RIDING THE WAVE OF UNCERTAINTY

NEW ZEALAND PERSPECTIVES ON THE BDO GLOBAL RISK LANDSCAPE REPORT

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BDO

FOREWORD

"Now more than ever, it's time for Kiwi businesses to understand the risks they face, and to embed a culture of risk management across their organisation."

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BDO Risk Advisory National Leader

The seventh annual BDO Global Risk Landscape Report, 'A Fragmenting World', focuses on the greatest risks facing businesses across the globe. It has been produced in the context of heightened geopolitical tensions that are having a significant impact on global economies and supply chains.

Conflicts and trade wars taking place on the other side of the world are having very real effects on the bottom lines of Kiwi businesses.

Meanwhile the increasingly pressing, global issue of ESG (Environmental, Social and Governance) is having a serious impact on NZ businesses, who are having to adjust to rapidly-evolving expectations from consumers, clients, employees and Government. With geopolitical and economic conditions changing every day, Kiwi businesses of all shapes and sizes, in every industry, are being impacted in a very real way by global events that they have no control over. What they can control, however, is their approach to managing these risks.

Now more than ever, it's time for Kiwi businesses to understand the risks they face, and to embed a culture of risk management that stretches throughout the organisation, from the board to the shop floor.

In 'Riding the wave of uncertainty: New Zealand perspectives on our Global Risk Landscape Report', we've taken the most relevant insights from our global report and summarised them into three key areas affecting NZ businesses today – helping you to ride the wave of uncertainty, not only embedding resilience into your organisation, but also harnessing the opportunities that some of these risks present.

GEOPOLITICAL TENSIONS AND ECONOMIC INSTABILITY

The war in Ukraine, volatile European markets and currencies, and challenges across China's political and economic landscape are just some of the issues impacting almost every country in every corner of the globe - including New Zealand.

We are broadly an import economy – and therefore this handful of issues playing out on the world stage is having a direct impact on our economy, and on our businesses. Many Japanese companies, for example, are attempting to create supply chains that do not depend on China, amid its growing conflict with the US. This has meant Japanese goods, including cars, have become more expensive and there have been delays in importing these into Aotearoa.

Meanwhile, although New Zealand does not depend on Russian oil, we do still depend on oil. Europe's sanctioning of Russia as a result of its invasion of Ukraine means that the EU has had to find its oil from alternative sources – including the Middle East and Asia – which is where NZ has traditionally imported from. We are now competing with other, larger economies, for fuel that has understandably increased significantly in price. It's simple supply and demand.

DOMESTIC INSTABILITY ALSO ON THE RISE

Increased global political tensions have combined with a heightening of domestic instability in countries around the world. The UK's recent experiences under the Liz Truss Government caused huge damage to Britain's economy – during a tenure that lasted only 45 days, the pound plunged to a record low, and the Bank of England was forced to bail out pension funds.

While at home, our politics have not been quite so dramatic, we do have an election coming up next year, and our three-year election cycles mean there is little room for Government to take a long-term view of issues – but the greatest threats we are seeing today, such as ESG, require long-term policies. Perhaps the best example of long-term thinking comes from the Māori economy, where businesses consider themselves as guardians of the whenua and its people, organisations often have business plans spanning 50 or even 100 years.

Political instability is leading to economic instability. Businesses are operating in a high-inflation, high interest rate, environment – one that is extremely volatile and has ramped up very quickly. It was worrying that while the Reserve Bank and Government both took actions earlier in the year to limit inflation, these have had no real impact. It is no surprise, therefore, to see in the BDO Wellbeing and Business Performance Index that business leader wellbeing has decreased significantly since earlier in the year – both external and internal costs are increasing as we see materials and people costs rising, resulting in margins becoming more and more squeezed.

Put simply, businesses are facing hard times. And yet one-third of respondents to the global risk landscape report said that they are unprepared for the risks stemming from geopolitical tensions (an increase of 8% from the previous year).

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FOCUS ON WHAT YOU CAN CONTROL

Businesses cannot control what happens in the geopolitical sphere, nor can they control rising inflation or interest rates. But what they can control is their approach to managing risk. In a volatile environment when the conditions of doing business are changing daily, the only action businesses can really take is to understand and monitor the different risks to their organisation, and know what controls are in place to mitigate those risks to an acceptable level.

The number one action you can take to manage uncertainty is to create an up-to-date risk register. This involves identifying the top risks facing your organisation (say 10 - 20), prioritising these risks before working out what controls you have in place to help mitigate them. This will give you a baseline to work from and allow you to make actionable plans to improve where and how your business is protected against risk.

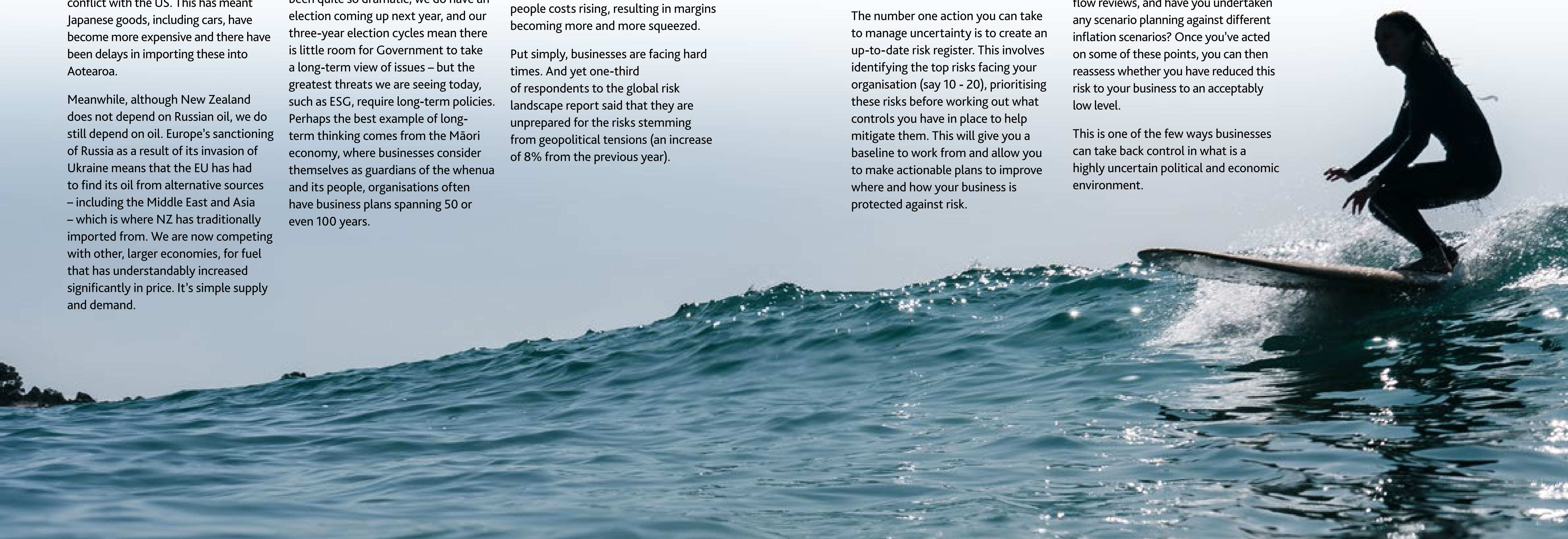
Importantly, this needs to become part of the fabric of the organisation – your register, and therefore action plan, should be a live document that evolves with your business and the risk landscape.

For example, no matter your industry or size, your business is likely going to be highly impacted by inflation in some way. If there is a risk that inflation might increase by a further 5% in the next six months, consider what your controls against that are. For example, how much do you understand your costs, how detailed and regular are your cash flow reviews, and have you undertaken any scenario planning against different inflation scenarios? Once you've acted on some of these points, you can then reassess whether you have reduced this risk to your business to an acceptably low level.

This is one of the few ways businesses can take back control in what is a highly uncertain political and economic environment.

ONE-THIRD

OF RESPONDENTS TO THE GLOBAL RISK LANDSCAPE REPORT SAID THAT THEY ARE UNPREPARED FOR THE RISKS STEMMING FROM GEOPOLITICAL TENSIONS (AN INCREASE OF 8% FROM THE PREVIOUS YEAR).



SUPPLY CHAIN

This year's global risk landscape report focused primarily on supply chains – already stretched from COVID-19, political uncertainty has caused further issues, with nearly half of respondents saying their supply chains have been severely impacted by disruption over the last 18 months.

Organisations have been forced to reassess how they're moving products, whether internationally or nationally, and there has been a clear shift in focus away from cost-efficiency and towards resilience.

New Zealand, being at the end of the global supply chain, has also suffered. Businesses in New Zealand have been forced to change their suppliers, find alternate routes, and purchase greater quantities of stock ahead of time, or endure unprecedented lead times. All of this has come at a cost – both real and opportunity - that is putting even further strain on cash flow.

In the BDO Global Risk Landscape Report, respondents ranked 5 key areas of supply chain risk:

1. GEOPOLITICAL TENSIONS

For example, at the time of writing, Russia has reneged on the international agreement to guarantee the Ukrainian global grain supply.

2. SUPPLY CHAIN TRANSPARENCY

Businesses that don't know where their suppliers are sourcing from are at increased risk of delays when a country or other factor involved in their supply chain experiences issues.

3. CYBER ATTACKS ON SUPPLY CHAINS

There has been a rise in cyber criminals attacking key supply chain infrastructure.

4. TRANSPORT AND DISTRIBUTION BOTTLENECKS

For example, when Shanghai went into lockdown earlier this year there were major delays in the delivery of Chinese goods to NZ.

5. RAW MATERIALS SHORTAGES

In particular, shortages caused by climate change events such as droughts and floods.

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You cannot limit your supply chain risk unless you understand it – supply chain transparency is therefore your first line of defence. There are a number of actions you can take from there to limit your exposure:

- **Engage with key suppliers to improve supply chain transparency –** understand who your key suppliers are, who is supplying them, and from which countries. Three-quarters of respondents to the global risk landscape survey ranked supply chain transparency as one of their business' highest priorities.
- **Increase inventory of critical components –** order more stock ahead of time so you can be sure you will have it when you need it.
- **Introduce dual sourcing of raw materials –** if one supplier in one country cannot deliver, you then have an alternative supply.
- **Regionalise your supply chain or near-shore production –** 52% of respondents to the global risk survey said that the risks of complex, global supply chains now outweigh the benefits. In an uncertain environment, the more local your supply, the better.
- **Introduce technology for supply chain analytics –** this enables you to better monitor goods at every stage of your supply chain, helping you identify potential roadblocks before they become an issue.
- **Create a full alternative supply chain as a backup –** while a significant cost, the global risk landscape report highlighted that many large multinationals have started to do this.

Even as we eventually overcome the issues around instability facing us currently, environmental considerations mean we will possibly never go back to the days of large, complex global supply chains. Now is the time to embed resilience at every level of your supply chain to manage the issues facing us today, and to future proof it against the issues that will face us tomorrow.

THREE-QUARTERS

OF RESPONDENTS TO THE GLOBAL RISK LANDSCAPE SURVEY RANKED SUPPLY CHAIN TRANSPARENCY AS ONE OF THEIR BUSINESS' HIGHEST PRIORITIES.

52%

OF RESPONDENTS TO THE GLOBAL RISK SURVEY SAID THAT THE RISKS OF COMPLEX, GLOBAL SUPPLY CHAINS NOW OUTWEIGH THE BENEFITS. IN AN UNCERTAIN ENVIRONMENT, THE MORE LOCAL YOUR SUPPLY, THE BETTER.

SUSTAINABILITY: ENVIRONMENTAL, SOCIAL & GOVERNANCE

ESG (ENVIRONMENTAL, SOCIAL & GOVERNANCE) HAS VERY QUICKLY BECOME ONE OF THE MOST PRESSING RISKS FACING BUSINESSES TODAY. IT CAN BE BROKEN DOWN INTO SEVERAL FACTORS:

COMPETITIVE ADVANTAGE

Consumers now expect businesses to be acting on ESG, while businesses pitching for new projects or work are frequently being asked what their ESG credentials are as part of that pitch. ESG considerations are becoming central to sustainable supply chain policies. Organisations who embrace sustainability stand to gain a competitive advantage, while those who are lax will see their bottom line suffer.

WAR ON TALENT

Just as consumers expect businesses to act on ESG, so too do employees. New Zealand is increasingly stretched for available talent, and recent visa changes have only made the process of hiring overseas workers more burdensome for the employer.

Taking meaningful action on sustainability could be the difference between a business hiring a perfect candidate or not hiring anyone at all. It also may just be what helps you keep your current employees.

INCREASED REGULATION

Almost every country has introduced some sort of ESG-related regulation and this will only increase over time. In Aotearoa, this has included mandatory climate-related risk reporting for large corporates, and emissions reporting and pricing for many of our biggest industries, including now our agricultural sector.

PHYSICAL RISKS TO BUSINESS INFRASTRUCTURE AND RESOURCES

We have already seen that raw material shortages as a result of climate change are presenting a key supply chain risk for many businesses.

As more extreme weather events begin to take hold, business infrastructure and resources are going to be increasingly at risk. Commercial fisheries, for example, are seeing lower yields of several key fish stocks as marine heatwaves become more common.

ESG has often been seen as secondary to other more immediate risks – it takes slightly longer to impact a business than the very immediate risks presented by supply chain disruption or inflation. This is reflected in the global risk landscape results, where only 22% ranked climate change and natural disasters as a significant priority.

However, ESG is an issue that is materially changing business' ability to win work, reach customers, and hire talent. Its effect on an organisation's bottom line is very real, and that's even without accounting for any risks presented by costs of compliance and physical risks to infrastructure. It is not something that can be put on the back burner any longer.

22%

RANKED CLIMATE CHANGE AND NATURAL DISASTERS AS A SIGNIFICANT PRIORITY.

While ESG is a risk, of all the issues discussed in this report, it also presents the strongest opportunity.

UNDERSTAND WHAT PARTS OF ESG ARE MOST IMPORTANT FOR YOUR BUSINESS

That said, it is a complex issue made up of many different facets. The best place to start is to undertake a materiality assessment. This doesn't have to be a complex and difficult task – take into account what your business does and what resources that requires, and then work out what issues are most important to you (this should be based on what you, your employees and your customers most care about). Then consider where you can have the most impact. Isolate the top three to five areas based on this, and then create a sustainability strategy that details what meaningful actions you will take on those topics and what targets you will put in place to measure your success.

For example, if you decide that limiting your emissions is a topic that is highly material to you, understand what your carbon footprint is (MBIE has a carbon emissions calculator designed for small businesses) and set a reduction target. This will then enable you to understand what you can do that will have the greatest impact – be that switching to a renewable energy supplier, limiting travel or talking to your suppliers to ensure they are minimising their carbon footprint.

Businesses tend to focus on environmental issues, but social and governance are also key parts of ESG. Social can include anything from community involvement to taking a strong stance on diversity internally.

Your clients, customers and employees want to know what you are doing in the ESG space, and so when it comes to governance, having strong data capture and reporting measures in place is key. Again, these are all key areas that can have a huge impact on your ability to attract and retain talent.

While ESG is a risk, of all the issues discussed in this report, it also presents the strongest opportunity. Businesses that do not act in this area face a very real threat as they witness their competitive advantage erode, their reputations suffer and their compliance and materials costs increase. However those that embrace ESG in a meaningful and genuine way are poised to attract and retain the best talent, improve their bottom line and create an organisation set up for success as the world transitions to a sustainable future.

WHERE TO FROM HERE?

Riding the wave of uncertainty is about accepting that there are many events entirely outside of your control, taking place all over the world, that are having very real impacts on your business and your ability to achieve your strategic vision.

But even as you accept this, you can still take action.

The only way to protect yourself from uncertainty is to build resilience into your organisation. Developing a strong risk management approach that enables you to stay up to date with changes as they happen, understand what the impact is to your business, and know exactly what levers you can pull to lessen those impacts, is really the only way to ride that wave and come out the other side.

When you do come out the other side, your business may look different. It may be more resilient, it may have contracted in some areas, or it may have expanded in others. You may be doing things a totally new way – and maybe, amidst all this tension and uncertainty, you may have harnessed an opportunity, and you may have found a better way of doing things.

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The only way to protect yourself from uncertainty is to build resilience into your organisation.

Scan the QR code for video insights and to learn more.

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