

Risks and Uncertainties

GKN has an extensive risk management framework designed to identify and assess the likelihood and consequences of risk and to manage the actions necessary to mitigate their impact. A detailed description of this framework is given on pages 48 and 49.

Set out below are the principal risks and uncertainties which could have a material impact on the Group and the corresponding mitigating actions that are in place. Additional risks not currently known or which are currently regarded as immaterial could also adversely affect future performance.

Market risks

Risk	Nature of risk and potential impact	Mitigation
Market cycles	Changes in macro-economic conditions, consumer demand and preferences and availability of credit. GKN's financial performance could be impacted by continued overcapacity in automotive production and changed consumer preferences for smaller, less sophisticated vehicles; rescheduling or cancellation of orders for civil aircraft and changes in value or timing of defence spending; lower agricultural and mining commodity prices and reduced levels of construction.	<ul style="list-style-type: none"> ➤ Diverse business portfolio serving different markets ➤ Extensive actions to reduce cost base ➤ Effective cash management including focus on working capital and investment spending ➤ Ongoing review of market indicators
Customers	Significant customer concentration in automotive and aerospace industries — some 65% of Group sales are from 25 major customers (although no single customer represented more than 10% of Group sales at 31 December 2009). The insolvency of, damage to relations or significant worsening of commercial terms with a major customer could result in the loss of future business opportunities, asset write-offs and additional restructuring actions.	<ul style="list-style-type: none"> ➤ GKN is not dependent on contractual or other arrangements with any individual customer ➤ Active management of customer relations and credit exposure ➤ Strong commercial and engineering focus at customer level, ensuring effective programme delivery
Competition	Highly competitive markets with customer decisions based typically on price, quality, technology and service. Customer vertical integration (including OEMs taking production in-house), the entry of new competitors or consolidation of existing competitors could restrict GKN's ability to grow its business.	<ul style="list-style-type: none"> ➤ Continual review of competition and market trends ➤ Investment in engineering and lean manufacturing capabilities ➤ Strong customer relationships
Technology	Inability to launch new products, new product applications or derivations of existing products in a timely manner to meet customers' needs. GKN may lose customers to competitors offering new technologies in the event of an inability to adapt to market developments. Changes in legislative, regulatory or industry requirements, competitive technologies or consumer preferences may render GKN's products obsolete or less attractive.	<ul style="list-style-type: none"> ➤ Regular assessment of market and technology trends and drivers ➤ Divisional technology plans aligned to emerging and future trends ➤ Focused investment in research and development

Operational risks

Risk	Nature of risk and potential impact	Mitigation
Supply chain	Lack of availability of equipment, components, services and raw materials that meet specifications. Volatility in production and the need to maintain appropriate inventory levels requires effective supply chain management. Supply chain disruption could impact GKN's sales to and relationships with its customers and result in additional unrecoverable costs.	<ul style="list-style-type: none"> ➤ Monitoring of financial viability of key suppliers ➤ Ongoing assessment of supplier technology and dependency ➤ Dual sourcing to reduce dependence on single supplier

Operational risks *continued*

Risk	Nature of risk and potential impact	Mitigation
Product quality	Potential liabilities for defects in products, warranty claims or product recalls. Product quality issues could adversely affect profits and damage GKN's reputation.	<ul style="list-style-type: none"> ➤ High levels of quality assurance and manufacturing systems ➤ Product liability insurance (although GKN does not generally insure against product warranty or recall)
People	Inability to attract and retain qualified personnel, particularly engineering professionals. The absence of adequate talent and a lack of continuity in management and leadership could result in an inability to execute the strategic plan and deliver financial performance.	<ul style="list-style-type: none"> ➤ Annual succession planning and performance development process ➤ Competitive reward packages and Group-wide training and development programmes
Acquisitions	Inability to realise expected benefits of acquisitions. A lack of suitable acquisition targets aligned with planned strategy, a failure to integrate acquired businesses successfully, or an inability to capture value from them could impact operations and prevent successful delivery of GKN's strategic objectives.	<ul style="list-style-type: none"> ➤ Focused reviews to ensure strategic alignment of acquisitions ➤ Extensive pre-acquisition due diligence ➤ Careful management of the integration plans by experienced on-site management

Financial risks

Risk	Nature of risk and potential impact	Mitigation
Pensions	Pension deficit levels are affected by changes in asset values, discount rates, inflation and longevity assumptions. Accounting valuations of post-employment obligations can cause volatility in financial reporting. Additional Company pension contributions could restrict investment in businesses.	<ul style="list-style-type: none"> ➤ Active management of pension scheme assets and long term view of liability assumptions ➤ Continuing review of the level of benefits provided ➤ Alternative funding and deficit reduction plans implemented where appropriate
Exchange rates	Currency risks: transactional (subsidiary sales or purchases in currencies other than their functional currency) and translational (exchange rate movements in investments in overseas operations in GKN's balance sheet). The Group's financial statements will fluctuate as a result of movements in exchange rates.	<ul style="list-style-type: none"> ➤ Hedging of transaction exposures through forward foreign exchange contracts ➤ Balance sheet translational hedging policy (currently suspended due to continuing volatility of foreign currencies against sterling)
Taxation	GKN is subject to complex tax laws and audit procedures. Actual tax liabilities could differ from accruals which are based on management judgement.	<ul style="list-style-type: none"> ➤ Ongoing monitoring of tax developments in major jurisdictions ➤ Group-wide tax compliance programme ➤ Actions taken to utilise tax losses

The Group insures against the impact of a range of unpredicted losses associated with both its business assets and liabilities. GKN's risk financing strategy is based on a significant level of capped self-insured retention at the Group level (within GKN's own captive insurance company, Ipsley Insurance Ltd, which does not insure the risks of any other entity) and a much lower retention at subsidiary level through deductibles. Catastrophe insurance is then purchased in the commercial market over and above these levels of retention. Ipsley's current participation in GKN's principal insurance programme is £10 million per incident capped at £20 million in any one year. Due to the nature of the risk, the Group's aviation products liability insurance is placed solely in the commercial market.