities going. This could cover issues such as temporary relocation and web or telephony solutions. These solutions protect a business’s ability to continue to meet important obligations to stakeholders, such as staff, customers and suppliers,” Bell adds. His own company’s Business Continuity Plan prepares them for disruption through criminal acts, accidents or natural disaster.

“It’s all about ensuring our people are not put at risk, our brand and reputation are protected and everyone knows what to do in order to maintain critical business functions.”

Who better to understand what is happening in New Zealand’s insurance industry and the change that is/has taken effect than major broker Marsh Limited. Grant Milne is executive director of Marsh’s SME/‘Middle’ Market operation. The company itself is a good example of an organisation adapting to changing markets. As cashflows have tightened across the SME board, Marsh has adapted products and its own marketing strategy to ensure vigorous growth in straightened circumstances – using business and other

associations to provide critical mass, and then providing targeted products at competitive prices.

“It’s at times like these, when everyone is stretched to the limit, after staff have been cut and the cleaners let go, when someone leaves a heater on overnight and there is no one around to double-check and switch it off – and the ‘inconceivable’ occurs. That’s life,” says Milne.

“So we are going to insurers and telling them that our clients cannot afford to pay the increases they want, but we need to ensure they continue to be adequately covered. In response, insurers are not so much innovating as twisting existing products; pulling together the essential components and pooling liability cover, for example.

“Now customers can take a roll-up of five or six policies and instead of individual limits on each, we can provide them with a shared limit across the whole package. This is affordable; the insurers have lessened liability; and we have met our obligations to our customers.”

Milne cites other examples where clients are reducing personal cover by having



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it kick-in at 90 days rather than 30 to 60 days, which had been the preferred norm previously. A very strong message of cutting your cloth to suit, but not cutting and running.

'Locum cover'

Across the world, SMEs are tardy when it comes to insurance cover (20 percent) and New Zealand has lagged by a further two percent on that.

New products have been introduced – like 'locum cover', where an SME owner/manager can nominate a specific amount of cover per month to cover the cost of hiring a particular person to cover the key person off ill. Companies, instead of opting

for say a \$5 million 'loss of profit cover', are calculating that in the event of a fire, landslide etc knocking out their enterprise, they will need only \$1 million to set-up down the road – and they'll make-up the lost profits later.

That these strategies are working for Marsh can be seen in the fact they are advertising for 13 additional staff as we go to press.

Given that most SMEs are still in the process of surviving the downturn or just starting to feel the slack in the reins tightening, what have we learnt and what has changed? Who better to ask than Joe Nel, GM of Baycorp New Zealand? “Debt collection rates are, and will remain,

Risk management advice nuggets

- Seek multi-disciplinary, specialist risk management advice at the planning stage.
- Establish your existing levels of cover.
- Understand short and long-term obligations.
- Calculate the financial impact of specific kinds of loss scenarios.
- Implement loss prevention recommendations.
- Complement risk reduction with the right mix of risk transfer solutions.
- Develop a Business Continuity Plan as part of your recovery strategy.

When the heat is on, your business deserves real protection.

You've worked long and hard to build your business. You've put everything behind it, risked failure and taken time away from your family. Now you've got something worth protecting.

As the world's leading insurance broker and strategic risk advisor, Marsh recognises the value of what you've achieved. And we'd like to show you how you can protect your assets, reduce your risk liabilities, increase your income and strengthen your balance sheet.

Our team of experts specialise in the Small / Medium business sector in New Zealand. Their aim is to provide you with personal service, great advice and an outstanding range of insurance products to protect you and your business.

If you'd like to know more about how Marsh can offer you some real protection, call 0800 627 744 or visit www.marsh.co.nz

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Grant Milne;

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under pressure as a consequence of lower disposable income and limited refinance opportunities. It is going to get worse before it gets better.

“In an overall context, while there are some signs of the economy improving, unemployment has continued to increase and businesses will continue to fail. The emergence from the recession and a shortage of credit to fund growth often has an even more severe impact on the viability of SMEs than the initial hit. Add to that a reduction in income, and debt referred to Baycorp, for recovery, has increased and become increasingly difficult to collect,” says Nel.

“In the SME market the response has been varied, but overall we have noticed that many organisations are undercapitalised, have weak debt management practices and undue exposure to a few debtors. In the event of delays or debtors not making payment, cashflows are impacted and the underlying business is at risk.

“Such businesses are often characterised by not having a clear credit policy in terms of approving credit or managing their debtors. A noticeable trend is a significant

increase in commercial (B2B) debt referred for collection from SMEs to Baycorp.”

What can be done to improve that situation in SMEs?

“Bad debt management starts at the decision to provide credit; all businesses should be addressing their credit policy. An organisation’s credit policy needs continual review to reflect the economy, the business and the industry. The organisation also needs to hold true to its policy,” says Nel.

“Many businesses may be hesitant to chase debts for fear of losing business. By having a clear and unswerving debt management policy, staff know how to respond and customers receive a consistent message.”

Nel warns SMEs wrestling with unpaid bills, particularly to a customer representing a high portion of company debt: “when in doubt, send it out”.

“It’s a clear case of the-sooner-the-better. Don’t be distracted from your primary role. We are professionals and take the task of recovering your debts most seriously. Just the mention of our name, very often has the immediate, desired effect.”

The company has responded to market changes by investing further in upgrading its technology which will not only enable Baycorp to increase debtor contact rates, but also exploit new channels such as SMS, voice messaging and email to contact debtors and negotiate payment.

In summary, innovation and adaptation are taking risk management to a new level in New Zealand even though it is a particularly trying time for the industry and its customers.

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Cautionary advice on under-insurance

- Directors, officers, trustees and others could be fined for not arranging and maintaining adequate cover.
- The levels of under-insurance in both the domestic and commercial sectors are alarmingly high.
- Being under-insured is nearly as bad as being uninsured.
- Critical failures include not insuring your business and its assets for the correct replacement value and failing to anticipate how long it will take to get your business back up and running.
- Be realistic about potential recovery costs so that you don't end up paying the cost of being under-insured.
- Allow for incidental costs such as architect's or engineer's fees. Also include an allowance for the cost of demolishing the remains of damaged buildings or plant and clearing the site of debris: the expense involved in clearing-up can exceed demolition costs.
- There is anecdotal evidence of an increase in the incidence of fraud and theft. Liability is also a critical area to regularly review.
- Think ahead, not short-term.

Relevant websites:

- www.qbe.co.nz
- www.risksociety.org.nz
- www.marsh.co.nz
- www.baycorp.co.nz
- www.vero.co.nz
- www.sovereign.co.nz
- www.riskmgmt.co.nz