ALLIANZ INSURANCE

Report

April 2013

Risky Business.

A report investigating how combining risk management and innovation in business can deliver growth

Allianz

“Our purpose is to enable people to **prosper in life and business**“

Foreword

ANDREW TORRANCE CEO, ALLIANZ INSURANCE

At Allianz our provision of risk management expertise is not just about physical protection. We act as an important resource for businesses as they seek to prosper in the challenging markets and the macroeconomic conditions that have prevailed since 2008. These conditions in and of themselves have exacerbated the risks that businesses already face, such as financial failure, which could interrupt supply, distribution and expose a company to bad debt.

Allianz is the largest Property and Casualty insurer in the world and our purpose is to enable people to prosper in life and business. Organisations come to us, not only because they need financial protection if things go wrong, but also for risk management expertise to make their operations safer and to support their plans to innovate and grow their operations.

Working closely with thousands of businesses around the UK, our belief is that risk management is shifting from being a specific operational function or job role, to an embedded commercial discipline that is important right across an organisation. We believe - and the evidence from experts supports this view - that those businesses that take a joined up approach to risk and innovation, be that entering new markets, employing more staff, expanding their premises or developing new products, are the ones most likely to prosper and grow.

We commissioned the Allianz Risky Business report in the hope of stimulating both a debate within the business community on this issue, as well as providing a stimulus for business leaders to reflect on their own attitudes towards the management of risk within their own businesses.

I hope you find the Allianz Risky Business report provides some interesting insight on the issue of risk in business innovation as well as growing your understanding of just some of the ways in which insurers support and advise the business community.

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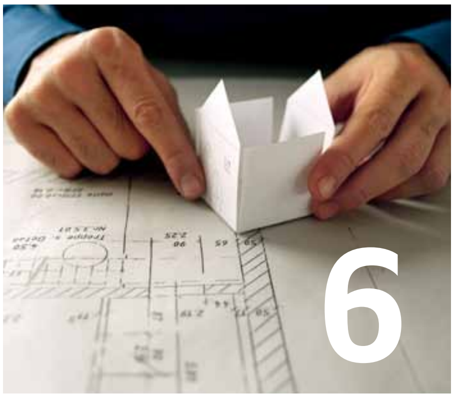


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Introduction: Can **managing risk** spur innovation, creativity and economic growth?

In the wake of the financial crisis that began in 2008, while businesses have been pre-occupied with survival, there is a growing recognition that survival also involves innovation and evolution, seeking out new markets, products or services. Concurrently , the span of business 'risk' has grown, connecting with global phenomena such as rising political instability, expanding technology and extreme weather associated with climate change.

This report investigates how the companies which appear to be making the most of these challenging conditions are applying the same business principles to risk management as they are to innovation. To them, risk management is no longer seen as a principle designed to thwart innovation. On the contrary, risk management and innovation are seen as flip sides of the same coin by many growing businesses.

In order to explore this, Allianz has commissioned new research among businesses to shed light on the changing relationship between risk and innovation and capture and highlight views on the topic.

What we've discovered is encouraging and suggests that companies are starting to work in new ways where managing risk is seen as being complementary to the desire to innovate and, as a result, is creating more value. The wider economic growth potential of supporting this trend is both clear and worthwhile.

Mitigating Risk:
Understanding challenges

Most company directors have a low appetite for risk. Historically, only around 6 per cent[i] of businesses characterise themselves as "risk seeking" according to the Business Culture Index[ii] - a figure that Allianz's latest research confirms. But if it infers that risk is avoided wherever possible by the vast majority of companies, then this couldn't be further from the truth.

What we have found is a growing distinction between risks to be mitigated and challenges a business needs to overcome in order to deliver growth. While risk management may have traditionally just covered the former, the business "challenges" outlined also now fit within risk management as companies set out to understand the risks, challenges and opportunities that will impact their growth strategies.

Across all sizes of business, credit risk sits second in the list of risks identified by businesses. This highlights the importance of a good financial position in enabling businesses to feel secure and ready for growth. Lukas Neckermann, Commercial Director, Euler Hermes, said: *"Trading on credit enables companies to grow, but it also exposes them to risks. The research is unsurprisingly clear; credit-risk and liquidity are among the top items that businesses worry about - as such, more and more recognise the risk of customer insolvencies to their cash-flow. Credit insurance helps businesses manage their risk by giving them a clearer picture of who they are trading with, and protecting them from non payment from their customers. We help businesses to mitigate their risks and work with them to turn the challenges into opportunities."*

Our research shows that company size is also a determinant of appetite for risk management. 34 per cent of SMEs (businesses with 250 employees or less) are currently making risk management a significant priority, compared with 20 per cent of larger businesses. This is of note as, although many SMEs may not have the resources to have staff dedicated to looking at risk management, it is still an area they are tackling.

John Joyce, Risk Manager at Allianz, said:
"In our experience, larger companies have a dedicated risk management function for identifying, assessing, controlling and monitoring their key risks. Smaller companies may have less resource to dedicate to risk management, but that doesn't mean that they take it any less seriously. Both approaches are valid; they only differ in terms of resource and complexity."

CASE STUDY
JAMES LOCK & CO

James Lock & Co, a heritage hat-making company, has worked with Allianz subsidiary and leading credit insurer, Euler Hermes, on incorporating risk management practices to cope with an international sales spike following the company's involvement with the royal wedding. The company works with Euler Hermes to assess new customers they haven't worked with before.

Rebecca John, James Lock & Co credit controller, said: *"We use credit insurance to give us peace of mind that if a customer does not pay us, or becomes insolvent, then we are covered."* Euler Hermes also gives the company flexibility and is willing to look at new evidence provided by customers if they do not meet checks the first time, to ensure James Lock & Co doesn't put off customers and can continue to grow.

When Allianz polled 500 business leaders, they identified their top risks and challenges

All Businesses

Top Risks	Top Challenges
1. Data security	1. Customer satisfaction
2. Credit risk	2. Strategy
3. Internal fraud	3. Reputation
4. Liquidity	4. Skills & competence
5. Lack of customer satisfaction	5. Specialising in a niche area

Businesses with 250 employees or less (SME)

Top Risks	Top Challenges
1. Litigation	1. Strategy
2. Liquidity	2. Lack of customer satisfaction
3. Credit risk	3. Specialising in a niche area
4. Data security	4. Reputation
5. Internal fraud	5. Competition from abroad

Businesses with over 250 employees (larger)

Top Risks	Top Challenges
1. Supplier/outsource failure	1. Natural catastrophe
2. Data security	2. Lack of customer satisfaction
3. Credit risk	3. Reputation
4. Internal fraud	4. Reduced access to funding/credit
5. IT Failure	5. Skills

Does risk have to be experienced before it is understood?

"27 per cent of UK businesses have experienced substantial negative impact from preventable risks"

Making generalisations about risk is clearly risky in itself. What one industry sector might consider risk, another might see as part and parcel of everyday business challenges.

For example, credit risk is perceived to be more of an external hazard in the telecommunications, property and construction sectors, but far less so in hospitality and financial services. So, is this a commercial twist to the old adage that "one man's meat is another's poison"?

Our latest research shows that the topic remains as complex as ever and that the identification of risks and the attitudes towards them vary considerably by sector. For example, 69 per cent of financial service companies in our survey believed that natural catastrophes posed the biggest threat to their livelihoods, whereas the figure was only 37 per cent for those in construction.

Reputational risk is an area where businesses often see the wider impact of not managing and mitigating the risks they face.

Elke Vagenende, Head of Product Development Financial Lines at Allianz Global Corporate & Specialty, UK Region, said: *"Companies agree that their reputation is their most valued asset. This can be seen in the Brand Finance Global 500 Report where, on average, 24 per cent [iii] of a company's value is in their brand. In addition, reputational risk ranked third [iv] in the top business risks according to business leaders. The increasing speed of communication via social media has seen the profile of this issue rise. With many companies feeling ill equipped to deal with it, outside expertise can often bring a solution.*

"A slow response to a reputational risk can have a significant impact. The key is getting a quick response in place via media monitoring and having a crisis communications plan in place. A professional response will mitigate damage and protect reputation. Supporting this, research shows that companies that could effectively manage crises rose in share price over 10 per cent. Whilst those who failed saw a drop of over 15 per cent [v]."

According to our research, over a quarter (27 per cent) of UK businesses have experienced substantial negative impact from preventable risks due to an absence of appropriate response planning. Even though 96 per cent of such companies subsequently change their behaviour by planning ahead for potential risks, this doesn't make experience a less painful tutor.

There is an increasing onus on company directors to take responsibility for assessing risks. In a white paper published in September 2011, the Institute of Risk Management said a successful risk appetite strategy should create tension in the boardroom. The *Risk Appetite and Tolerance white paper*[vi] called for risk appetite to go beyond a "mere tick-box activity" in order to influence board level decisions. It found that effective risk management can help businesses grow and prosper.

The document was prepared by an IRM working group led by Richard Anderson, deputy chairman of the Institute and managing director of Crowe Horwarth Risk Consulting. Anderson said: *"This is about helping boards to steer their organisations in achieving their objectives, as well as complying with corporate governance requirements. In the corporate world, this will result in more sustainable, long-term value creation and in the public sector or not-for-profit world, it will result in better social outcomes."*

“Growing understanding of risk across an organisation can help drive long-term success“

Taking the risk debate beyond the boardroom

It is not just the board of a business that needs to concern itself with risk. Responsibility for something that can quite literally make or break the organisation is spreading across all functions and to all levels. Andy Miller, Manager, Technical Risk Control at Allianz, said: *“For example, the role of technology in business and managing the risks associated with it is an area where we see significant development as businesses increasingly rely on technology. As many food retailers have recently discovered, technology cannot shoulder all the blame. The leakage of horsemeat into the human food chain in the UK is a reminder that businesses are only as safe as their supply chain.*

“In modern business, with the many direct and indirect suppliers a company may deal with, supply chain management has become a critical feature, particularly with regard to business continuity and protecting against reputational risk.

“Despite this, there is evidence to suggest that managing the supply chain is simply overlooked or not given the thorough consideration it deserves. Whilst a business may have fully vetted direct suppliers, should it really stop there? What about those who provide suppliers with components, food stuffs or processing facilities? Those sub-suppliers are further down the supply chain and businesses may not even be aware of their involvement, let alone their procedures and standards.”

Part of the problem is that boards are stretched as it is. Along with the realisation that there is greater public scrutiny of businesses, easier and speedier communications and a growing desire for swift punishment or correction of failings, the need for an awareness of regulatory and political risk is becoming more widespread within companies. In effect, it’s everyone’s business.

For the business looking to innovate and grow, potentially exploring supply chains or looking at new ways of managing risk provides clear opportunities. Growing understanding of risk across an organisation can help drive long-term success.

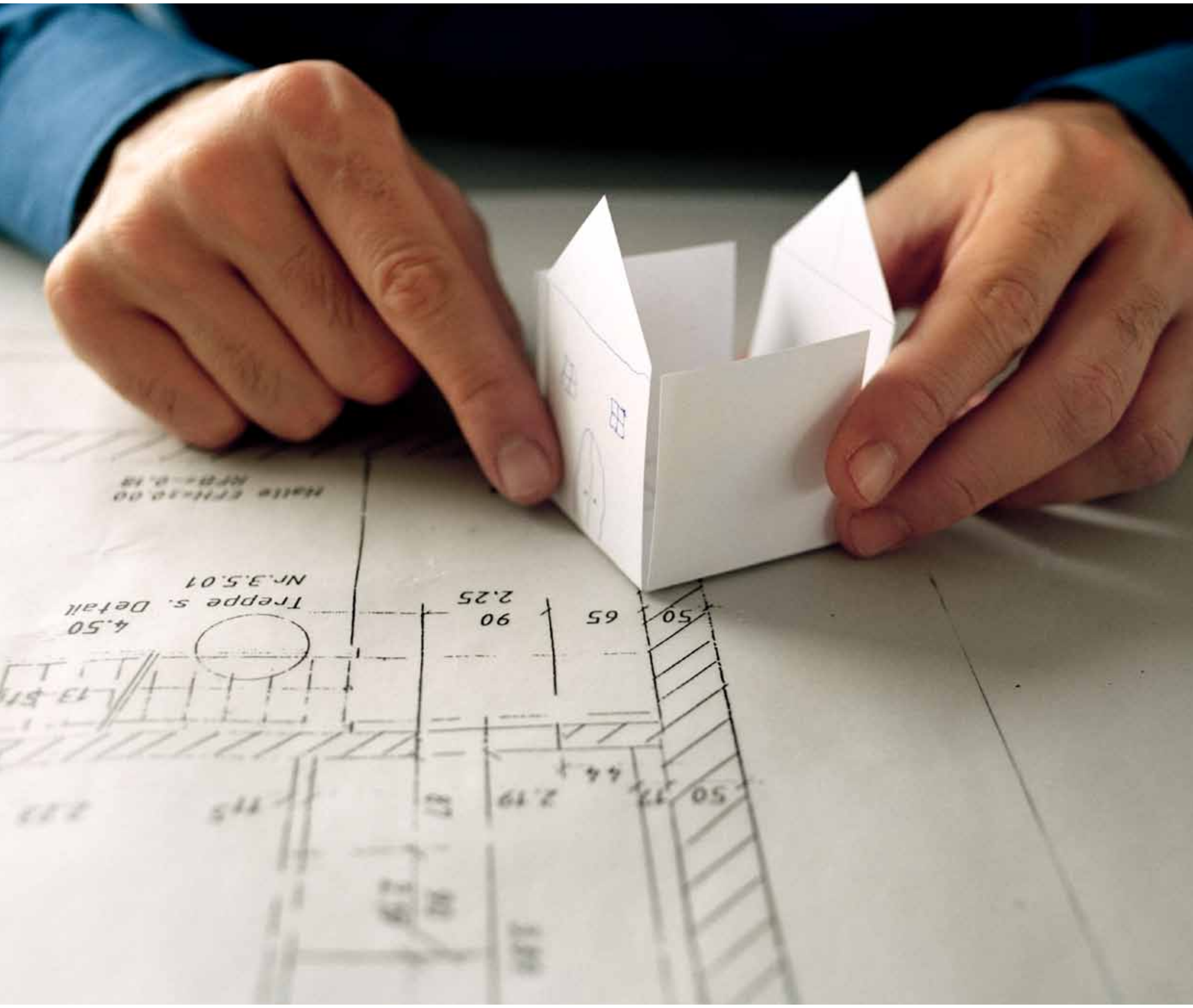
Signs that thinking about innovation is **evolving**

Just as has been the case with risk management, innovation has started to become mainstream in recent years. Increasingly, the most successful businesses realise that - while they can run laboratories and other facilities dedicated to research and development and even use specialist consultancies to focus their efforts - they cannot entirely compartmentalise responsibility for what is their lifeblood; bringing ideas to life.

Innovation experts Paddy Miller and Thomas Wedell-Wedellsborg have collaborated on a book, *Innovation As Usual: How to Help Your People Bring Great Ideas to Life*[vii] that says business leaders need to help people working for them to be innovative as part of their daily working lives rather than just during isolated brainstorming events. They must create an ecosystem in which employees at every level, in roles as varied as finance, marketing and operations, make innovation happen all the time in order to succeed.

Allianz itself has set out on this journey. During the last six years the company has implemented 38,000 ideas from its 5,000 employees, which have improved customer service and led to £18million in annualised benefits. Andrew Torrance, chief executive of Allianz Insurance, says: *"Fostering employee creativity makes business sense as well as improving engagement within the workforce. We believe one of the biggest risks to business is to not innovate and we introduced a scheme to embrace the best ideas of the people in the business to drive us forward."*

At a roundtable at the World Economic Forum in Davos in January 2013,[viii] it was made clear by John Chambers, chief executive of the technology company Cisco: *"If you're in an environment where you don't take risks and don't push innovation, you will get left behind very quickly."*



How close are the practices of **risk management** and innovation?

“How an organisation conceives of risk management will, in large part, determine how effectively innovation is pursued“

CASE STUDY
COMMERCIAL PROPERTY

Allianz Insurance supported a commercial property letting agent with its purchase of over 100 properties from a local council. As the properties were in varying states of repair, the company and Allianz worked together to provide tailored insurance cover for each property taking into account their individual state. Allianz provided a team of seven to analyse each property and through these risk assessments placed each property on a red, amber or green scale depending on the level of risk attached.

This risk management programme was conducted over a 12 month period in which time the joint effort took about 10 per cent of properties out of the most expensive red category and into amber. This was achieved by undertaking essential repairs that reduced the risk of those in the red category as quickly as possible, ultimately helping the business to eliminate risks to its properties as well as reduce their insurance premium.

Mark W. Johnson, co-founder of the innovation strategy consulting firm Innosight and author of *Seizing the White Space: Business Model Innovation for Growth and Renewal,*[ix] has long argued that the relationship between risk management and innovation is “poorly understood”. In an article[x], he says: *“Many people see risk management as largely preventative or as the opposite of the bold risk-taking that breakthrough innovation is assumed to entail.”*

Risk management isn’t the antithesis of innovation, it’s the essence, he believes. *“How an organisation conceives of risk management will, in large part, determine how effectively innovation is pursued.”* The core competency of the most effective and successful innovators is risk management. *“For these innovators, whether in new ventures or in a corporate setting, the ability to identify, prioritise, and systematically eliminate risks is what drives innovation forward. They approach risk management not as a safety procedure but as a learning process. They know that no new business model is perfect from its inception. So they test its various components and their combinations - its customer value proposition, profit formula, key resources and key processes - in controlled experiments in tightly circumscribed markets, learning as they go and making adjustments.”*

Johnson also urges businesses to understand that risk management *“isn’t the brake on innovation; it’s the accelerator.”* Risk management, *“treated as a learning process, not only propels innovation forward but can also speed it up,”* he says. Moreover, having *“real discipline in innovation risk management”* means a business can take a more relaxed approach to the financial measures. Knowing which measures are right for a particular stage of the business or product is key. The real financial discipline in innovation risk management is *“the unswerving ability to resist applying the wrong kind of financial metrics at the wrong time and so, unwittingly, choke off growth potential before it can reach full fruition.”*

It is a view echoed by Steve Culp, head of the risk management practice at the consulting firm Accenture. In an article[xi] authored with his colleague, Wouter Koetzier, he writes about the benefits of better connecting innovation and risk management. He says his firm increasingly sees innovation and risk management being viewed as partners, not adversaries. *“When properly fused, the two disciplines can help organisations pursue opportunities that a risk-averse culture might leave on the cutting room floor. Risk management can help foster a company’s innovation agenda by revealing blind spots and areas of underinvestment that threaten the upside of a company’s future,”* he adds.

SECTION 7

Accelerating innovation and growth through **effective** risk management

Organisations seeking a better balance of risk and innovation apply three key principles, according to Accenture. First, they are flexible. Rather than placing all their bets on one or two experiments, companies may want to consider building a portfolio of early innovation investments that act as options. Advanced analytics and other sophisticated risk management tools can then be used to guide decisions by regularly assessing value against multiple variables and scenarios. This support can include risk methodologies and tools designed to measure both positive and negative uncertainty and provide realistic estimates of results. Risk scenario analysis can also simulate results and provide better operational flexibility.

CASE STUDY
BOTICCA.COM

Boticca.com is an online marketplace for designer jewellery and accessories. Employing just 15 people (of 10 different nationalities) it ships to about 90 countries all over the world and in its first full year achieved revenues of about £2m.

Co-founder Kiyan Larizadeh is certain that adopting the lean start-up, or minimum viable product, approach has been central to the business's success. *"We are a small team sitting next to each other so we can put things out for test rather than going through layers of approval,"* she explains.

The process enables the business to keep innovating without taking too much risk. In fact, not wanting to take the risk forces the constant iteration that keeps the business innovative.

Speed is also important. Successful innovation often requires speed. Companies can use rapid experimentation and agile development to increase their chances of filling their innovation portfolios with new products and extensions to existing product lines. An iterative approach that is closely linked to customers and markets can draw attention to risks and integrate them into decision-making. In a high-speed environment, effective risk management often encourages risk-taking within the bounds of a company's risk appetite. As the Institute of Risk Management[xii] points out, risk management can, and should, facilitate discussions about which risks are acceptable, which aren't, and how much risk is appropriate based on potential returns.

Finally, there is control. But rather than preventing actions, controls in these organisations are designed to increase risk tolerance, fostering a culture that embraces the logic of intelligent mistakes. Innovative companies often create a safe ground for experiments, through making risks controlled, managed and measured. This typically entails bringing together the finance and operating sides of the business. For the finance people, risk is often something to avoid or mitigate, while those in operations often see risk as inherent and necessary for growth. Effective risk governance can bridge these two viewpoints, translating strategic challenges into specific risks to take and providing rules, parameters and measurements to guide both the investments and the process.

CASE STUDY
MYSHOWCASE.COM

MyShowcase.com is a new kind of beauty retailer, selling independent beauty brands through its network of stylists at private events in homes and offices, and also via its website. The company was founded in 2010.

Rodrigo Dauster, COO and co-founder, says: *"We stripped away many of the risks typically associated with a startup. We were able to launch MyShowcase and start generating revenues within two months of launch with less than 10 per cent of the budget we had originally estimated. We gained speed to market, maximised our learning and eliminated wasteful investment."*

"Programmes designed to accelerate innovation are becoming more common, in part, because successful innovation can be a cure for many of the risks companies face," write Culp and Koetzier[xiii]. *"The new and higher regard for risk management reflects its potential to provide controls in complex business environments."*

"Risk management has a vital role to play in making innovation more effective"

Conclusion: Being brave is no longer dangerous

A number of factors are coming together to create the view that the world is riskier than it has ever been. The most immediate, of course, is the lack of confidence hanging over from the financial crisis which started in 2008. But rising political instability in many parts of the world – including those where businesses might look for growth – is adding to the wariness, while the growing connectedness of the global economy raises concerns about technological and related threats. On top of all of these are the continuing – and, some might say, increasing – environmental risks. It is easy to conclude that being brave is just too dangerous.

And yet businesses (and policymakers) also know that growth is essential. And the new products, new services and new markets upon which this growth depends bring risks. In such circumstances it is easy for businesses to come to the wrong conclusions – either taking unreasonable risks or avoiding them altogether. These are the conditions in which functions within businesses batten down the hatches and stick to their prescribed tasks, rather than cooperate for the benefit of themselves and the businesses.

Innovation thinker Mark Johnson asserts that one of the biggest challenges to innovation is to see risk management as a framework to be superimposed on new business creation, rather than as an inseparable part of the process itself. It is an attitude shared by Steve Culp, head of the risk management practice at the consulting firm Accenture, who says: *"Risk management can, in fact, add a level of discipline and transparency to the innovation process, while supporting desired risk culture and appetite. Marrying risk management and innovation can boost innovation efforts by creating confidence that innovation bets are well-placed and that innovation risks are well-managed."*

Allianz's view is that risk management has a vital role to play in innovation, and businesses that see both sides of the same coin will be the businesses not just of today, but also the businesses of tomorrow.

SECTION 9

Appendices

i Barriers to Growth, November 2011, NESTA

ii Business Culture Index, 2008 – 2011, Kantar Media

iii Global 500 Report, 2013, Brand Finance

iv Risk Index, 2011, Lloyd's

v Reputation Review, 2011, Oxford Metrica

vi Risk Appetite and Tolerance, September 2011, A guidance paper from the Institute of Risk Management

vii Innovation As Usual: How to Help Your People Bring Great Ideas to Life, March 2013, Harvard Business Review Press

viii World Economic Forum at Davos, January 2013

iv Seizing the White Space: Business Model Innovation for Growth and Renewal, February 2010, Harvard Business Review Press

x Risk Management and Innovation, November 2010, Bloomberg Businessweek

xi Risk Management Can Stimulate, Rather than Deter, Innovation, January 2013, Forbes Magazine

xii Risk Appetite and Tolerance, September 2011, A guidance paper from the Institute of Risk Management

xiii Risk Management Can Stimulate, Rather than Deter, Innovation, January 2013, Forbes Magazine

Allianz in the UK

1 to 19 **Allianz Insurance Offices**

London

Allianz Insurance and AGCS

Allianz Global Investors (UK) Ltd

Allianz Global Assistance (UK head office)

Euler Hermes UK

PIMCO

About **Allianz**

Allianz Group

The Allianz Group is a global financial services provider. Approximately 78 million retail and corporate clients in more than 70 countries rely on our knowledge, global presence, financial strength and solidity. In fiscal year 2012, around 144,000 employees worldwide achieved total revenues of 106.4billion euros and an operating profit of 9.5billion euros.

Allianz SE, the parent company, is headquartered in Munich, Germany.

Allianz in the UK

The Allianz Group is active in the UK via a number of subsidiaries, employing approximately 7,200 people and achieving £2.78billion of gross written premium.

Allianz offers a wide range of products and services from its UK subsidiaries. For example, Allianz Insurance is a top ten general insurance provider in both the commercial and retail general insurance markets. Allianz Global Corporate and Specialty is dedicated to serving the specific needs of corporate & specialty insurance customers within the UK and globally. Allianz Global Investors has a range of strategies for retail and institutional investors, from specialist equity, to fixed income and multi asset.

Allianz Global Assistance is one of the UK's leading assistance and insurance providers servicing the travel, finance, telecommunications and automotive industries. Euler Hermes is the world leader in credit insurance and Pimco provides investment solutions and superior service to clients in countries all over the world.

About Allianz Insurance and Risk Management

At Allianz Insurance we are committed to working with our customers to help them manage risk and make it an activity that they can revisit as their growth plans change. We have specialist teams dedicated to providing our customers with the expertise to identify and manage risk as well as providing a range of solutions to a broad spectrum of businesses from one man operations to large corporate entities.

About the Risky Business report

indexB conducted desk research, expert interviews and interviews with businesses to understand more about how firms are approaching risk management. In addition, research via an online survey was undertaken by One Poll of 500 business leaders in Q1 2013. Statistics in this report, unless indicated otherwise, are from this survey.

About indexB

indexB is a network of experienced business writers, academics and researchers that investigates and reports on trends in business behaviour.

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