Board Perspectives: Risk Oversight

The Most Important Risks for 2014

Issue 52

Time marches on! Out with the old year, in with the new. But with changing markets and circumstances spawning new risks, altering risk profiles and reducing the effectiveness of established risk management capabilities, the story remains the same. The profile of macroeconomic, strategic and operational risks continues to evolve in terms of significance and complexity for many organizations. As these companies compete in the global business environment, these risks create uncertainty for their executive management and boards of directors.

Key Considerations

In a survey designed to identify their companies' most significant risks, nearly 400 C-level executives (a majority of whom represent organizations that operate globally) were polled. The following summary of major business challenges provides a context for many of the top-of-mind risks and uncertainties companies are facing as they move forward into 2014.[1] Though different industries face different issues and priorities and the applicability and prioritization of the following challenges vary by industry, we ranked the risks in order of priority on an overall basis (to provide greater context, last year's rankings are noted parenthetically, with "NR" meaning "not rated").

1. **Regulatory changes and increased regulatory scrutiny may affect operations (1).** This risk continues to be ranked as the top risk, even though the year-over-year rating declined. The pace of regulatory and legislative change has been significant in recent years, affecting the operating model used by a company to produce or deliver products or services, altering its costs of doing business and positioning relative to its competitors. Even marginally incremental regulatory change can add tremendous cost to a corporation. The mere threat of change can create significant uncertainty that can hamper hiring and investment decisions.

2. **Economic conditions in current markets may not present significant growth opportunities (2).** While ranked second again on our list, this risk also is not rated as high as it was last year. Economic growth makes business planning easier. Growth across the globe is somewhat mixed and uneven from region to region. The survey participants appear to be expressing concern that prospects for growth in 2014 present a challenge for them in selected markets. Needless to say, the economic dynamics of the past several years also suggest that the pace of economic growth could shift, dramatically and quickly, in any region or all regions of the global market.

3. **Uncertainty surrounding political leadership may limit growth opportunities (3).** Political uncertainties remain important on our list. Divided government in the United States and geopolitical dynamics continue to present a complex and uncertain business environment.

[1] Protiviti and North Carolina State University's ERM Initiative partnered to conduct this survey, which is available at **www.protiviti.com.**

4. **Succession challenges and the ability to attract and retain top talent may constrain efforts to achieve operational targets (4).** Acquiring, developing and retaining the best and brightest have been elevated as priorities, driving companies to focus on their talent management processes. Executives are finding that motivating and equipping the growing number of younger workers, the so-called “millennials,” may require different tactics. As we noted last year, the baby boomer generation is approaching retirement, placing succession front and center on the agenda. To that end, companies are considering alternative staffing models that provide more flexibility, such as part-time arrangements and contractors, for retaining or replacing talent.
5. **Organic growth through existing customers presents a significant challenge (5).** Participating executives see challenges in 2014 with respect to increasing their organization’s overall customer base, increasing output per customer or generating new sales. This could be due to a number of factors, such as increased competition, the challenge of retaining customer loyalty, and reduced consumer spending due to lower disposable income.
6. **Ensuring privacy/identity management and information security protection (in response to social business, cloud computing, mobile computing and other developments) could require resources the organization may not have; cyber threats could significantly disrupt core operations (6).** These risks continue to be top-of-mind. They present a moving target in terms of changing technology that makes security and privacy more complex and tougher to manage and control. Although new developments (e.g., social business, cloud computing, mobile computing, new platforms and devices, and workplace virtualization, among others) present opportunities for companies to create new markets and disruptive business models, they also present fresh venues for cyber attacks and mischief that can harm an organization significantly.
7. **Resistance to change could restrict the organization from making necessary adjustments to the business model and core operations (7).** As yet another issue that has continued in importance for 2014, this risk points to the priority executives are placing on positioning the organization as agile, adaptive and resilient in the face of change in the marketplace. Early movers that exploit market opportunities and respond to emerging risks are more likely to survive and prosper in a rapidly changing environment.
8. **Anticipated volatility in global financial markets and currencies may create challenges (3).** On the economic front, central bank policies, most notably the policies of the Federal Reserve in the United States, create risk of sudden and dramatic volatility in financial markets, which could adversely affect rates, credit availability and currencies. We combined this risk with political uncertainty (see No. 3) last year and are breaking it out this year because they are not rated at similar levels this year.
9. **Uncertainty surrounding costs of complying with healthcare reform legislation will limit growth (NR).** This risk ended up on our global top 10 list on the basis of the assessments of companies based in the United States and those headquartered outside the United States with significant operations in the United States. With the delay of the employer mandate, as well as other uncertainties around the implementation of healthcare reform in the United States, companies are unsure of the operational impact at this time. These uncertainties are impacting hiring plans and investment decisions for companies of all sizes. Not surprisingly, companies domiciled outside of the United States with no U.S. operations did not consider this risk to be relevant.
10. **Other: The organization’s operations may be unable to meet performance expectations as well as competitors (8); new technologies may disrupt the organization’s business model (NR); and the organization could be**

impacted by an unexpected crisis (9). In tenth place are three risks that were rated at the same level by the survey participants. First, there is the risk the organization's operations may not be able to meet performance expectations as well as competitors. Improving quality, time, innovation and cost performance continues to be a priority. Second, there is the risk of disruptive innovation and/or new technology within the industry outpacing an organization's ability to compete unless the company makes significant changes to its business model. Finally, there is the risk of an unexpected crisis having a significant impact on the organization's reputation due to its lack of preparedness. All three of these risks were rated at about the same level by the participants.

Note that the inability to utilize data analytics and "big data" to obtain needed market intelligence and increase operational efficiency was ranked No. 10 last year and fell out of the top 10 risks this year. That stated, the impact of big data and business intelligence is implicit in many of the risks that make up the top 10 list this year.

The survey results show that the ranking of the first seven risks did not change from last year. However, all of the risks in our top 10 list were rated lower than last year, except for the risks related to succession and talent retention, resistance to change, and an unexpected crisis, which were rated at the same level as last year, and the risks of healthcare reform and disruptive technologies, which were rated higher than last year. Although many of the top 10 risks were rated lower, they continue to be top-of-mind for executives and remain a concern.

These are significant challenges identified in our survey that companies across the globe face as they approach 2014. These challenges frame the environment within which boards and their standing committees must formulate appropriate risk oversight agendas.

Questions for Boards

The board of directors may want to consider the above risks in evaluating its risk oversight focus for the coming year in the context of the nature of the entity's risks inherent in its operations.

How Protiviti Can Help

As the board and executive management evaluate how to organize for risk oversight, Protiviti can assist them with identifying and assessing the enterprise's risks and implementing strategies and tactics for managing risk. We assist public and private companies with integrating their risk assessment processes with their core business processes, including strategy-setting. We provide an experienced and unbiased perspective on issues separate from those of company insiders to help organizations improve their risk reporting to better inform the risk oversight process.

About Protiviti

Protiviti (**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 FORTUNE Global 500® companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

Protiviti is partnering with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on www.directorship.com/author/jim-deloach/ in the "Blogs & Opinion" section. A compilation of blog posts and articles is maintained and categorized by author's name. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* will be consolidated into a printed booklet that will be co-branded with NACD. Protiviti will also post these articles at **Protiviti.com**.

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