

MARSH

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Industry research report  
Executive highlights



# New risk management insights in the power and utilities sector



The current downturn in the global economy has been swift and severe. It raises important questions about how organisations conduct their business – and particularly about how they assess and manage risk. It also poses two fundamental and interconnected threats for the power and utilities industry.

The first is a short-term decline in demand driven by falling industrial activity across the region. While the power and utilities industry customer base is spread across all industries, smoothing and diluting some immediate recessionary risks, it is heavily regulated, a public service industry in effect, with statutory obligations preventing many companies from withdrawing their service or supply in the event of non-payment.

The second fundamental threat of the downturn is the lack of available investment capital, a symptom of this bank-led recession, and a reluctance on the part of many project developers and operators to incur more debt at this time. Not only can this delay power projects in the near-term, it can also have significant bearing on the long-term outlook for the industry, namely its ability to meet long-term demand expectations while reducing CO2 emissions, increasing energy efficiency levels, and investing in renewable energy and clean technologies as set by the European Union’s 2020 targets.

To examine how organisations are responding to the downturn, Marsh commissioned the independent research agency Ipsos to conduct a survey of changing attitudes to risk management across European organisations. Over 700 organisations were interviewed across 12 countries and 7 industry sectors; of these, 56 are in the power and utilities sector. This comprehensive study of the European power and utilities sector examines the industry’s immediate risk management concerns, its confidence in its ability to manage these, and reviews how power and utility companies plan to address risk management in the coming months.

### Impact of the economic downturn is limited but the industry is not immune

A picture has emerged of a confident industry, but mindful of the longer-term impact that the downturn may bring. Its confidence, second only to that of the life sciences industry - see Figure 1 - seems well-founded: future demand is assured, and there is a pervading sense across the industry that the downturn is a momentary blip in its growth curve.

**Figure 1: Results at a glance**  
(Percent of respondents in respective industries)\*

|   | CMT          | FI                     | LS                      | PE               | P&U            | RCB          | T                 |
|---|--------------|------------------------|-------------------------|------------------|----------------|--------------|-------------------|
| Impact of downturn perceived to be greatest | 51           | 64                     | 14                      | 35               | 21             | 30           | 54                |
| Reviewed approach to risk                   | 71           | 84                     | 60                      | 54               | 66             | 67           | 73                |
| RM at senior levels is now more important   | 85           | 87                     | 65                      | 56               | 73             | 66           | 77                |
| Risk aversity among Board                   | 36           | 52                     | 33                      | 25               | 45             | 36           | 40                |
| Retaining more risk                         | 18           | 13                     | 13                      | 22               | 16             | 23           | 22                |
| Very confident in RM processes              | 25           | 20                     | 26                      | 22               | 36             | 34           | 32                |
| Increased budget for RM                     | 36           | 47                     | 38                      | 25               | 36             | 29           | 30                |
| Group causing most concern                  | Customers 69 | Customers 68           | Customers 43            | Citizens 54      | Customers 48   | Customers 55 | Customers 62      |
| Priority risk - free choice                 | Credit 36    | Credit 41              | Credit and liquidity 12 | Credit 10        | Credit 43      | Credit 36    | Credit 26         |
| Most significant risk                       | Credit 69    | Business Continuity 58 | Cash flow 78            | Environmental 73 | Power price 66 | Cash flow 76 | Cash retention 75 |

Key: ■ indicates highest percent of respondents, ■ indicates lowest percent of respondents.  
CMT: Communications, Media and Technology, FI: Financial Institutions, LS: Life Science, PE: Public Entities, P&U: Power and Utilities, RCB: Retail and Consumer Brands, T: Transport

### Responding cautiously; no complacency

Many are confident that their existing risk management processes will address near-term organisational risks. Yet despite this apparent confidence, the industry also demonstrates a high degree of conservatism. There is a heightened risk consciousness across the industry with three quarters of participants believing that risk is now seen as more important across the senior levels of their organisations and 66% reporting that they have reviewed, or are in the process of reviewing, their approach to risk management. Indeed, 45% of those surveyed say the downturn has led to a reduction in risk appetite – only the financial institutions industry demonstrates a greater increase in risk aversion (52%). But even for those less risk averse,

### About Marsh’s Power and Utilities Industry Practice

With over 500 clients in 50 countries Marsh is the acknowledged market leader in the provision of insurance and risk management services to the international power and utilities sector. Our client base encompasses the whole spectrum of power and utilities, including vertically integrated nationalised industries, transmission and distribution companies, Independent Power Projects (IPP), Combined Heat and Power (CHP) projects, as well as nuclear and renewable energy companies. Fresh and waste water companies are also among our clients.

Our industry practice approach allows us to build a unique knowledge of the particular needs of power and utilities companies and to tailor our services and solutions accordingly. Services are delivered through a long established international network of centres of excellence and

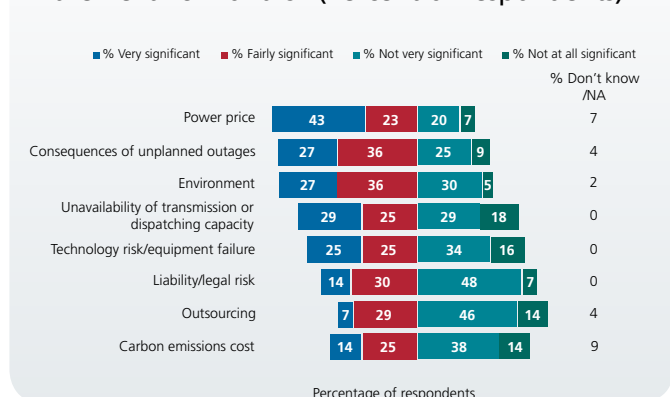
management and boards are demanding tighter controls, improved communication and reporting flows, and deeper and closer analysis into investment projects and opportunities.

### Changing near-term priorities – focussing on the value-chain but operational risk still prevalent

With the contraction in the availability of finance and the highly leveraged balance sheets of many organisations, it is not surprising that immediate concerns focus on working capital, cashflow and the wider value-chain. As with all the industries that we surveyed, concerns about customers were the greatest in the power and utilities sector - 48%. Furthermore, organisations are looking at margin volatilities and exposures across all areas of the business, including primary operations and support services, and are looking closely at better understanding and managing their customers, clients and suppliers.

While near-term focus will continue to be on financial and macroeconomic concerns – credit risk for example was highlighted by 43% of respondents as an ongoing concern over the next 18 months – organisations are facing these concerns alongside strategic and operational risks. We asked participants to rate the significance of eight industry risks as shown in Figure 2, stripping away the immediate economic focus, and the results confirm that operational risks have by no means dissipated.

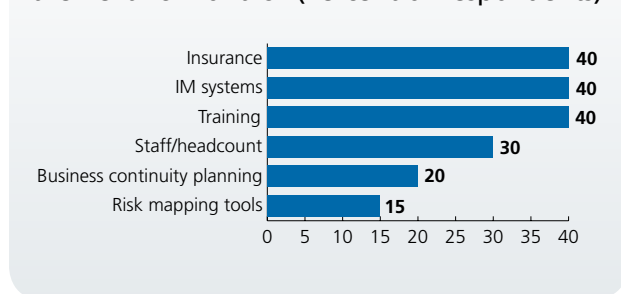
**Figure 2: How significant will each of the risks mentioned below be for your organisation in the next 18 months? (Percent of respondents)**



### Building-out risk management infrastructures and increasing budgets

Over a third of participants we surveyed expect risk management budgets to increase over the next 18 months, at a time when many organisations are reducing costs and budgets. This is partly driven by the expectation that insurance rates will harden; however, as Figure 3 illustrates, equally important is investment in risk management information systems, training and even headcount.

**Figure 3: In what areas do you expect the budget for risk management to increase in the next 18 months? (Percent of respondents)**



This building-out of risk management infrastructures reaffirms changing attitudes and commitment to robust risk management at the very top level. Although confident overall, the power and utilities industry continues to review the wider economic environment cautiously.

### Recommendations and actions

Building upon these executive highlights, the Marsh industry research report entitled “*New risk management insights for power and utilities*” analyses in full the impact of the downturn, the changing risk attitudes of the sector and examines how the industry is responding. It also outlines Marsh’s recommendations on evaluating and understanding risk priorities, risk financing and best practice risk management.

For further information or to obtain a full copy of the report, please contact Mark Pollard (Power and Utilities Practice Leader for Europe, the Middle East and Africa) or your local Marsh representative.

in-country industry specialists, many of whom have formerly worked in the power industry. These dedicated resources span all relevant disciplines including client servicing, insurance broking, risk engineering and risk management, and offers clients dynamic risk assessment, deep market relationships and bespoke consulting services.

Through our market relationships, industry knowledge and programme design capabilities, Marsh and MMC has a unique and unrivalled ability to assist power and utilities companies in minimising their total cost of risk by ensuring the optimum combination of risk retention, risk control and risk transfer.

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