What the future holds: the biggest risks and top opportunities facing business

Most economists may have predicted another year of economic turbulence globally, but hope remains for companies eyeing growth in the coming year. According to Ernst & Young's latest report on risks and opportunities, many respondents believe there is scope for boosting revenues – providing they avoid the likely pitfalls along the way.
There are few absolutes when operating in today’s harsh corporate climate but it is widely accepted that organizations will always face risks and encounter opportunities, irrespective of whether market conditions are solid or unstable.

How they choose to protect themselves from any threats or take advantage of situations that could improve their bottom line differs from one company to the next. Much depends on their business strategy, the products and services they offer, the markets and territories they operate in and the state of their respective industries.

To prepare for what lies ahead, organizations need to understand the risks and opportunities that await them over the next few years. According to our recent report Business Pulse: exploring the dual perspectives on the top 10 risks and opportunities in 2013 and beyond,¹ the biggest three threats for companies are pricing pressure; cost cutting and profit pressure; and market risks.

More positive is the top three opportunities cited by the 641 companies from 21 countries that took part in the survey. Most of those questioned believe innovation in products, services and operations; emerging markets; and investing in processes, tools and training could offer the greatest rewards over the next few years.

A shift in thinking is evident among companies. Rather than waiting for developed markets to recover from an often-severe crash, following the global financial crisis of 2008–09, they now accept that the duration of the downturn is uncertain. Therefore, they are concentrating on optimizing their business by cutting costs and increasing efficiency on the one hand, accepting that they must find a way to be profitable in shrunken markets. And, on the other hand, they continue to look to grow with new markets: with many developed economies stagnating, they are looking to rapid-growth markets for growth.

“There is not a question of companies getting into rapid-growth markets. It is a question of how they win.”

Randy Miller
Global Risk Leader, Ernst & Young

Tread carefully: the top three global risks that businesses should prepare for

Few businesses considered pricing pressure a major threat when it came 15th in our 2010 risk and opportunities survey.² But three years on, it is the biggest concern for companies that are under increasing pressure to outpace their rivals amid tough market conditions.

The fallout from the global economic downturn is instrumental in forcing businesses to revise their prices in order to secure and retain existing clients. When the crisis struck, several industries in developed

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¹. Business Pulse: exploring the dual perspectives on the top 10 risks and opportunities in 2013 and beyond, Ernst & Young, 2013.

². Turn risks and opportunities into results: exploring the top 10 risks and opportunities for global organizations, Ernst & Young 2010.
nations crashed as credit dried up, banks became more risk averse and people, concerned about losing their jobs, stopped spending.

At the time, economists and financial analysts believed that markets would recover quickly once the crisis ended. But with many economies still struggling, company executives have realized that the downturn is unlikely to disappear anytime soon. Whether operating in shrunken developed markets or rapid-growth ones, businesses are cutting costs and prices to stay competitive.

Dealing with pricing pressure is a major challenge for companies, but it can be helped with the right strategy. For example:

- Productivity can be improved through technological innovation.
- Working practices can be made more flexible, or work can be offshored or outsourced.
- Products and services can be innovated.
- With slow revenue growth in mature markets, supply chains must create sustainable cost savings to support margins and help pay for growth elsewhere. Innovation in this area is crucial for a business’s sustainability in a globalized environment.

The traditional response to downward pricing pressure includes more frequent and aggressive price cuts in response to current pricing trends and competitor analysis.

Cost cutting and profit pressure is another big concern for the world’s commercial executives. In times of crisis, most companies focus on cutting staff, closing offices and putting any expansion plans on hold. After five years in a global downturn, the big challenge facing today’s executives is making further cuts without damaging products and services. But businesses that get it right will benefit. We estimate that a 1% reduction in costs, achieved through a sophisticated procurement strategy, is equivalent to a 10% increase in sales.\(^3\) Organizations that realize this are using technology such as the latest IT systems to improve productivity, introduce more flexible working hours and re-engineer supply chains to service growth in rapid-growth markets.

Cost cutting and profit pressure are pushed in large part by market risks, including commodity price volatility, interest and exchange rates, and equity risk. Such market volatility was named as the third-biggest risk facing companies.

The downturn is encouraging companies in developed economies to explore rapid-growth markets for investment and expansion opportunities. But volatility in commodity prices, interest and exchange rates, and equity risks have to be accounted for when attempting to tap rapid-growth markets.

The issue of commodity price volatility may not be as bad going forward as it has been. Currency pricing, however, could continue to fluctuate during the same period.

We expect oil prices to hover between US$100 and US$120 per barrel and metal markets to perform stronger throughout 2013.\(^4\) Nevertheless, the absolute price of some commodities remains high, feeding into price pressures and influencing decisions over which markets companies choose to buy from and sell to.

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Opportunity knocks: identifying the key markets and business areas that could drive growth

When picking the top opportunity for businesses, most respondents chose innovation through new products and services, or operational changes within their respective companies. However, innovation is not always a managed process, with the flow of new products and services commanded from the top. The innovation process needs to be fluid and flexible. It also tends to be messy, unpredictable and spontaneous; “one size fits all” is rarely a productive approach. Organization culture, and the ability to do things bottom-up as well as top-down, makes a huge difference to success.

What we see is that innovative organizations drive a culture and set up policies to promote and reward innovation systematically. Having a clear vision of what this means for your business is key.

External contributions such as commercial and academic partnerships can help too. Innovation often occurs through networking and critical mass. Companies exist close to one another and compete, collaborate and learn together.

Emerging markets is the second major opportunity for businesses, according to respondents. Most say they spend four times more on research and development in countries such as China and India, than in mature markets such as the UK and US.

With developed economies still struggling, executives are confident they can boost company revenues by selling innovative products and services to rapid-growth markets. And with good reason. The International Monetary Fund expects rapid-growth markets to expand by 5%-6% between 2013 and 2014, which is significantly more than some developed nations.

Based on such figures, companies from a range of sectors believe the bulk of their growth will come from these markets. As such, they have adjusted their business strategy to focus more on these economies.

Creating products and services specifically for untapped markets may make commercial sense, given that the BRIC nations (Brazil, Russia, India and China) have registered strong GDP growth in tough market conditions. But developing economies are not completely immune to these troubles.

Rapid-growth markets have attracted lots of inward investment from developed economies in recent years, but they’ve struggled at times throughout the downturn.

Nevertheless, rapid-growth markets still offer good opportunities to investors – providing they target the right nations. For example, it’s surprising that more companies don’t focus on the Philippines, Vietnam and Indonesia, which have populations of 100 million people or more. Such numbers create a huge target market that businesses from developed markets should be looking to exploit.

Investing in processes, tools and training to achieve greater productivity is the third-biggest opportunity, according to respondents. The first step toward maintaining a flexible operating model is to recognize where internal investment will help the organization. Productivity is an area where many companies feel
there is much room for improvement. That is especially true of developed markets, such as North America and the EU, where companies place this opportunity second. Rapid-growth markets place it fourth. However, some of the best examples of innovation to cut costs and create better service can be found in rapid-growth markets. Some private hospital groups in India are lowering treatment costs through remote diagnosis and surgical specialization – an example likely to be followed by some African countries. And yet, the question remains: will cheaper really mean better services?

Thoughts on the greatest opportunities and biggest risks could change depending on how economies and industries perform. If growth in rapid-growth markets fails to meet expectation, companies eyeing BRIC countries for improved revenue will turn their attention elsewhere. The upshot is that the top three opportunities in our recent report may fall down the ranking if market conditions force companies to put innovation or new processes lower down their priority list. Whatever happens, one thing is sure: forecasting the future is risky, but businesses that fail to look forward will almost certainly be left behind in an increasingly competitive, globalized world.

Top 10 business risks and opportunities as ranked by respondents

<table>
<thead>
<tr>
<th>Rank</th>
<th>Risk</th>
<th>Opportunity</th>
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<tbody>
<tr>
<td>1</td>
<td>Pricing pressure</td>
<td>Innovation in products, services and operations</td>
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<tr>
<td>2</td>
<td>Cost cutting and profit pressure</td>
<td>Emerging market demand growth</td>
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<tr>
<td>3</td>
<td>Market risks</td>
<td>Investing in process, tools and training to achieve greater productivity</td>
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<tr>
<td>4</td>
<td>Macroeconomic risk: weaker or more volatile world growth outlook</td>
<td>New marketing channels</td>
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<tr>
<td>5</td>
<td>Managing talent and skill shortages</td>
<td>Improving execution of strategy across business functions</td>
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<td>6</td>
<td>Expansion of government’s role</td>
<td>Investing in IT</td>
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<tr>
<td>7</td>
<td>Regulation and compliance</td>
<td>Excellence in investor relations</td>
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<tr>
<td>8</td>
<td>Sovereign debt: impacts of fiscal austerity or sovereign debt crises</td>
<td>Leveraging CSR and public confidence</td>
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<tr>
<td>9</td>
<td>Emerging technologies</td>
<td>Investing in cleantech</td>
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<tr>
<td>10</td>
<td>Political shocks</td>
<td>Global optimization and relocation of key functions</td>
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How can you be confident your company is well placed to meet the risks currently on the horizon? And how can you know that opportunities aren’t passing you by?

The following questions will help you gauge how ready you are.

**Cost competitiveness**

1. How do you ensure you focus on the right strategic relationships (e.g., open innovation to design the right products from the best materials and secure critical supply)?
2. How do you sustain margins and operating results in the face of increased global competition?
3. What factors should you consider when expanding globally?
4. Which supply markets and categories should you be targeting? Are you sourcing from the right locations to be cost-competitive?
5. How do you preserve value while minimizing costs?
6. How do you balance pricing pressure and customer service excellence?
7. How frequently do you track metrics that can predict fundamental marketplace shifts?
8. How do you determine which objectives and opportunities to pursue within the organization’s appetite for risk?
9. Is your information security controls framework efficient and are there additional ways to save costs?
10. Keeping cost saving in mind, are you successfully focused on the information security risks that matter?

**Customer reach**

1. How do you evaluate rapid-growth markets effectively to make sure they fit with your competencies and your strategic objectives?
2. How is innovation embedded in your business models?
3. How do you work effectively with channel partners to ensure effective articulation of the value proposition?
4. How do you track risk and adoption rates of emerging technologies to identify which ones are highly likely to have limited value or high deployment risk?
5. How do you assess changes in factors such as adoption of IT, workforce demographics and rise of social media technologies to identify the most impactful opportunities in emerging technologies?
6. What financial analysis do you conduct to identify the true costs and benefits of sourcing to rapid-growth markets?
7. How do you connect to your customers, suppliers and employees to drive innovation in your business?
8. How extensively is technology used to accelerate and drive adoption of new ideas and programs?
9. How do you consider technology and information security, while launching a new product or entering a new geographical market?
10. How secure are your new go-to-market strategies (websites, mobile apps, social media) including digital payment systems to ensure customer confidence and brand reputation?
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1. How do you minimize variability in your supply chain while introducing more cost-effective processes and solutions?
2. How do you plan and prepare for the increased volatility of the market we operate in?
3. Have you effectively consolidated and standardized global activities, including using a shared service center?
4. Do you have the right people with the right skills in the right roles?
5. Do you have the right solutions and integrated systems and processes in place to increase collaboration?
6. What risk-assessment measures for innovations do you undertake?
7. Are you carrying out a regular market technology scan to identify new tools and options to protect critical systems and data?
8. Can you analyze your business processes to ensure optimal performance (i.e., marketing spend analysis and supplier spend analysis)?
9. Are your information security and compliance functions best-in-class and efficiently integrated with other risk functions?
10. How do you continuously improve service levels and meet ever-greater business demands, while optimizing IT service costs?

1. How do you develop insights on possible impacts on business strategy and performance in the event of a shift in government regulations?
2. How do you evaluate in which way new regulations or laws can create new markets for specialized products or services?
3. What capability do you have in scenario analysis and taking any pre-emptive action necessary to offset any impact of change in government role?
4. Who do you collaborate with to track changing regulations and seek compliance assistance?
5. How do you reduce your exposure to share price volatility?
6. How do you identify cleantech investment opportunities that are supported by proprietary technologies and multiple partnerships to minimize risk?
7. Is communication about your compliance program part of your go-to-market strategy and used to build confidence between your organization and your customers?
8. Do you have a regulatory intelligence and reporting system that protects the organization from unnecessary fines and other legal impacts?
9. Is IT and information security a standing agenda item in the boardroom and in large transformation projects?
10. Is your compliance-monitoring system effective and efficient?

“When all companies are thinking about emerging technologies, there’s a danger that you will miss the boat without sufficient investment.”

Paul van Kessel
Global IT Risk and Assurance Leader, Ernst & Young