2023 Technology and Telecommunication Industry Key Risk Factors

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Technology

The technology and telecommunications industry thrived throughout the COVID-19 pandemic despite the massive headwinds and unprecedented consumer demands faced during the global crisis.

Now the industry must face the residual challenges from that success as well as those connected to an ever-evolving global economic landscape. Looking forward to 2023, the technology and telecommunication industry face a number of significant challenges. We have identified 17 key issues ranging from microeconomic/global in nature, to technology-driven matters, to concerns more specific and unique to the industry. Supply chain disruptions, technology–driven disruption, rapidly changing consumer expectations, recession-driven cost and competitive pressures, unprecedented regulatory change, risks associated with expansion in emerging markets, increased social demands on environmental sustainability and increased economic uncertainty are just a few issues identified. This article will take a look at key issues facing the industry and some of the risk measures, both insurable and not insurable, being taken by the industry to combat these new and evolving risks.

MACROECONOMIC/GLOBAL

1. **Continued Pandemic Risks**
   The COVID-19 crisis has created increased demand and a greater functionality coupled with enhanced service offerings from the technology industry. Concerns centered around the impact of government policies concerning public health regulations, social distancing, occupancy limits, and other pandemic-related restrictions and protocols could have a negative impact on business performance as well as the financial stability of technology consumers. Extreme diligence must be conducted in the funding for future capex and customer service expansion to protect the organization's future cash-flows and profitability in the event of another global pandemic.

2. **Looming Global Economic Recession**
   Current economic conditions are a top concern noted by most technology C-suite executives. Economic conditions in markets currently serviced by technology companies, particularly those reliant upon government funding and the subject of high levels of unemployment, may have a significant negative impact on international growth opportunities. A global recession will have a severe impact on economies struggling to recover from the COVID-19 crisis as well as developing economies where investment is highly attractive but risky due to potential financial solvency issues. This will negatively affect the industry as emerging economies are key growth areas for many technology companies. According to the World Bank, given a rise in global interest rates in response to inflation, the world may be edging toward a global recession in 2023 and trigger a string of financial crises in emerging markets and developing economies that would do them lasting harm. Technology firms should take immediate action to achieve a secure financial path to surviving and thriving through the next economic downturn. Technology firms that prioritize specific cost-saving actions in each phase of the recession will likely find themselves outpacing their competitors.

3. **Natural Catastrophes**
   The technology and telecommunication sector's resilience to natural disasters and its ability to recover in the aftermath is critical to the resilience of the local economies in which they operate. Many technology, especially telecommunication operations, assets are highly subjective to Nat Cat losses given the rapid development of global climate change and resulting damage to business and property assets. A robust business continuity plan backed by an efficient, cost effective risk transfer strategy, involving both traditional insurance and alternative risk markets, is critical for many companies in the sector.

4. **Compliance With Evolving Government Regulation**
   Changes in legislation are being driven by a combination of factors, such as new and innovative technologies and high-profile cyber incidents covered by the media outlets. Data security and privacy laws are top concerns in the technology sector with a number of companies receiving significant fines for failing to adhere to GDPR and other regional regulatory requirements. Regulatory changes often lag behind technological advances, which can inhibit the adoption of innovations and hurt an organization's growth strategy both near and long-term. They can also affect a company's bottom line as they require new ways of working and can lead to fines and penalties for businesses that do not comply. Regulatory and policy priorities are shifting with a focus on consumer protection, especially within digital entertainment and the global supply chain. The emphasis varies country-to-country and the maturity of regulation varies significantly between developed and emerging regions. With a never-ending list of requirements worldwide, a robust compliance program supported by a worldwide insurance program is imperative to protect and support today's global business operations.

5. **Supply Chain Disruption**

The pandemic has put technology supply chains under unprecedented strain and the technology sector was no exception. Lockdowns limiting the availability of technology workers coupled with an unprecedented demand is contributing to the ongoing microchip crunch. Government restrictions on some technology vendors is also continuing to disrupt long-term 5G and other infrastructure deployment plans threatening to slow industry growth. With new technology cycles already disrupting established supply chains, technology firms are further exposed to disruptions in their own supply chains when global events adversely affect distribution channels. More than ever, supply chains need to be evaluated and precautions need to be put in place for disruption. There may also be insurance and alternative risk transfer solutions available to technology companies to help analyze and protect against lost revenue caused by a disruption in its supply chain.

6. **Geopolitical Risks**

Central banks across the world simultaneously have hiked interest rates in response to inflation. The world is edging toward a global recession in 2023, which will drive a string of financial crises in emerging markets and developing economies that would do them lasting harm, according to a comprehensive new study by the World Bank. As governments find themselves under extreme financial pressures, foreign payments and banking operations may get disrupted causing financial loss across the globe having direct consequence for the technology sector. Technology firms need to be circumspect when investing in politically exposed regions as they may encounter serious government actions that adversely affect regional operations and the effects may jeopardize the entire organization's financial stability. A robust compliance process backed by a credit/political risk insurance program will help protect international business assets and income.

TECHNOLOGY RISKS

7. **Network/Cybersecurity**

Cyber risk and network security is a top priority for technology companies. The level of urgency and concern has clearly escalated during the COVID-19 era; according to an ING survey, most technology executives put cybersecurity as a top three risk. Technology service provider networks are highly attractive targets for cybercriminals. Business continuity planning (BCP) reviews are essential and must be regularly updated. Cyber protection should include regular backups, segmentation of data, the right end-point detection and multifactor authentication. A properly placed insurance program can leverage company data to facilitate a tailored risk assessment plan then backed by a state-of-the-art global insurance program.

8. **Privacy and Information Security**

Coupled with network and cybersecurity, privacy and information security risk is further compounded by the fact that more people are now shopping online and streaming videos from personal devices, actions that require sharing more personal data online. In the ING survey mentioned above, technology executives indicated that their biggest risk issue is ensuring they have adequate resources to provide privacy/identity management and information security protection. With continuously evolving and changing consumer needs and advancing regulatory requirements across the global landscape, the protection of data is critical to maintaining customer trust and loyalty. Privacy risks coupled with cybersecurity remain mission critical in 2023 and resourcing the right vendors and insurance partners will be critical for organizational success.

9. **New Technology Risks**

New technologies are becoming bigger and more high-profile than ever before in the history of the industry. Autonomous vehicles are a perfect example of this risk. With the emergence of 5G networks, autonomous vehicles and supporting technology, AI technology companies will need to expand their traditional contractual agreements to cover the potential new risks associated with joining the autonomous car industry. AI is just one area affecting the way technology business operate, the customer demand has never been higher for a new technology. Insurance programs will need to address the risks associated with supporting new technology risk factors while continuing to look to protect the known risks of today.

The evolving exposure to new and emerging technologies will need to continuously be reviewed and backed by bespoke insurance policies brokered to mitigate these risks as new technologies come online.

10. **Disruption From Digital Technologies and AI Risk**
Disruptive innovation often occurs in challenging times as we have seen during the recent pandemic. There are some strong indicators that the technology industry is about to change due to new emerging products such as the Metaverse and a global recession may accelerate the change. Adding to the issue is the shortage of skilled workers to support the digital demand and increased cyberthreat further jeopardizes industry expansion and profitability. Resiliency in the sector relies heavily on investment in core revenue generators well before the recession, especially in areas with lead time. Solutions could include building advanced analytic capabilities to better understand customers' willingness to invest in additional services during the pending downturn in the economy, so that technology companies can personalize offers and solidify customer retention. However, this reliance on advanced analytics and AI adds additional risks to the business and could jeopardize profitability. There are now cutting-edge risk transfer products available in the market to help offset the risk of new AI technologies.

INDUSTRY RISKS

11. **Environmental, Social and Governance (ESG)**
ESG is perhaps the biggest issue facing business world today and the technology sector again is no exception. Investor activism exerts pressures and a younger generation of investors has driven additional focus on ESG concerns. Companies must evolve or face more shareholder and class actions around areas such as climate change, diversity and executive pay. In a recent Moody's report, researchers outline a connection between a delay in the implementation of environmentally sustainable policies and an increase in the probability of default. As the evaluation of company-level environmental sustainability continues to become intertwined with long-term business strategy, the link between environmental policy and disclosures, and credit risk may hurt a company's valuation and therefore, increase its vulnerability to activist shareholders. Increased borrowing costs stemming from potential credit rating downgrades due to lack of environmental disclosures, eat into cash flows and increase the total cost of capital, both of which negatively impact a firm's value. When combining the effect on cost of capital with the level of focus from major institutional investors, as well as the sizable increase in funds managed with a specific ESG mandate, environmental disclosures and net-zero strategies may be an obvious lever for outside shareholders to pull in the presence of management inaction. The technology sector is highly subject to ESG risks and insurance coverage needs to respond to lawsuits derived from investors activism. A robust Directors & Officers policy that would respond to an adverse ESG situation is mandatory in the technology space.

12. **Ability To Attract and Retain Talent**
Access to talent is challenging the technology sector, as well as many other industries. There is an ongoing need to educate working populations and reduce barriers to entry for skilled workers globally, however, this has been the struggle for many industries across multiple decades. With no clear near-term solution, many companies are taking an aggressive stance to retain talent. A large US technology firm recently doubled its maximum base salary for its technology-based workforce, citing a competitive labor market. Higher salaries will make it harder for tech companies around the world to compete, and while an economic slowdown may lessen the demand for new talent in the short-term, more global mobility in the workforce remains critical for industry expansion.

Multinational technology firms are uniquely positioned to take advantage of the global workforce, however, attracting and retaining employees is a constant battle even for large global firms. Beyond increases in compensation, robust employee benefit programs will be critical to attract and retain talent for many years to come.

13. **Reputational Risks**

    Failure to ensure infrastructure reach and resilience is critical exposure for the technology industry. While networks have withstood higher usage during the pandemic, technology service providers remain under pressure to improve network performance and expand its service offerings further to maintain its customer loyalty. Many users feel frustrated at being unable to access the latest speeds, and there's a widening gap between network reach and service adoption, particularly in emerging markets. While there are limited insurance products offered to offset reputational risk, there may be alternative risk transfer solutions available for given situations.

14. **Corporate Responsibility**

    Today's technology firms have insights into every single one of our lives. Service providers know more about everything than anyone ever has in the history of humankind, due in large part to these companies leveraging the power of data and AI. An article in *Forbes* magazine exemplifies the demand for corporate responsibility within the technology sector, "Technology companies have a special obligation to society, to the people who bought their products, clicked on their ads, and built businesses and ways of life with this technology." Given the absolute accountability of technology firms today, technology companies cannot afford to be underinsured. Gallagher's **CORE**360® risk review process ensures our clients will have the right coverage and limits when the need arises.

15. **Errors & Omissions (E&O)**

    Employee errors and omissions are a leading cause of liability and data breach claims in the technology sector today. Often the root cause of a significant data breach, breach of contract or copyright infringement is due to employee error. Many E&O lawsuits can be prevented by improving communications with clients and additional training of employees. If a technology provider is sued, these strategies may reduce, but not completely eliminate, the cost of a lawsuit by demonstrating that the organization fulfilled all of its professional responsibilities. Maintaining and continuously updating a robust risk management suite of protocols and purchasing the proper insurance limits and coverages will remain critical to protecting the organization's balance sheet.

16. **Financial Rising Capex Burden**

    Technology companies are subject to heavy requirements in investment and interest rate swings in the financial sector. The risks associated with the foreign exchange rate, tax and credit risk make navigating the global financial sector even more difficult during the economic downturn. Mistakes in investment strategy during troubling times can take years to recover, jeopardizing near-term shareholder value. Insurance underwriters see the technology sector as high-risk given the ongoing investment required to maintain and grow the business. Capex optimization is a dynamic process and an enhanced Directors & Officers policy can assist in minimizing the total cost of risk (TCOR), especially leveraged organizations.

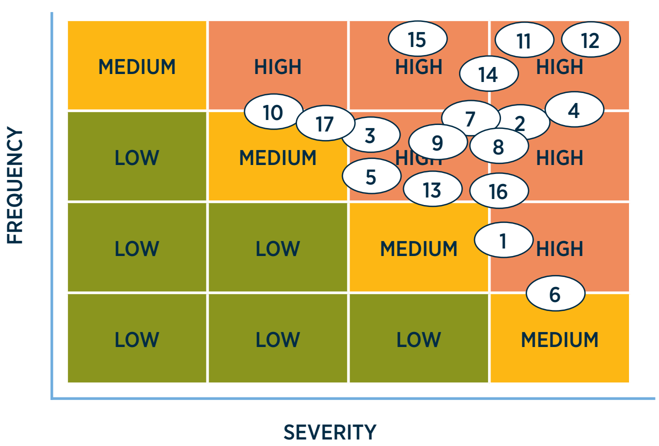
17. **Acquisition Risk**

    Acquisitions are often the largest investment that a technology company makes over the course of its lifetime and by definition, makes them a significant risk. The primary risk is financial — mergers and acquisitions can place a huge cash burden on companies if not executed properly. Key risks for technology acquisitions include but are not limited to the following: overpaying for the target company, overestimating synergies, integration shortfalls, lack of attention to culture and change management, and unforeseen market disruptions that devalue the acquisition. Gallagher is uniquely situated to assist in the risk management function within the due diligence process of an acquisition. A well-suited broker partner can assist in reviewing the targets ERM process and review its current insurance programs to identify gaps in coverage and place reps, and warranties coverage when needed to off-set much of the financial risk associated with an M&A transaction.

RISK ANALYSIS

As this discussion focuses on key risks for the technology industry, it is easy to see how most are identified as high-risk in our modeling. The numbers in the graphic below correspond to the risk factors identified in the section above. The top risks identified are 1) Ability To Attract and Retain Talent; 2) Environmental, Social and Governance (ESG), and closely related to ESG ; and 3) Corporate Responsibility. The following graphic provides a complete breakdown of the 17 risks identified.

INDUSTRY RISK FREQUENCY/SEVERITY



RISK MITIGATION

Given the wide-ranging risks examined in this article, it is difficult to provide a single best answer for any particular risk as a solution that works for one firm will not necessarily work for the next given each organization's unique set of circumstances. The following are some general themes for mitigating risks in each category of risk identified.

Macroeconomic

- Maintaining liquidity reserves to provide protection from adverse economic conditions due to pandemic and/or recession
- Take advantage of attractive lending agreements when available
- Cautious expansion into territories/countries subject to financial stress in the looming recession
- Maintain extreme diligence in meeting new and advancing regulations regarding operations and data/network security
- Utilizing third-party providers to validate and audit supplier risk management and social business processes to assure continuity as well as compliance and where necessary buildout new relationships to ensure against disruption

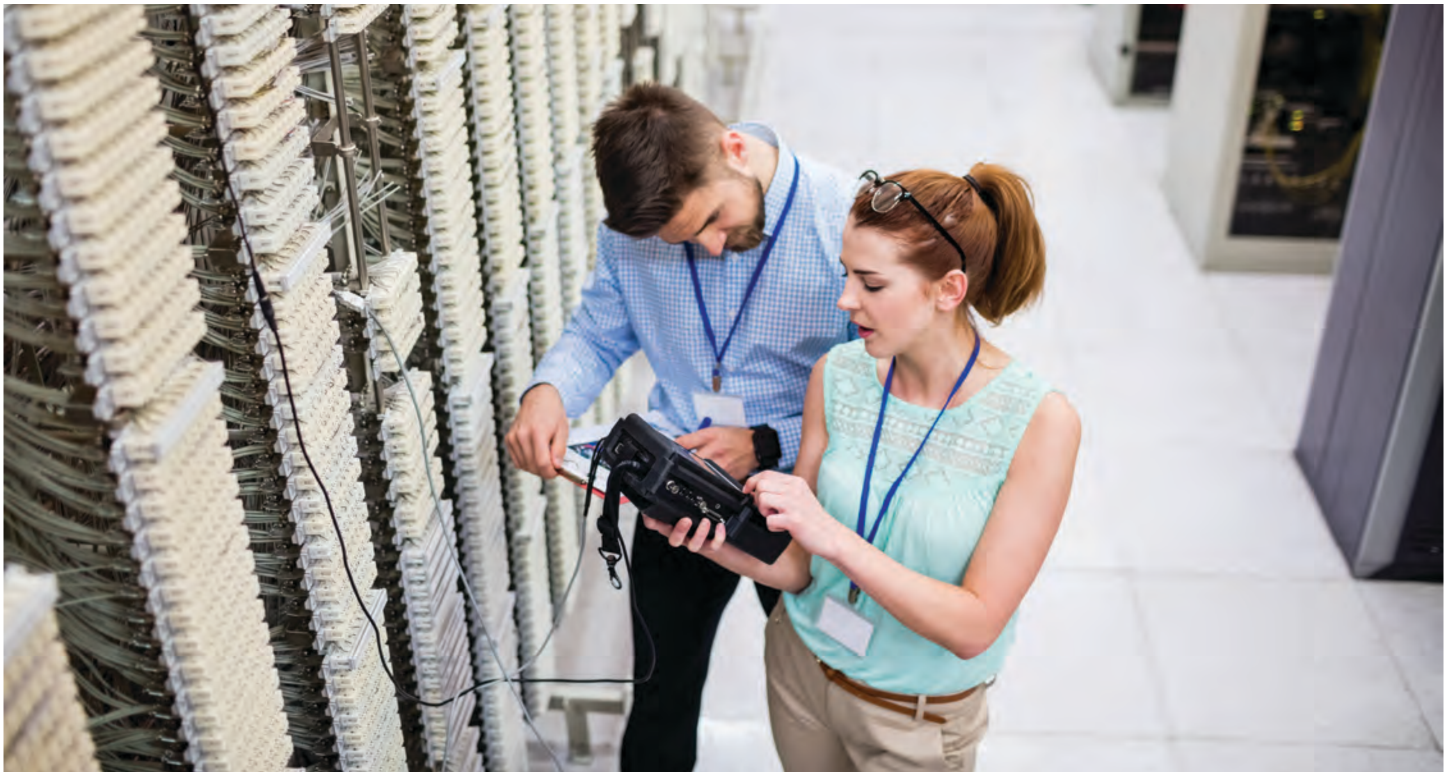
Technology

- Install robust processes around data management and use extreme caution in adapting AI frameworks as they are proven to function as intended and maintain data integrity over time
- Establishing emergency redundancies for services provided and ongoing operations in high-hazard geographies
- Invest and lead the industry in cutting-edge cyber protection
- Maintain a robust cyber insurance program
- Utilization of the latest, cutting-edge data protection methods and vendor services
- Invest in new and emerging technologies to ensure relevancy as technology advances

Industry

- Maintain a robust and ongoing community outreach to create goodwill
- Reducing carbon footprint via a net-zero company plan to be fully executed within five years or less
- Seek environmental awards and other external recognition on ESG issues at every opportunity
- Invest in local communities, children welfare and education initiatives
- Invest in employee benefits, training and education. Pay higher wages to attract and maintain talent
- Attract and retain the workforce through a dynamic and inclusive culture, and by providing exceptional benefits
- Establish diversity and inclusion employee resource groups and maintain a culture of inclusion
- Look for partnerships to train workers for high-demand jobs in the new digital economy—from online courses to mentorship to job placement

Mitigating risk for technology and telecommunication firms in 2023 will be more challenging than ever given the social and economic pressures placed on the sector. The proper employment of a solid financial and enterprise risk management strategy will be more important than ever and partnering with the right risk mitigation partner(s) is critical for a well-executed risk financing strategy. Gallagher has resources and the global scale to assist globally while meeting the unique requirements within each local geography to help drive employee growth and retention. As the technology industry carves out new territories, Gallagher is there, leveraging data to develop the right risk solutions to minimize exposure so organizations can focus on growth and development.



Connect With Us

Damion Walker
Managing Director
Technology Practice

595 Market Street, Suite 2100
San Francisco, CA 94105
T: 213.219.1991
E: Damion_Walker@ajg.com

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