LLOYD'S AON

Implications for businesses: Construction and manufacturing

Ukraine: A conflict that changed the world

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Lloyd's Futureset

The impact of the crisis on macroeconomic themes will be felt across all industries to varying degrees.

Inflationary pressures associated with supply chain issues, such as costs of materials, labour and logistics are mounting, with companies considering a number of solutions to maintain revenue and profitability. For instance, oil and gas producers and food manufacturers will be the most impacted by inflation, largely due to Russia and Ukraine having dominant positions as major exporters of key raw materials across these industries.

Other industries may need to change business models as a result of subtle changes in trading behaviours. As each nation becomes more focused on developing domestic production to avoid geopolitical risks, transportation and logistics companies will likely need to evolve to accommodate a lower demand for international trade but growing interest in national logistics solutions.

With ESG becoming an increasingly prominent topic on corporates' risk agendas, significant resources are being allocated to dedicated ESG teams across multinational corporations to develop risk management strategies. With increased awareness and potential scrutiny from employees, customers and stakeholders, businesses could incur significant costs to adhere to ESG standards.

In order to meet public expectations, thousands of companies have exited from or paused Russian operations. Those that continue to conduct business in Russia face potential reputational damage in the affected region, which could lead to economic repercussions (for example a. decline in business due to global boycotts). Corporates are also spending significantly more on due diligence and compliance reviews to ensure any direct or indirect relationships with Russia are identified and replaced.

Aon Global Risk Management Survey

Aon's 2021 Global Risk Management Survey illustrates today's traditional and emerging corporate risk portfolio. The Survey collates responses of over 2,300 risk managers from 16 industries, spread across varying territories and company sizes. In 2021 respondents selected and rated 10 top risks that their organizations were facing:

01	Cyber Attacks / Data Breach
02	Business Interruption
03	Economic Slowdown / Slow Recovery
04	Commodity Price Risk / Scarcity of Materials
05	Damage to Reputation / Brand
06	Regulatory / Legislative Changes
07	Pandemic Risk / Health Crises
08	Supply Chain or Distribution Failure
09	Increasing Competition
10	Failure to Innovate / Meet Client Needs

The following analysis breaks down the results of this survey by industry sector and considers how each sector's risk profile has changed as a result of the conflict in Ukraine. Risks highlighted in bold indicate risks that will be further amplified by effects of the crisis.

Overview

The following table summarises the implications of each of the market forces explored in this report to businesses over the short to long term. These are assessed in greater detail over the following pages for the different industry groups expected to be most impacted by the crisis.

	Cyber	Supply chain	Food security	Climate transition	Energy security	ESG	Public sentiment
Banks and financial institutions	Minimal	Minimal	Minimal	Minimal	Minimal	Significant	Medium → Significant
Construction and manufacturing	Minimal	Medium → Significant	Minimal	Minimal	Medium → Significant	Medium	Minimal
Energy	Medium	Significant	Minimal	Significant	Significant	Medium → Minimal	Significant → Medium
Food and beverages	Minimal	Significant	Significant	Minimal	Medium	Minimal	Medium → Minimal
Public sector and healthcare	Significant → Medium	Minimal	Significant → Medium	Significant	Minimal	Minimal	Significant
Technology	Medium → Significant	Minimal	Medium	Medium	Minimal	Minimal	Minimal
Transportation and logistics	Significant → Medium	Minimal	Medium	Medium	Significant → Medium	Minimal	Minimal

Key:
- **Minimal:** Market forces will have no or minimal impact on the industry
- **Medium:** Market forces will have an indirect impact on the industry
- **Significant:** Market forces will have a clear, adverse impact on the industry

Construction and manufacturing

Cyber	Supply chain	Food security	Climate transition	Energy security	ESG	Public sentiment
Minimal	Medium → Significant	Minimal	Minimal	Medium → Significant	Medium	Minimal

Global insurance premium: $115bn

Aon 2021 Top 10 Global Risks
(Risks in **Bold** are likely to be further amplified by effects of the Ukraine crisis):

01	**Economic Slowdown / Slow Recovery**
02	**Commodity Price Risk / Scarcity of Materials**
03	Cash Flow / Liquidity Risk
04	**Business Interruption**
05	Accelerated Rates of Change in Market Factors
06	**Cyber Attacks / Data Breach**
07	**Workforce Shortage**
08	Capital Availability
09	**Damage to Reputation / Brand**
10	Pandemic Risk / Health Crises

Manufacturers with a production site in affected regions may face significant challenges and potential losses from supply chain issues and from a business continuity perspective. Contractors and manufacturers will need to consider the extent to which their insurance policies provide the protection they need. In the longer term, taking risk in-house through captives or self-insurance may become increasingly prominent.

Short term: The Western allied democracies could look to push on with climate transition, raising the demand for renewable energy projects. However, a number of raw materials that are key to renewable builds are typically exported in scale by Russia (e.g. nickel is commonly used for battery storage products), thus increasing the pressures on manufacturing of products such as semiconductors. As a result, a number of manufacturers have turned their attention to supporting defence efforts – weapons production may be seen in a more positive light by the public as support of Ukraine defence companies can be viewed as social benefit.

Medium to long term: Smaller construction firms face the risk of insolvency as a result of inflationary pressures. With a typical bidding process for a particular construction project lasting up to 2 years, businesses are anticipating elevated long-term effects on inflation and therefore avoiding bidding altogether. Interest rate rises also present a sizeable hurdle for infrastructure projects – many that were due to come online this year have been paused due to rising inflation.

Construction and manufacturing (continued)

> Many construction projects' budgets were set pre-Ukraine although inflation was already impacting building materials and the wider supply chain. The conflict has caused more uncertainty, increased inflation and supply chain disruption and brought further labour shortages. Therefore, many pre-crisis projects have had to reassess their viability at the planning, design or tender stages, thereby requiring restructuring around budget availability and contract certainty around the inflation risk
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Case study: Renault has its second largest operations based in Russia. They have made the decision to exit by selling their assets to the Russian government, but have sustained a 5-year buy-back option.

More likely scenarios | Less likely scenarios

01 Defensive push-back	02 Protracted conflict	03 Annexation	04 Collapse of Ukraine	05 Escalation
– Increased financing and construction of renewables projects – Execution of projects that were temporarily paused	– Production companies setting up locally – e.g. UK companies with international operations may revive local production	– Smaller construction companies go insolvent due to long-lasting inflationary pressures	– Pause development of long-term projects – instead focusing efforts on building domestic supply chains – Sizeable mining projects are accelerated to meet domestic energy demands	– Planned and pre-execution projects would need to be put on pause for the foreseeable future – Companies shift operations to support war efforts and defence (e.g. Dyson building ventilators during COVID) – Potential loss of physical assets due to migration of critical infrastructure as a result of cyber attacks will boost demand for risk mitigation which comes at a higher cost – Military vessels used to bring in emergency supplies where needed

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