Top 3 risks facing the construction industry

With Fitch Solutions predicting sluggish growth of only 2.4% for 2019, the South African construction industry currently finds itself in an unpredictable macro-environment. Talks of a looming global recession is causing capital expenditure on large-scale construction projects to dwindle, sending the industry into a rally to achieve higher levels of risk readiness to address increasing uncertainty.

Clarissa Rizzo, business unit manager for professional risks at Aon South Africa

"Aon's Global Risk Management Survey shows that the construction industry has experienced a massive increase in reported losses from 18% to 24% due to risks facing the industry," says Clarissa Rizzo, business unit manager for professional risks at Aon South Africa. "It is therefore no surprise that the construction industry reported a 5% increase in efforts deployed to increase the industry's risk readiness, compared to two years," she adds.

Top three risks facing the construction industry:

1. Economic slowdown / slow recovery

The construction industry considers the risk of an economic slowdown its top concern. Businesses generally tend to reduce or hold back on capital expenditure when experiencing economic strife, causing the growth of the industry to grind to a halt.

2. Cash flow / liquidity risk

It refers to the possibility that an organisation could fail to obtain the cash required to meet short or intermediate term obligations. According to CPA Australia, liquidity risk can arise from a number of scenarios within the business. It includes unplanned reduction in revenue, business disruption, sustained reduction in profitability, unplanned capital expenditure, increase in operational costs, future debt repayments and breach of loan covenants.

3. Capital availability / credit risk

The failure of businesses across the spectrum is bringing the problems organisations face when they run into capital availability problems into sharp focus. Despite the fact that it is ranked as the third most pressing risk facing the construction industry, accounts receivable is often the largest uninsured asset on a company's balance sheet, constraining cash flows.

Mitigating the risk

Aon's Global Risk Management survey found that 25% of respondents from the construction industry have developed risk management plans to address assessed and quantified risks, while a further 15% have evaluated risk finance or transfer solutions. An additional 14% of the industry put continuity plans in place.

"It is very encouraging to see that 87% of respondents say they have adopted either a formal or partially formal approach to risk oversight and management at board level, with all companies ranging from multinationals to SMEs placing more importance on risk management than before," says Rizzo.

"The proof is, however, in the pudding, and the question to ask is whether their efforts have reduced the probability or the resulting impact of risks occurring and also how they performed in comparison to past risk-based incidents," she says.

The Aon Risk Maturity Index Insight Report found that organisations with higher levels of risk maturity generally invest time and effort in reviewing the performance and effectiveness of their risk management programme. Measuring its effectiveness involves the following:

- Reducing the total cost of a risk by incorporating a Value at Risk (VaR) metric.
- Aligning strategic risk management activities with the risk management plan and overall strategic objectives of the organisation.
- Identifying best practices and applying them to the business.
- Identifying weak practices and taking correctional steps.
- Performance benchmarking against peers.

"If we compare this year's survey results with those of 2017, we see an overall increase in the proportion of organisations evaluating their risk management programmes with more companies lowering their total cost of risk (TCOR). North America proved to be the most developed region in this regard, while the Middle East & Africa use the TCOR measurement proportionally less," says Rizzo.

More organisations are embedding risk into the business and looking at ways to turn these challenges into business opportunities. "Larger companies are more likely to implement an effective risk management programme as opposed to their smaller counterparts making it crucial for the industry - as a whole - to get into a space where it is aware of the risks facing it and actively planning to improve preparedness, resilience and sustainability," Rizzo concludes.