Linking Risk Management to Business Strategy, Processes and Operations

by
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Corporate goal setting and performance management and measurement are the cornerstones of almost all types of organizations with a mission, whether they are private or public sector, for-profit and not-for–profit. While strategic planning is good corporate governance; both of these 'management' concepts are tied into effective risk management practices. Moreover, if risk or impediments to goals are not properly contemplated and assessed there is no viable strategic management, and frequently poor outcomes or results. This article in brevity will explore the significance of linking and integrating systematic risk management with an organization's business strategy and operations and therefore creating greater value for its stakeholders.

Today's Business Environment

If these aren't the years of living dangerously we should all be very surprised. Corporations and organizations in general are living with a dynamically changing business environment. Stakeholders' expectations have necessarily climbed much higher with both more sophisticated stakeholders or investors and more activist Boards. What are the changes that have taken place? Here are the most prominent ones:

- A dynamically changing risk profile
- Increased rules and regulations (greater government intervention)
- Credit crisis / economic crisis / meltdown
- Increased corporate governance expectations
- Market expectations
- Competition
- Confidentiality rules (privacy laws)
- Technology & business recovery
- Sarbanes–Oxley requirements
- International Basel 2 capital accords (banking)
- International financial reporting standards (IFRS)
- Environmental compliance and reporting
- Foreign Corrupt Practices Act

- Anti-money laundering
- Terrorism, natural and man-made disasters
- Climate change

It should be no surprise that what the majority of these changes have in common are risk management-related regulations & standards or practices. Risk management in one way or another has been long practiced by both corporate and public sector executives, however, today's complex and challenging environment demands a shift from ad hoc or hap hazard risk management to systematic and embedded risk management. As referred to above the risk management processes of corporations are under increasing regulatory and private scrutiny. Properly managed risk drives growth and opportunity. Furthermore, as executives struggle with business pressures and challenges that could also be partly or completely beyond their control, such as a distressed economy; resultant restructurings; reduced knowledge resources and global health pandemics, to name a few, risk management (and enterprise risk management) needs to mature.

Many organizations have already begun this more sophisticated path and others have mid and long range plans to implement an enterprise risk management program piloted by a new Chief Risk Officer or managed and coordinated by corporate services that include internal audit, risk management, information technology and legal services, (interfacing with external auditors) depending on their size and structure. Standard & Poor's recent ERM and corporate debt ratings (plans to include a series of questions about risk management in its company evaluation process) which is also for non-financial companies finally drives home that ERM (and its benefits) is here to stay.

What Do the Professional Surveys and Literature Reveal?

According to a recent Ernst & Young survey the business world in general still has a lot of work to do in order to improve its risk management, but there are encouraging signs of progress:

- Four in ten companies do not have formal processes to align risk management with corporate strategy;
- Investment in risk management will increase substantially over the next three years (66% of companies responded to such an increase);
- Further alignment needed between risk management functions and line management as well as across individual functions; and
- Risk management challenges over next three – five years include developing a more integrated & systematic approach – clarifying risk ownership & embedding a risk culture throughout organization

A 2008 survey by Towers Perrin involving life insurance companies noted that responsibility for ERM usually resides within the C-suite but that most often, the chief risk officer (CRO) or the chief financial officer (CFO) is in charge of ERM, and they typically report directly to the CEO. From their wider vantage point, the CRO and CFO are able to look across the organization and develop a perspective on the risk profile of the organization and how that profile matches its risk appetite and risk tolerance.

In Canada, the majority of the 'big banks' currently have the CRO ultimately responsible for ERM capability, and this typically includes credit risk, market risk, operational risk and hazard risk. A few years ago internationally active banks around the world became subject to the implementation of the Basel 2 Capital Accord that included 'three pillars' - (1) minimum capital requirements (addressing risk), (2) supervisory review and (3) market discipline – to promote greater stability in the financial system. The first pillar focused on maintenance of regulatory capital calculated for three major components of risk that a bank faces: credit risk, market risk and operational risk.

Deloitte & Touche have developed a risk management maturity model or diagnostic tool known as 'The Risk Intelligent Enterprise'. It portrays enterprises on a continuum from ad-hoc and reactive to systematic and finally, 'risk intelligent'. In some businesses such as financial services and energy, their industry-specific risks are managed with a high level of refinement and

focus, using complex probability modeling and sophisticated analyses. Risk ownership is usually well defined at the mature end. The cost of risk is better measured (although operational risk still remains a weak link).

How Directors Understand Risk

A fairly recent Conference Board Study of larger companies revealed the following:

- Research found significant differences in how directors understand risk & how companies manage risk
- 77% of directors say they fully understand risk/return tradeoffs of a given strategy
- 73% of directors say their companies fully manage risk
- 59% of directors fully understand how business units interact in company's overall risk portfolio
- 54% have clearly defined risk tolerance levels
- 48% of Boards rank key risks
- 42% have formal practices/policies in place to address reputation risk

ERM Strategy and Organizational Realignment

The question that is often asked is what type of organizational structure best lends itself to the most effective risk management process. One size doesn't fit all. The risk management process must adapt itself to the organization's existing hierarchical management structure and whether it is highly centralized or decentralized. Real estate development projects across North America with geographic regional management versus a three plant single province executive structure pose different risk management challenges and requirements. However, there are critical factors driving risk management success. These factors appear to be universal and include:

- Clear ownership of risk within the organization
- Mechanisms, methodology to review, discuss and communicate risk
- A formal process to link risks to organizational objectives
- Proactive board and senior management level in both oversight and managing/monitoring risk

- Specific policy covering risk management as it relates to the organization's business and challenges

In addition, as commented on earlier in this article, risk management is most effective when:

- the CEO is truly committed to the process;
- other officers such as the CFO and General Counsel manage the risks under their jurisdiction;
- a proactive internal audit activity exists; and
- business unit executives and managers who own the risks assume everyday responsibility for managing the risks and controls under their jurisdiction.

Ultimately, management owns the ERM process just as the Board owns the corporate governance process.

Risk Communications for Stakeholders

In summarizing the relevancy of effective risk management communications for an organization, stakeholders should consider a risk management framework that consists of three formally connected components and one informal profess:

1. [FORMAL] A corporate-wide risk management policy
2. [FORMAL] Companywide risk management guidelines
3. FORMAL] An audit function charter of authorities and responsibilities
4. [INFORMAL] Maintaining and building ongoing dialogue with senior management and all operational and corporate functions across the company on goals, risks and controls

Overall, this improved communication paradigm provides for better decision making and strategic planning as a result of risk management being aligned with organizational goals.

- Risk management and Internal Audit have the same vision of the company's mission and objectives
- A better understanding to see and appreciate risk in a wider context
- The overlap of processes and risk issues in different geographic regions and businesses become more transparent
- More accountability by various risk management champions or risk owners (CEO, CFO, Operational Executives)
- There's more dialogue on key risk issues among Board members and strategic planning incorporates risk

With the combination of significant regulatory and market pressures in a much more uncertain world risk management and corporate strategy need to be dancing to the same tune. Also, not only for banks, insurance companies and hedge funds (who live by and sell risk) but all organizations need to strengthen risk management practices. ■

About the Author

Aaron M. Konarsky is director, risk management and internal controls at Canada Lands Company. He has overall responsibility for risk management policy and procedures, internal controls review as well as corporate insurance risk management. In chairing the company's risk management working committee he ensures that key risks are identified, assessed, mitigated, managed, transferred where feasible, and monitored. Aaron has developed significant risk management methodologies, frameworks and architecture in the companies and industries in which he has worked. These include banking, management consulting and public sector organizations, including Crown Corporations and consulting work with the Auditor General of Canada on strategic risk management. He has very broad risk management, corporate governance and internal controls experience and has spoken at North American conferences, the Institute of Internal Auditors as well as lecturing at universities on risk management related topics.

Aaron's focus in recent years has been on the improved alignment of risk management activities with the organization's strategic and corporate planning process and linking them to good corporate governance. He is a graduate of McGill University and an active member of the Institute of Internal Auditors, including sitting on the Government Relations Committee. Aaron is fluently bilingual.

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