SCALING UNCERTAINTY:

PERSPECTIVES ON THE NEW ZEALAND RISK LANDSCAPE

INSIGHTS FOR NEW ZEALAND BUSINESSES FROM THE 2021 BDO GLOBAL RISK LANDSCAPE REPORT

BDO's annual Global Risk Landscape report is available, providing an overview of critical challenges faced by businesses around the world. In compiling the data, we've found that New Zealand's response to COVID-19 has put us in a different position to most.

FOREWORD

2021 marks the sixth year of BDO's Global Risk Landscape report, this year titled "The Art of the Unknown." If the past year has taught us anything, it's that the unexpected can and will happen.

But the unexpected poses an unusual challenge for businesses—how can we best prepare for a challenge when we don't have all the necessary information? To many, this seems essentially impossible, and it's tempting to simply view things through the lens of blind luck; those who have succeeded over the past eighteen months just happened to get lucky. Our data shows this isn't the case.

The risk report opens with reference to the "wicked problem", a term from game theory that defines a problem which is impossible to completely understand. No matter how long you wait, or how much you observe, the problem never becomes completely clear, and never offers a clean divide between right or wrong solutions. This describes the last year of business.

Our primary discovery in the report is that there is a common thread among the businesses that overcame this "wicked problem", which means there is a path to success for businesses looking to prepare for the "wicked problems" of tomorrow.

That common thread is an agile mindset. Businesses that adapted to the situation quickly, even without the full picture, proved more resilient, and our survey found that these businesses were more likely to perform this way if they had already developed a risk-welcoming attitude. This is, of course, easier said than done. After all, the "wait-and-see" approach is instinctual—one in four of the businesses we spoke to identified they had reacted too slowly to the pandemic as it unfolded, and 60% of them had made an explicit decision to do this.

A conservative approach like this does, on paper, make sense. Before taking the next step, leaders wanted clarity on the problems they were facing. That's why the risk report is called "The Art of the Unknown"; because clarity never came, and waiting for information proved more of a risk than making quick decisions with incomplete information. "The Art of the Unknown" is the skill of wading out into uncharted waters and being decisive in the face of uncertainty. Below, we've taken the most relevant insights from the risk report, aiming to make clear how NZ businesses can develop this skill, and what challenges are most likely to come next for us here in Aotearoa.

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WHAT DOES IT MEAN TO BE A 'RISK-WELCOMING' BUSINESS IN NZ?

It's very clear that a company's attitude toward risk plays a central part in how it overcomes challenges. 53% of respondents who self-identified as risk-welcoming reported that the fallout of the pandemic had been 'less significant' or 'much less significant' than they were expecting, whereas only 16% of risk-averse companies felt the same. In fact, more than half of the risk-averse businesses reported that the impact was worse than expected.

COMMON HURDLES

Our respondents were asked what prevented them from welcoming the risks they faced, and this turned up some interesting results. For example, we found that stubborn adherence to pre-pandemic plans was a common roadblock, with 24% reporting it had locked them into a path that fast became irrelevant. We also saw that 23% of all respondents felt that blame culture in their business had exacerbated problems, making it more difficult to react quickly.

The full report identifies blame culture as a failure to keep employees feeling safe and secure. If employees feel that they will be penalised for acting outside of their jurisdiction, or trying something unconventional and failing, they will not act to fix problems that they identify outside of their job description.

FAMILY BUSINESSES

Our data also shows that family businesses in particular took most of the impact from the pandemic. This is especially relevant to us, because family business is the backbone of the New Zealand economy in a way that is not the case for many other countries.

Being risk-welcoming essentially boils down to investing in a formal structure for managing crisis situations, and planning possible contingencies for future challenges. There's a significant lack of this throughout New Zealand businesses, and this gap is more pronounced in family-owned businesses. The reasons for this are interesting, and largely cultural.

As a national community our outlook tends to be relaxed, and the "she'll be right" attitude is a key element of our national identity, so it's no surprise it carries through into business. Family businesses in particular prefer an implicit, informal system, as formalising risk management can be seen as "worrying too much", or even as a lack of confidence in the business. It does not come naturally to us. After all, why plan for failure?

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The truth is that risk management isn't planning for failure, it's planning for success in spite of failures outside our control. Understanding this, however, requires a perspective shift across Kiwi businesses everywhere. This might sound like a tall order, but it's actually already happening, spurred on further by the Delta outbreak and most recent wave of lockdowns.

THE BIG PICTURE

In exploring these ideas, it's really important to keep the full context of Kiwi business in mind. It's not hard to understand why we are playing risk management catch-up with other countries when we examine how young the New Zealand economy really is. Until as few as 30 or 40 years ago, we were not on the international economic map. Our biggest businesses are really only one generation old.

Those founders who have grown their companies from a shed to millions of dollars, and are still involved today, are understandably confident in their view of business. But the approach that built these pillars of our economy is not, in many cases, an approach which will help sustain them as we enter a more uncertain future.

BDO's Emanuel van Zandvoort highlights the solution in the report: "Businesses of a certain size or complexity should have an ERM framework in place, but do not necessarily need a risk manager. Risk management should be an integral part of decision-making and not a separate, and sometimes isolated, function."

As we've seen, it's possible to thrive even during tumultuous change by accepting risk, and looking at a crisis as a chance for growth. The alternative, as many have now experienced first-hand, is falling prey to disaster paralysis.

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WHAT ARE THE KEY RISKS TO NZ BUSINESSES?

The first step in becoming risk welcoming is grappling with the major risks that are out there. The Global Risk Landscape report provides a full breakdown over global risks, but not all of these apply to New Zealand as they do to other nations. While there is some overlap, our national response to COVID-19, our geography, and particular economic pressures have all dealt us a slightly different hand, giving us a unique set of priorities.

The top three pressures on global business caused by the pandemic are: Low employee satisfaction and wellbeing, lack of digital transformation capability / lack of adequate tech, and internal cultural issues.

Internal cultural issues are hard to examine by nature, and while they are still important for New Zealand businesses, they are not as important as another key pressure: Environmental, social, and governance risks (ESG), which sits around number seven on the global list. This means the top three for NZ look more like:

You'll notice that low employee satisfaction and wellbeing is still critical in NZ, even though it's been pushed to number two. This point is worth touching on, as it is embodied in a key hurdle that a majority of businesses are already facing right now—the NZ labour and skills shortage.

While our border policy has protected our economy from major damage, it is also currently preventing skilled migrants and working-holidaymakers from entering the country in the way they used to. This has laid bare how many businesses relied on migrant labour, and how many are now unable to attract local labour.

Over and over again, we hear about the difficulties that businesses are having finding staff, and the takeaway here is that no business is able to influence border controls, but all businesses can influence how they attract candidates. This includes re-examining how comptetitive renumeration packages are, which recruiting channels are best used, whether or not upskilling could fill internal gaps, and whether digital transformation may be the answer – a key point which we'll examine shortly.

1. ESG

2. Low employee satisfaction and wellbeing, linked closely to labour shortages generally

3. Lack of digital transformation capability/lack of adequate tech

Those who operate on a profit motive alone will be dismantled by the market.

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Finally, it's worth noting that cybersecurity is also a growing risk. That's not to say that it is an emerging risk; as past Global Risk Landscape reports have highlighted, cybersecurity risks are a prominent and present feature of doing business today. We've chosen not to highlight it beyond this mention because it is a constant risk, and should always be on everyone's radar regardless. Furthermore, it's a tangential part of the third risk on NZ's list—adequate technology.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE RISKS (ESG)

At their heart, ESG risks are tied to sustainability and social cohesion. Many people thought that the COVID-19 pandemic would signal a reverse of recent progress on sustainability, as happened during the financial crisis a decade ago. However, the reverse appears to be true.

For some time, corporates have thought of ESG policies as an optional extra, but it is becoming more apparent that they are not. A clear structure around ESG issues benefits risk management, but also creates more opportunities. For instance, many governments have linked their post-pandemic stimulus programs with the imperative to tackle climate change.

Meanwhile, renewable energy has developed to the point where it can comfortably rival traditional fossil fuels, across many applications given the growing magnitude of conventional power's drawbacks. In terms of sustainability, we have already reached the tipping point where companies are now expected to "walk the walk" and follow through on meaningful change in this area.

We also saw the pandemic highlight social issues, including gender and racial diversity, income equality, and employee welfare overall. Consumers, employees, investors, and governments are all demanding change in this arena, and with the transparency of social media and the increased availability of big data tools, corporate businesses have found there is nowhere to hide from these issues—they must be addressed sooner rather than later. Businesses are now actively judged on their ability to rise to the task of serving the community. Those who operate on a profit motive alone will be dismantled by the market.

To many corporates, this doesn't mesh with their understanding of business. It can be extraordinarily difficult to make changes in this area because it seems on the surface like a cost with no gain. What we are finding is that the gains that can be made here, while hard to track on paper, are not just beneficial—they are vital to survival.

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Responding to ESG risks is something to prioritise while managing employee satisfaction, because in the long run, solid policy on ESG issues will be what attracts people in the first place. Here, you can see how the key risks tend to tie into each other—ESG issues will only become more relevant to managing labour shortages.

Peter Bakker, World Business Council for Sustainable Development chief executive, points out that unless we use the post-pandemic return to "normal" to create a truly better focus, we will miss a massive opportunity, making things much harder for ourselves long-term. "We need to strengthen the links between sustainability, biodiversity loss, climate change, inequality, health, and big shocks to the system that are happening today," he says. "Never waste a good crisis: We have both the collective responsibility and the opportunity to act to be part of the solution, to take the lessons we can draw from this crisis into the core of the future of business."

TRANSFORMING BUSINESS FOR A DIGITAL FUTURE

The other common theme from the pandemic that businesses have likely already heard about is digital transformation. Those businesses that were already poised to switch most of their business to online channels were able to continue through lockdowns much less affected. This has since created a scramble for businesses to put these technologies in place. Inadequate technology was, in fact, the top pressure point for those firms that identified as risk-averse.

Research has also shown that predictive analytics played a key role in helping businesses navigate the problems they were facing. Companies that were able to leverage consumer and market trend data had more information, taking the edge off the "wicked problem", as described earlier. Essentially, investing in data analysis helped businesses adapt faster, because they had a better view of the situation. The key takeaway here is that collecting data isn't enough—tools like AI and machine learning have been invaluable for turning that data into usable insights, giving companies that had invested in them more confidence to make accurate decisions.

These advantages will only become more pronounced. We now live in a world in which events like the pandemic are predicted to become more frequent, but our ability to communicate about them is faster than ever, and it's this second point that makes data analysis hyper-relevant. Massive amounts of data are generated during a crisis, but only those who can separate the wheat from the chaff can do anything with it, and this is the crux of technology as it relates to risk management today.

Only 11% of respondents said they use data technology to forecast risk, implying there's a lot of room for improvement here. The good news is that computing power and technologies like cloud computing and AI mean data can be far more accessible than ever before. The real challenge for many will be ensuring they foster a culture in their workplace that encourages the actual use of these insights, especially in a crisis.

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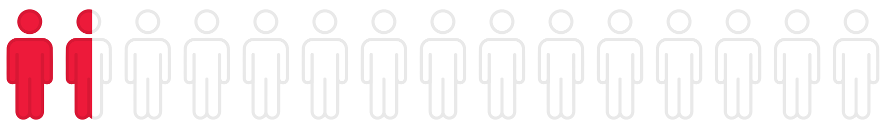

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WHAT HAPPENS NEXT?

COVID-19 continues to impact business, but it's likely the future holds bigger challenges, and the best way to manage them is to start preparing now. As we've seen, responding effectively to global crisis is feasible—many were able to pivot business models, increase investment in digital technology, and redouble effort into supporting staff wellbeing. The 2021 Global Landscape Risk report clearly showed that the companies able to embrace and welcome risk tended to cope better, often experiencing a less significant impact from the coronavirus, but a majority of Kiwi businesses still describe themselves as risk-averse.

Success in business is not about avoiding risks. Rather, it's about managing them, because ultimately risks are unavoidable. Uncertainty is simply part of life, and the only question is how soon businesses will choose to accept it—now, or after the next crisis? Despite the way it may sound, this isn't a cynical viewpoint. In fact, accepting these issues demands optimism and hope.

Changing the cultural perspective around risk is no easy task, but choosing to see crisis situations as chances for growth and development is the only real long-term option, and we're lucky that it also happens to be the most effective.

Risks are not static. Existing risks evolve, new ones emerge. The more that businesses can improve their understanding of risks through the use of new technology and accurate data, the more they can improve their ability to adapt when the next crisis occurs. This way, companies can thrive regardless of what happens next. After all, the one thing we know for sure about the future is that it is unknown, and this is the way it has always been.

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FOR MORE INFORMATION please contact your BDO adviser and visit bdo.nz/en-nz/services/business-services/risk-advisory or scan here to view the 2021 BDO Global Risk Landscape Report