

Unlocking the Potential of Risk Management

Engaging the Business to Add Value

Recent economic events and business failures can confirm: While there are certainly good risk management practices within pockets of individual organizations and within certain industries, it is clear that as a whole they are no match for the complexities of today's marketplace.

Current risk management best practices should be benchmarked, understood and adapted as appropriate for use in other organizations. However, the missing link in moving from current best practices to next generation practices is **better integration**.

While risk management structures and practices always need to be highly customized to the strategy, culture, and operation of a particular enterprise, the need for integration at multiple levels is common to every organization.

The lack of this integration is a leading cause of the failures by risk management disciplines in many organizations to truly help organizations optimize their success and stay true to their mission, vision and values.

Risk Management integration needs to occur along the following five dimensions:

Dimension #1: Driving business engagement (adding value)

Dimension #2: Addressing all aspects of risk (understanding exposure)

Dimension #3: Connecting to key management processes (creating synergy)

Dimension #4: Coordinating with key monitoring disciplines (seeing things whole)

Dimension #5: Enhancing board risk oversight (governing effectively)

Today's paper focuses on the first two dimensions of integration.

Adding Value: Driving business engagement (Dimension #1) – If the entire business is not engaged in the risk management discipline, it can be a “check-the-box” compliance exercise, and true business risks will not be surfaced in the right way or at the right levels. Effective risk management must include aspects that drive business-specific value. When managers understand the risks of their next technology initiative, product rollout or acquisition integration, understanding risk becomes very relevant and engagement increases. The following activities should be key focus areas for engaging the business in a discussion of risk:

Enterprise Risk Assessment

Optimizing the overall control environment and delivering peace of mind to key stakeholders

- Strong risk management, governance, accountability, transparency
- Considering both the upside and the downside of risk
- Establishing and monitoring risk tolerances

Business Plan Performance

Identifying and managing the risks to the achievement of the business plan

- Link to strategic and business planning provides context for meaningful risks
- Link to periodic performance management process provides context for risk management performance

Major Change Events

Identifying and addressing the risks associated with major change events

- Enhance change execution of strategies and initiatives with higher risk profiles (e.g., international expansion, new business lines or products, process reengineering, technology platform changes, off shoring, high growth, acquisitions, etc.)

Chronic Underperforming Areas

Identifying and addressing the risks/root causes underlying chronic underperforming areas

- Underperforming business units, divisions, processes, initiatives, etc.

Emerging Risks

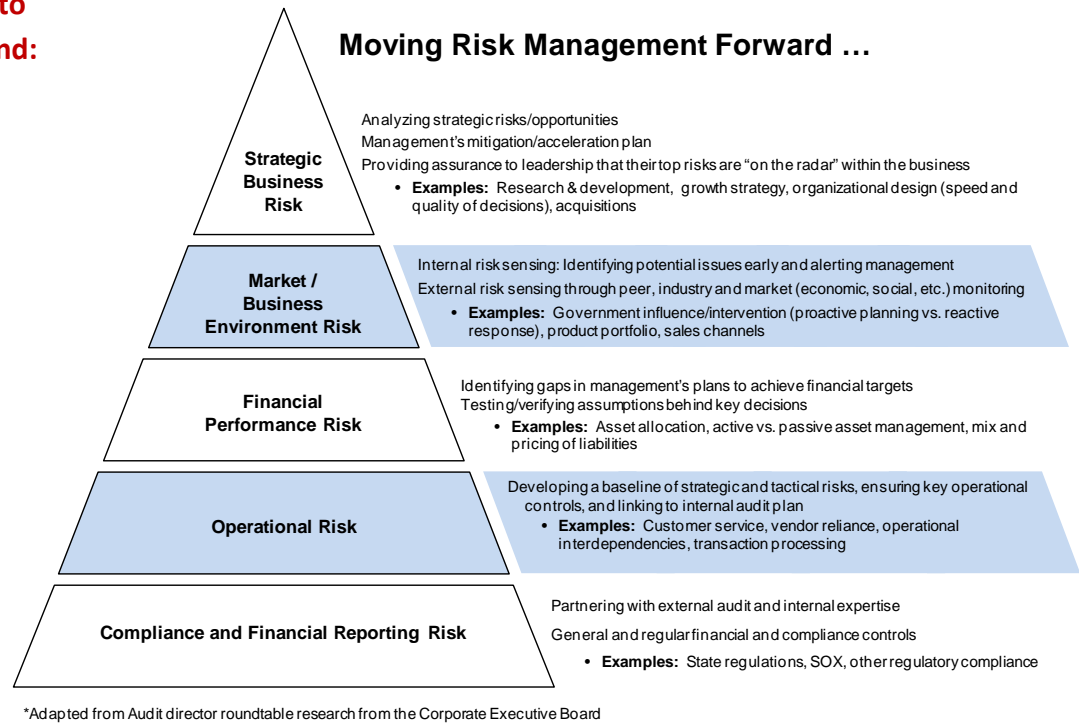
Identifying and monitoring “over the horizon” risks to ensure they are proactively addressed

- Emerging risks related to industry, competitor, environment, regulatory, etc.

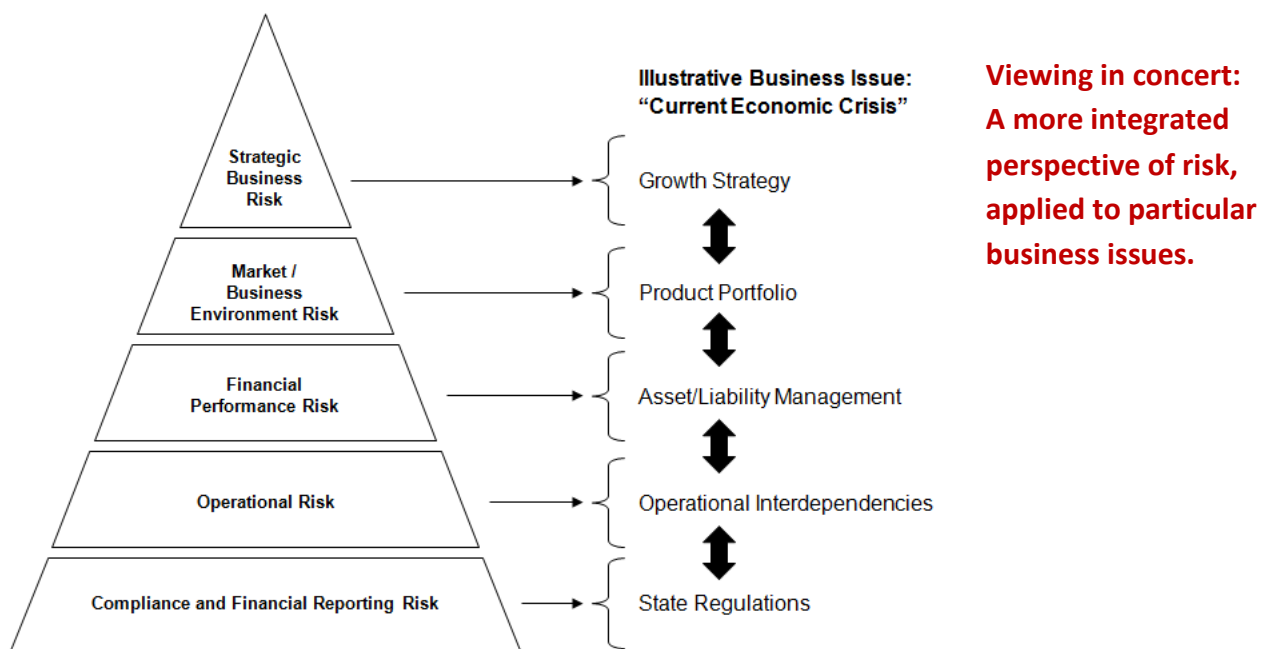
In addition to supporting enterprise risk assessment and governance, a risk management process must also help the business understand and manage the risks to the business plan, successfully navigate major change, address underperforming areas of the business, and appropriately consider emerging risks that might not be significant today, but will be in the future.

Understanding Exposure: Addressing all aspects of risk (Dimension #2) – It is not uncommon for business leaders, especially those not responsible for a risk function, to have a relatively narrow view of risk, such as financial or insurable risk. An integrated view of risk, however, includes many aspects that must be considered, moving beyond solely financial or insurable risk. The following illustrates the different aspects of risk which must be integrated for a successful risk management discipline:

Different levels of risk to consider and understand:



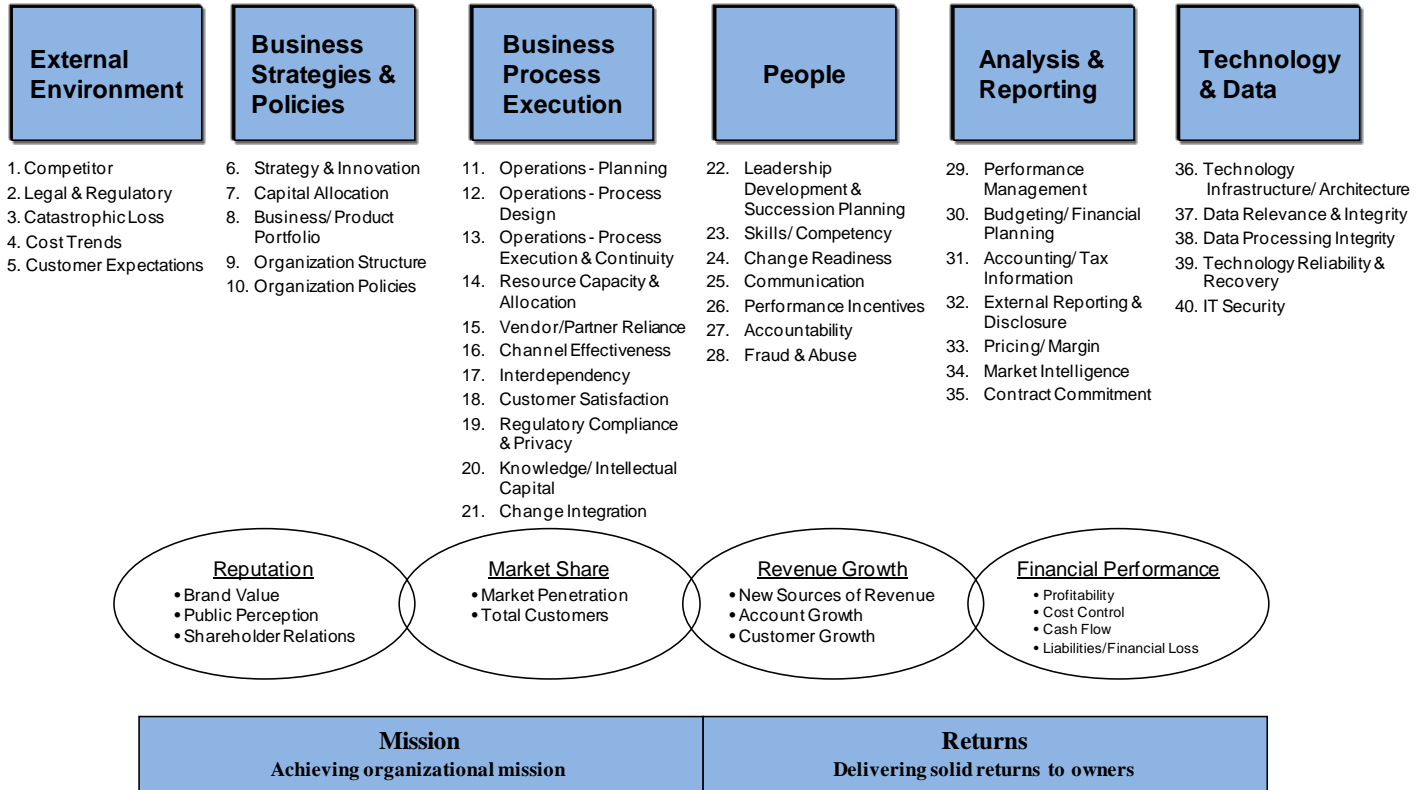
All dimensions of risk need to be viewed in concert, not as separate elements. Often, these dimensions of risk are divided up and assigned to isolated management and board groups for management and oversight responsibilities. The danger in viewing risk in such a disaggregated way is that **interrelationships** between these risks can be lost, and the real exposure not well understood. As seen below, issues such as the current economic crisis have real impact on growth, products, and operations. Considering issues only for their impact on financial performance or compliance will inhibit effective decision making.



It is also important to have a common risk language that encompasses all relevant aspects of risk that can be utilized across the business to identify, assess, and manage key risks.

The key concept of including all relevant aspects of risk can be thought of as the organization’s “universe” of business risk, illustrated below. Each of these elements has the potential to be an Achilles’ heel for an organization, and a careful review of each element should be on the agenda, asking “what could go wrong, and what would be the impact?”

A Business Risk Universe:



By engaging the business and understanding exposure through consideration of all aspects of risk, those responsible for risk management can avoid pitfalls and begin to add real value in their organization. The next paper in our series will focus on the dimensions of connecting to key management processes (creating synergy) and coordinating with key monitoring disciplines (seeing things whole).

Unlocking the Potential of Risk Management

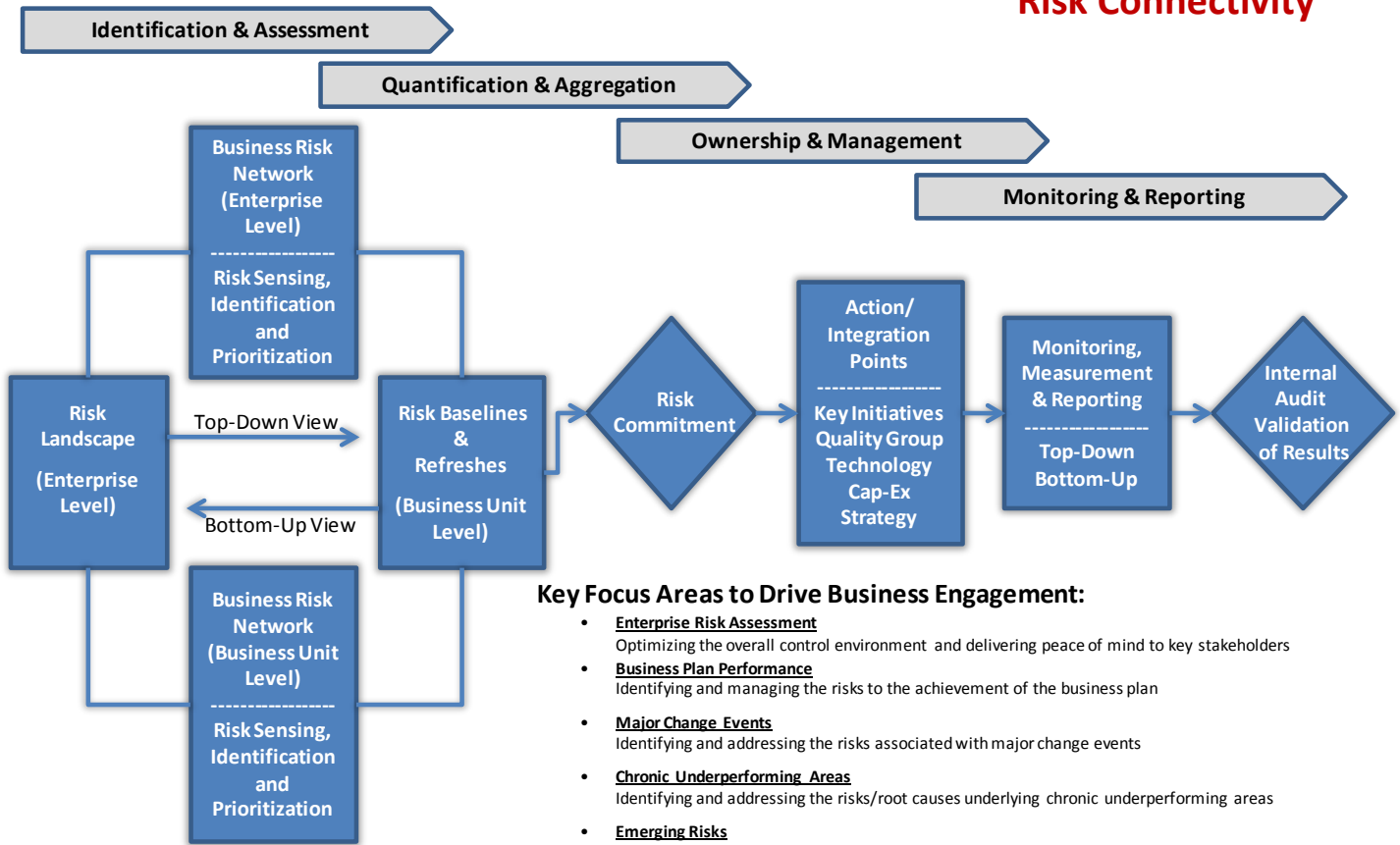
Connecting the Dots to Create Synergy

The first paper in our series, “Engaging the Business to Add Value,” focused on two dimensions of unlocking the potential of risk management: Driving business engagement (adding value) and addressing all aspects of risk (understanding exposure). Now we focus on connecting processes and coordinating disciplines to make risk management more effective.

Creating Synergy: Connecting to key management processes (Dimension #3) – Creating synergy requires integration of the risk management process with other key processes for managing the business, such as strategic planning, performance management, quality, and the capital expenditure process.

This is important because risk and return should be managed in conjunction with the strategic direction of the business, how business performance is measured and monitored, how the business ensures quality, and how the business allocates capital. A high level illustration of how risk management should connect and integrate with other key business management processes follows.

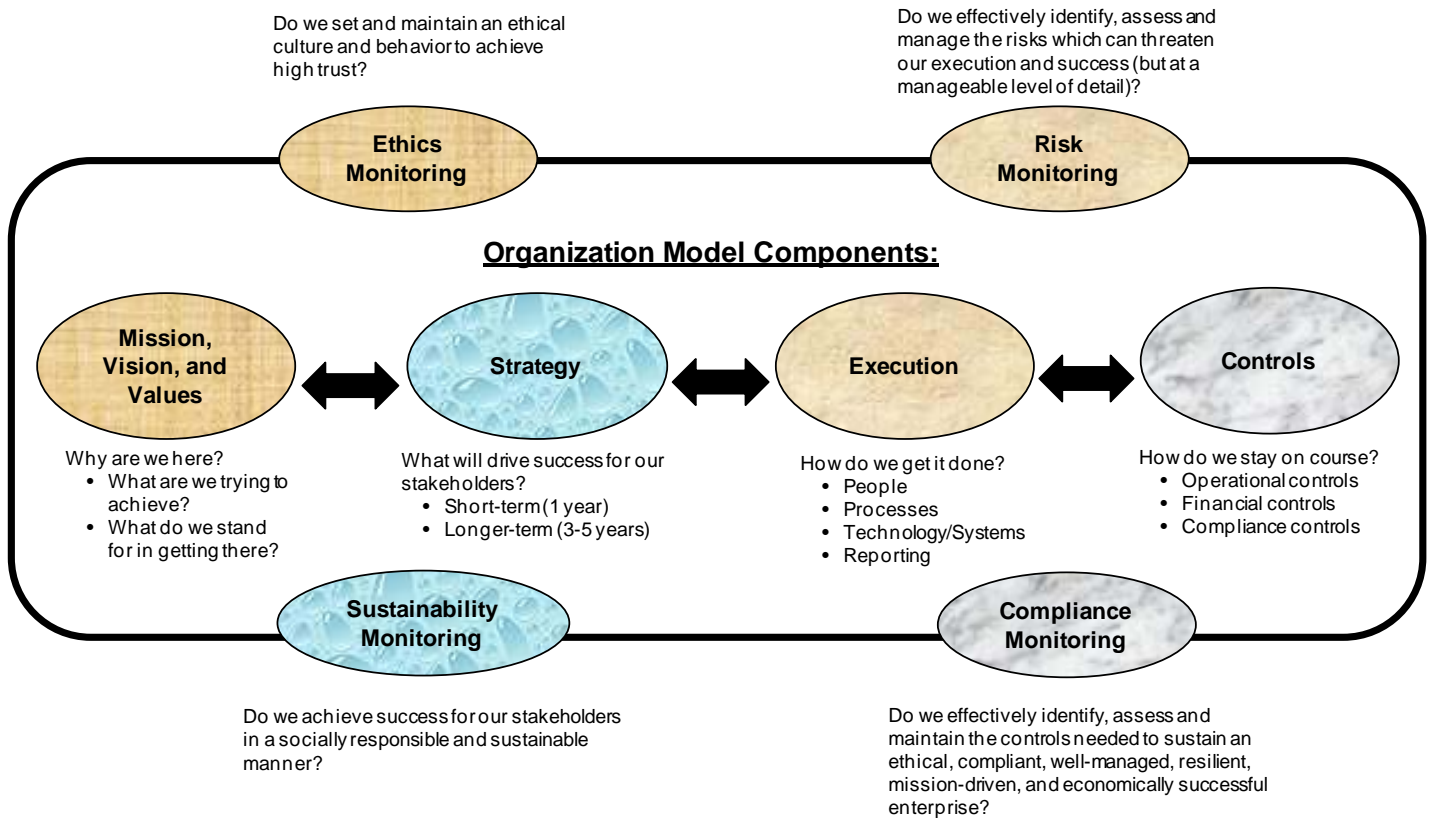
Risk Connectivity



Seeing Things Whole: Coordinating with key monitoring disciplines (Dimension #4) - There are typically four primary **monitoring disciplines** that should exist within an organization: ethics, social responsibility, and audit/compliance are important in addition to risk monitoring. And each of these monitoring disciplines has a primary relationship to one of the four cornerstone components of any business operating model – mission/vision/values, strategy, execution and controls.

Just as the business would not function well if these business model components were not well aligned and integrated, the monitoring system’s ability to monitor the health of the business and “see things whole” is also significantly constrained if these four basic monitoring elements are not aligned or coordinated.

For example, consider the recent subprime lending crisis. Was there an ethical component, or issues around social responsibility? Of course there were, in addition to the more obvious links to risks and controls. More effective and integrated monitoring could have – even should have – identified these issues sooner.



Creating An Aligned & Integrated Monitoring System

By connecting processes and coordinating disciplines, risk leaders can align these critical elements of an organization’s success to their overall objectives. The final paper in our series will focus on the dimension of enhancing board risk oversight and introduce a practical, integrated implementation approach to risk management.

Unlocking the Potential of Risk Management

Engaging the Board to Overcome Pitfalls

Our first papers in this series focused on the value of engaging the business and connecting processes and disciplines in unlocking the potential of risk management: Our final focus really takes an end-to-end view on global risk management, from the board room through implementation.

Governing Effectively: Enhancing board risk

oversight (Dimension #5) – Governing effectively requires strong integration of the organization’s risk management process and reporting with the board’s responsibilities for risk oversight. This is an area of heightened focus in today’s marketplace as well as within the legislative/regulatory bodies for U.S. corporations. The current disintegration that frequently occurs at the board level around risk oversight often centers around one or more of the following common pitfalls:

Poor Risk Management Information

- Lack of organizational sophistication, competency, and holistic reporting mechanisms
- Weaknesses around risk aggregation, interdependencies, and portfolio concentrations

Unclear Oversight Ownership

- Unclear ownership by the board of risk management – both components and overall

No Assessment Mechanism

- No effective mechanisms to assess the risk management process and information quality

Inadequate Risk Expertise

- Inadequate level of deep risk management expertise on the board (member and advisory)

Reactionary Posture

- Tendency to not listen or respond to early warnings of risks until it is too late to avoid crisis
- Most prevalent when current performance and performance trend is favorable

An approach that integrates board-level risk oversight with the risk management process will help organizations overcome these common pitfalls and be leaders in risk management effectiveness. This will help their businesses be more successful, and will quickly build and restore public trust in business overall. Following are some additional aspects to consider:

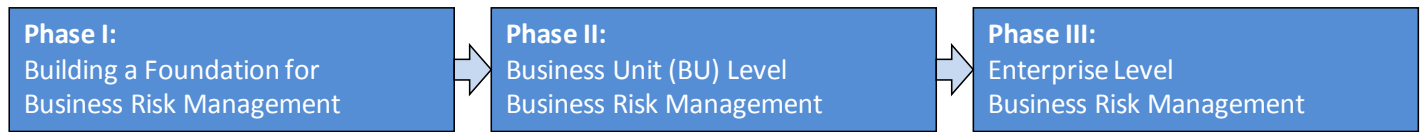
The full board must oversee and assess (possibly through an appropriate board committee, such as a risk committee) the organization’s overall risk management effectiveness, taking all elements of risk into consideration. This includes consideration of the organization’s risk profile in the aggregate, based on a holistic view of risk oversight assignments to individual board committees.

- Aspects of risk that require clear senior executive and board ownership:
 - **Risk Types:** compliance and financial reporting, operational, financial performance/liquidity, market and business environment, strategic/business.
 - **Risk Exposure:** aggregation, interdependencies, and **portfolio** concentrations.
 - **Risk Acceptance:** ongoing risk levels accepted in **consideration** of established risk appetite and specific risk tolerances.
- The full board is informed of key aspects of risk by each appropriate committee.
- The full board also assesses the aggregate risk portfolio in light of established risk tolerances and organizational strategy, and separately assesses individual areas of identified weakness in risk management.

Implementing Next Generation Risk Management

Moving to a practical implementation strategy is often the challenge that, unmet, becomes the downfall of well-intentioned leaders in any discipline. The following integrated implementation approach will help ensure that risk leaders meet objectives.

It is important to build a foundation of support, engage leaders throughout the organization, and then deepen and enhance the understanding of the value that integrated risk management provides. As shown in this graphic illustration, driving from an overall foundation through real integration is an effort, but certainly important and worthwhile. By focusing these efforts in a phased approach, engagement will increase, collaboration will improve, and risk management leaders will have a powerful platform for delivering a holistic view of the risks facing their enterprise and how the organization can respond to those risks.



Phase Objectives:

- Build executive-level support
 - Strengthen core team and operating model
 - Align expectations through a risk management commitment process
 - Develop specific segment-level risk management commitments
- Execute a consistent risk management approach across all businesses
 - Engage specific areas to help the business remediate significant risk issues and fulfill their risk management commitment
 - Engage business unit-level personnel at appropriate levels in the risk management process
 - Demonstrate the tangible value of a disciplined risk management process within each business unit
- Evolve to an enterprise risk commitment and accountability model by “connecting” the BU risk commitments to consider cross-BU risk issues and interdependencies
 - Enhance coordination and integration among BU Business Risk Management (BRM) teams to help the enterprise remediate significant risk issues and fulfill the enterprise risk commitment
 - Deepen risk management focus on potential risk issues applicable to all business segments
 - Enhance coordination with other components of the enterprise risk management operating model that focus on specific areas of risk exposure

Stage Objectives:

<p>Stage 1: Awareness Build risk management vision, strategy & awareness.</p>	<p>Stage 2: Capability Build initial risk management foundation of structure, resources, and operating model.</p>	<p>Stage 3: Alignment Align expectations through a risk management commitment.</p>	<p>Stage 4: Engagement Engagement in specific risk issues to help fulfill the risk management commitment.</p>	<p>Stage 5: Value Demonstrating tangible value from a disciplined risk management process.</p>	<p>Stage 6: Institutionalization BU-level personnel at all levels fully-engaged in and institutionalizing the risk management process.</p>	<p>Stage 7: Collaboration Enhance BRM collaboration across other BU teams to consider cross-BU risk issues and interdependencies.</p>	<p>Stage 8: Coordination Enhance BRM coordination with other areas within the BU and the enterprise that focus on specific areas of risk exposure.</p>	<p>Stage 9: Integration BRM is fully-integrated with business planning, performance management, quality, and other key management processes.</p>
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By focusing on adding value, understanding exposure, creating synergy, seeing things whole, and effectively working with their boards, leaders can build next generation risk management practices which truly support business objectives and enhance the ongoing performance of the enterprise.

In order to accelerate a return to economic health for individual organizations and the U.S. marketplace, Integrated Governance Solutions has developed NextGen RoadMaps™ to guide organizations to next generation governance. IGS is making these RoadMaps publicly available. To obtain your copy of the IGS NextGen Risk RoadMap™, [click here](#).

For more information, see www.integratedgovernance.com.

About the authors:

Integrated Governance Solutions is a Minneapolis, MN-based firm who has created NextGen Roadmaps™ -- a portfolio of solutions that provides boards with tools for strengthened oversight, comprehensive monitoring systems and more effective risk management. IGS defines Next Generation Governance as “the new standard of governance necessary to restore trust in an increasingly challenging and complex environment.”