

RISK/Factor

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Intangible Assets, Tangible Risks

By Mary Adams

Service companies make money by leveraging the intangible. Your “products” cannot be seen or put in a box. Your processes are much less visible than those on a Ford production line. Your core productive assets are not on your balance sheet. In fact, many of your most important assets walk out the door every night. Yet these intangibles are the key to your company’s growth, innovation, and competitive advantage.

The portfolio of intangible assets of a corporation is referred to as its intellectual capital (IC). Intellectual capital includes a broad range of people, knowledge and relationship assets. Understanding the current strength and future outlook of this portfolio is a key strategic challenge for the management team of a service company. Risk assessment plays an important role in the strategic management of intellectual capital. How can you best assess IC risk? Read on for a discussion of your options.

The Importance of Intellectual Capital

The easiest and most graphic way to understand the importance of intellectual capital to service businesses is to look at stock market values of public companies. Today, the book value of the S&P 500 averages less than 20 percent of their market value. For some service companies, their tangible book value represents less than 5 percent of their corporate value. The remainder comes from a market premium and intellectual capital. (See chart on page 3)

Where Are the Risks in Intellectual Capital?

Like all corporate assets, IC is vulnerable to catastrophic risks due to weather, crime or accidents. These risks are already on the radar of most companies. What you may not be watching are some of the specific risks associated with the different components of the IC portfolio. The following summary looks at each of the four major components:

Structural capital includes the huge range of knowledge that resides within your organization. At one end of the spectrum is the formally recorded, legally protected knowledge in patents and trademarks. Next is the knowledge included in software and formal process. Then, there is all the other knowledge residing in manuals, instructions, intranets and other written resources. At the other end of the spectrum is the shared knowledge that is manifested in how people do what they do—but may not be written down.

(Continued from page 1)

The key risks associated with structural capital include the:

- Inadequate documentation and dispersion of knowledge
- Weak and/or inconsistent work processes
- Inadequate protection of proprietary knowledge

It is pretty common to focus on defenses against loss of intellectual property. However, with structural capital, the best defense is actually a good offense. What do I mean by that? The best way to protect your ideas is to implement them consistently across the firm, provide good training and consistent quality control. The better your execution, the harder it is to imitate your ideas.

Human capital includes all the people that work in your organization. The skills and experience of your people are critical. Hopefully, you have a set of core competencies that are shared throughout your organization. There are also specific management skills that you want to have and nurture. However, the most important long term role of human capital is to originate and perfect new knowledge that can create future earnings.

The key risks associated with human capital include the:

- Probability of and vulnerability to key management and staff turnover
- Inadequacy of skills levels and/or inconsistent dissemination across the firm
- Failure to create a culture that accepts change and values learning

The impending retirement of the Baby Boomer generation is a serious risk to the human capital of many companies. In a service businesses, the loss of informal knowledge and experience that is not (and in many cases cannot) be formally recorded, represents an especially big risk.

Relationship capital is in many ways the most important component because it represents your connection with the marketplace. Customers pay the bills in every business. The strength of your customer relationships and your brand will determine your current and future potential to generate business. IC also looks at your external networks of vendors, outsourced services, and complementary partners as a critical resource for the firm.

The key risks associated with relational capital include the:

- Probability and vulnerability to customer or partner defections

- Relationship loyalty to individuals, not the corporation
- Threats to the brand

The growth in outsourcing of all kinds (from accounting to IT to labor) makes external relationships more important than ever. We have seen many cases recently where the core of both customer and outsourcing relationships is overly dependent on a single person or very limited group. Although strong personal relationships enhance your corporate relationship, there needs to be a balance so that a loss of a single person does not translate into a significant business loss overall.

Business recipe is your firm's strategy. The right strategy is an asset. This includes staking out the right market and having the right approach to that market. Business recipe is also the critical touchstone for evaluating IC and answering the question, "Do we have the right IC to deliver on our strategy?"

The key risks associated with business recipes include the:

- Threat of new competitors
- Potential of substitutes
- Exposure to economic cycles

Examining your business recipe risk forces you to look at the interdependencies of the IC portfolio. No one component of IC creates value—value is created by matching resources together. A good example of the benefit of looking at IC as a portfolio comes from an event company we know that has a strong staff skilled with strong core competencies associated with its existing business. However, the organization is facing competitive threats and is in the process of launching new offerings that involve elements of training and consulting. The product launch team was relying on existing staff to man this new business but an evaluation showed that the staff's skills in the new areas were weak. The firm no longer has the right IC to deliver on its business strategy. It was only through a portfolio examination, looking at people, knowledge and relationships together, that this risk became clear.

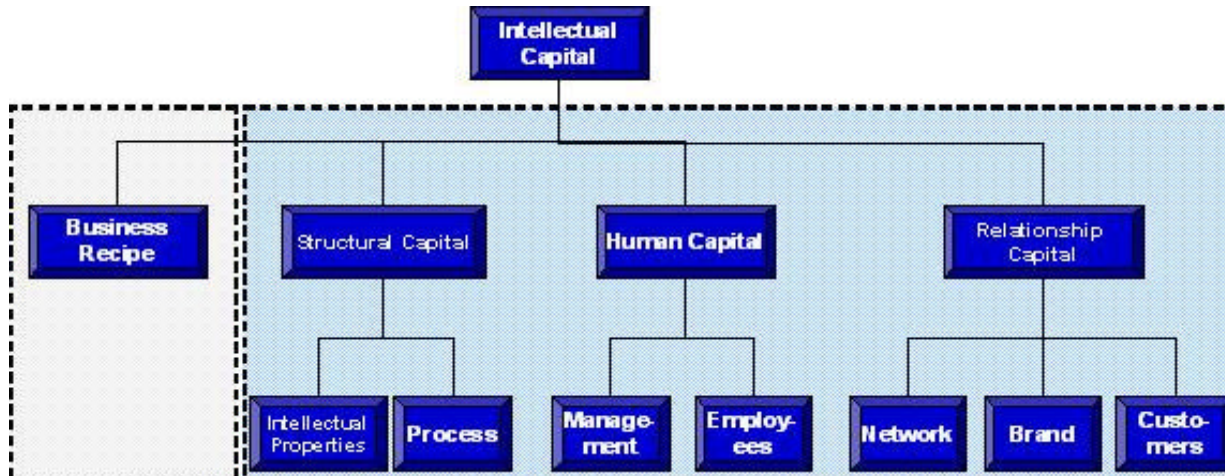
Options for Identifying IC Risks

There are basically three ways to evaluate the risk of a corporate intellectual capital portfolio.

Rely on functional departments – Most businesses today see the risk of individual IC components to be the province of functional departments such as human resources, marketing, sales, operations, knowledge and corporate management. This approach benefits from the deep knowledge of each function—who better understands the specific risks facing the company

The IC Infrastructure

The phrase *intellectual capital* is frequently used as a synonym for knowledge. While knowledge is a critical part of IC, it is much more, as seen in the following graphic:



(Continued from page 2)

in that specific area? However, a divided approach lacks the overall perspective that comes from seeing IC as a portfolio.

Perform a corporate-wide self-assessment – A company-wide IC assessment can be performed by focusing on the full portfolio and examining the specific risks of each category using factors such as those discussed in the previous section. This approach guarantees a broad perspective to better understand the complex interaction between the business recipe, knowledge, people and relationships that make up IC. However, as with any self-assessment, there is a risk of skewed results due to lack of perspective and vested interests.

Use a third-party assessment – Many consulting firms have developed intellectual capital assessments that support corporate management teams efforts in the

field of corporate value enhancement, innovation and change management. Some tools, such as IC Rating, include a specific risk rating for the IC. A third party tool ensures objectivity and often provides comparability due to the use of a consistent methodology.

In a service business, your core asset is intellectual capital. Although it is intangible, the risks to IC are all too real and tangible. Protect your company from these risks by understanding IC and the unique risks that can threaten it. Identify, measure and put in place risk management plans for the specific risks faced by your company.

Mary Adams is a co-founder of Trek Consulting. She is an expert in intellectual capital and recently founded the IC Knowledge Center (www.icknowledgecenter.com).

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Driving Risk Out Of The Service Industry

By Bruce Moeller

Are your employees putting your organization at risk? They might be if they are operating company-owned vehicles to deliver materials or make service calls.

It is estimated there are more than 100 million commercial vehicles in the world (Bobit Auto Group Research Dept. 2002). Many of these vehicles belong to trucking and transportation companies that employ professional drivers trained specifically to haul goods and people. But there are also hundreds of thousands of drivers in the services industry—from waste management and utilities to telecommunications and construction—who operate fleet vehicles every day. More often than not, their core competencies include installing cable, repairing appliances or landscaping as opposed to driving. Your employees could be putting your organization, your corporate image and their own lives at stake each time they get behind the wheel of a fleet vehicle.

A Dangerous Problem

According to the National Safety Council, motor vehicle crashes are the leading cause of accidental death and injury both on and off the job. Of the more than 110,000 accidental deaths in 2004, 46,200 Americans died in motor vehicle collisions and another 2.4 million were seriously injured. Motor vehicle crashes accounted for 2,086 of the 5,000 workers killed on the job. Studies show that risky driving behaviors are the cause of most accidents.

The tragedy, loss of life and impact on loved ones involved in fatal collisions cannot be measured. Monetary costs of non-fatal collisions are high and affect employees and their organizations.

On average, crash-related costs across fleets trend \$2,000 to \$2,400 per vehicle (*Journal of Transportation and Statistics*), meaning a fleet of 50 vehicles incurs an average of \$100,000 to \$120,000 in crash-related costs annually. Fleets of 1,000 or more vehicles, and organizations with high-value vehicles (e.g. waste management, cement, emergency), can expect crash-related average costs to exceed \$1 million.

To mitigate risk across your fleet, you must identify risky drivers before their actions result in a collision and provide coaching to help them improve their driving behavior. Standardized training for all drivers at orientation, driving simulators, workbooks and ongoing training can help and should play a role in your overall safety program, but to accurately predict and prevent incidents from happening, it is necessary to understand the unique risky behaviors of each driver.

For instance, a careful driver with a clean record who follows the rules of the road, maintains the speed limit and does not allow herself to become distracted

by loud music or a cell phone, may have an unidentified tendency toward following too close and hard braking. Not only is she causing unnecessary wear and tear to your vehicle, she may be putting herself at risk for a potential accident by not maintaining proper distance between her vehicle and the one in front of her. Slick roads or a distraction one day, coupled with her tendency to follow too closely, may result in a rear-end collision.

Driver risk management solutions can capture only those risky driving behaviors likely to result in a collision enable organizations to identify accidents waiting to happen. When combined with effective analysis and follow up coaching, drivers will improve their driving behavior before a collision occurs. This type of predictive and preventative approach directly impacts the bottom line, and more importantly, protects drivers and those who share the roadways with them.

Driving Home Reductions

Ancillary benefits of identifying and correcting risky driving behaviors include reductions in vehicle maintenance and damage costs associated with risky driving, potential for reduced insurance premiums and an increase in morale among employees who know their employer cares about them and their safety and is committed to helping them become safer drivers and protect them from liability in no-fault accidents.

Companies that have elected to reinforce their fleet safety programs with solutions that identify and correct risky driving behaviors have experienced significant return on investment. A leader in the cable industry, for instance, elected to deploy exception-based video event recorders in its vehicles to reduce the frequency and severity of preventable driving accidents.

Almost immediately, drivers became more aware of their behaviors and felt protected in the event of an accident because they knew the video event recorder captured what actually happened. The company realized a 30 percent reduction in preventable vehicle accidents in the first year and 41 percent reductions in the second year. The number of positive call-ins to the company's "800" number increased 500 percent in the first year.

Risky driving behavior is costly, but it also is avoidable. Consider your organization's approach to fleet safety and driver training. Are you identifying and correcting the risky behaviors that may be putting your employees at risk?

Bruce Moeller is president and CEO of DriveCam, the Driver Risk Management company. Moeller can be reached at bmoeller@drivecam.com. Visit www.drivecam.com

Risk and Third-Party Service Providers

By Jim Hietala

Risk that is inherited from third-party service providers is a significant concern in today's business climate. As many industries reconstruct their supply chains by outsourcing critical business processes, new risks emerge from these service providers. This article will explore the kinds of risks that are created from third-party relationships, the methodologies used to assess and mitigate risks, traditional static or periodic approaches to risk assessment, and continuous process for evaluating risk and maintaining regulatory compliance. In addition, the article will describe how some industries, in particular financial services, are moving toward an industry standard assessment for third-party services.

Outsourcing Business Processes, Adding Risks

The rise in outsourcing of business processes is the result of many factors, including constant pressure on companies to reduce costs, and the availability of highly competitive and lower cost services from companies around the globe. Examples abound:

- Banks outsourcing check processing
- High-tech companies outsourcing the actual manufacturing of their products
- Health care organizations outsourcing transcription of medical records
- Companies of all sorts outsourcing customer service to call centers overseas

With these outsourcing relationships come lower costs. However, in each instance there are new risks to be considered, evaluated, and responded to.

Traditional Risk Assessments

After making a decision to outsource a business process, many organizations will attempt to measure the associated risks using a multi-step process. This process will generally start with the creation and distribution of an assessment questionnaire to the service provider. The next step in the process requires evaluation of the questionnaire responses. For very critical business processes, an audit or site visit may be scheduled. An analysis of the risks is performed, to attempt to quantify the probability of the risk occurring, the expected loss per occurrence, and the annual loss that might be expected. Formulas such as the one below are often times used to try and quantify risks:

Annual Loss Expectancy = Probability of Occurrence X Average Loss per Occurrence

Finally, after analyzing the risks, the organization that is outsourcing the business process will make decisions regarding what to do about the risks – accept them, mitigate against their occurrence, or potentially obtain insurance for the specific risk. Some of the risks that are inherent in a third-party services relationship may include:

- Service level performance ability
- Level of information security controls
- Business continuity for the third party
- Compliance risk
- Reputation/brand damage risks
- Ability to switch providers

Risk assessments have traditionally been done manually, on a periodic basis, resulting in a “snapshot in time” understanding of the risks associated with each business partner. This approach has obvious flaws, in that the operational environment of the service provider is likely to be dynamic in nature. As the IT environment of the service provider changes, so too do the risks that are inherited by the organization that is using the service provider. Another problem with the manual risk assessment approach is that service providers are asked for assessment data from many of their customers, in many different formats. This is particularly a problem in financial services, where large financial service providers may have to respond to “similar but different” assessments from hundreds of customers. The burden of responding to these requests is significant, and increases the service providers cost of delivering services.

Automating the Risk Assessment Process

A goal for many risk managers is to make the risk assessment process more accurately reflect the risks that their organization is exposed to at any point in time. Recent developments in technology used to facilitate and carry out risk assessments is enabling risk managers to measure and react to risk in real-time, as opposed to using periodic and outdated assessment reports to make decisions about risk. These new software tools are capable of measuring risk across the enterprise, including the risks inherited from third party service providers. The architecture of these tools allows risk to be related to specific business units and processes at a very granular level, and to have the risks be reflected through all affected parts of the organization. As risks are mitigated, the risk measure-

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Sweeping Ergonomics Changes

By Allen Rathey

If your employees are involved in bending and stretching motions, ergonomics becomes a big issue for your company. Likewise those employees who use vacuums as part of their jobs (hotel workers, food services, office cleaning services, etc.) Applying ergonomic principles to vacuum cleaner selection, in addition to labor costs, productivity and application considerations, has the potential to enhance workers' productivity, decrease risk of injury and illness, and improve the quality of individuals' work life. Today's vacuum cleaner options offer risk management professionals the opportunity to find the best-fit vacuum for their site and their workers, whose efficiency and safety can be impacted by an educated decision.

Just as a range of cleaning sites demand varied approaches, workers themselves benefit from having the best-fit equipment, including backpack vacuum cleaners.

Recently published research, in fact, shows how different shapes and sizes of vacuum cleaners can impact workers' energy expenditures and cleaning efficiency. This is particularly important for professional cleaners, for whom vacuuming may be a prolonged task of repetitive motion. That daily task can be quite physical, but is undertaken by men and women of varying size, age, and fitness level. Handling and operating an ill-suited piece of equipment can present daily problems for the worker and can compromise efficiency and site maintenance.

Improved Performance

Using the best-fit vacuum cleaner can result in a faster cleaning rate and less energy expended by the worker, according to a study published in *Applied Ergonomics*. The study measured work rates, energy expenditure and perceived exertion of 12 industrial cleaners (both women and men) in controlled, one-hour tasks that simulated industrial vacuum-cleaning tasks. Cleaners used both an industrial upright vacuum cleaner (UVC) and an industrial backpack vacuum cleaner (BVC).

Researchers quantified that workers could clean more than twice the area with the BVC than the UVC in the same amount of time. Energy expenditure demands and cleaners' perception of their physical exertion were similar between the two vacuum cleaner types. While this study used a large BVC, the same principles and findings apply to much smaller models, which would be appropriate for small-framed cleaners.

Backpacks are designed to counter the hard, slow approach to vacuuming that involves pushing or dragging a vacuum cleaner around throughout the task, which increases labor time and costs. The International Sanitary Supply Association in its 447 Cleaning Times

publication has demonstrated that typical backpacks double the speed of cleaning versus standard upright vacuums. Their powerful airflow and static lift at the tool head remove soil from low-pile commercial carpet as well as hard and resilient floors quickly and effectively. Some backpacks incorporate multi-stage filtration, which captures fine dust better than typical machines. This improved filtration not only maximizes cleaning, but it also protects cleaners and occupants from inhaling dust, which is contained rather than being blown back into the room.

A variety of backpack models are available and can increase cleaners' mobility and productivity. Small, medium and large sized BVCs incorporate features such as ergonomic backplates, lightweight wands, and a range of capacity, filtration and sound levels, depending on the commercial site. Configurations vary and are adaptable for different locations such as airplanes and medical facilities. Overall backpack design puts the primary weight of the vacuum on the user's hips and diminishes upper body twisting, back bending and other biomechanical stress. Several sizes and weights of BVCs are important when fitting individual workers and minimizing physical stress.

The Perfect Fit

Facility managers selecting a vacuum cleaner should assess the right fit both for their workers and the application. As vacuum cleaner designs and efficiency have evolved, there's no longer a "one size fits all" approach to the equipment.

Consider where the equipment will be used:

Type of facility and flooring. Are areas primarily carpeting, hard surface, or a mix? Will staff be cleaning around customers?

Density of furnishings and obstructions: Are workers vacuuming under seats, in booths, in tight corners, and around closely aligned furnishings? Are floor plans open, and how much is hallway?

Desired level of power, capacity, and filtration: How large is the debris typically vacuumed? How large is the overall site being serviced? Is HEPA filtration required by the site?

When analyzing styles of vacuum cleaners, facility managers should consider the following:

Mobility: Does the vacuum cleaner move easily for cleaners who are various sizes? Is it small and light enough to move freely? Will attachments provide easy access to tight and difficult-to-reach areas?

Productivity: How quickly can the unit clean an area? Does the vacuum cleaner have an effective balance of power, cleaning speed and cleaning effective-

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ness? How much soil does it remove, and does it provide access to soil on areas other than flooring?

Ergonomic Factors: Do the size, weight and design of the vacuum cleaner minimize physical stress such as upper body twisting and back bending? Are attachments such as wands lightweight? Do attachments enable workers to reach easily under furnishings with minimal bending?

Filtration, Airflow & Lift: Does the vacuum cleaner effectively balance airflow, lift and filtration so that

soil is lifted and particles are captured by sufficient filtration, without compromising airflow powering the suction?

Properly selecting vacuum cleaners can be complex, but understanding the elements that can improve worker mobility and productivity while protecting their safety will help focus managers' analysis of styles, shapes and sizes available.

Allen Rathey is president of InstructionLink/JanTrain, Inc. He can be reached at arathey@jantrain.com

News Briefs

AIG reports that computer equipment holding the personal information of 930,000 people was stolen from one of the company's Midwest offices in March. The information was provided to AIG by 690 insurance brokers seeking quotes for companies nationwide.

Accounting errors totaling \$11 billion have cost **Fannie Mae** shareholders \$25 to \$30 million, says the acting director of the Office of Federal Housing Enterprise Oversight.

The Hartford Financial Services Group announced it has entered into an agreement with **Equitas** and all **Lloyd's** syndicates reinsured by **Equitas** that resolves, with minor exception, all of the company's ceded and assumed domestic reinsurance exposures with **Equitas**, including the company's reinsurance recoveries from **Equitas** under the company's Blanket Casualty Treaty. The terms of the settlement were not disclosed.

Willis Group's CEO and chair **Joe Plumeri** has called for adoption of an optional federal charter. Plumeri cited the industry's inability to cover a "worst-case scenario," despite his contention that the insurance industry is "stronger than ever." Plumeri said a multitude of large-scale disasters could deplete the industry's capacity.

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ments at any level of the organization are dynamically adjusted. And as new risks are identified, the risk score for all affected parts of the business will also be adjusted. In addition, these tools are capable of automating much of the process of risk management and compliance, allowing companies to significantly reduce the costs of their programs.

Financial Industry Approach to Risk Assessment

The banking and financial services industry is taking an innovative approach to the risk assessment process for third party service providers. An independent non-profit financial industry consortium, BITS (a part of the Financial Services Roundtable) is developing and publishing standard assessment questionnaires for use by banks with

their third party service providers. The BITS Financial Institutions Shared Assessment Program (FISAP) seeks to drive efficiencies for both financial institutions and service providers through the use of these standard assessments. The benefits to both service providers and financial institutions of this program will be considerable.

Increased outsourcing of business processes is likely to continue in many industries. Assessing the risks introduced by each new outsourcing relationship is an important management responsibility. Forward-looking industries and companies are adopting automated and standardized assessment methodologies to drive increased efficiencies in the risk assessment process.

Jim Hietala is director of product marketing for ControlPath, a regulatory compliance software solutions firm.

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- SOX and Electronic Documentation

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Conference Calendar

August 10, 2006 Vermont Captive Insurance Association Annual Conference, Sheraton Hotel, Burlington, Vt. "Twenty-five Years and Beyond" is the theme. For registration information, visit www.vcia.com

September 12, 2006 CPCU Society Annual Meeting, Gaylord Opryland Hotel, Nashville, Tenn. To register, visit www.cpcusociety.org

September 17-20, 2006 Bermuda Captive Conference, Fairmont Southampton Hotel, Southampton, Bermuda. For information, visit www.bermudacaptive.bm

October 8-11, 2006 Excess/Surplus Lines Claims Association Annual Conference, The Fairmont Southampton Princess, Hamilton, Bermuda. For registration, visit www.slca.org

October 9-12, 2006 26th Annual IRMI Construction Risk Conference, San Diego Marriott Hotel & Marina, San Diego, Calif. Educational programs and continuing education classes. To register, visit www.irmi.com/Conferences/Crc/

November 8-9, 2006 WCRI 2006 Annual Issues & Research Conference, The Boston Park Plaza Hotel & Towers, Boston, Mass. To register, visit www.wcrinet.org/conference.html

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