VIEW FROM THE TOP
A BOARD-LEVEL PERSPECTIVE ON CURRENT BUSINESS RISKS

CLIFFORD CHANCE

Including analysis from

The Economist Intelligence Unit

86%

of board-level respondents say they are much better equipped to address the principal risks facing their industry than they were 2 years ago

52%

of US respondents say that their board has become over-cautious to the extent that it inhibits progress and growth in the business

82%

of respondents say that reputational risk arising from unethical behaviour has become much more important to their board

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About this report:

In the first half of 2014, The Economist Intelligence Unit carried out a global survey on behalf of international law firm Clifford Chance to assess boardroom attitudes to risk. In the aftermath of the global financial crisis, the survey of board members from across the world's largest global corporates explored which areas of risk feature at the top of board agendas and what issues are keeping directors awake at night. The survey also explored the extent to which board-level investment in risk management is paying off, and the depth of change required to ensure more robust risk management.

The Economist Intelligence Unit surveyed 320 executive and non-executive board members from organisations with annual revenues over US$ 500m, from across a wide range of industries and regions. In addition it conducted a series of in-depth interviews with senior executives and experts. Further details are on pages 40–41.

FOREWORD FROM CLIFFORD CHANCE

"The global financial crisis has brought about a seismic shift in the landscape of business risk. From our work with clients, we know that the world's leading organisations are operating in an environment where the rules of play have changed dramatically.

Politicians, regulators and bankers have seen their reputations suffer for their perceived role in bringing the world's financial system to the brink of collapse and ushering in prolonged economic decline and instability. As the media fuel this sense of mistrust by highlighting every error or misdemeanour, politicians and regulators want to be seen to do the right thing – and they have set their sights firmly on all large corporates, as well as on financial institutions.

Society's trust in business must be restored. A new approach to managing risk will be central to doing this.

Against this landscape we commissioned The Economist Intelligence Unit to find out what the boards of the world's largest companies think about business risks in today's environment and to explore their approach to risk management.

The results highlight interesting perceptions – and considerable tensions. Boards are keenly aware that the risk landscape has changed: they know the public's trust in business has broken down, and they understand how quickly and severely a crisis can spread. However, many are uncertain about how best to address new and emerging risks, particularly in an increasingly global economy where 'local' issues in far corners of the world can lead quickly to major reputational damage at home. Boards strive to look around corners, but they can't see every potential pitfall.

Business risk is a governance issue – and tackling it will require a fundamental shift of boardroom focus. Organisations must now seriously consider ethical concerns and society's expectations of their business, while maintaining their traditional focus on financial and regulatory risk. And senior management must set the right tone to support cultural change. If they don't, they leave their organisations vulnerable to the possibility that an event will come out of nowhere, bringing quick and severe repercussions to reputation and damaging corporate strategy.

But businesses that meet the new and evolving challenges of risk management stand to gain – by enhancing, and protecting, their reputations and standing out from competitor organisations that have not adapted as effectively.

Many global organisations are part-way through a long journey to tackle this. However, like super-tankers, large businesses take a long time to change direction.

We hope you find this report and our perspectives on the central issues helpful as you move your business forward."

Guy Norman

Global Head of Corporate, Clifford Chance LLP
T: +44 20 7006 1950
E: guy.norman@cliffordchance.com

Jeremy Sandelson

Global Head of Litigation and Dispute Resolution, Clifford Chance LLP
T: +44 20 7006 8419
E: jeremy.sandelson@cliffordchance.com

KEY FINDINGS

1

Since the onset of the global financial crisis in 2008, businesses around the world have faced a barrage of new risk-related challenges.

Media coverage of bankers' improper behaviour has fuelled a climate of consumer and government distrust stretching beyond financial services. Regulators, politicians, consumers and shareholders are looking for ways to impose increasingly demanding standards on corporate behaviour, spurred on by a range of scandals, from tax avoidance schemes and revelations of corruption and bribery, to horsemeat being sold as beef and exaggerations of the benefits of new drugs.

The macroeconomic environment of recent years, marked by the global financial crisis, fiscal uncertainty in the US and sovereign debt problems in Europe, has also helped to make companies more risk-averse, leading them to swap bold investment decisions for more cautious behaviour and cash hoarding.

The tide is turning, however, with most expecting 2014 to mark a return to growth. Greater corporate confidence should see a return to braver strategic moves, although these, of course, bring their own challenges. In *View from the top,* The Economist Intelligence Unit (EIU) examines the areas of risk featured at the top of boards' agendas in the short term; considers to what extent board-level investment in risk management is paying off; and looks at the depth of change required to ensure a more robust approach.

The key findings of this report are as follows.

Safeguarding the organisation's reputation is a top priority for boards…

A majority of board members identify reputational risk as a key area of focus; over three-quarters (78%) say it will become an increasingly important priority for their board over the next two years. In the event of an incident or scandal, more board members are worried about the damage to their company's reputation than about direct financial costs or a falling share price. The importance placed on protecting a company's reputation is a global phenomenon; respondents based in all three main regions (Europe, North America and Asia Pacific) are concerned about this in roughly equal measure.

…yet many boards are not prioritising areas in which an incident could significantly damage their organisation's reputation.

Board members are focusing their attention on more traditional risk areas, such as financial and compliance risk, with most predicting that these will become even more important in the short term. But devoting time and energy to such easily identifiable and well-understood risks means that other – often new and emerging – areas of risk could receive inadequate attention, despite having the potential seriously to damage a company's reputation. For example, 57% of respondents to the survey admit that they are worried by the prospect of a cyber-attack, yet only 15% say it is a current focus for their board, with just 21% predicting it will become more important over the next two years.

Although heavy investment has made boards confident about risk management, it does not always translate into a more robust approach across the organisation.

Boards recognise the need to invest in risk management: according to 74% of respondents, their board is devoting more time to risk issues, and 83% report an increase in their organisation's financial investment in risk management. Perhaps as a result of this, 86% are confident their board is now better prepared to address the principal risks facing their industry. However, despite the investments made and interviewees highlighting the need for risk management to be everyone's responsibility, just 27% say non-management employees are actively engaged in risk management.

Making room at the top table for a risk manager is no silver bullet.

The number of senior-level risk managers has increased in recent years, according to risk analysts. Concerns, however, are voiced by a number of interviewees that appointing senior risk managers could be considered a silver bullet by the rest of the board, leading to a complacent attitude towards risk management. There is also a danger that board-level risk directors become the "fall guy" – someone to blame when things go wrong. While ensuring that dedicated risk oversight at board level marks a commitment of senior-level attention, boards also need to ensure that the risk function does not lose its independence as a check on executive decision-making, and that a risk mentality is instilled across all levels and functions in the organisation.

Managing risk across borders continues to be a challenge.

Companies with international operations need to ensure that the global policies set by headquarters are implemented by staff on the ground. Such a process is not without its challenges, however, with 64% of board members reporting that ensuring a uniform approach to risk is difficult owing to cultural differences across the organisation's international operations. Interviewees for the report also agree on the importance of a centrally approved risk-management framework, while mentioning the sensitivities arising from having to impose central control on local operations.

Boards are starting to address unethical behaviour, but changing a company's culture inevitably takes time.

Over four-fifths (82%) of respondents report that the reputational risk arising from unethical corporate behaviour has become more important. Steps are being taken to address this, with 24% saying they have conducted reviews of corporate culture from a risk perspective and 41% planning to do so over the next two years. Boards, then, recognise that mitigating risks associated with unethical behaviour cannot be left solely to the risk function. It is for senior management to set and enforce standards on what is expected from the company as a whole. Effective and lasting changes to corporate culture, however, will take time to embed.

Board members surveyed and interviewed for the research refer to a number of procedural steps taken to improve risk management in recent years. But the most challenging changes will be those concerning corporate culture, whether it is rooting out unethical behaviour, ensuring that all employees operate with a risk mentality, or enforcing central risk-management frameworks at the local level. Embedding risk management throughout the organisation will take time, significant financial investment and great effort.

As such, there is also a danger of the process being left incomplete now that the global economy is improving and board members are beginning to concentrate on other priorities.

THE BOARD'S RISK CHALLENGE

2

Being accused of causing the death of your customers is one of the most serious and damaging allegations that can be made against a company, and one that General Motors (GM) is having to defend itself against.

A report by the Center for Auto Safety in the US linked a faulty ignition switch in GM cars to 303 deaths, which the company is disputing.[1] In February 2014 the huge US car manufacturer issued a recall for 1.6m of its vehicles, while admitting that some employees might have known about the fault since 2004.[2]

1 "US safety watchdog says 303 deaths linked to recalled GM cars", Reuters, March 2014.

2 "GM recall: report 'links' faulty vehicles to 303 deaths", BBC Online, March 2014.

GM reacted to the incident by, amongst other things, creating a new senior post – that of global vehicle safety chief – perceived by some as suggesting that the company ran into trouble because it did not have a single leader to integrate safety processes.[3] But can such appointments really prevent similar failures in the future? And what else can a board do to prevent employees from making the kinds of decisions that can lead to such situations?

The board of a company has many duties and responsibilities. A significant one is to set the strategic direction for the company, while striking a balance between pursuing financial profits and growth opportunities on the one hand, and limiting business risk on the other. The tension arises as board members are urged to hit profit and revenue targets while at the same time having to assess the level of business and regulatory risk that can and should be tolerated.

3 "GM Creates Vehicle Safety Job In Wake of Recall Questions", Forbes, March 2014.

Figure 1: Countries where respondents consider the risk of political interference in business to be the greatest

1	US	6	Germany
2	Russia	7	Mexico
3	China	8	Brazil
4	India	9	Japan
5	UK	10	France

Source: The Economist Intelligence Unit

Note: Survey respondents were asked to choose from a list of top 10 countries by GDP

Finding that balance between risk and reward has, however, been a particular challenge in recent years. Developed economies have struggled to grow while the pace of growth in emerging markets has also slowed down considerably; regulators have turned up the heat across a number of sectors; and politicians, under pressure from disgruntled voters, have often turned to unfriendly business policies. As a result of such trends, there is a sense that many companies and their boards have been erring on the side of caution, staying away from activities or regions that could yield results, but which are also perceived as high-risk. This is especially the case in the US, where over one-half (52%) of respondents are concerned that their board has become overcautious to the extent that it inhibits progress and growth for the business.

As companies look forward to improved global economic growth in 2014 and beyond, questions arise about what boards have learnt from past experiences, which areas of risk are at the top of their agendas, and to what extent they and their companies are managing these effectively.

Clifford Chance view

"Our survey results suggest that many now see policy decisions in free-market economies as giving rise to the same level of political interference risk as controlled markets. This perhaps implies that people's definition of 'political interference' is now broader than instability in the market or significant government intervention such as expropriation of assets and protectionism. This sentiment may well be driven by increased regulation and enforcement by government against what had become market-standard practices, particularly in connection with the financial crisis.

Given the environment of heightened enforcement, multinationals need to be more careful than ever in assessing whether operating 'in line with market practice' is sufficient."

Nigel Wellings, Partner, Dubai

CLIFFORD CHANCE VIEW
MANAGING POLITICAL INTERFERENCE: CHINA AND THE UNITED STATES

"Doing business in China is widely considered a risky proposition in terms of political interference, but it seems the rest of the world is even more cautious about the political machinations of the United States in business affairs. When asked in our survey to name the country with the greatest risk of political interference in business, the United States comes top of the list among US, UK and European respondents, and second after China among Asia Pacific respondents.

Despite the perceived risks, businesses continue to invest in both economies, partner with PRC and US companies, and to list on US stock exchanges. Good examples include Peugeot's recent alliance with Chinese automotive company Dongfeng and the proposed IPO of Alibaba, China's largest e-commerce company, in New York. While companies recognise that the risks in these countries can be material, they also recognise that the rewards may be similarly great, if they are able to navigate effectively the possible political obstacles.

Political interference in China comes from both directions. On the one hand, businesses are very aware of the risk of public sector bribery: at high levels to ensure the awarding of contracts with state-owned entities, but also at lower levels in connection with permits and licences that need to be approved in time to allow businesses to operate on a daily basis. But on the other hand, PRC businesses also face political interference due to the recent government crackdown on corruption and price-fixing by the new political leadership. Companies with links to 'tigers' identified by the current leadership are finding themselves in the enforcement crosshairs, as are some industries such as healthcare, particularly foreign companies with domestic customers or competitors.

Across the world, the United States is seen as the focus for global lawmaking, regulation, and criminalisation around risk areas. Extra-territorial implications of US lawmaking around bribery/corruption, tax and antitrust and US sanctions apply even where the nexus to the United States is extremely limited. Companies contemplating investment with a US company, whether inside or outside the United States, partnering with a company listed on a US stock exchange or listing themselves on a US stock exchange can unexpectedly find themselves subject to a wide range of US laws. Moreover, even where the legal restrictions are not clear, the American political system can make certain potential foreign investments impracticable or unpalatable through high-profile investigations and congressional hearings, where foreign companies, such as Huawei, are targeted and, subsequently, blocked on deals.

How do companies navigate the risk of political interference? Understanding the local politics, regulatory requirements and laws is the first step. With appropriate due diligence prior to investment, including background investigations, contractual protections such as audit rights, and compliance representations and warranties, a company can demonstrate its intent to comply with international and local laws. Careful ongoing monitoring and training, remediation and reporting will provide additional insulation.

Political interference cannot always be avoided, but combining local expertise with a global perspective can help a company anticipate where and when it is likely to arise.

By understanding and managing the risk, a company will be better placed to realise the rewards these investment opportunities represent."

Wendy Wysong

Partner, Hong Kong/Washington
T: +852 2826 3460
E: wendy.wysong@cliffordchance.com

Glen Ma

Partner, Shanghai
T: +86 21 2320 7217
E: glen.ma@cliffordchance.com

CLIFFORD CHANCE VIEW
THE ENFORCEMENT AGENDA: EYES WIDE OPEN!

Luke Tolaini

Partner, London
T: +44 20 7006 4666
E: luke.tolaini@cliffordchance.com

Antonio Golino

Partner, Milan
T: +39 02 806 34509
E: antonio.golino@cliffordchance.com

"The financial crisis led to a breakdown in trust between business and the public. With governments and enforcement agencies being perceived as 'asleep at the wheel', they have sought to enhance their credibility through higher-profile enforcement activity – often with criminal repercussions. Although there are good arguments that this reaction has been excessive, the trend appears likely to continue for some time".

While the US has long been a leader in enforcement against corporations, other jurisdictions are catching up. UK regulatory activity is increasing, and its criminal authorities are looking to take action against corporates and individuals alike. Continental Europe has seen regulatory powers extended. In Italy, for example, the criminal liability of corporations has been expanded to include new areas such as bribery and environmental crime, in addition to market abuse and fraud in obtaining government and EU grants. Civil actions (often within criminal proceedings) are being brought on behalf of corporate entities against previous directors. And regulators in Asia are also strengthening their enforcement capabilities. For global companies, this creates a complex environment – with activities across different jurisdictions usually attracting the attention of multiple enforcement agencies and creating competition among them.

Significant enforcement action against a company casts a long shadow. It damages reputation, creates prolonged periods of uncertainty for business and imposes burdensome costs. So, it's hardly surprising that boards are seeking to prevent these actions. Legal advisers are working much more closely with boards to limit these risks – from helping build good governance and risk-management systems to advising on risk in acquisitions or other sophisticated transactions.

One of the key policy issues for criminal authorities and their political masters is whether it is more effective to punish individuals involved in criminal conduct or seek routes to make companies pay. Countries disagree on this, but there is a trend and policy drive to exact swingeing sanctions on corporates – including criminal conviction. This is a leap in the dark. The Arthur Andersen case serves as a cautionary tale – a global brand that disintegrated in the face of alleged criminality and the reputational damage that followed. Authorities seem unconvinced about the economic risks that aggressive criminal enforcement may pose: big fines against big names are the order of the day.

So what can boards do? They can focus carefully and thoroughly on risk management, maintaining the right balance between over-caution and entrepreneurial bravado. They can not only put in place good governance but ensure that it is driven, by values and behaviour from the top, through the whole corporation: a 'zero-tolerance' culture is the best protection. Cooperation between board directors and enforcement agencies in the punishment of corporate corruption may satisfy a widespread public need for more transparency and, at the same time, protect corporations from show-stopping sanctions. But all boards must remain nimble and thoughtful. Risks change with economic, regulatory, legal and business developments. An alert board is the best prevention available."

MAPPING THE BOARD'S RISK AGENDA

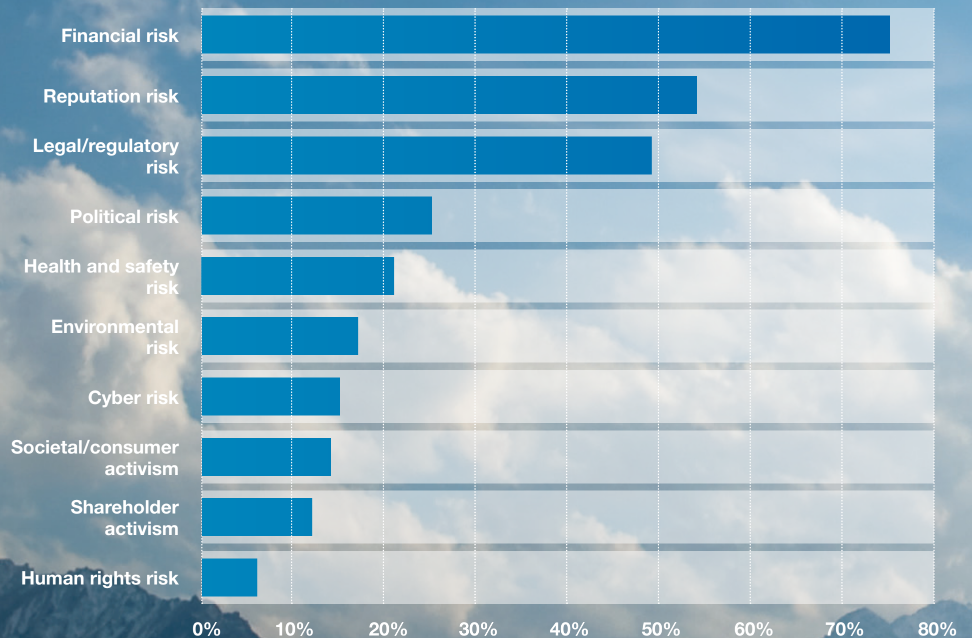
3

In an era of ever-increasing scrutiny, whether by the media, consumers or politicians, even a small incident can have major consequences for a company's image.

It is understandable, then, that over one-half of board members surveyed by the EIU are focusing on protecting the company's brand and reputation (Figure 2).

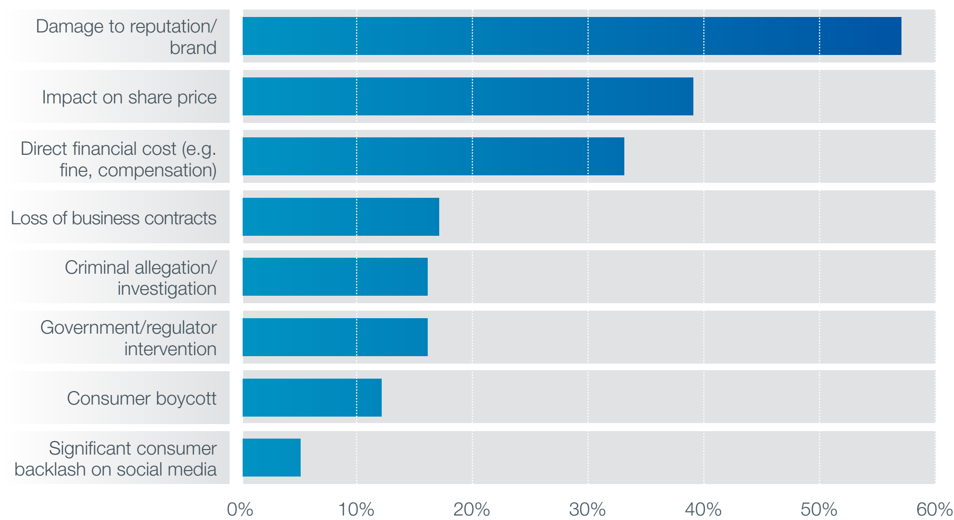
Similarly, nearly three-fifths (57%) of respondents say they are most concerned about the potential damage to the reputation and brand of their company as a consequence of a scandal or incident (Figure 3). In contrast, just 39% are most worried about the impact on share price, and only one-third are most concerned about direct financial costs, such as fines or compensation.

Figure 2: Which risk categories is your board currently focusing on?



Source: The Economist Intelligence Unit

Figure 3: In the event of a major incident or scandal, which consequence would be of greatest concern from your organisation's perspective?



Source: The Economist Intelligence Unit

Clifford Chance view

"The supply chain is a critical risk area – the collapse of a factory in Indonesia not only brings a potentially devastating loss of life but the resulting adverse publicity for the multinational consumer goods retailer which the factory supplies can seriously damage its image with its customers in key markets. Influencing and working with supply chain partners to promote best practice in areas such as health & safety, and environmental laws, is fast becoming a core part of many companies' risk management policy towards the protection of their brand and reputation."

Valerie Kong, Partner, Singapore

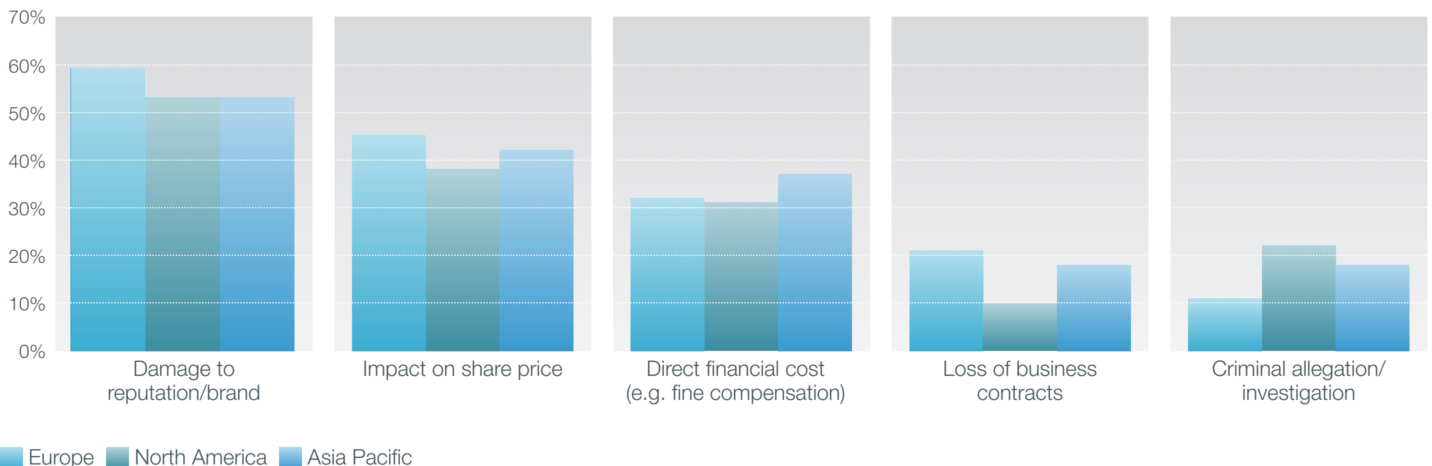
Protecting the company's reputation is a priority for boards around the world (Figure 4). Similar proportions of respondents from all three major regions (Asia Pacific, North America and Europe) worry about damaging the brand and confirm that reputational risk would become more important for their boards over the next two years. Yet the survey results also suggest that concern about corporate reputation is not always reflected in the attention boards pay to areas in which a scandal could severely damage the company's image.

Changing focus?

Along with reputational risk, three-quarters of boards represented in the survey are focusing on financial risks and 49% on legal risks (Figure 2 on page 14). These risks have, of course, presented a particular challenge to financial services companies trying to meet fast-changing, and often onerous, regulation since 2008. José Morago, group risk director at the insurance giant Aviva, understandably singles out compliance and strategic risk as areas of focus for his board.

But the current concentration on regulation and compliance across all industries could lead to neglect in other areas of risk, according to Steve Culp, global managing director of risk management at Accenture, a consulting firm. This concern is exacerbated by the fact that companies have finite resources, which by default tend to be deployed against immediate concerns rather than longer-term or more abstract threats.

Figure 4: In the event of a major incident or scandal, which consequence would be of greatest concern from your organisation's perspective? (% of respondents by region)



Source: The Economist Intelligence Unit

For example, many companies have failed to plan for the threat of natural catastrophes, despite the availability of historical data. This has led to the kind of supply-chain disruptions that resulted from the 2011 earthquake and tsunami in Japan: a local factory supplying 60% of global car engine airflow sensors was shut down, after which the auto industry scrambled for rare resources,[4] and a car manufacturer had to close its production line for two weeks as its sole supplier of brake parts was destroyed, amounting to US$325m in sales losses for the car-maker.[5] After experiencing the effects of such natural catastrophes, companies have revisited their supply-chain strategies. In cases such as these, ignoring a seemingly remote risk proved costly.

New and emerging risks

There are a number of other areas of emerging risk to which both the EIU survey and the analysts interviewed suggest boards are not paying enough attention – perhaps as a result of dedicating resources to more traditional areas. Cyber risk is one example where "the bad guys move faster than companies", according to Professor Howard Kunreuther, co-director of the Wharton Risk Management and Decision Processes Center, who comments on the difficulty in joining up the actions of companies, regulators and lawmakers quickly enough to combat a fast-moving, and evolving, threat.

Cyber risk is a danger of which board members in the EIU survey are not unaware. Nearly three-fifths (57%) say that they are worried by the prospect of a cyber-attack (Figure 5 on page 18). However, just 15% say it is currently a focus for their board (Figure 2 on page 14), with 42% saying it will become less important from the board's perspective over the next two years, and just 21% saying it will become more important (Figure 6 on page 18).

4 "Japan Parts Shortage Hits Auto Makers", Wall Street Journal, March 2011.

5 "Japan One Year Later: The Long View On Tech Supply Chains", Forbes, March 2012.

CLIFFORD CHANCE VIEW
INFORMATION MANAGEMENT: PRIVACY AND PROTECTION

Alvin Khodabaks

Partner, Amsterdam
T: +31 20 7119 374
E: alvin.khodabaks@cliffordchance.com

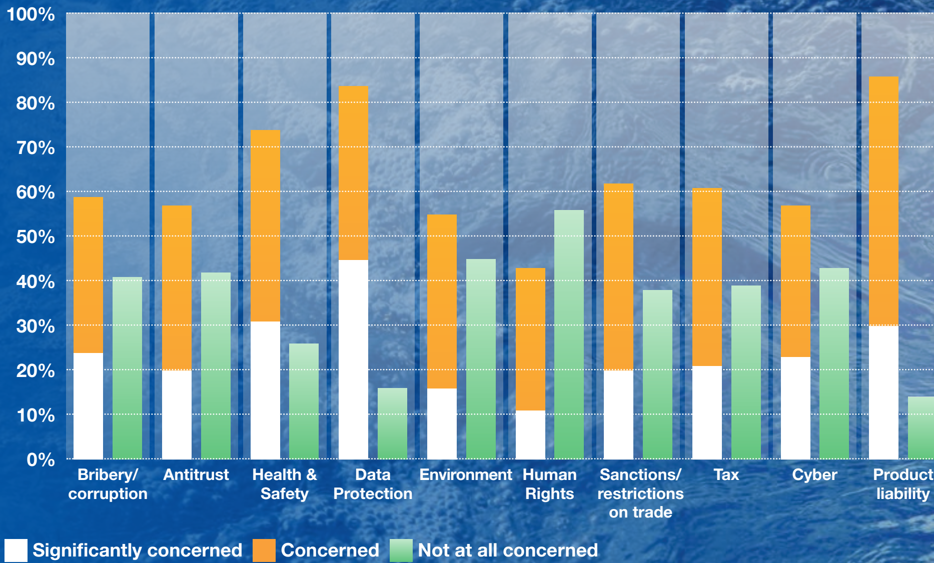
"From public disquiet about the way private data is being used by social networking sites and governments, to concerns over companies' ability to protect their customers' credit card details from hackers, data protection and cyber security are growing issues.

Our survey highlights that US boards – operating in a more litigious environment than their European counterparts and with a strong focus on cyber security as a component of national security – are at the forefront of awareness and prevention. But European boards are also starting to focus on this, driven by the globalisation of security concerns and proposed European regulation that could dramatically change the European data privacy and cyber security landscape. Global companies operating in Europe will also be affected by these new rules, facing significant financial penalties in the event of data protection breaches: under proposed regulation, these could run up to €100 million or up to 5% of annual worldwide turnover, whichever is higher.

Research shows that the overwhelming majority of data and cyber security incidents do not result from malicious attacks, but from 'innocent' failures: out-of-date software or lack of security and compliance procedures. The good news is that companies typically have control over these areas and can address them directly. On the flipside, directors may unwittingly be exposed to personal liability for failure to manage risks that are within their control through governance and proper management of operations.

We help boards take a holistic approach to these areas and identify a commercially viable approach for their companies. Experience shows that by increasing awareness and taking a few focused measures, they can significantly reduce their risk."

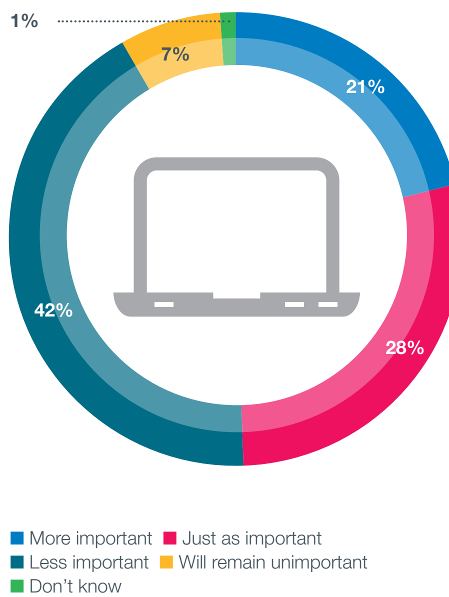
Figure 5: To what extent is your organisation concerned about an incident or scandal arising in the following areas?



Source: The Economist Intelligence Unit

Paying little attention to cyber risk could be a sign that boards have delegated responsibility for it to a specialised department. That is certainly the view coming across from the senior managers interviewed for this report who appear confident that skilled teams in their security and IT departments are on top of the threat. A spate of recent problems, however, such as the US retailer Target losing the credit card details of 40m customers, begs the question whether cyber risk should receive more attention in the boardroom, given how embarrassing and costly these incidents can be.[6]

Figure 6: Is cyber risk likely to be more or less important from your board's perspective over the next two years?



Source: The Economist Intelligence Unit

Clifford Chance view

"Recent events in Ukraine have been a catalyst for sanctions, showing that this is a dynamic risk area in today's business environment, with potentially significant consequences for organisations which are under-prepared. It is important that businesses have in place compliance systems that enable them to monitor this constantly changing landscape and to anticipate and address new risks as they emerge."

Victoria Bortkevicha, Partner, Moscow

6 "Missed Alarm and 40 Million Stolen Credit Card Numbers: How Target Blew It", Bloomberg Businessweek, March 2014

CLIFFORD CHANCE VIEW
SANCTIONS: COMMERCE IN THE CROSSFIRE

"International politics spill over into the commercial arena when politicians rely on sanctions to effect change outside their borders. Our survey suggests that boards are increasingly concerned about the far-reaching implications that such sanctions – either unilateral or multilateral – may have on their businesses. As one respondent put it, 'With these restrictions on trade, it becomes difficult for our supply chain team to carry out their daily routine'.

For instance, sanctions may hamper a local Middle East exporter's ability to conduct business with a US-sanctioned country in the same region – even though the business is local, uses local currency, and its trade is not restricted under local law – because its bank's sanctions-compliance programme blocks the deal. Because the US sanctions programmes seek to promote this outcome, financial institutions are taking a risk-averse approach that effectively flows down into their wider corporate client base.

Sanctions compliance remains a moving target. The challenge is to anticipate, identify and address new risks as they emerge. That's why many global organisations need to have sanctions-related systems in place that can be easily adapted to changes as they come into effect, often without much notice. Sanctions risks arise in a number of guises and can affect any kind of business activity – including acquisitions, public offerings, supply chain issues and expatriate employment. For example, US-based investors and enterprises that acquire interests in, or do business with, law-abiding non-US companies need to appreciate that doing business with companies that are targets of US sanctions may be legal for non-US companies – but it's illegal for the US company to finance or facilitate it.

And even keeping to official guidance is no guarantee against inadvertent sanction-breaking – often with the serious consequences of criminal liability or exposure to large losses on transactions.

To top it all off, even pledging blind obedience to US sanctions programmes may put non-US companies at risk of violating EU and national blocking laws, as many legal orders prohibit participating in a boycott against another country in connection with foreign trade and payments transactions.

All of this can seem onerous. Some companies may try to avoid sanctions risk entirely, as far as they can, by withdrawing wholesale from doing business with companies that have exposure to sanctioned countries. But at what cost in terms of lost opportunities?

In contrast, others recognise that an accurate risk calculation, together with rigorous adherence to the right procedures, can allow them to access opportunities that their more cautious peers may miss out on. The calculation will include policy and reputational issues and well as legal compliance. Navigating through the sanctions minefield also puts a company ahead of the game when sanctions are lifted, as we have seen recently in Myanmar.

Buried among the undeniable risks, there can be great opportunities."

George Kleinfeld
Partner, Washington
T: +1 202 912 5126
E: george.kleinfeld@cliffordchance.com

Heiner Hugger
Partner, Frankfurt
T: +49 69 71 99 1283
E: heiner.hugger@cliffordchance.com

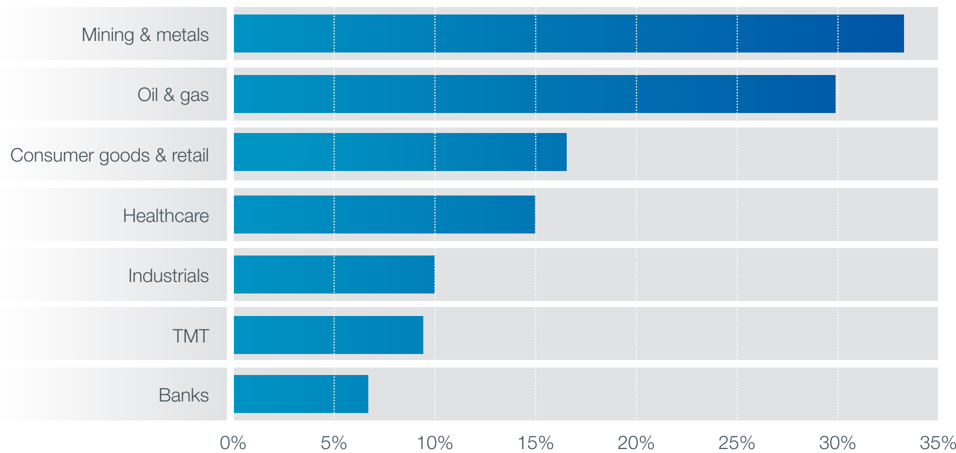
Figure 7: Key factors underlying respondents' risk concerns

In your own words, what underlies your organisation's principal risk concerns? Our survey respondents answered as follows:

Educating employees to foster secure workplace behaviour. We are responsible for providing a safe workplace. A lapse may turn tragic. Safe work practices are essential. Investment in quality, and safety of the products. Product liability is considered as a strict liability offence. Products need to be well-designed to avoid accidents. Managing different taxation rules for business operations in several countries. Avoid failure in compliance of taxation law. Different countries impose different sanctions and restrictions on trade. Legal compliance is the key to fair trade. Safeguarding domestic producers by restricting international competitors. Global anti-trust laws, organisational behaviour, and non-compete policies. Forming cartels for bid rigging. Cyber threats are unknown until discovered. Cyber risk due to the growing dependence on technology and web-based solutions. Protecting the identification of our customers. Cyber breaches can jeopardise reputation. Bribery and corruption are serious concerns as they negatively impact the brand. Corruption damages our reputation, affecting shareholder's trust. Challenge in performing due diligence on foreign agents or partners. We want to protect and promote human rights. One needs to be socially responsible. Environmental issues can have an impact on our sustainability. Our responsibility to safeguard our environment. Important to adopt fair operating practices. Our vision is to treat everyone with equality.

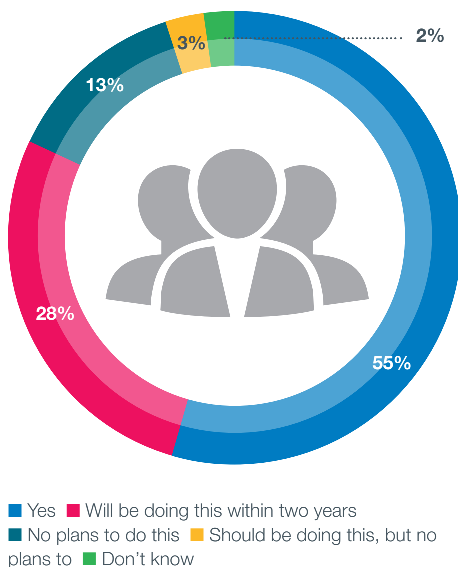
Source: The Economist Intelligence Unit

Figure 8: % of respondents reporting environmental risk as a key focus for their board, by industry



Source: The Economist Intelligence Unit

Figure 9: Has your board assigned responsibility for risks arising from social issues (ie, human rights, sustainability, environmental impact on communities) to a specific board member, or is it planning to do so over the next two years?



■ Yes ■ Will be doing this within two years ■ No plans to do this ■ Should be doing this, but no plans to ■ Don't know

Source: The Economist Intelligence Unit

Social risks

Just 17% of board members surveyed say that their board is currently focused on environmental risk (Figure 2 on page 14), despite mounting international concerns over global warming and financial penalties for incidents involving environmental damage. In September 2013, for example, an Italian court seized €900m (US$1.25bn) worth of assets and wealth from Riva Group, an Italian family-owned company operating one of Europe's largest steel plants in southern Italy. Riva Group had for some time been at the centre of a court case involving allegations of corruption and violations of environmental standards at the plant, which have allegedly led to deaths.[7]

The attention given at board level to environmental risk of course varies depending on the industry: respondents from mining and oil and gas companies are twice as likely to be focusing on this area of risk than others (Figure 8). Environmental risk is certainly evolving quickly in certain parts of the energy industry. For instance, shale gas extraction in the US is an industry undergoing rapid expansion despite fears that it could create serious environmental problems and liabilities. Frank Nutter, president of the Reinsurance Association of America, says that his members are conducting in-depth research into the threat posed by such new technologies. The question is whether they will be able to keep up with the pace at which the industry is moving.

Similarly, few express deep concern over failures to protect human rights (Figure 5 on page 18), even though an incident in this area can cause great damage to a company's image. In early 2013, for example, the iconic US technology company Apple found multiple cases of human rights abuses in its supply chain through an internal audit.[8] The revelations emerged less than a year after both Apple and its chief Taiwan-based supplier, Foxconn were the targets of activist campaigns.[9]

Indeed, companies that have complex and global supply chains have seen their record on human rights come under increasing scrutiny in recent years by consumers, politicians and the media. Whenever stories of human rights abuses are reported, these companies become at risk of serious brand damage, regardless of their involvement or awareness. For the majority of respondents in at least one industry represented in the EIU survey – consumer and retail – concerns over damage to the brand have actually led to changes to their supply-chain partners.

It seems encouraging that despite few saying social issues such as environmental or human rights protection are a priority for boards as a whole, over one-half (55%) of companies in the survey have assigned responsibility for these social risks to a specific board member, with 28% planning to do so within two years (Figure 9). The danger, however, is that this might lead to reliance on a single individual to steer the company away from such risks when in practice a broader focus across the whole organisation might be required.

7 "Italy's Riva Group to close plants after court seizes assets", Financial Times, September 2013.

8 "Child labour uncovered in Apple's supply chain", Guardian, January 2013.

9 "Dividends Emerge in Pressing Apple Over Working Conditions in China", New York Times, March 2012.

CLIFFORD CHANCE VIEW
HUMAN RIGHTS: 'SOFT' ISSUES, HARD CHOICES

Rae Lindsay

Partner, London
T: +44 20 7006 8622
E: rae.lindsay@cliffordchance.com

Ben Luscombe

Partner, Perth
T: +618 9262 5511
E: ben.luscombe@cliffordchance.com

"Despite the risks they can present, many so-called 'soft' issues remain on the periphery of board concerns. While boards say they are very concerned, in general, with reputation risk, more than half of those surveyed are 'not at all concerned' about the possibility of a human rights incident triggering a crisis for their company. Perhaps more of them should be.

Activities such as sponsoring sporting events in far corners of the globe or using security forces to protect facilities in conflict, as well as major incidents involving supply chain partners, open up obvious areas of vulnerability. When garment workers in Bangladesh died in the collapse of the Rana Plaza factory in April 2013, US and European businesses that were linked to the tragedy suffered immediate reputational damage and faced longer-term commercial implications. Similar outrage erupted when, in the early stages of the Arab Spring, some governments reportedly required local branches of global mobile phone providers to shut down services, cutting off disaffected people. The public and shareholders are often uncertain where to point the finger: governments, companies or both. But the calls are growing louder for business to be brought to account for any perceived involvement in infringements of human rights.

Issues such as corruption and data protection are regulated within clear legal frameworks – but exposure to human rights risk is harder to define. When the legal issues are hard to pinpoint, a standard compliance approach doesn't fit the bill. But the stakes are high: being linked to a serious human rights abuse creates an image that can be hard to shed.

The role of business in human rights is an emerging one, predominantly framed within voluntary standards. But these standards have normative effect and are gaining traction internationally. As governments develop policies, regulation is on the rise.

Still, organisations remain slow to address these concerns in a coherent way or to see them as potential legal risks: it's tempting to 'park' them within human resources or health and safety. Companies at the forefront in this area are taking a more considered and integrated approach, engaging with human rights issues at board level and adopting appropriate governance procedures across the organisation.

As an organisation's policy commitment to human rights plays out through its contractual relationships, and as it responds to calls for transparency, boards need to come to terms with the hardening edges of risk. They need to be able to recognise emerging trends and take early steps to ensure that they manage risks appropriately across their organisations and avoid pitfalls.

We are seeing this whole area gaining momentum, notably in industries – such as financial services – where players have not traditionally considered themselves to be 'high risk' in relation to human rights issues. But even the sectors that have a track record of managing these risks are upping their game. Companies need to focus on how to protect themselves against the reputational and financial damage that can arise from so-called 'soft' issues."

Losing control?

Two-thirds of board members recognise that increased scrutiny by social media channels has materially increased their exposure to risk, particularly to their reputation (Figure 10). Given the multitude of such outlets available, and the speed at which news can spread through them, companies have to a great extent lost their ability to control messaging to external stakeholders. These days even a small incident can cause great damage. When a musician flying with United Airlines arrived at his destination to find the guitar he had checked in severely damaged, the airline's customer service proved indifferent to his plight. In response he went on to write a song about his experience, entitled "United breaks guitars", posted it to YouTube and sat back as the video went viral.[10] Similarly, the US coffee company Starbucks faced a huge consumer backlash on social media channels when it emerged that it had reportedly paid just £8.6m (US$14.5m at current rates) in corporation tax in the UK over 14 years.[11]

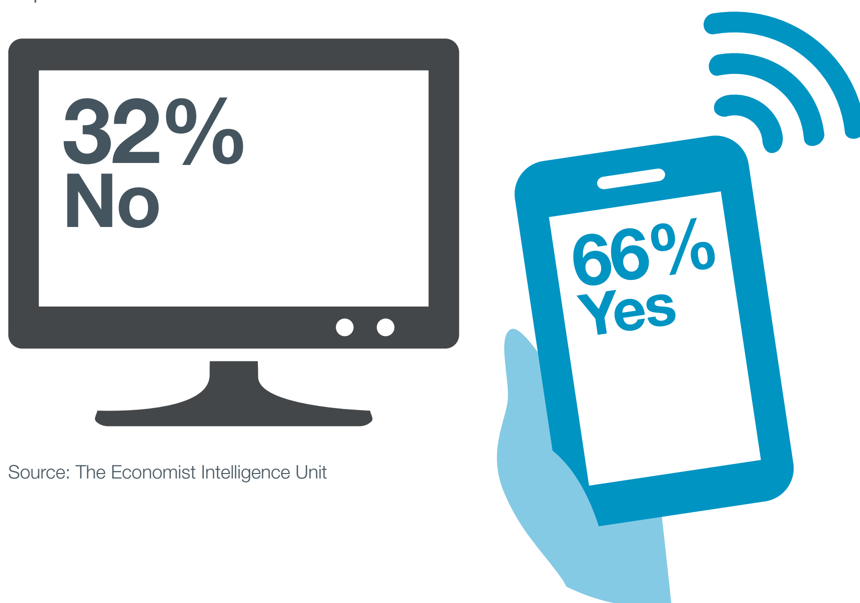
With that in mind, it is even more important for boards to devote enough attention to those areas where a serious incident or scandal could lead to significant reputational damage by way of consumer, shareholder and media backlash. In the following chapter we consider what boards are doing to mitigate risks, and whether their strategies go deep enough to avoid damaging – and in some cases avoidable – incidents.

Clifford Chance view

"In today's 24-hour news cycle, a local problem can quickly become a global crisis. How boards respond in such situations will have a long-lasting effect on a company's reputation, results and morale. Every board now needs agreed and practised protocols for its public response in a crisis to avoid social and news media disaster."

Diana Chang, Partner, Sydney

Figure 10: Has increased scrutiny of business on social media materially increased your exposure to risk?



Source: The Economist Intelligence Unit

Clifford Chance view

"The company that manages a crisis best is the one that can impose calm and order on the situation – the one that makes the right decisions, early in the story and looks not just to fight the fires but can see where the issues are going. The right advisory team is key to that process".

Luke Tolaini, Partner, London

10 "Singer gets his revenge on United Airlines and soars to fame", Guardian, July 2009.

11 "Starbucks Twitter campaign hijacked by tax protests", The Telegraph, December 2012

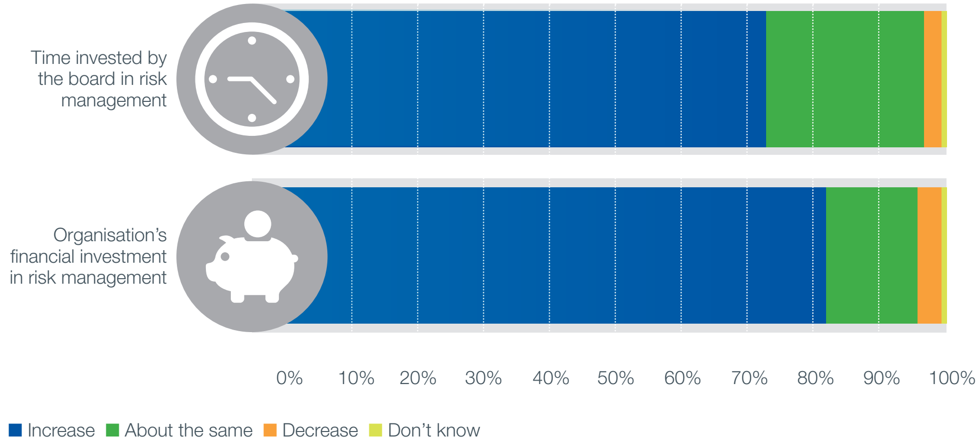
MAKING RISK MANAGEABLE

4

According to the survey, over the last two years nearly three-quarters (74%) of board members have increased the time they spend looking at risk management (Figure 11).

Over four-fifths (83%) have matched this with an increase in the organisation's financial investment. Boards, then, understand the importance of risk management in the current business environment and are dedicating more resources to it. But a closer look at what boards are doing begs the question of whether their actions are sufficiently far-reaching or pre-emptive.

Figure 11: Compared to two years ago, how has your organisation's investment in risk management changed?



Source: The Economist Intelligence Unit

Clifford Chance view

"Respondents to our survey say they are investing heavily in risk management, with 58% confirming their company has increased spending on risk by over 50% in the last two years. With many plates constantly spinning, it is about finding the right balance between the cost of compliance and legitimate commercial risk-taking, but investment in risk management infrastructure will have to be made and for some companies this will be significant."

Simon Cooke, Partner, Hong Kong

Clifford Chance view

"What are the essential ingredients for informed decision-making? A well-composed board is open-minded, balanced and far-sighted. It needs to be aware of the major challenges facing the various business units, and the steps being taken by management to mitigate those risks that have been identified. It also needs to ensure that it is being regularly updated by the management on the financial situation of the company."

Yves Wehrli, Managing Partner, Paris

Risk at the top table

According to Accenture's Mr Culp, the number of board-level risk officers has increased in recent years, especially in the US. In other parts of the world they are still quite rare: putting the recent increase in numbers into perspective, Richard Waterer, managing director at Marsh Risk Consulting UK and Ireland explains that fewer than one in ten FTSE 100 companies have a board-level risk officer.

Appointing a main board risk director can help ensure that risk is factored into strategic decision-making, but some argue that risk management should be separated from the executive board. "Our job is to keep the CEO's ego under control," says the chief risk officer of a multinational interviewed for this report. Others see their role as assisting board members to make better-informed decisions. "Risk appetite is down to the CEO," says Jake Storey, in charge of enterprise risk management at the shipping company Gearbulk. Mr Storey is not on the executive board and sees his job as pooling information to inform senior decision-making.

In fact, many worry that appointing a risk director may be no more than a token gesture, that could lead to complacency on risk management responsibilities among other board members, or at worst it could lead to the risk officer being used as a scapegoat for any failures. According to Andre Katz, head of enterprise risk management at the UK telecoms giant BT, there is intentionally no chief risk officer on BT's executive team: "It could be dangerous to attribute sole responsibility to a named individual for risk across the company as it's important that all executives take responsibility for managing risk." Instead, Mr Katz explains, risk-management responsibilities are shared across the operating committee.

NON-EXECUTIVE DIRECTORS AND RISK MANAGEMENT

"Non-executive directors are there to foster discussion and make the [executive] board see matters from a different angle," says Michael Lynch-Bell, a non-executive director of mining company Kazakhmys and others. His comment echoes the UK Institute of Directors' definition of the non-executive role as "providing an independent view of the company and general counsel on matters of concern".

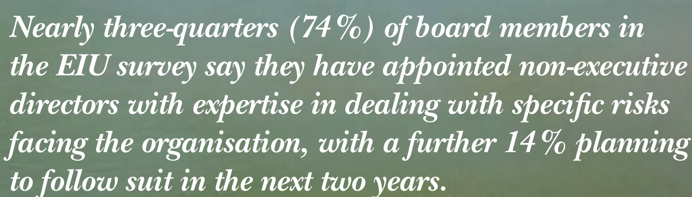
Nearly three-quarters (74%) of board members in the EIU survey say they have appointed non-executive directors with expertise in dealing with specific risks facing the organisation, with a further 14% planning to follow suit in the next two years. But what are the challenges faced by companies shopping around for non-executive directors?

One potential pitfall when selecting non-executive directors, according to Mr Lynch-Bell, is that they tend to come from a relatively small pool of male, retired executives. Describing a recent board meeting, Mr Lynch-Bell refers to the blank faces as the discussion turned to cyber risk. Similarly, he admits that the older generation of executives is not as up to speed as younger colleagues might be on risks such as reputational damage that might be caused by social media. A lack of diversity at the top table could lead to companies being blindsided by an emerging and significant risk.

Another fear is that, at least in some parts of the world, there is an increasing concern among non-executive directors that they could face legal action if their companies mess up. In the US, and to a lesser extent in Europe and Asia, there are worries that the risk of criminal prosecution has made it harder to hire non-executives because the personal stakes are too high. Nearly three-fifths (58%) of US respondents to the EIU survey report they are reluctant to join a board as a non-executive for this reason.

Ilana Atlas, a non-executive director at Coca-Cola Amatil, Suncorp and Westfield, agrees that regulators have been more active against non-executives recently, and badly run or troubled companies might find it trickier to find independent directors. In the Australian context, Ms Atlas suggests that the pressure on non-executive directors reinforces the caution of companies already facing a weakening economy.

For Mr Lynch-Bell, however, these worries might be unfounded: "If you do your job thoroughly and ensure open discussion, there should be no need to be afraid."



Nearly three-quarters (74%) of board members in the EIU survey say they have appointed non-executive directors with expertise in dealing with specific risks facing the organisation, with a further 14% planning to follow suit in the next two years.

CLIFFORD CHANCE VIEW
CRISIS MANAGEMENT – BE ONE STEP AHEAD

"Every company of any size and stature will encounter 'out-of-the-ordinary' problems – that's a reality of doing business. The unlucky ones will suffer a crisis that can threaten the company's reputation – and, in some cases, the very existence of the business.

A company in crisis will be fighting on all fronts. It will be dealing with regulatory or prosecutorial authorities, political scrutiny, the market, shareholders, its employees and customers – all while grappling to understand fully the issue causing the crisis and the repercussions.

Cool heads are crucial. The board will need advisers who can impose order and bring expert judgement and skills to bear on the situation – while allowing directors and management to continue running the business.

The reaction must be organised, nimble and dynamic as the situation unfolds. These crises require a mix of contentious and non-contentious legal expertise, including company and corporate law, disputes, investigation and enforcement experts and labour law – often supplemented by support from communications experts.

Companies can prepare themselves to handle a crisis with contingency planning, 'dawn raid' training and dry runs of emergency scenarios – but, in truth, total preparedness is unattainable. The best protection is prevention."

David D. DiBari
Partner, Washington
T: +1 202 912 5098
E: david.dibari@cliffordchance.com

Jeremy Sandelson
Partner, London
T: +44 20 7006 8419
E: jeremy.sandelson@cliffordchance.com

In the boardroom and beyond

The EIU survey found a number of other ways in which board members are changing risk management practices (Figure 12). Nearly three-quarters (74%) have appointed non-executive directors with expertise in dealing with specific risks facing the organisation, and 57% provide regular training for board members on how to identify and address specific risk areas, with a further 26% planning to do so within two years. Three-quarters (77%) will have clear processes for identifying new, emerging risks and clear crisis management procedures in place.

Outside the boardroom, one-third of respondents say they have made risk management a measurable element in the performance of key staff, taking it beyond the realm of the compliance function, and 35% are planning to do so within the next two years. For those who have suffered a major risk incident in the last two years, such a measure has been a higher priority, with 47% of these respondents saying they already measure staff performance by reference to risk management.

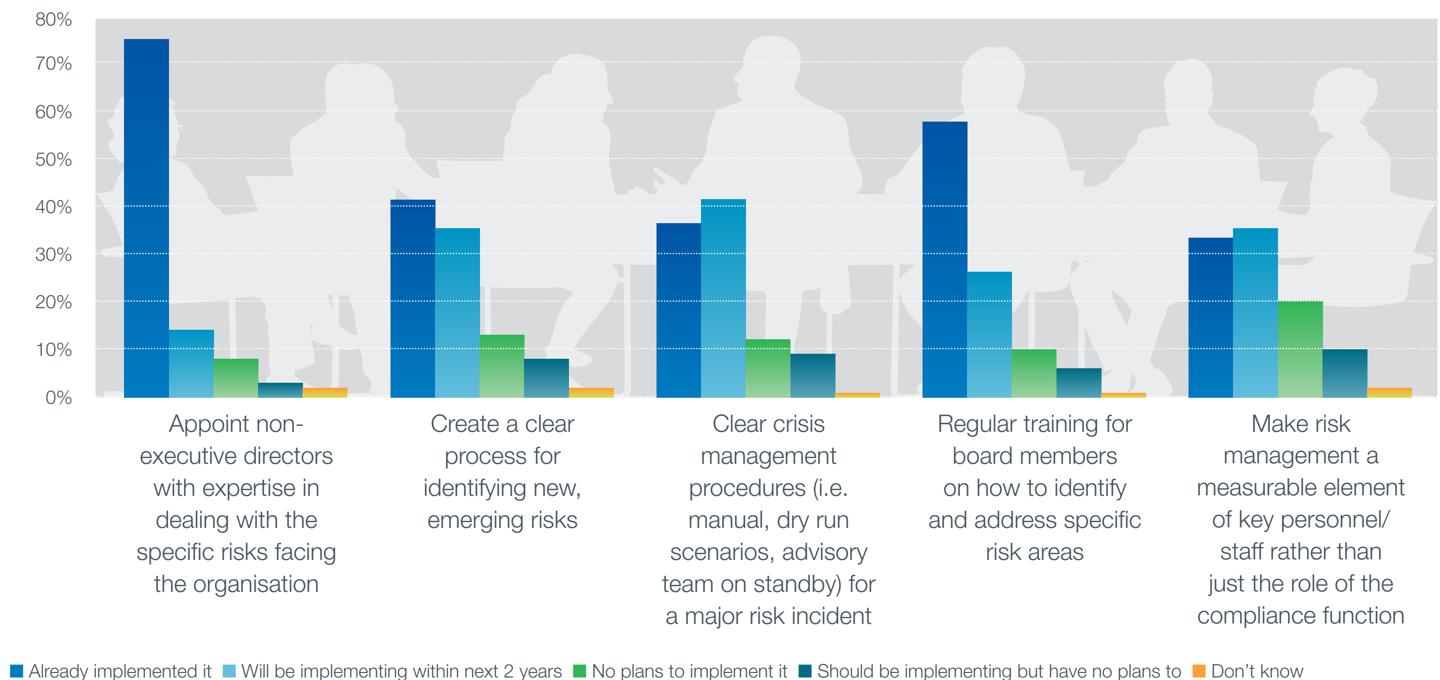
All of the above are procedural responses that are tangible and relatively easy to measure, however, begging the question whether on their own they are enough, or whether what is needed is a deeper behavioural change across the organisation. Such transformation can be a harder and much lengthier process.

Clifford Chance view

"A risk manager reporting directly to your board can be an effective solution. What really makes a difference though is if those managers in your local business units, for example your factory in Hanoi, really understand and are genuinely implementing, on a daily basis, your global risk management strategy and policies. It is the board and management as a whole that should drive this approach."

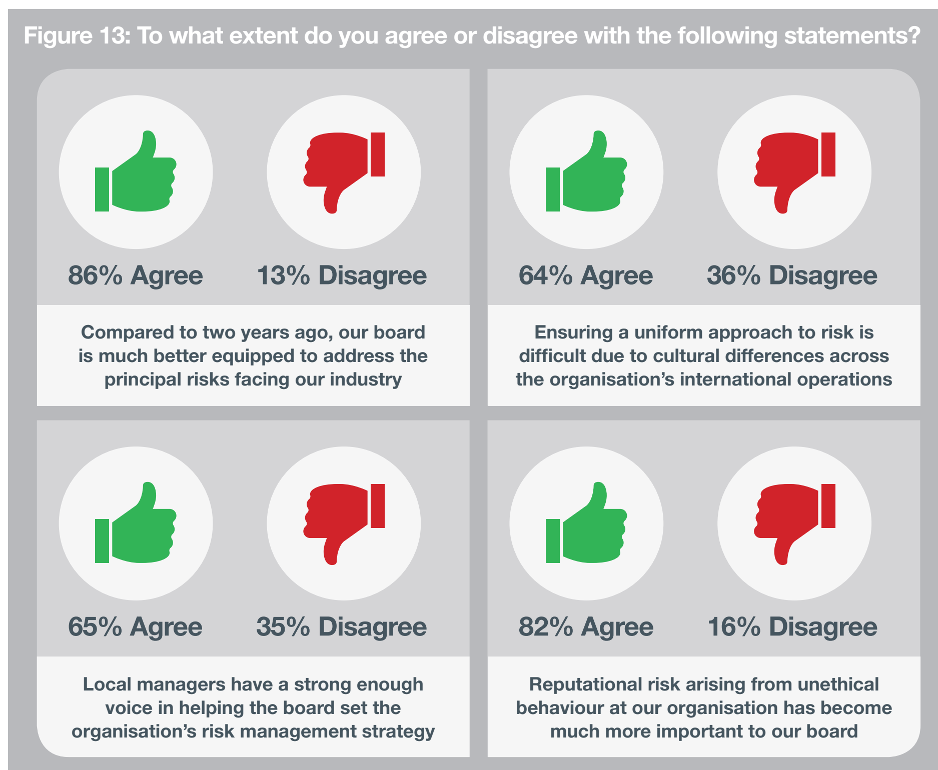
Edward O'Callaghan, Partner, New York

Figure 12: Has your board already implemented, or is it planning to implement these measures over the next two years?



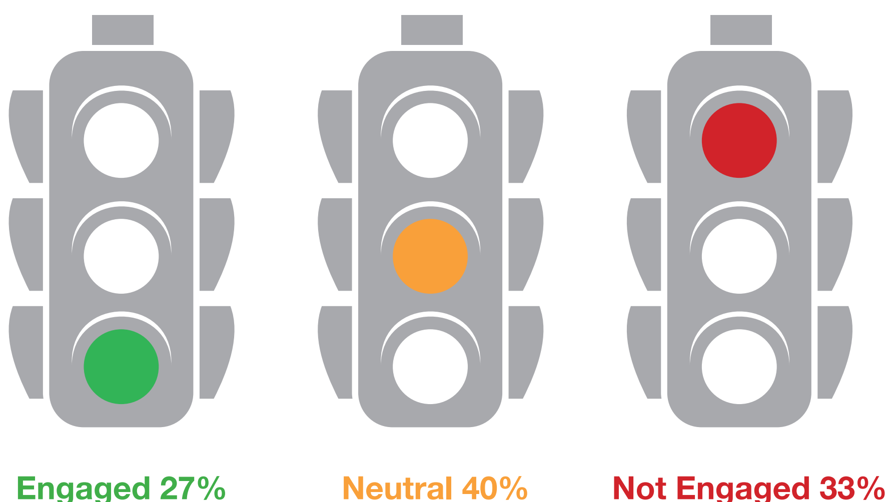
Source: The Economist Intelligence Unit

Figure 13: To what extent do you agree or disagree with the following statements?



Source: The Economist Intelligence Unit

Figure 14: To what extent are non-management employees engaged in risk management in your organisation?



Source: The Economist Intelligence Unit

Sharing responsibility

Risk management should not be left entirely to senior management. It needs to permeate deep through the entire organisation, so that junior bank staff, for example, do not sell inappropriate insurance products and automotive engineers report faults in a timely manner. While a remarkable 86% of respondents are sanguine that their board is now better prepared for risk management than two years ago (Figure 13), just 27% of respondents say that non-management employees are actively engaged in risk management (Figure 14). In trying to embed risk management through the organisation, boards run into a number of challenges. Here we consider two related ones.

The first is striking the right balance between adherence to uniform global standards and accounting for local idiosyncrasies. Companies with international operations need to ensure that risk management remains under the overall control of headquarters, with a centrally determined approach being properly applied across the group. At a local level, however, it may be necessary to take into account local managers' needs and priorities. In fact, nearly two-thirds (65%) of respondents report that local managers in their organisation are given a sufficiently strong say over the organisation's risk management strategy (Figure 13), suggesting that central risk policies are at least to some extent informed by local needs. The process is not without its challenges, as 64% agree that ensuring a uniform approach to risk is difficult owing to cultural differences across the organisation's international operations (Figure 13). Recent stories of alleged corruption and bribery involving multinational companies, such as GlaxoSmithKline in China, highlight the tension that can arise between what is expected as standard behaviour at the global level and local managers dealing with on-the-ground pressures when doing business.

CLIFFORD CHANCE VIEW
ADDRESSING RISKS ACROSS A GLOBAL ORGANISATION: DOES 'ONE SIZE' FIT ALL?

"As our survey shows, ensuring a uniform approach to risk across international operations is a crucial challenge for corporates. With tens of thousands of employees and a web of subsidiaries, partnerships and distribution networks across multiple regions, global organisations face a tall order to educate employees, control standards and monitor compliance.

Cross-jurisdictional regulations such as the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act are driving the development of global compliance programmes. The trend to hold management personally liable and levy substantial fines is also prompting businesses to act.

Board members who fail to put adequate, properly resourced structures in place to mitigate and monitor these risks can be held individually responsible – and this applies to breaches abroad, as well as at home. Organisations also can face severe fines for relatively minor misconduct in certain countries if their agents or distributors violate anti-corruption provisions.

Upholding global standards across different business cultures and legal frameworks can be daunting. For example, gift-giving at Diwali in a business relationship in India, or the practice of giving small wedding gifts to government officials in Indonesia, may be legal and culturally acceptable in the region where it takes place – but a global company can suffer severe penalties and reputational damage if enforcement authorities in their home country judge these actions to be non-compliant.

There are strategic risks, too. Emerging markets are a key growth avenue for many US and European businesses, and the traditional ways to build a position – through local partnerships, distribution agents or acquisition – all present risks. Companies must thoroughly understand the practices of the partner, agent or target company before and after a transaction. Failure to do so can damage an organisation's reputation, bring on expensive fines – or lead to the discovery that a business model operating legally in the region may no longer work when international regulatory standards are applied.

What can be done to address these challenges? The answer is a combination of raising awareness, identifying and assessing risks, building compliance structures and processes and ensuring buy-in and training throughout the organisation. But the toughest challenge is to set up an effective, legally protective global organisational structure in all countries where business takes place. It is crucial to find the right balance between centralised and de-centralised organisational structures and responsibilities.

To develop and implement such structures, organisations need advisers with experience of advising multinationals in all major jurisdictions; presence in emerging markets; and deep sector understanding and expertise."

Peter Dieners

Partner, Düsseldorf
T: +49 211 43 55 5468
E: peter.dieners@cliffordchance.com

Sarah Jones

Partner, New York
T: +1 212 878 3321
E: sarah.jones@cliffordchance.com

Linda Widyati

Partner, Jakarta
T: +62 21 2988 8301
E: linda.widyati@cliffordchance.com

TWO APPROACHES TO INTERNATIONAL OPERATIONS

"InterContinental Hotel Group's strategy is not to own hotels," says John Ludlow, head of global risk management at IHG. "It is to build a portfolio of brands. And so for us risk management means managing our reputation." IHG has been selling off its hotels and returning cash to shareholders in recent years, meaning most hotels operate under a franchise agreement or are managed by IHG on behalf of owners.

The global hotel group has raised more than US$800m from asset sales over the past year, announcing the US$120m sale of the InterContinental Mark Hopkins San Francisco in February 2014. After selling hotels to developers it continues to manage them itself. This has allowed the firm both to continue expansion and modernisation of its network and to return cash to its shareholders — some US$10.3bn since 2003. Its system now covers more than 4,700 hotels across nearly 100 different countries.

In essence, says Mr Ludlow, franchisees must be allowed autonomy within strict central guidelines covering everything from health and safety to the quality and consistency of the service delivered to customers. Along with a major risk review programme and project risk management, he singles out risk training as a crucial area; the company offers even junior staff online training courses.

The asset disposal programme looks dramatic, but in fact the franchising model is not so unusual; it is widely used for fast-food outlets such as McDonald's, for example, which must ensure that its burgers, restaurants, and indeed safety and hygiene standards, are of consistent quality across the world.

IHG's strategy contrasts with that of Saatchi & Saatchi, the advertising group, which until recently relied heavily on franchising to cement its global spread, giving it a presence in smaller or non-core countries around the world. But now it is retreating from the model, realising that reliance on outside companies it cannot entirely control could damage its reputation badly.

"Franchising is something we have done in the past and currently we are moving away from this", says Johann Xavier, the company's CFO for the Asia Pacific and Greater China regions. He cites the notorious 2007 case of a senior creative worker at Gulf Saatchi & Saatchi, a franchise, who was sacked (by post) two weeks after suffering a massive stroke. Saatchi & Saatchi paid him compensation in the end, while denying it was legally liable because it had little control over the franchisee.

"That sort of case causes us real damage," says Mr Xavier, adding that the company has stopped granting new franchises in areas such as central and eastern Europe. He accepts that this causes problems and gaps in a network that needs to service multinational clients active in many different countries. However, Saatchi & Saatchi is making a determined effort saying that it needs more direct control over its operations – which are audited by big clients fearful of scandal as well as of financial problems. The Groupe (holding company) has policies in regards to these, which are followed by Saatchi & Saatchi. These policies are in place to minimise risk. Setting up its own operations in every country would be impractical and expensive. However Saatchi & Saatchi now follow the practice of using sister agencies within the group in the local markets whenever possible.

Like IHG, Saatchi relies on a system of allowing local managers some autonomy within a tight central risk framework. But that autonomy can be stretched only so far without endangering the central brand and company, it seems.

Roger Cagle, deputy chief executive officer at energy company SOCO, agrees: "We have dedicated managers and employees who are trained to recognise and confront the challenges of our business in their respective locales. However, it is not always easy to integrate the London regulatory environment and perspective with the local regulatory environment and perspective."

According to Johann Xavier, chief financial officer (Asia Pacific) at the advertising group Saatchi and Saatchi, headquarters tend to be stricter when imposing risk standards for emerging markets, although the framework is no different to the central one. He also says that headquarters will clamp down on a unit that is under-performing and give successful ones more autonomy to lead the agency, provided they adhere to processes in place to manage risks.

Ultimately, says Carol Pullan, non-executive director at oil and gas industry firms Caracal, Salamander and PGS, boards need to satisfy themselves, through regular reporting, that policies agreed at board level are being implemented effectively by staff on the ground. After all, failures in risk management locally can have serious repercussions for the company around the world.

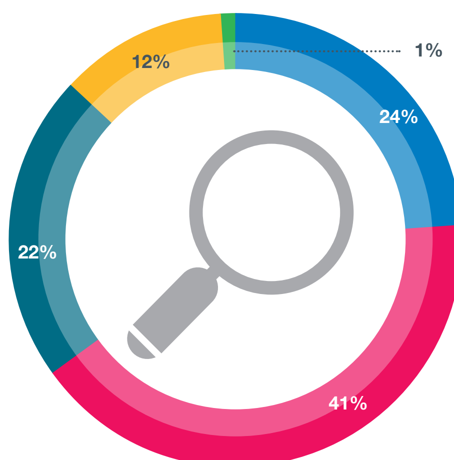
Changing culture: a question of trust

A second corporate culture challenge relates to the issue of unethical behaviour. The EIU survey indicates that this is high on boards' agendas: 82% of respondents agree that reputational risk arising from unethical behaviour at their organisation has become much more important (Figure 13 on page 30). And while only 24% of surveyed firms have carried out a review of their corporate culture from a risk perspective, a further 41% are planning to do so within the next two years (Figure 15). The board's involvement as reported in the survey results indicates an understanding that the risk or compliance function cannot always prevent unethical behaviour; the board and senior management can and should set expectations in this area and monitor how well these are respected. It is about instilling a strong corporate culture that permeates through the entire organisation.

In many ways, because of the unique challenges they have faced in recent years, financial services firms are ahead of the curve in addressing corporate culture issues. HSBC Bank, for example, has launched a thorough review since being hit by post-crisis scandals, including money-laundering and foreign-exchange rate fixing.

It is an approach being adopted by many other big banks, including Barclays. Senior management have not simply spent more on risk managers but have instead launched ambitious programmes to change the way their companies act, accepting that avoiding a repeat of past mistakes and regaining the trust of shareholders, politicians and the public calls for a deep and extensive review of the company's culture. These exercises take time, however, as Deutsche Bank's co-chief executive, Juergen Fitschen, recently said, asking for patience while the transformation at his bank takes root.[12]

Figure 15: Has your board implemented a review of corporate culture from a risk perspective, or is it planning to do so over the next two years?



Already implemented it ■ Will be implementing within next 2 years ■ No plans to implement it ■ Should be implementing but have no plans to ■ Don't know

Source: The Economist Intelligence Unit

Clifford Chance view

"Not all organisations embrace the idea of whistle-blowing. However, the identification of behaviours that create risk is a key part of any risk management strategy, and this is best achieved by empowering those working in an organisation to raise concerns.

Engagement and visible endorsement from those at the top of an organisation is essential if speaking up, with the confidence that there will be support and protection for those who do so in good faith, is to become part of the culture.

Complex, international organisations face business risk in many forms and a robust, transparent procedure that encourages those with concerns to come forward is the mark of a healthy organisation."

Chris Goodwill, Partner, London

12 "Deutsche Bank's Fitschen says culture change will take time", Reuters, January 2014

CLIFFORD CHANCE VIEW
TAX: CAN PAY, SHOULD PAY?

Liesl Fichardt

Partner, London
T: +44 20 7006 2044
E: liesl.fichardt@cliffordchance.com

Carlo Galli

Partner, Milan
T: +39 02 806 34525
E: carlo.galli@cliffordchance.com

"With media reports casting a harsh light on the tax affairs of household names such as Google, Amazon and Starbucks, most boards now view tax as a reputational issue. But is tax also a moral issue? While our survey is not conclusive on this, there is a perception that corporates and individuals have to be seen to pay the right amount of tax, whether legally required to do so or not. This is not an easy issue for in-house tax departments.

Growing awareness of reputational risk and the 'morality of tax' are not necessarily negative. Boards, shareholders and other stakeholders are increasingly interested in tax affairs, meaning that they take tax seriously, take care to consult their advisers and ensure that adequate systems are in place to ensure compliance. The reputational issue has also more recently become personal: it reaches beyond the image of the corporate entity to include the image of those who 'call the shots', be it the executive or board members. In Italy, for example, those at the top can find themselves criminally exposed for tax schemes which are found to be unlawful.

Some companies are pre-empting potential problems by voluntarily consulting their tax authorities regularly and seeking clearance before implementing a transaction. If coupled with the right legal advice, this can be a sound approach. In the UK, for example, the aim is to be regarded by HMRC as a low-risk organisation. Companies might achieve this through cooperative compliance programmes in which they share with tax authorities their risk-assessment models and manage risks adequately. As corporates expand their operations globally, the reputational and moral scrutiny of their tax affairs is no longer restricted to a particular jurisdiction; this has become significantly more international. Is this now a global issue? Yes, but it has significant domestic consequences.

As corporates expand at a broader level within the European Union, tax avoidance has become a key focus area. This is likely to result in the implementation of a new regime aimed at stamping out tax avoidance at international level. Will this simplify matters? Perhaps; however there is a real risk that the mix of international and domestic issues could complicate rather than simplify, and the result could be more disputes with a plethora of tax authorities across multiple jurisdictions.

The survey results indicate that the environment isn't easy to navigate and there is no immediate solution. But boards that do take steps to assess their risk profile regularly and who take advice to put appropriate structures in place are certainly taking steps in the right direction."

Clifford Chance view

"One of the effects of the financial crisis has been to shine a spotlight on the contract between society and the world of business. That relationship is dependent both upon trust and the rule of law. If that trust breaks down, as it has – certainly the view today is that markets cannot be trusted to regulate themselves – then all that society can do is to resort to other means of voicing its disapproval, with very unpredictable results. That is why you need to keep up the pace of change in your organisation. Some commentators focus on the financial sector, but this is not a development that is limited to banks or other regulated businesses."

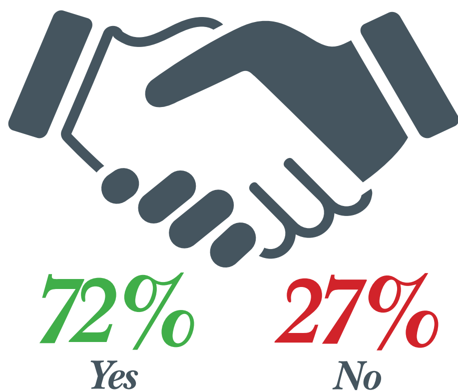
Michael Bray, Consultant, London

Clifford Chance view

"Achieving a level playing field in a global market is a challenge. Benchmarking investments into risk management across an industry or peer group, and working with others to develop industry standards, particularly around compliance and reputational risk, may be beneficial to all. Some industries actively work together on these areas to good effect, such as healthcare and consumer. Good examples are the ethical codes put in place by advertisers or pharmaceutical companies aimed at preventing practices that might entail reputational risks for the entire sector."

Javier Amantegui, Partner, Madrid

Figure 16: Is being percieved as trustworthy by society a key business priority for your organisation at the moment?



Source: The Economist Intelligence Unit

Because of increasing public scrutiny in the years following the start of the financial crisis, 72% of board members across all industries say that being perceived as trustworthy by society is a key priority for their organisation (Figure 16). Addressing unethical behaviour is part of that strategy. However, the question is whether, as the business environment and consumers' own economic prospects improve, boards' focus on addressing these concerns will move down the priority list.

Risk management incorporated

Risk management needs to be forward-looking and about unlocking opportunities rather than just being a policing function, says Carolyn Williams, technical director at the Institute of Risk Management in London. With that in mind, some companies are associating risk management much more closely with overall commercial decision-making.

Skoda Transport, the Czech transport engineering company, is one such example. It faces two principal risks: the macroeconomic situation in Europe (both the euro zone crisis and cuts to national and municipal budgets) and project management risk.

To safeguard against the first one, explains CEO Tomáš Krsek, the company is splitting its operations into city and national businesses, so that cuts to budgets in one do not affect the other. It is also addressing its reliance on Europe by reducing the region's revenue contribution from 70% to 50% within five years – it will do so by increasing sales to markets such as Russia, Turkey and China.

As for project management risk, Mr Krsek says that some of the 10–15 projects the company carries out per year are worth 10–20% of annual revenue. Any mistake could wipe out the company's profits, so each project manager reports directly to the board.

In the case of Skoda Transport, then, managing risk has not been assigned solely to a separate function; rather, it has been integrated into the company's strategy and operating practice. Similarly at BT, Mr Katz agrees that the role of a central risk team should be to provide co-ordination, support and challenge, but the wider business must always own and manage its risks. As a result, Mr Katz adds, the risk-function staff at BT remains intentionally lean, and risk management responsibilities at BT are shared across departments.

A DIFFERENT OLYMPIC LEGACY

It was a failure of management, said G4S chief executive Ashley Almanza in November 2013.[13] Mr Almanza took over at the security group when his predecessor stepped down in May 2013 after a profits warning, and the departure of other senior executives.[14] "We need to invest more in risk management systems and processes," he said. "The fact is, we didn't have a group risk manager with executive responsibility, and now we do."

The group risk director appointed is a former Deloitte partner, Alastair James, who took up his post in September 2013. "There needs to be more joined-up thinking over risk," he says, asked about the scandals that have rocked the company's reputation, share price and results in recent years.

In many ways Mr James sees the scandals as a symptom of deeper problems, with a rapid international expansion (often through acquisition) diluting the culture. Most notorious was the inability to provide sufficient security staff for the London 2012 Olympics. "It was a failure of project management," says Mr James, adding that the changed company would now appoint a senior person to oversee such a big project. "Now we're working hard to mend our relationship with the UK government." That sort of damage outweighs even the £88m loss the company suffered as a result of the bungled Olympics contract.[15]

It is a good example of the reputational damage that can be done through a big failure in risk management. But for G4S, the scandals went much further than that. The UK's Serious Fraud Office is also investigating allegations that G4S overcharged for the electronic tagging of offenders, part of another contract for the UK government.[16] In July 2013 G4S security guards were found to have unlawfully killed a UK deportee,[17] and the South African authorities took over control of a G4S maximum security prison, saying that the company had in effect lost control.[18]

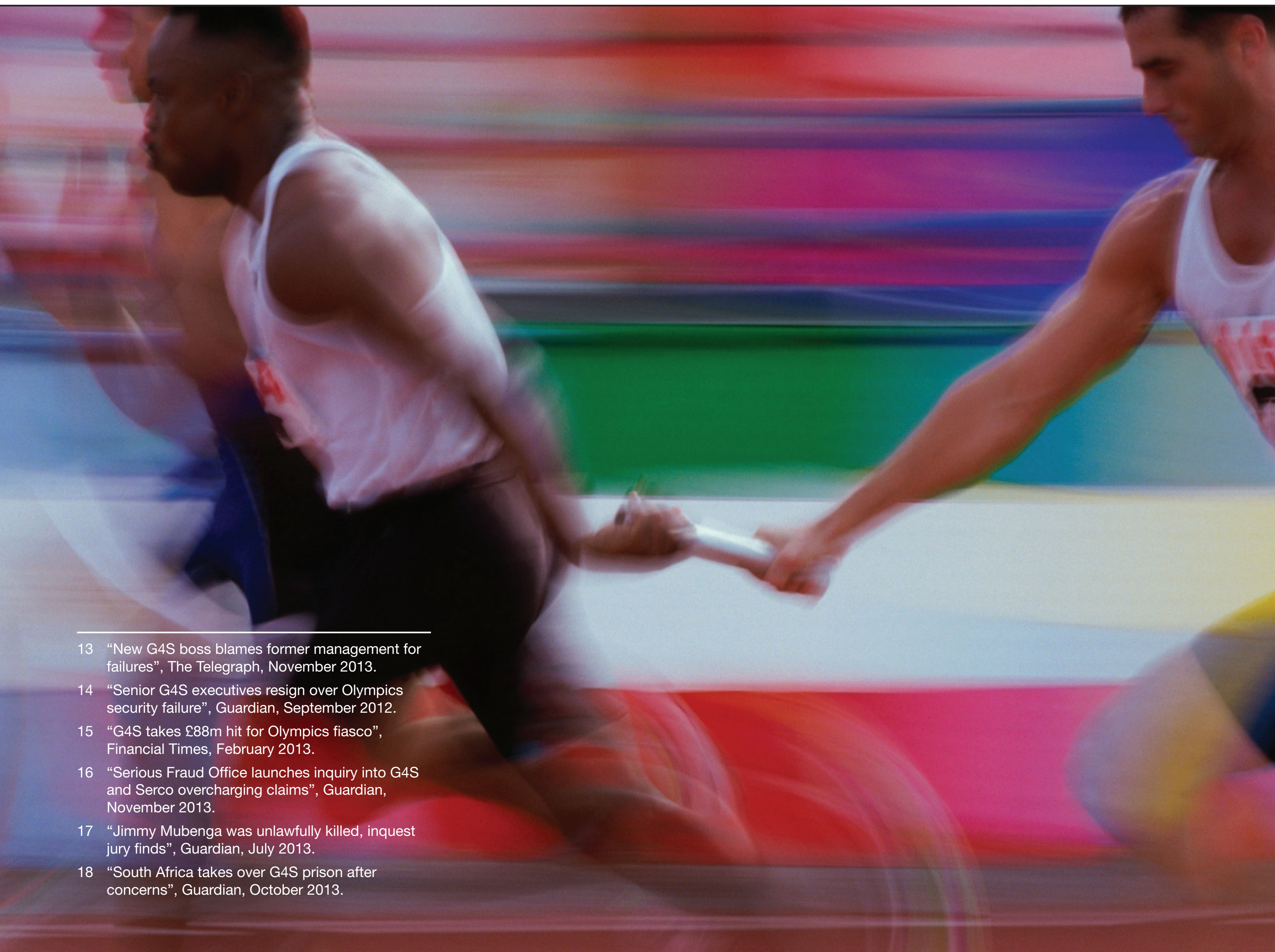
The company's response to such problems went much deeper than just hiring a risk director. The new chief executive immediately launched a strategic review, the greatest impact of which was to make the company review its international strategy, with fast-growing emerging markets now accounting for around 40% of revenue. "Rather, we're looking to extend some of our existing services such as cash management into countries where we already have a good presence," says Mr James. It is also exiting a series of businesses and countries and has cut back on the amount of autonomy allowed to country and regional managers.

It is a big change in the way the company thinks and acts, and the appointment of a risk director to bridge various functional aspects of the group is just one part of that.

SEEKING OPPORTUNITIES IN RISKY TERRITORY

With readership and advertising levels falling, the magazine publishing industry has had to change substantially in recent years. Andrew Zerzan, head of risk management at publisher and information provider Reed Elsevier Group, says that the company has shifted away from print and towards data provision (among other areas), and he talks of his role as being to co-ordinate talk between diverse departments ranging from events to data analysis.

Mr Zerzan has also been instrumental in the company's international expansion. Reed Elsevier sees potential in China and entered the market through its events division. Mr Zerzan is charged with making sure that



13 "New G4S boss blames former management for failures", The Telegraph, November 2013.

14 "Senior G4S executives resign over Olympics security failure", Guardian, September 2012.

15 "G4S takes £88m hit for Olympics fiasco", Financial Times, February 2013.

16 "Serious Fraud Office launches inquiry into G4S and Serco overcharging claims", Guardian, November 2013.

17 "Jimmy Mubenga was unlawfully killed, inquest jury finds", Guardian, July 2013.

18 "South Africa takes over G4S prison after concerns", Guardian, October 2013.

other parts of the company looking to enter China meet with the handful of employees who know it. It adds some substance to claims that good risk management can unlock opportunities.

Retail is another industry which has been going through significant change. Staples, the biggest supplier of office equipment in the US, has found itself on the back foot as its corporate clients have moved online. The challenge it faces now is to adapt its product mix to respond to trends in digital technology and to continue to adequately serve its retail customers, who still prefer a bricks-and-mortar shopping experience.

The board at Staples, according to CFO Christine Komola, is squarely focused on changing the company to meet the demands of a different marketplace. And while the enterprise risk management committee, which reports to the board, covers the expected areas such as credit and supplier risk, it also plays an important role in helping to understand where the market is going and in finding out how to get there, says Ms Komola.

"Retail is another industry which has been going through significant change. Staples, the biggest supplier of office equipment in the US, has found itself on the back foot as its corporate clients have moved online."

CONCLUSION

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As distrust of corporations has mounted and social media fan the flames of corporate scandals ever faster, boards have become more aware of the need to protect their company's brand and reputation.

This has now become a risk management priority in its own right, alongside more traditional responsibilities such as guarding against financial and compliance risk.

In their quest to protect their company's image, however, few boards are actually focusing on new and emerging areas of risk, such as cyber attacks, where an incident could cause serious damage to the company's reputation. Going forward, a re-evaluation of how resources are allocated to different categories of risk may be in order. Similarly, the priority given to more immediate concerns – such as compliance risk – over longer-term or more abstract threats somewhere down the supply chain – such as human rights abuses – may also merit review.

Beyond procedural steps to improve risk management, there are also a number of cultural changes that boards are undertaking, which, given their nature, will take time to be fully implemented. The public scrutiny under which corporate behaviour has been placed in recent years – whether as a result of employees mis-selling financial products, corruption of public officials or companies' use of tax avoidance schemes – has clearly put unethical behaviour on the board agenda. Believing it to be an area that could cause significant reputational damage, companies are starting to pay greater attention to their corporate culture more generally, with senior management accepting that they will have to take the lead in rooting out unethical behaviour.

The biggest challenge now, however, is not to stop half-way. Boards have a tendency to invest time and money into risk management during tough periods, but attention levels fall abruptly when the economic climate improves. So, as the macroeconomic mood brightens and buoyancy returns to markets, board directors would do well to remember that the time to fix the roof is when the sun is shining.

Clifford Chance view

"The survey responses demonstrate that risk is very much on the agenda of the world's largest companies and on the minds of their boards. There is a need to keep that focus and, in some cases, to broaden it to consider some of the newer, emerging categories of risk in today's rapidly changing business environment.

It is equally important for boards to bear in mind that risk is not necessarily all downside. For companies with strong leadership and vision that identify risks and implement an appropriate risk-management culture throughout their organisations, risks can be managed effectively – and turned into rewarding business opportunities that help them move ahead of competitors who may be less well-prepared. Management of risk plays a key role in building and maintaining the relationship of trust with key stakeholders and the broader community that is so critical for all successful businesses."

Matthew Layton, Managing Partner

ABOUT THIS REPORT

About the research

View from the top: A board-level perspective on current business risks examines the areas of risk corporate boards are prioritising in today's business environment. With the global financial crisis now over and the expectation of better times ahead, this report considers the extent to which board members and their companies are managing these risks effectively. The Economist Intelligence Unit draws on two main sources for its research and findings:

- **A global survey of 320 board-level executives conducted in the first quarter of 2014. Of these, 33% are non-executive directors, 43% are CEOs, and 14% are CFOs. The remainder are all executive directors representing a number of functions. All respondents are from companies reporting annual revenue in excess of US$500m.**

  Of the total, 16% are from the financial services industry, 13% are from healthcare and pharmaceuticals, 11% are from telecommunications, the media and technology, and 9% each are, respectively, from the consumer and retail, oil and gas, mining and industrial sectors.

  Over one-third (34%) of respondents are based in Europe, 28% in Asia-Pacific, and 24% in North America.

- **A series of in-depth interviews conducted with the following senior executives and experts:**

  - Ilana Atlas, non-executive director, Coca-Cola Amatil, Suncorp Group, Westfield Group
  - Roger Cagle, deputy chief executive officer, SOCO
  - Adrian Clements, general manager, asset risk management, ArcelorMittal
  - Steve Culp, global managing director of risk management, Accenture
  - Irene Dorner, chief executive officer, HSBC (United States)
  - David Hancock, head of risk and benefits, Transport for London
  - Andrew Hitchcox, chief actuary and risk officer, Tokio Marine Kiln
  - Alastair James, group director of risk and programme assurance, G4S
  - Andre Katz, head of enterprise risk management, BT Group
  - Christine Komola, chief financial officer, Staples
  - Tomáš Krsek, chief executive officer and chairman, Skoda Holding
  - Howard Kunreuther, co-director, Wharton Risk Management and Decision Processes Center, The Wharton School, University of Pennsylvania

- John Ludlow, senior vice president and head of global risk management, InterContinental Hotels Group
- Michael Lynch-Bell, non-executive director, Kazakhmys, Lenta, Equus Petroleum and Seven Energy International
- Erwann Michel-Kerjan, managing director, Wharton Risk Center, The Wharton School, University of Pennsylvania
- José Morago, group risk director, Aviva
- Frank Nutter, president, Reinsurance Association of America
- Carol Pullan, non-executive director, Caracal Energy, Salamander and PGS
- Jake Storey, chief risk officer, Gearbulk
- Richard Waterer, managing director, Marsh Risk Consulting UK and Ireland
- Carolyn Williams, technical director, Institute of Risk Management
- Steve Wilson, chief risk officer of general insurance, Zurich Insurance
- Johann Xavier, chief financial officer, Saatchi and Saatchi (Asia Pacific)
- Andrew Zerzan, head of risk management, Reed Elsevier

We are grateful to all interviewees and survey participants for their valuable time and insights. The Economist Intelligence Unit would also like to thank the Clifford Chance Global Risk Team for their insights.

About this report

This report is published by Clifford Chance LLP and written by The Economist Intelligence Unit, with the exception of the foreword, the Clifford Chance perspectives and views, and those quotes that are attributed to Clifford Chance. The views expressed by the Economist Intelligence Unit do not necessarily reflect those of Clifford Chance LLP.

OUR GLOBAL RISK TEAM

Our Global Risk Team brings together governance, risk and compliance expertise from across Clifford Chance. Our cross-border risk team is here to help you tackle the challenges facing your global business in the current environments.

At Clifford Chance we regularly advise corporations across all regions and sectors who are navigating the kinds of issues highlighted in this report. We help clients navigate and plan for regulatory changes, address accusations of misconduct at board level, prepare for emergency scenarios and tackle risk and conduct issues once they arise. We also provide risk assessment and compliance advice.

We believe there is real value to be added in bringing together our depth and breadth of experience into a core risk team, which regularly works together sharing developments and experiences across this broad area, for the benefit of our clients.

We would welcome your questions and feedback on this report and look forward to the opportunity of working with you to address your organisation's risk challenges and concerns.

Clifford Chance Global Risk Team

Guy Norman
Partner and Risk Team Leader
T: +44 20 7006 1950
E: guy.norman@cliffordchance.com

Jeremy Sandelson
Partner and Risk Team Leader
T: +44 20 7006 8419
E: jeremy.sandelson@cliffordchance.com

Michael Bray
Consultant to the Risk Team
T: +44 20 7006 1291
E: michael.bray@cliffordchance.com

David D. DiBari
Partner, Washington
T: +1 202 912 5098
E: david.dibari@cliffordchance.com

Peter Dieners
Partner, Düsseldorf
T: +49 211 43 55 5468
E: peter.dieners@cliffordchance.com

Valerie Kong
Partner, Singapore
T: +65 6410 2271
E: valerie.kong@cliffordchance.com

Rae Lindsay
Partner, London
T: +44 20 7006 8622
E: rae.lindsay@cliffordchance.com

Glen Ma
Partner, Shanghai
T: +86 21 2320 7217
E: glen.ma@cliffordchance.com

Edward O'Callaghan
Partner, New York
T: +1 212 878 3439
E: edward.ocallaghan@cliffordchance.com

Luke Tolaini
Partner, London
T: +44 20 7006 4666
E: luke.tolaini@cliffordchance.com

Nigel Wellings
Partner, Dubai
T: +971 4362 0676
E: nigel.wellings@cliffordchance.com

Wendy Wysong
Partner, Hong Kong/Washington
T: +852 2826 3460
E: wendy.wysong@cliffordchance.com

C L I F F O R D
C H A N C E

OUR INTERNATIONAL NETWORK

Abu Dhabi
Clifford Chance
9th Floor, Al Sila Tower
Sowwah Square
PO Box 26492
Abu Dhabi
T +971 2 613 2300
F +971 2 613 2400

Amsterdam
Clifford Chance
Droogbak 1A
1013 GE Amsterdam
PO Box 251
1000 AG Amsterdam
T +31 20 7119 000
F +31 20 7119 999

Bangkok
Clifford Chance
Sindhorn Building Tower 3
21st Floor
130-132 Wireless Road
Pathumwan
Bangkok 10330
T +66 2 401 8800
F +66 2 401 8801

Barcelona
Clifford Chance
Av. Diagonal 682
08034 Barcelona
T +34 93 344 22 00
F +34 93 344 22 22

Beijing
Clifford Chance
33/F, China World Office Building 1
No. 1 Jianguomenwai Dajie
Beijing 100004
T +86 10 6505 9018
F +86 10 6505 9028

Brussels
Clifford Chance
Avenue Louise 65
Box 2, 1050 Brussels
T +32 2 533 5911
F +32 2 533 5959

Bucharest
Clifford Chance Badea
Excelsior Center
28-30 Academiei Street
12th Floor, Sector 1,
Bucharest, 010016
T +40 21 66 66 100
F +40 21 66 66 111

Casablanca
Clifford Chance
169 boulevard Hassan 1er
20000 Casablanca
T +212 520 132 080
F +212 520 132 079

Doha
Clifford Chance
Suite B
30th floor
Tornado Tower
Al Funduq Street
West Bay
PO Box 32110
Doha
T +974 4 491 7040
F +974 4 491 7050

Dubai
Clifford Chance
Building 6, Level 2
The Gate Precinct
Dubai International Financial Centre
PO Box 9380
Dubai
T +971 4 362 0444
F +971 4 362 0445

Düsseldorf
Clifford Chance
Königsallee 59
40215 Düsseldorf
T +49 211 43 55-0
F +49 211 43 55-5600

Frankfurt
Clifford Chance
Mainzer Landstraße 46
60325 Frankfurt am Main
T +49 69 71 99-01
F +49 69 71 99-4000

Hong Kong
Clifford Chance
28th Floor
Jardine House
One Connaught Place
Hong Kong
T +852 2825 8888
F +852 2825 8800

Istanbul
Clifford Chance
Kanyon Ofis Binasi Kat. 10
Büyükdere Cad. No. 185
34394 Levent, Istanbul
T +90 212 339 0000
F +90 212 339 0099

Jakarta*
Linda Widyati & Partners
DBS Bank Tower
Ciputra World One 28th Floor
Jl. Prof. Dr. Satrio Kav 3-5
Jakarta 12940
T +62 21 2988 8300
F +62 21 2988 8310

Kyiv
Clifford Chance
75 Zhylyanska Street
01032 Kyiv
T +38 (044) 390 5885
F +38 (044) 390 5886

London
Clifford Chance
10 Upper Bank Street
London
E14 5JJ
T +44 20 7006 1000
F +44 20 7006 5555

Luxembourg
Clifford Chance
10 boulevard G.D. Charlotte
B.P. 1147
L-1011 Luxembourg
T +352 48 50 50 1
F +352 48 13 85

Madrid
Clifford Chance
Paseo de la Castellana 110
28046 Madrid
T +34 91 590 75 00
F +34 91 590 75 75

Milan
Clifford Chance
Piazzetta M. Bossi, 3
20121 Milan
T +39 02 806 341
F +39 02 806 34200

Moscow
Clifford Chance
Ul. Gasheka 6
125047 Moscow
T +7 495 258 5050
F +7 495 258 5051

Munich
Clifford Chance
Theresienstraße 4-6
80333 Munich
T +49 89 216 32-0
F +49 89 216 32-8600

New York
Clifford Chance
31 West 52nd Street
New York
NY 10019-6131
T +1 212 878 8000
F +1 212 878 8375

Paris
Clifford Chance
9 Place Vendôme
CS 50018
75038 Paris Cedex 01
T +33 1 44 05 52 52
F +33 1 44 05 52 00

Perth
Clifford Chance
Level 7
190 St Georges Terrace
Perth WA 6000
T +618 9262 5555
F +618 9262 5522

Prague
Clifford Chance
Jungamannova Plaza
Jungamannova 24
110 00 Prague 1
T +420 222 555 222
F +420 222 555 000

Riyadh
Clifford Chance
Building 15, The Business Gate
King Khalid International Airport Road
Cordoba District, Riyadh, KSA.
P.O.Box: 3515, Riyadh 11481,
T +966 11 481 9700
F +966 11 481 9701

Rome
Clifford Chance
Via Di Villa Sacchetti, 11
00197 Rome
T +39 06 422 911
F +39 06 422 91200

São Paulo
Clifford Chance
Rua Funchal 418 15º- andar
04551-060 São Paulo-SP
T +55 11 3019 6000
F +55 11 3019 6001

Seoul
Clifford Chance
21st Floor, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210
T +82 2 6353 8100
F +82 2 6353 8101

Shanghai
Clifford Chance
40th Floor, Bund Centre
222 Yan An East Road
Shanghai 200002
T +86 21 2320 7288
F +86 21 2320 7256

Singapore
Clifford Chance
Marina Bay Financial Centre
25th Floor, Tower 3
12 Marina Boulevard
Singapore 018982
T +65 6410 2200
F +65 6410 2288

Sydney
Clifford Chance
Level 16
No. 1 O'Connell Street
Sydney NSW 2000
T +612 8922 8000
F +612 8922 8088

Tokyo
Clifford Chance
Akasaka Tameike Tower
7th Floor
2-17-7, Akasaka
Minato-ku
Tokyo 107-0052
T +81 3 5561 6600
F +81 3 5561 6699

Warsaw
Clifford Chance
Norway House
ul.Lwowska 19
00-660 Warsaw
T +48 22 627 11 77
F +48 22 627 14 66

Washington, D.C.
Clifford Chance
2001 K Street NW
Washington, DC 20006 - 1001
T +1 202 912 5000
F +1 202 912 6000

*Linda Widyati & Partners in association with Clifford Chance

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Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA
Clifford Chance US LLP

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