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Risk in the transportation sector 2007

Keeping on the right road

Changing risks, changing responses

Changes in the nature and extent of business risk are creating new threats and opportunities for operators in the transport and logistics sector.

Risk must always be managed. To protect against the unwanted and unplanned, and to give management the confidence to take the risks that will fuel growth and strengthen competitive advantage in the future. Our research has shown that while many firms in this sector only view "risk" in a negative light, some are responding in such a way that allows them to address the opportunities that only the most confident companies can pursue.

Thank you to all the firms that participated in this research project. Marsh is constantly monitoring the evolution of risk management across all EMEA industries and business sectors. If you would like to participate in our next transport and logistics sector report, please just get in touch.



A handwritten signature in white ink, appearing to read 'Brian Sullivan', written over a dark blue background.

Brian Sullivan
EMEA Transportation Industry Head

Executive summary

Risk profiles change over time in every industry, but in recent years the type and rate of change in the European transport and logistics sector has been exceptional. Perhaps the most significant reason for this has been the tendency for transport and logistics risk to become more complex, caused in large part by new regulations covering the environment, employment, terrorism and health and safety. More complex contracts and new areas of liability, including in the field of public-sector infrastructure, have also contributed to the rapidly changing picture.

Embracing risk management

Our research demonstrated that risk professionals in transport and logistics companies were fully aware of these changes, and saw risk management as a way both to mitigate risk and to reduce the associated costs. Nine out of ten said risk management activity had reduced, or would reduce, costs associated with insurance, accidents, damage and bad debt. Two-thirds agreed that successful risk management had prompted insurers to reduce their premiums.

A third of companies surveyed had suffered serious losses in the previous few years, and so well understood how unmanaged risk could damage them. This was confirmed by the fact that 70% overall said they embraced risk in all aspects of their businesses. With a clear idea of their risk management priorities, companies were actively engaged in risk management and were taking professional advice from insurance brokers and other sources.

“My definition of risk is any kind of factor that might influence or have a negative effect on the financial success of a company, and that is not predictable. It could be storm damage to our warehouse. Or maybe one day the motorway toll fees will go up. These sorts of expenses we cannot pass on to our customers.”

Head of legal department, Germany

Risks perceived to have greatest financial impact

Contractual risk	68%
Reputation / brand risk	50%
Regulatory risk	56%
Customer retention	46%
Environmental risk	38%

Lack of clear focus

Although risk professionals understood the importance of risk, there was a discrepancy between those risks they identified as priorities – operations, contracts, regulations, hazards – and those areas they planned to target over the coming 12 months. Plans centred on implementing general, tactical improvements to risk management processes, and on controlling costs. There was little indication of companies taking a strategic approach, targeting those risks they knew could hurt them most and improving their management information to allow more confident risk-taking. By implication, many companies seemed to view risk solely as a negative factor (the quote from Germany below is typical), rather than as something that could – if properly managed – lead to increased market share and sharper competitive edge.

There is considerable scope for using key performance indicators (KPIs) more effectively. Our survey showed that many companies were using a wide range of KPIs to measure the impact of their risk management activity, but appeared to do so without a clear idea of what they were trying to measure or how the information would help them improve. Specialist risk management services can give companies bespoke KPIs that focus on the key areas in which they need to improve.

Getting the right advice

Risk management is already established as an important business-planning tool within the European transport and logistics sector. However, to reap the full benefits in terms of reduced costs, competitive edge and more efficient operations, companies need to adopt a more structured and tightly managed approach, guided by risk-management specialists. By establishing clear risk priorities and KPIs – closely aligned to business-growth objectives – they will better equip themselves to survive in what remains a highly competitive sector.

“The new European anti-terror regulations are coming into play and we are forced to integrate them into our policies – they will have an immediate impact on how we do things in the transport industry.”

Head of Legal, German company

“The aim is not to be made responsible by any gaps in the liability clause – it’s not about simply closing the liability gaps to minimise the risk. The challenge is to transport things using the greatest care possible. That is how you keep the customers.”

Risk Manager, German company

“Attitudes towards risk management are a challenge. A lot of people have been around for a great number of years and think that some of the risk management measures you put in place are over-burdening, or unnecessary – they cannot see the benefit. So it is a challenge educating them.”

Risk Manager, UK company

What are the risks?

Our research found that European risk professionals in the transport and logistics sector were aware of a wide range of risks, and of the potential for these to damage the finances and reputations of their businesses. They were especially conscious of the need to invest in risk management activity for key areas such as operations, contracts and corporate reputation.

The 10 people interviewed in depth referred to 11 main areas of risk, without prompting from the interviewer. The most frequently cited drivers for risk are listed below in descending order.

Reviewing risk in Europe's transport and logistics sector

The research was managed in two separate phases by London-based market research consultancy Arnold & Bolingbroke (A&B).

Phase 1 – qualitative

A&B conducted telephone interviews with risk professionals and senior executives at 10 transport and logistics companies in the UK, France and Germany in July 2006. The interviewers employed a 'stream of consciousness' technique that allowed interviewees to speak spontaneously and freely about risk in their companies. The interview transcripts, and accompanying analysis, offer a snapshot of the market perception of risk.

Phase 2 – quantitative

A&B conducted 50 web-based interviews with transport and logistics companies in the UK, France, Germany and other European countries in January 2007. Participants were asked a series of questions about the risks their companies face, covering areas such as:

- Financial impact of risk
- Significance of risk
- Cost of risk

Operational

This was the most frequently mentioned area of risk. Concerns centred on business interruption, rising fuel and road toll costs, and wider issues such as the need to educate workers about risk management.

Hazard

This category includes the risk of accidents, damage to goods in transit, damage to buildings, and spillages resulting from the transport of hazardous materials.

Strategic

These are the top-level risks associated with operating in the transport and logistics sector: fierce competition from other operators, loss of major clients, damage to goods in transit and the need to keep pace with technological change.

Liability and contractual

Concerns centred on areas where the limits or nature of liability were unclear or might be increasing, such as civil responsibility and public safety. Risks associated with managing large customer contracts were also mentioned.

Financial/credit

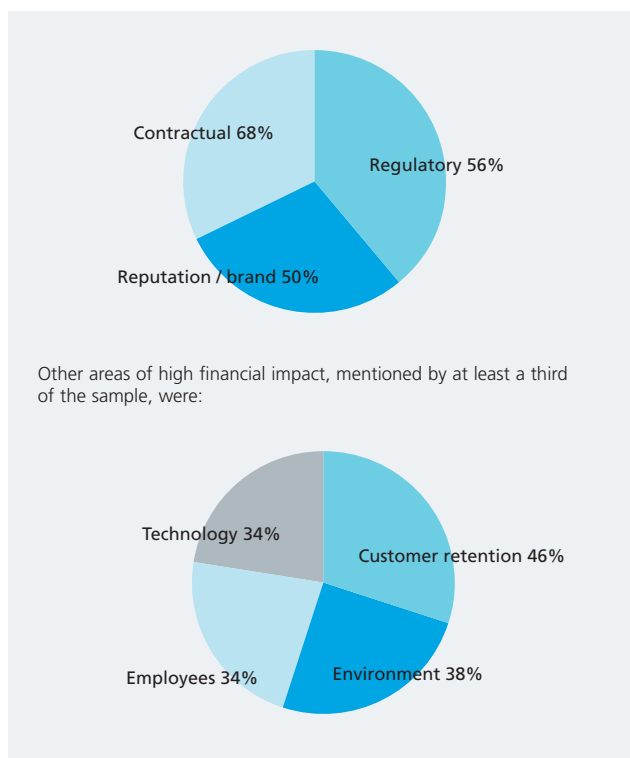
Cash flow and the threat of bankruptcy, both to transport and logistics companies and their customers, were significant areas of financial concern. A third of companies in our web survey had suffered a high-impact financial loss in the previous three years. Credit was treated as a standalone category, where the priorities for transport and logistics companies were avoiding bad debt, minimising overall debt, and effectively credit-checking their customers.

Other risks

Five other areas of risk were mentioned in the telephone interviews:

- HR – keeping employees safe and the threat of losing key employees
- Regulatory – effects of anti-terror legislation and of France's 30-day payment rules
- Environmental – pollution and carrying hazardous goods
- Brand – need to retain a good reputation and impact of bad publicity
- Other points – the need for full risk assessment across all areas.

Similar areas of concern emerged from our web survey of 50 companies, although priorities were expressed differently. At least half of respondents said the following three areas of risk had the highest potential financial impact on their businesses:



Level 1 area	Number of mentions	Number of respondents
Operational risk	8	6
Hazard	8	4
Strategic risk	6	5
Liability / contractual risk	6	4
Financial risk	5	4
Credit risk	3	2
HR risk	3	3
Brand risk	2	1
Regulatory risk	2	2
Environmental risk	2	2
Other points	5	3

“The transport sector is fiercely competitive. For the last three years running, about two thousand transport companies have gone bankrupt every year. You have to be absolutely vigilant. As soon as we take on a client there is risk involved in terms of money and being paid on time.”

Credit manager, France

Although a few key categories predominated, survey respondents were clearly aware that risks for companies in the transport and logistics sector were varied and complex and needed careful management.

The underwriters' response

Marsh constantly monitors how clients use insurance markets as part of their total approach to managing risk. Our industry benchmarking helps them understand what's typical in their sectors, how their peers are behaving, and how the markets are responding to actual or perceived risks – and how businesses are managing them.

The table shown here is taken from Marsh's transport and logistics industry liability buying report for 2006, benchmarking general and product liability buying and pricing across Europe. To receive your copy of the 2007 report, available from July, please contact us at the address provided on page ten.

Country/Region	Minimum limits (€)	Maximum limits (€)	Average limits (€)	Average price per million	Average cost per €1000 revenue
Austria	0.8	150	52	2,196	2.03
Belgium	2.5	50	20	38,554	4.30
Denmark	0.7	769	133	1,153	0.24
Estonia	<0.1	7	2	7,140	0.46
Finland	3.5	6	5	10,361	0.09
France	1.5	168	59	8,865	0.14
Germany	2.5	30	13	12,547	0.31
Italy	0.3	1,000	153	3,629	1.07
Netherlands	1.1	50	12	5,176	1.57
Spain	0.6	250	23	10,699	1.65
Turkey	<0.1	8	4	26,036	0.62
United Kingdom	2.9	581	96	5,420	0.59
Europe totals	<0.1	1,000	76	5,100	0.45

Base: 141 companies in the transport and logistics sector.

Why risk matters to transport and logistics companies

One of the greatest challenges facing transport and logistics companies in Europe today is the need to keep pace with the changing nature of risk, and with its growing diversity and complexity. Operators are contributing to this trend by moving into new geographical markets and taking on contracts to serve supply chains that extend across several countries.

National governments and the European Union are adding to the complexity of the operating environment by introducing new regulations in areas such as the environment and counter-terrorism. These factors are making the overall picture increasingly complex – and perhaps the greatest risks facing transport and logistics companies today is that they fail to recognise this fact.

However, there is little sign of complacency. Most of the risk professionals interviewed for this research were actively trying to manage risk. Nearly all saw risk as a significant area for their businesses, and said its importance was steadily growing, rating it 8.5 out of ten for importance (where ten is highest importance). Only three of the ten people in our telephone survey rated risk at less than eight out of ten for importance, and did so in part because they believed they had already identified and managed their companies' key areas of risk. In our web survey, 44% of respondents said risk was "very significant" to their businesses. Risk management is clearly important to transport and logistics companies, and telephone respondents cited a variety of reasons for this.

Greater awareness of risk

Managers are becoming increasingly aware of the importance of investing in risk management, both because the number of risks has increased and because premiums have risen. The stakes are often very high. Some firms fear they will go out of business if they ship at a loss as a result of damage to goods in transit, so it is vital for them to identify and manage their risks, and to be appropriately insured.

To protect employees, vehicles and goods, many companies are working hard to instil a culture of health and safety, although they sometimes meet resistance. One UK risk manager said: "A lot of people have been around for a great number of years and think that some of the risk management measures you put in place are over-burdening ... it is a challenge educating them."

Respondents also recognised that investment in risk management could help their companies become more transparent and better run, resulting in a sharper competitive edge.

Operational risks loom large

Greater focus on risk management has led transport and logistics companies to look closely at their own operations, and to identify many areas of concern. In fact, operational risk – including business interruption, and rising fuel and toll costs – was mentioned more frequently by our telephone interviewees than any other type of risk. Respondents were particularly concerned about employee accidents, plant shut-downs and other serious problems, which they said could result in "massive interruption" to their business.

Contracts are complex

Transport and logistics companies recognise that complex contracts, with unfamiliar terms and conditions, can expose them to new and unexpected areas of liability. Survey respondents expressed their fears of taking on contractual risks they did not fully understand, and of the resulting possibility that their profits would "take a hit" – either through liability when something went wrong or through high insurance premiums. A risk manager from Germany explained the position: "If I agree on that [limits of liability] with my clients, then I have to also agree on that with the trucker, so that if it comes to a claim then I am covered. The aim is not to be made responsible by any gaps in the liability clause..."

Threat to reputation

The 50 large European transport and logistics companies who responded to our web survey gave greater prominence to brand risk and customer retention. One risk and insurance manager in our telephone interviews also alluded to these risks: "What is at stake with risk management is civil responsibility. We are the guardians of these products, so we are the ones responsible for safeguarding the public from any harm ...".

Regulation

A raft of new laws and regulations – governing such things as anti-terror regulations, workplace accidents and drivers' hours – means that risk management requires much more attention than previously. Those companies that don't co-ordinate their risk management activity could face higher insurance premiums. One respondent pointed to the sheer quantity of legislation covering the transport and logistics sector, describing the possible consequences of a failure to comply as "horrendous".

"In France new legislation states that the net amount of transport services should be paid no later than thirty days after the bill has been sent out. The stakes are very high. Reducing your rolling costs to thirty days is a huge task."

Credit manager, France

Finance

The pace of economic change is having a major impact on the management of risk. For instance, the rising cost of raw materials – which cannot be passed on to customers – is depressing margins and profits. Consequently, mistakes and problems that occur in other areas of the business may have a far greater financial impact than previously. Credit risk is of particular concern to nationally based freight forwarders, as their cash flow depends on prompt payment and the need to avoid untrustworthy clients. A French credit manager said: "You have to be absolutely vigilant. As soon as we take on a client there is risk involved in terms of money and being paid on time".

The big picture

Strategic risk has several dimensions, including competitive pressure, the risks of diversifying into new areas, the need to retain customers and the need to keep up with technological change. Such strategic risks are intangible and therefore less easily controlled than others. One respondent in Germany said his company had addressed these strategic risks by investing in a centralised risk-management initiative, giving departments in other countries a framework within which they could develop their own risk-management strategies.

"Risk starts with the customer side of things, such as losing customers or providing a bad service. Then there is also the side where the customer goes bankrupt, which of course can happen. Then, of course, all the problems connected with transporting the goods – accidents can happen."

CEO, Germany

"Lately, the new European anti-terror regulations are also coming into play and we are forced to integrate them into our policies – they will have an immediate impact on how we do things in the transport industry."

Head of legal department, Germany

Is risk growing in importance?	
Base:	total (n=50)
Increasing	64%
Why growing?	
New laws and regulations	84%
Contractual conditions	81%
Effect on profits	78%
Increased competition	63%
Operational efficiency	63%
New products	59%
Central risk mgt function	56%
Loss in transit	50%
Employee management	50%
Insurance costs	34%

What is the cost of risk to your company?	
Base:	total (n=50)
Over €1 million	70%
Below €1 million	16%
Don't know	14%

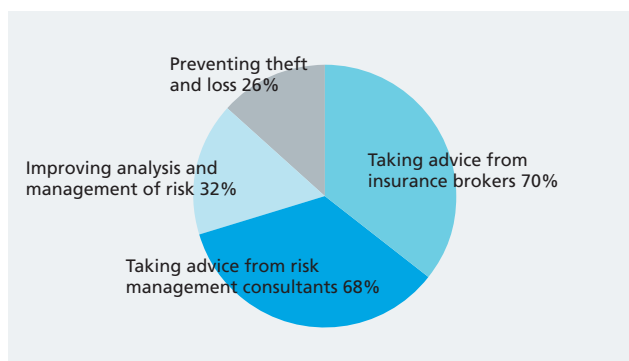
What are transport and logistics companies doing about risk now?

Legislation varies across Europe, but in most countries transport and logistics operators are required to make risk assessments, and to manage any risks they identify. However, this mandatory activity is often limited in scope and has a negligible impact on how underwriters rate companies for insurance purposes.

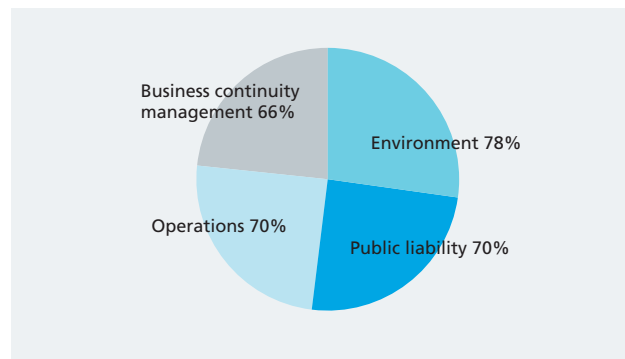
Well-advised companies take a more strategic view, and invest in systematic and detailed risk management that exceeds mandatory requirements. It is an approach that often persuades underwriters to place them in a lower category of risk than their competitors.

In our web survey, two-thirds of companies agreed that insurers had reduced their premiums based on the outputs of risk management. Effective risk management can also sharpen a company's competitive edge. Put simply, an operator that takes the right advice, and implements a plan for understanding and managing risk, is likely to perform more efficiently and profitably.

However, this activity comes at a price. When asked to state the cost of risk to their businesses, 70% of web respondents estimated it at over €1 million, which includes the costs of assessing risk, managing it and insuring against it. To reduce these costs, companies were taking measures such as:



Many (60%) said they were receiving external risk management services specific to the needs of their sector, and were using consultants to help them understand and manage current and emerging risks in areas such as:



This is all positive activity, but our findings suggest that even companies with a pro-active approach to risk management often fail to achieve maximum financial and operational benefit. This is reflected clearly in the wide and disparate base of annual key performance indicators (KPIs) used by transport and logistics companies to measure the effectiveness of their risk management. Respondents to our web survey listed a total of 11 KPIs, but only one was used by more than 20% of all companies. No KPI or set of KPIs predominated, which indicates the absence of a systematic approach to the analysis and management of risk in the transport and logistics sector. There is clearly significant potential for the development and use of KPIs to measure the success of risk management activity.

"We need to keep up to date with technology to be able to compete financially... We strive to be better... so that we have something to offer that a customer might not get by using another firm."

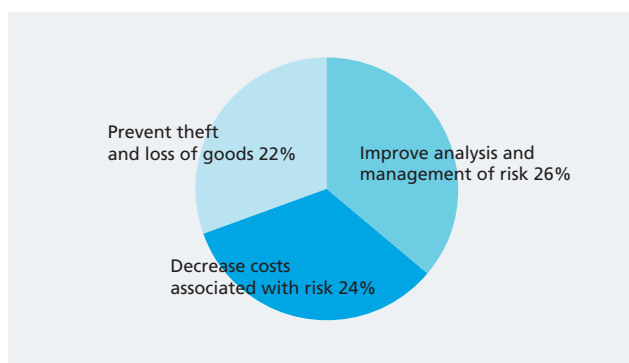
Risk manager, UK

KPIs for risk management?	
Base:	total (n=50)
Track profits and losses	22%
Claims / premiums ratio	16%
Accident reduction	12%
Frequency / cost of damage	10%
Staff sickness / turnover	8%
Use Marsh KPIs	6%
Environmental factors	6%
Cost analysis	6%
Contract analysis	6%
Reduce human liability	4%
Statutory reports	4%
None	14%

What can transport and logistics companies do in the future?

The lack of consistency in the way transport and logistics companies use KPIs was also evident in their approach to risk in the coming year: their named priorities did not align with the most significant risks identified elsewhere in the survey.

Our web survey asked companies to name their top three risk priorities for the coming year, and the resulting list of 19 was diverse. Only three activities were named by more than 20% of all respondents:



A near identical picture emerged from the telephone interviews. The most frequently mentioned priority for the coming year was improvement to risk management processes, with reducing insurance costs second and protection of goods and employees while in transit third.

Need disconnected from action

However, while these activities are desirable in themselves, they are essentially tactical and do not specifically target those areas identified as top priorities elsewhere in the web survey (contractual, reputation/brand and regulatory) or during the telephone interviews (operational, hazard and strategic). These issues were effectively ranked as 'second tier' priorities for the coming year, mentioned by only 10%–16% of web respondents.

This is inconsistent, because elsewhere in the survey respondents showed a clear appreciation that the risks facing transport and logistics companies in Europe were increasing in number and becoming more complex. On the one hand respondents recognised the changing nature and complexity of risk, but on the other appeared to have limited

their focus for 2007 to 'playing catch up' – prioritising tactical risk management objectives over strategic, targeted activity that could result in lower insurance premiums and sharper competitive edge.

Who to call?

Both telephone and web survey respondents cited insurance brokers as a primary source of advice on how to reduce the cost of risk, with employees as the most common secondary source. There is undeniably excellent advice to be had from these sources, but companies that rely exclusively on insurance market solutions miss out on the planned, specialist services available from companies acting in an advisory role. Such service providers can help companies identify and manage those areas of risk that impact most heavily on their businesses. They can also help companies refine their KPIs to create an accurate and targeted tool for measuring the effectiveness of risk management activity.

QK Top 3 risk priorities in coming year?

Base:	total (n=50)
■ Improve analysis and mgt of risk	26%
■ Decrease risk costs	24%
■ Theft / loss prevention	22%
■ Review and tighten up contracts and policies	16%
■ Financial risk	14%
■ Review business / employee / public liab'y	14%
■ Environmental issues	14%
■ Operational risk	14%
■ Continuity and increase in sales / profits	12%
■ Employee risk	10%
■ Training and information to staff	8%
■ Political risk	6%
■ Review procedures / policies	4%
■ Credit risk	4%
■ Forecast regulatory issues	4%
■ Accident risk	3%
■ Foreign business risk	2%
■ Strengthen mgt team / clarify responsibilities	2%
■ Brand / reputation risk	2%

About Marsh

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The Practice serves over 1,000 clients worldwide, and has more than 150 specialists operating around Europe and the Middle East, collaborating with another 300 industry experts worldwide.

The Transportation and Logistics Practice specialises in identifying and solving the risk issues facing the following sectors:

- Supply chain management and delivery services
- Warehousing and distribution
- Freight forwarding
- Post, parcels, couriers and home delivery
- Road haulage
- Fleet, including car hire/lease
- Ports and terminals
- Airport service providers
- Rail

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- Environmental risk management
- Fleet risk management
- Contract due diligence
- Business impact and continuity
- Alternative risk transfer/financing
- Brand and reputation protection
- Behavioural risk improvement
- Health and safety
- Human capital risk training

For further information about this report, or about risk and insurance challenges in the transportation and logistics sector, please email:

brian.sullivan@marsh.com

Brian Sullivan
Transportation and logistics industry practice leader,
Marsh EMEA

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MARSH MERCER KROLL
GUY CARPENTER OLIVER WYMAN

Marsh Ltd, Tower Place, London, EC3R 5BU

020 7357 1000 www.marsh.co.uk

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