

Principal Risks and Risk Management

The Group has an established process for the identification and management of risk, working within the governance framework set out in our corporate governance statement (see pages 48 to 52). Ultimately the management of risk is the responsibility of the Board of Directors, and our system of risk management, which is intended to be comprehensive and robust, continues to evolve as the Group and the environment in which it operates increases in size and complexity.

The Board’s role in risk management includes promoting a culture that emphasises integrity at all levels of business operations and setting the overall policies for risk management and control.

During the year the principal risks affecting the Group were comprehensively reviewed and re-categorised by the Group Executive team and approved by the Board.

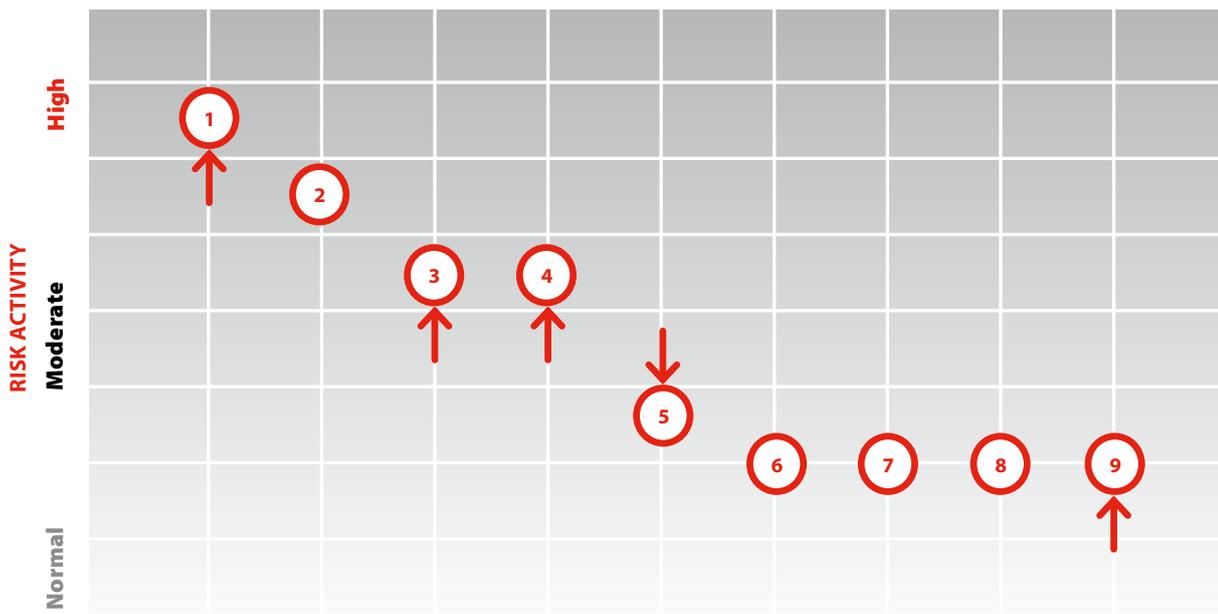
Each risk area continues to have priority tasks allocated to it that are the responsibility of the members of the Group Executive to deliver during the financial year. This process inherently manages risk by ensuring the principal risks are being mitigated by prioritised business activity.

As we move into 2019 increased focus is being given to how effectively risk is also being mitigated by the control structures embedded throughout the Group. Both divisional executive teams have provided feedback on this to a newly formed risk management steering group. This group is in the process of implementing a quarterly review of the effectiveness of these control structures by reference to a set of key risk indicators. We will report on this enhancement to the risk management process in more detail in next year’s report.

In the meantime, the following pages include an insight into what happened in 2018 and areas of focus for 2019.

The principal risks are listed on the following pages in order of significance. We have made this assessment by reference to the volume and intensity of activity in each area and not by assessing potential severity of impact, as there are examples of severe impacts across all risk areas and these are all mitigated to a high degree. The recategorised risk themes within the principal risk areas are shown alongside. Available mitigations in the form of control structures are shown next to each identified risk area.

Risk Rating and Movement in 2018

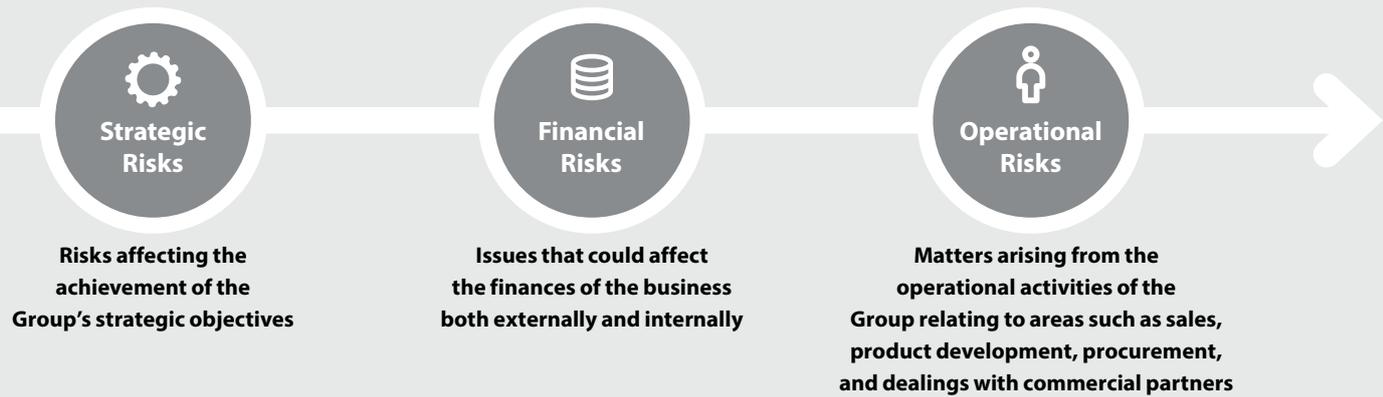


- 1. Strategic initiatives
- 2. Market threat to core business
- 3. Talent management

- 4. Cybersecurity and information technology
- 5. Customer dependency
- 6. Financial management

- 7. Manufacturing risk
- 8. Compliance and legal matters
- 9. Political and economic stability

There are three main risk categories:



1. STRATEGIC INITIATIVES



Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Failure to identify correct strategic projects or to deliver them Failure to identify and implement new products Failure to identify, complete and integrate acquisitions 	<ul style="list-style-type: none"> AEF divestment and the acquisition of Merrick's product line reflects the strategic focus on operating in our core markets Relocation of West Palm Beach electronics production demonstrates focus on operational efficiency Increased capital investment to deliver enhanced product range to meet customer requirements First orders for key new products; MCM100 and NIOSH approved supplied and powered air SCBAs 	<ul style="list-style-type: none"> Board oversight of clear strategy definition and communication combined with effective management Product development linked to Group strategy and customer requirements Intellectual property protection considered and implemented Clear acquisition strategy and alignment with divisional structures 	<ul style="list-style-type: none"> Delivering new product programmes to meet customer requirements within capital allocated budget Continued focus on operational efficiency and value enhancing acquisitions
Impact on			
<ul style="list-style-type: none"> Strategy delivery Sales, costs and profitability Employee morale 			

2. MARKET THREAT TO CORE BUSINESS



Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Lack of sales growth/threat to current sales Loss of major bids/tenders Threat from competitors 	<ul style="list-style-type: none"> Sustainable growth achieved in core lines of business Product sales base expanded with strong growth in hoods and masks in LE and the first orders for MCM100 Enhanced dealer and distribution network focused on core markets Focused Military leadership team to support key customer relationships and sales strategy Unique lease model in Farm Services continues to provide wider access to product range 	<ul style="list-style-type: none"> Customer relationships prioritised and managed through dedicated leadership channels Product differentiation/innovation and diversification and protection of intellectual property Diversified sales channels with comprehensive distribution/intermediary network Effective and up to date competitor monitoring and analysis to maintain competitive advantage 	<ul style="list-style-type: none"> Sustainable growth in all lines of business and order growth in new products
Impact on			
<ul style="list-style-type: none"> Sales volume and profitability 			

3. TALENT MANAGEMENT



Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Poor employee competence and failure to train and develop Inability to recruit and retain talent Dysfunctional organisational structures 	<ul style="list-style-type: none"> Improved employee satisfaction scores Continuing commitment to graduate and internal leadership training programmes to develop talent base Focus on separate leadership for Military and Law Enforcement combined with extensive succession planning for key roles in the organisation Alignment of annual bonus scheme targets across all employees 	<ul style="list-style-type: none"> Robust succession planning and effective performance management process Effective training and development strategy and activities Appropriate organisational structure with clear lines of authority and communication Maintaining positive Avon culture - Great Place to Work 	<ul style="list-style-type: none"> Continued focus on people and culture including launch of new training and development strategy
Impact on			
<ul style="list-style-type: none"> Strategy delivery Sales, costs and profitability Employee morale 			

Principal Risks and Risk Management continued



4. CYBERSECURITY AND INFORMATION TECHNOLOGY

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Business interruption/cash cost of cyber-crime and fraud IT system or communications failure could lead to business continuity event Military security requirements result in excess cost and management time. Failure to comply results in loss of contract 	<ul style="list-style-type: none"> Third party cybersecurity review Transition to cloud based servers to reduce infrastructure risk and deliver enhanced security Employee wide cybersecurity training and development programme Completion of full GDPR assessment and policy implementation DOD and MOD cybersecurity assessments completed 	<ul style="list-style-type: none"> IT strategy anticipates forthcoming requirements. IT sufficiently resourced with specialists to ensure compliance Robust network/IT controls and security protocols/policy Cyber insurance and IT disaster recovery plan and backup 	<ul style="list-style-type: none"> Continued focus on infrastructure stability and IT operating efficiency
Impact on			
<ul style="list-style-type: none"> Ability to ship products Financial loss Reputational damage 			



5. CUSTOMER DEPENDENCY

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Over reliance on customers, e.g. the US DOD, and its funding and contract process Failure to diversify customer base Negative impact of Dairy market cycle on customer buying behaviour 	<ul style="list-style-type: none"> First orders expected for M69 and M53A1 underpin strong relationship with the DOD MCM100 product/market differentiation bringing new Military customers UK GSR contract win re-establishes relationship with UK MOD Growth in Farm Services model provides customers access to product base through lease hire Expansion of Law Enforcement customer base 	<ul style="list-style-type: none"> Strong customer relationship management with an appropriate team structure, communication and customer service Understanding our Military customer requirements and forthcoming procurement requirements Strategy provides for diversification of customer base Regular tracking of Dairy market cycle indicators and mitigation plan for market downturn 	<ul style="list-style-type: none"> Continued focus on customer relationships and strong dealer/distribution network
Impact on			
<ul style="list-style-type: none"> Sales and profitability 			



6. FINANCIAL MANAGEMENT

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Insufficient management of risks for tax, cash flows and foreign currency exposure Insufficient funding capacity to meet strategic objectives Insufficient overhead control and working capital management erode margins or impair investment ability Poor quality financial reporting and business information impacts decision making 	<ul style="list-style-type: none"> Net cash of £46.5m at the year end provides capital allocation flexibility Operating cash conversion of 108.2% delivers sustainable cash flows Renewal of undrawn \$40m revolving credit facility on more favourable terms West Palm Beach facility relocation to support operational efficiency 	<ul style="list-style-type: none"> Robust and professional corporate finance function supported by network of professional advisors Full compliance with bank facility covenant requirements Robust internal financial control and divisional reporting procedures supported by the external and internal audit process Effective currency hedging strategy 	<ul style="list-style-type: none"> Continued focus on strong cash generation and working capital management
Impact on			
<ul style="list-style-type: none"> Costs and profitability Reputational damage 			

7. MANUFACTURING RISK 

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Poorly functioning supply chain impacts production and cost of manufacture Quality control process failure leads to product recall Health and safety incident results in plant closure and prosecution/ fines Poorly managed distribution or logistics network impacts delivery and reputation Delays in new product introductions 	<ul style="list-style-type: none"> West Palm Beach facility consolidation supports manufacturing efficiency No product recalls or significant warranty claims in the year highlights quality product control Very low rate of health and safety incidents 	<ul style="list-style-type: none"> Robust supplier audit and quality management Written supply agreements in place including dual source where necessary Robust manufacturing/operational disciplines and fully functioning and effective systems Strong site leadership and engaged, motivated manufacturing workforce Insurance and effective business continuity planning 	<ul style="list-style-type: none"> Continued focus on operational efficiency and better business approach
Impact on			
<ul style="list-style-type: none"> Costs, sales and profitability 			

8. COMPLIANCE AND LEGAL MATTERS 

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Failure to comply with export controls slows or removes ability to ship abroad Prosecution, fines and negative publicity resulting from bribery and corruption Litigation drains cost and management time negatively impacting other areas Failure to comply with government contract obligations results in loss of contract 	<ul style="list-style-type: none"> UK Export Control audit passed No US voluntary disclosures or export control breaches Code of Conduct reviewed and communicated US Government audit at Cadillac passed 	<ul style="list-style-type: none"> Effective export control policy supported by training Effective anti-bribery and corruption policy supported by training Embedded and effective Code of Conduct Effective internal legal and finance function Effective Government contract specialist knowledge reporting at a senior level 	<ul style="list-style-type: none"> Maintain high standards and integration of compliance teams within the businesses
Impact on			
<ul style="list-style-type: none"> Ability to ship products Financial loss Reputational damage 			

9. POLITICAL AND ECONOMIC INSTABILITY 

Business Risk	What happened in 2018	Mitigation	Focus for 2019
<ul style="list-style-type: none"> Unpredictable timing/amount of Federal funding for Fire and Law Enforcement customers DOD budgets/funding withdrawn Negative impact from Brexit on: trade, regulation, people, contracts and IP 	<ul style="list-style-type: none"> Continual monitoring of potential Brexit implications and wider global trading conditions US DOD budget agreed for the next two years to provide funding certainty Wider proliferation of chemical weapons use raising awareness of commercial and Military customers readiness assessment and product effectiveness Close monitoring of the milk to feed price ratio to forecast changes in farmer confidence 	<ul style="list-style-type: none"> Close monitoring of Federal funding and budget position Lobbyist/Government advisers and key influencers aligned to Avon's interests Brexit risk assessment and identified mitigations ready for implementation 	<ul style="list-style-type: none"> Readiness and planning for all potential changes in global trading conditions We are less exposed to the political instability and impact on trading of Brexit with our US-based businesses constituting around seventy percent of the Group and a facility located in continental Europe (Italy).
Impact on			
<ul style="list-style-type: none"> Sales and profitability Ability to ship products Financial loss Reputational damage 			