

# Board Perspectives: Risk Oversight

## The Evolving Risk Landscape

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The business environment continues to change and with it the risk landscape that companies face. Earlier this year, the World Economic Forum (WEF) published its update on Global Risks.<sup>1</sup> The report's objective is to improve public and private sector efforts to map, monitor and manage global risks, all of which cross national boundaries.

### Key Considerations

WEF organizes some 50 risks in five categories: economic, environmental, geopolitical, societal and technological. Presented as five separate landscapes mapping risks based on severity of impact and likelihood of occurrence over the next 10 years, the report provides a useful longer-term view. Because the complexity and velocity of change in an increasingly interdependent world are altering the dynamics of decision-making in fundamental ways, annual risk assessments focused on shorter time horizons linked to business plans may ignore the impact of powerful global forces in these five risk landscapes. For that reason, the WEF report warrants consideration.

The five risk categories are discussed further below:

- **Economic** – According to WEF, the two most likely macroeconomic risks over the next 10 years are (1) the risk of extreme energy and agriculture price volatility causing vital commodities to become unaffordable, provoking public protests and increasing geopolitical

tensions, and (2) the risk of a collapse in a financial institution or currency regime of systemic importance affecting the global financial system. The WEF refers to four “critical connectors” driving the level of resilience or instability within the overall global risk system and leading to chronic fiscal imbalances if efforts to address excessive government debt obligations fail. They include the two aforementioned risks, as well as widening gaps between the richest and poorest citizens (severe income disparity), and regulations that have unintended effects, such as negatively impacting industry structures, capital flows and market competition. These forces are evident today and need to be watched closely over time by business organizations and policymakers.

- **Environmental** – These risks include natural disasters, such as extreme weather and geomagnetic storms, and man-made disasters such as irremediable pollution and species overexploitation (resulting in extinction or ecosystem collapse). They have the potential to destabilize both economies and societies over the long term, triggering geopolitical conflict and devastation of vital resources. Man-made risks, such as mismanaged urbanization and land and waterway use mismanagement, were rated as more likely to occur in the next 10 years than natural disasters.
- **Geopolitical** – From an impact perspective, WEF rated global governance failure second, with diffusion of weapons of mass destruction rated first, but regarded the former as relatively more likely

<sup>1</sup> *Global Risks 2012, Seventh Edition: An Initiative of the Risk Response Network*, World Economic Forum, January 2012, available at [http://www3.weforum.org/docs/WEF\\_GlobalRisks\\_Report\\_2012.pdf](http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2012.pdf).

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to occur in the next 10 years. From a likelihood standpoint, pervasive entrenched corruption, critical fragile states, terrorism, entrenched organized crime, failure of diplomatic conflict resolution and widespread illicit trade were all rated at a higher likelihood than global governance failure; however, their perceived impacts are rated lower.

- **Societal** – This category includes risks with a relatively high likelihood of occurring in the next 10 years. Water supply crisis has the highest impact and highest likelihood, with food shortage crisis closely behind. Unsustainable population growth is interconnected with risks from all categories, except for technological risks. Strongly connected to mismanaged urbanization and severe income disparity, unsustainable population growth also is linked to the “critical connectors” mentioned earlier, underscoring its systemic importance.
- **Technological** – “Known unknowns” dominate this category, such as cyber attacks (highlighted as having the highest likelihood and impact) to critical systems failure (rated highest impact but with lower likelihood). Closely interconnected with risks from all five categories, critical systems failure is strongly associated with cyber attacks, prolonged infrastructure neglect, unforeseen negative consequences of regulation and major systemic financial failure.

Because of the complexity and interconnections that underpin many of these global risks, no single country, region, sector or industry is likely to be able to manage them alone successfully. Accordingly, WEF concludes with three observations for business executives in all

industrial sectors, as well as policymakers, research institutions and the public to consider. First, incentives are needed to improve cross-border collaboration in response to global risks. Second, trust/confidence (or a lack thereof) in leaders, public safety systems and cross-border communications is a crucial factor in how risks may manifest themselves. Finally, greater transparency is needed in conveying risks and uncertainty to the public.

### Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity’s operations:

- Is management considering longer-term global risks that are germane to the organization’s strategy, business model and geographic footprint, even though the risks may not manifest themselves over an annual period or a three- to five-year planning horizon? Does the organization consider the interrelationships among risks to identify risk themes germane to the company when formulating business plans?
- Is management periodically monitoring changes in the business environment to identify impacts on the assumptions and risks inherent in the corporate strategy? Is the board apprised in a timely manner of significant changes in the enterprise’s risk profile?

### How Protiviti Can Help

Protiviti assists companies with assessing their risks and the capabilities for managing those risks. We help organizations identify and prioritize their risks, including emerging risks that can impair their reputation, brand image and enterprise value.

### About Protiviti

Protiviti ([www.protiviti.com](http://www.protiviti.com)) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE® 1000 and Global 500 companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

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