

Finding the Upside in Strategic Risk

Over the past 10 years, Oliver Wyman has seen strategic risk surge to the forefront of management challenges for our clients across many industries. Increasingly, we are finding that one of the key characteristics of successful companies is that they are exceptionally skilled at not only recognizing, anticipating, and managing strategic risks, but in converting such risks into meaningful growth opportunities.

In our new book, *The Upside*, we explore how to anticipate strategic risks, how to prepare for them, and how to transform them—revealing the hidden upside. The following brief perspective focuses on some of the specific strategic risks that we see across the transportation industry and how companies can consider mitigating and turning these risks into competitive advantages.

The Realities of Strategic Risk in Transportation

No sector has had as much experience in managing casualty risk as the transportation sector. The modern insurance industry owes its very existence to 17th century ship owners, who met at Edward Lloyd's coffeehouse in London to find underwriters for risky ocean voyages.

But even as transportation companies have long sought to protect their physical assets against loss, they have been slower to address the strategic and market risks to which they are uniquely vulnerable. Such risks have the potential to devastate enterprise value. For example:

- In the 1990s, several North American railroads struggled to integrate the remnants of recently acquired rail assets, a failure that in some cases cost them almost half of their collective market capitalization.
- In the 1980s and 1990s, the failed mergers of large less-than-truckload and other motor carriers many times wiped out the total revenue of the acquired carrier, sometimes for as long as two years.
- Recently, one North American railroad suffered an operational meltdown when it failed to respond quickly enough to an upsurge in demand, leaving it short of crews and creating a downward spiral of congestion and delays. The market value of the company dropped by 30 percent and took more than a year to recover.
- A few years ago, a leading ocean vessel operator ended a streak of successful acquisitions by fumbling the post-merger integration of a large rival. The company lost almost a third of its market value.

The tendency to think of “risk” in terms of external hazards such as extreme weather events or terrorism can blind managers to far more important strategic risks. More importantly, it robs companies

of the opportunity to shape strategies to take advantage of the upside of risk.

Turning the Tables on Risk

As in other industries, the greatest risks for transportation companies—strategic risks—represent the flip side of the greatest opportunities. For example:

- European freight railroads face a profound threat from new entrant competitors that can “cherry pick” their traffic and out compete them on cost. Oliver Wyman has estimated that, for some incumbents, 10 percent of freight market share will be lost in the near term if the railroad takes no action, with this loss only growing over time. The upside of this risk, however, is the opportunity to rebuild the business design around rationalized networks and specialization on certain corridors, services, or customer segments.
- European passenger railroads, long accustomed to a local monopoly position, will soon face EU-mandated competition from new entrants, which are said to be already ordering rolling stock. To turn the tables in their favor, incumbents will have to alter their business designs, creating firewalls around their most profitable customer segments. At the same time, they will need to develop new business designs that can take advantage of the new cross-border opportunities.
- Truckload carriers in North America are seeing their profitability threatened by rising costs for key inputs and the difficulty of retaining drivers. The most successful carriers have responded by redesigning their operations around the driver: paying closer attention to factors that build loyalty and eliminating aspects of the job that cause drivers to leave.
- Postal services around the world face a dual threat from the decline of traditional letter mail and the introduction of private competition, such as EU postal liberalization directives. Where management is far-sighted enough to confront the risk, tremen-

dous upside opportunities present themselves: the opportunity to get to know the anonymous customer, to build value added services, and to reinvent postal services as specialized logistics providers.

- Many investors have convinced themselves that the North American freight rail sector is immune to strategic risks. Closer analysis reveals a more complicated picture. Coal transportation, the bedrock of railroad profitability, must deal with growing environmental concerns and the resurgence of the nuclear industry. Intermodal transportation, the fastest growing segment, faces risks associated with every aspect of international trade: currency devaluation, political instability in China, scarce port capacity on the West Coast. These types of strategic risks should trigger a robust discussion about building resilience into business designs and finding new value growth opportunities.
- The international maritime sector, having enjoyed a recent run of profitability, has not escaped the fundamental strategic risk of commoditization, which quickly ruins profitability when new capacity comes on line faster than it can be absorbed. Finding the upside in this environment means reversing com-

moditization, either by becoming indispensable to the customer or by focusing on key lanes where the carrier can develop a dominant capacity share.

The Upside

In researching *The Upside*, we found many striking examples of companies turning the sow's ear of strategic risk into the silk purse of competitive advantage. For example, when express parcel carriers began to expand into international services, cumbersome customs procedures presented a formidable risk to their business. After all, who wants to pay for expedited service if delivery can't be guaranteed? The major parcel carriers realized that they needed to become experts in moving goods through bureaucracies as well as moving them around physically. As a result, international express has consistently outgrown domestic express and gained share against other forms of cross-border transport.

By looking at strategic risk through the lens of business design innovation, transportation companies can proactively protect existing value and reveal hitherto-unknown opportunities for new value growth. ❖

Oliver Wyman

Oliver Wyman is building the leading global management consultancy, combining deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm works with clients across a range of industries to deliver sustained shareholder value growth. We help managers to anticipate changes in customer priorities and the competitive environment, and then design their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities.

Oliver Wyman's Transportation Practice

Oliver Wyman has the largest and most experienced consultancy in the world dedicated to the transportation industry. We would be pleased to discuss with you our perspectives on better managing strategic risk. For more information, please contact your Oliver Wyman account representative, or one of our transportation team leaders:

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