MAKING THE MOST OF MARKET UNCERTAINTY

COMPANIES NEED TO IMPROVE THEIR ABILITY TO RECOGNIZE WHEN RISKS PRESENT OPPORTUNITIES

ALEX WITTENBERG

The current uncertain business environment is creating an unprecedented opportunity for companies to build long-term shareholder value

When confronted with an uncertain future, many executives often revert to past practices or closely follow their industry peers in an attempt to insulate their organizations from undue volatility. But for those who choose to take calculated risks, the uncertain nature of the current business environment presents a unique opportunity to improve their strategic position and financial performance.

As global markets, national economies, and industries search for innovative and efficient solutions to fundamental issues, and new technologies disrupt the status quo, there is an unprecedented chance for companies to revamp their business models and create long-term shareholder value. There is also a disproportionate downside in failing to recognize and meet these challenges, causing companies to recede into irrelevance from once unassailable positions.

Across a wide range of industries, unconventional players are displacing traditional leaders by seizing new opportunities created by shifting industry landscapes. In financial services, for example, non-banks such as insurers and pension funds are capturing market share from traditional banks in a rapidly growing shadow banking system. In the energy sector, over the next 30 years natural gas could overtake coal as the second-most used energy source after oil. In health and life sciences, innovative health care providers are challenging the pervasive inflation in medical delivery by pioneering new models for providing better health care at lower cost.

Our research shows that chief financial officers and treasurers recognize that uncertainty is rising in the current business environment. (See Exhibit 1.) In a survey of more than 500 senior financial professionals, the majority said their companies are exposed to the same or greater earnings volatility compared to previous years. Eighty-six percent anticipate they will have as much, if not more, difficulty in forecasting critical risks to their businesses over the next three years.

IMPROVING STRATEGIC DECISIONS

Finance executives seem to be less sure about how to determine the best course for their companies. Organizations are launching various initiatives to counter current and emerging business risks. Some of the most common actions include focusing more on risk culture and awareness within their companies and investing more in information technology.

EXHIBIT 1: A TAXONOMY OF EARNINGS UNCERTAINTY

For the *2014 AFP Risk Survey* (published by the Association for Financial Professionals in collaboration with the Marsh & McLennan Companies Global Risk Center), more than 500 senior financial professionals were asked to share their views of their company's ability to forecast risks to earnings. These pages summarize some of the results.

Four years after the "Great Recession," companies anticipate that it will only become more difficult to anticipate risks to earnings. In addition to external factors, one reason for this predicament could be that risk management and financial planning and analysis teams generally do not work closely together, even though most executive management teams consider risk assessment important.

Source: Oliver Wyman analysis

However welcome these steps may be, many companies are missing a fundamental requirement for realizing the strategic rewards that will differentiate them from their competitors. Companies must integrate risk analysis and financial forecasting seamlessly into their evaluations of strategic opportunities in order to take advantage of new prospects. Otherwise, they will be unable to identify quickly and thoroughly those opportunities that offer the greatest short and long-term rewards.

CONCLUSION

Many companies are now moving away from defensive tactics to proactive initiatives such as launching new products and services, entering new geographic markets, and increasing their capital expenditures. But four years after the "Great Recession," most senior financial professionals believe their companies' financial planning and analysis teams have only a low-to-moderate level of cooperation with risk management.

If this status quo continues, there is a real danger that companies will be unable to respond rapidly to opportunities presented by external events, in part because they will have to wade through excessive data and inconsistent inputs from business units. Companies need to continue to improve how they integrate risk and forecasting analysis into strategic decisions if they hope to keep up with the speed at which new risks are reshaping the business landscape.

Alex Wittenberg is the New York-based executive director of the Marsh & McLennan Companies Global Risk Center.