Human beings have always wanted to know what is in store for them and have developed various hopes and fears. Back in the mists of time, they were afraid of ghosts, gods and demons; in later eras, of devils or witches; and today of viruses, climate change and terrorists. These all share one common trait: they are threats from outside, so-called external risks.

But there are also internal risks, something that many people overlook – possibly because they are risks for which they themselves are responsible. If they do not identify them, or underestimate them, the result will be failures or distress such as, for example, loss of credibility, mismanagement or burnout. In this case, looking for external culprits does little but exacerbate the damage.

Allianz Global Corporate & Specialty (AGCS), the industrial arm of the Allianz Group, carried out a series of analyses in its research and development division to find out what the greatest risks for its customers will be in the future. These customers include not only large companies, but particularly their employees and executives. We have detailed the key findings here.

Best-known global risks
With the aid of an international group of experts, the World Economic Forum identified and published the major risks in the Global Risk Network Report in 2009.

Risks are assessed according to likelihood of occurrence, loss expenses and human casualties. According to the analyses, the greatest risks include food price volatility, asset price collapse, fiscal crisis, a slowing Chinese economy, chronic disease, international terrorism, extreme climate change-related weather, pandemics and critical infrastructure breakdown.

These are the typical risks seen in an industrialised country from the viewpoint of an objective observer and which – should they be affected personally – impact on them from outside. The risks all bear the characteristics of external risk; risks caused outside individuals’ own sphere of responsibility. They attract the largest portion of public attention and today appear to be the major risks for the individual, for companies and for society as a whole.

Our own analysis of the most important global developments and the risks and opportunities they entail revealed the following topics:

- further population increases (competition for resources, migration, urbanisation);
- climate change (space weather, Holocene/ice age transition);
- increase of intangible needs (demand for health, wellness, love, knowledge);
- widening gap between rich and poor (expansion of the security economy, change in the function of money); and
- accelerating technology development (scarcity of classical resources and energy, development of new forms of energy).

External risks that could gain significance in the future therefore include:

- geomagnetic storms during the next period of maximum solar activity in 2012, resulting in potential blackouts in critical infrastructures;
- monopoly risks for hardware and software in information technology, which also lead to ongoing blackouts;
- vaccination disasters during preparation for pandemics because of increased time pressure in production; and
- loss of data security in internet traffic, despite encryption.

Internal risks – those for which the observer himself can be accountable – include egotism, ambition, resistance to change and pessimism. Additional risks arise within companies as well, including, for example, blind faith in figures, lack of checks and balances, tunnel vision or short-term thinking. Usually, the internal risks are pushed to the background in light of the apparent portent of the external risks.

Many employees and executives find it relatively easy to manage external risks, but quite difficult to address internal risks openly. They find it easier not to deal with them or to classify them as less important. Plus, people never compare which risks – internal or external – cause the greatest damage, particularly because there are no

Which risks will be more dangerous in the future: internal or external risks?
Michael Bruch and Dr Rudolf Kreutzer of Allianz take a closer look

Looking forward
The inside job

Many employees and executives find it easier not to deal with internal risks or to classify them as less important.
simple benchmarks for comparative risk evaluation.

**Sum of all fears**
The simplest answer to the question about the greatest risk facing human beings would be "death". But while humans can live up to about 120 years, the lifespan of a company is not necessarily limited. Many reach multiples of this life span, with some more than 1,000 years old.

This gives rise to the following questions: "What gives these companies their longevity?" and "What risks are life-threatening for companies?"

As part of a survey of risk awareness in German conglomerates, AZT Risk & Technology GmbH, the leading consulting entity of AGCS for risk engineering, safety, and technology, asked some 300 respondents to list the risks they regarded as particularly threatening to the survival of their company. The following were the most common, starting with the answer most frequently given:

- competition;
- changes in consumption and consumer behaviour;
- employee demands;
- state regulatory policy;
- US mortgage-lending risks and financial market turbulence;
- US dollar exchange rate;
- developments in raw material and energy prices;
- ratings; and
- shareholder behaviour.

It's striking that almost all of these responses are external threats, affecting the company from outside. Only about 1% of respondents regarded an internal risk as being a threat. These included:

- sabotage of data protection by adept insiders;
-...
• loss of expertise through inability to
  maintain key competencies; and
• if I make a wrong decision as
  chief executive.

This low response rate could be
explained by the fact that disclosing
internal risks in a survey carried out by
an insurance company is not desirable
under corporate policy.

There is another possible
explanation, however: top management
could have only limited knowledge of
internal risks. In a survey we took
among middle management and lower
levels of corporate hierarchy at the
same time, internal risks were
mentioned in 70% of responses.

We also discovered that the flow of
information, particularly in the direction
of higher levels of hierarchy, does not
function so well for these risks as it
does for external risks.

In the same survey, the various
levels of hierarchy were also asked
about the reasons for any failures
they experienced and any set goals
they did not achieve. The qualitative
and quantitative distribution of these
responses was identical across all
levels – that is, external reasons were
named primarily.

External attribution

In psychology, this allocation of blame
is termed ‘external attribution’. This
thought pattern is widespread in
professional and private life and is
often expressed when people talk
about workplace conflicts, road traffic
accidents or marriage crises: the other
party is almost always at fault. It is
also expressed in most annual reports
when the reasons for failures or losses
are described.

And it can be found with similar
regularity within the pages of the risk
report listing the possible reasons for
not reaching set targets. For example,
the risks foreseen for the future by the
30 DAX companies in 2008 and 2009
were almost exclusively external risks:
• losses due to global recession;
• disruptions in the supply chain;
• product imitations; and
• price volatility among raw materials.

It was only recognised in a few cases,
particularly in the financial services
sector where risk awareness is better
developed, that internal risks can also
have serious effects, such as:
• negative effects of management’s
  business strategy decisions; and
• limits of our own risk models.

Many global players do not mention
any internal risk factors in their annual
reports. The willingness to address
this issue openly and self-critically is
greater in many companies in the
USA, for example, than in Europe.

These risks are then typically presented
in a generic manner:
• if we are not able to achieve our
  overall long-term goals, the value of
  an investment in our company could
  be negatively affected;
• if we are unable to maintain our
  brand image and corporate
  reputation, our business may suffer;
• our risk management and loss
  mitigation efforts may not
effectively mitigate the risks we
  seek to manage; and
• the integration of X may not be
  successful.

Based on analyses about the
successes and failures of 50 top
managers (primarily in Germany and
the USA), we examined how the
thought pattern of attribution differed
among more or less successful people.
The results are clear:
• The more frequent and the larger
  the failures are, particularly at the end
  of a person’s working career, the more
  frequently only external attribution is
  used in any explanations. In contrast,
  these people use internal attribution
  only when giving reasons for their
  few personal successes. Managers
  who fail do the opposite when
  explaining the success and failure
  of other managers.
• People who are constantly success-
  oriented behave completely
differently. They look for and
  recognise both internal and external
  attributions for every success and
  for every failure. They also apply
  this behaviour when explaining the
  successes and failures of
  other people.

Causes of worst cases

As an ACGS analysis of companies’
most spectacular major loss events
over the last decades shows (by which
oil tankers, nuclear power stations, oil
rigs, skyscrapers, chemical factories
and aircraft were particularly affected),
the companies survived loss events,
despite the financial loss reaching
several billion dollars. This might be
due in no small amount to their good
insurance cover.

However, in the same period, a raft
of other well-known companies also
suffered spectacular losses and
subsequently ceased to exist
(for example, from the automotive,
aeronautic, banking, insurance and
energy sectors). What is significant
is that no externally influencing or
physical events preceded any of these
failures. This shows that internal
risks can cause financial damages
that are many times greater than the
external ones.

Internal risks could be summarised
under ‘management failure’ or
‘mismangement’. The following
causes, for example, could fit under
these headings:
• wrong strategic decisions
  (short-term thinking, overcapacity,
  oversatisation, selection of
  unsuitable advisers, monocausal
  thinking);
• lack of leadership (technical
  incompetence, hubris, lack of
  credibility, negative role model
  behaviour, lack of self-criticism);
• lack of separation of powers
  (dependencies between supervisory
  board, management board and
  auditors);
• corporate crime (corruption,
  embezzlement, personal gain,
  creative accounting, fraud); and
• lack of innovation.

But attempting to lay the blame
solely at the feet of management points
to a lack of systemic thinking, as
ultimately the quality of management
depends not only on the people
carrying out the function, but is always
the result of the interplay between
them and the owners, employees, the
market and society as a whole.

The greatest threats facing
companies are not related to
unforeseeable external events, but to
ongoing, observable conditions existing
within the companies themselves. In
a nutshell, companies are at risk when
they ignore or underestimate their
internal risks.

To prevent this, a company’s owners
or shareholders, as well as its
management and employees, must
ensure that the risk management
system values internal risks at least as
highly as external risks. This will not
only reduce losses, but boost the
number of successes.