



Flu Pandemic How Big is the Threat?

Pandemics are a very serious threat. As three of the major 20th century pandemics were caused by the mutation of avian influenza viruses, there is understandable concern that the H5N1 virus will mutate, creating a strain that could be directly transmitted from human to human and cause a pandemic of apocalyptic proportions. Yet, this virus has been present in numerous wild bird populations for at least a decade with no objective evidence that it has ever been transmitted directly from human to human. There is also growing evidence that its frighteningly high mortality rate may be biased upward because only the sickest of victims have been seen by the medical profession. So, in the current environment, there is a cloud of uncertainty around the magnitude of the threat posed by avian flu and pandemics more generally. How should business leaders respond to such a threat – one where experts disagree as to the probability of occurrence, but where the impact could potentially have catastrophic outcomes?

Flu pandemics as a business risk

There are at least three different levels on which a risk like avian flu can impact business. The first and most important level is the human health dimension. The second and third levels are the economic consequences of the pandemic itself and of the responses to the threat of a pandemic. A widespread pandemic endangers the well-being of a business' employees and customers, and the business has a moral, and often, legal obligation to take measures which mitigate the direct threat to the lives of these stakeholders. However, there are also economic shifts to both demand and supply which need to be considered, as they can have far-reaching and long-lasting impacts that will threaten the survival of a business. For some firms, it is also possible that the response to the perceived threat of a pandemic will pose an equal or greater short-term risk than the pandemic itself.

While each business will have a unique pattern of vulnerabilities to pandemics, we have identified at least five broad categories that will need to be assessed by most organizations:

- *Human Health*: has the organization taken the necessary steps to protect the safety and well-being of its stakeholders? The response will most likely run the gamut from anti-viral soap in the washrooms, to increasing the use of video conferencing to ensuring that the firm can meet obligations to the dependents of deceased employees
- *Customer preference shifts*: before any direct consequences of the pandemic hit, many firms will see dramatic revenue declines as individuals change their behavior to reduce their perceived exposure to the pandemic. These consumer shifts may be hard to predict, as there is no reason to suspect that the response will be entirely rational. One such example is provided by the fortunes of US chicken producers: the price of chicken legs at the Georgia docks has fallen from recent levels of 32¢ per lb to 17.5¢ per lb and dragged down the stock prices of the producers; this has occurred although there is no evidence that H5N1 has ever been transmitted by eating infected poultry
- *Demand volatility*: just as some organizations will see demand for their products decline (e.g. declining air travel, tourism and entertainment), other firms will have to deal with the organizational strains of demand spiking to levels that were unimagined before the pandemic threat emerged (e.g. health care, telecommuting technology). Here the danger lies in over-stretched organizations failing to meet quality standards as they struggle to meet demand levels that exceed anything envisaged in production plans
- *Supply Chain*: catastrophic events tend to expose the vulnerabilities inherent in supply chain design; a pandemic will be no exception. Judging by the experience of SARS, we may very well see regional crises, with transport to and from the affected region severely curtailed, possibly for months. With no way of predicting in advance which regions will be impacted, companies with flexible supply chains may enjoy significant competitive advantage
- *Erosion of confidence*: inevitably even a relatively small outbreak will have enormous impacts on business confidence; capital expenditure will be postponed and it may prove harder to raise capital in the equity and debt markets

Some 70% of businesses in a global survey¹ conducted on pandemic preparedness believed that a pandemic would damage profitability. Despite this risk, only 47% have a business continuity plan that takes into account this pandemic risk and even fewer, 17%, have budgeted for pandemic preparedness.

¹Mercer Global Avian Flu Survey

How Mercer Oliver Wyman can help

Mercer Oliver Wyman specializes in risk and strategy consulting, with deep expertise in quantifying the financial impact of risks. We help our clients use risk modeling techniques to gain a deeper understanding of the drivers of their earnings volatility, which in turn enables them to make better risk mitigation and business strategy decisions.

There are three types of work we do relating to the risk of pandemics:

1. Mapping the firm-specific vulnerabilities

Each firm has a unique profile of customers, suppliers, employees and processes which will drive its particular vulnerability to the business risks associated with a pandemic. We help our clients map the unique risk exposures of their organization to support a comprehensive assessment of their vulnerability to avian flu and other pandemics

2. Quantifying the financial impact

Understanding the vulnerability of the firm to the threat of a pandemic is useful, but it is only the first step in crafting a well-rounded response. In principle, optimizing the firm's response to avian flu is no different than taking any major strategic decision; the expected costs must be set against the expected benefits and the return balanced against the risk. It is here that Mercer Oliver Wyman's deep expertise can help our clients by bringing to bear our proprietary risk modeling techniques to quantify the financial impact and inform business strategy decisions:



3. Embedding Pandemic Risk in a Full Enterprise Risk Management review

The pandemic threat should be considered in the context of other risks faced and modeled today by our clients. Technology component manufacturers already deal with the risk of supply chain disruption, and the travel industry is all too familiar with dramatic declines in passenger numbers. We can embed the impact assessment of a pandemic in a comprehensive assessment of all of the client's risks to enable a balanced response that neither over- nor under- weights the importance of the threat of a pandemic in the overall strategic dialogue.

At this time, we do not know whether or not avian flu will mutate and cause a major pandemic. In this uncertain environment, we think business leaders should evaluate their responses carefully – not only to preserve the well-being of our employees and customers, but also the economic well-being of our businesses. The quantitative modeling techniques and risk management know-how of Mercer Oliver Wyman can help elevate the discussion around pandemics from a general qualitative dialogue to a quantitative analysis of the cost/benefit of potential risk mitigation and business strategy responses.

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