Conference KeyNotes

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Building Resilient Risk Management Practices in a Post-Crisis Economy

The Enterprise Risk Management Conference

As a community of business leaders, The Conference Board convenes senior executives to share cutting-edge ideas and best practices. These Conference KeyNotes summarize the discussions of the senior executives that attended the *Enterprise Risk Management Conference: Building Resilient Risk Management Practices in a Post-crisis Economy* in Chicago, Illinois in October, 2009. The views expressed are those of the presenters and participants of the conference.

THE CONFERENCE BOARD
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KEY ISSUES

Enterprise Risk Management (ERM) is evolving beyond compliance to become a more integral part of strategy. Boards and senior management must develop a clear perspective of potential consequences and a more comprehensive approach to identifying, understanding, and mitigating risk to be able to fully integrate risk management throughout the company. But emerging risks also present opportunities. Two areas of risk that are gaining interest are the unfolding impacts of globalization on the workforce and on supply chains.

Risk Management Is Evolving beyond Compliance

Risk is inherent in business: without risk there is no reward. Risk needs to be viewed as part of the business' value proposition, not only as a component of compliance.

- Enterprise risk management is a series of strategic, forward-looking processes that enable management to build risk and reward tradeoffs into decision making to help meet corporate objectives.
- One global information systems provider adopted ERM with a focus on consistent growth and economic returns, using a scale to improve performance by better identifying and managing enterprise risks. Today, ERM is an integral part of its leadership model and its strategic planning process.
- The objective of ERM is to provide business with a proven, sustainable framework to understand and deal with complex business risks – tangible and intangible, existing and emerging – across the entire organization. The purpose is to determine what is actually achievable by business units in the context of corporate performance objectives.
- Risk management also helps shape the business strategy. One participant shared that his company studied business interruption at a key facility over different lengths of time, leading to a realignment of the distribution network.
- Companies are at different stages of ERM development, yet many intend to move from a narrow focus on disaster, compliance, and auditing to a more comprehensive risk management program.

Boards of Directors Are Assuming a Greater Role in Risk Management

The board's role in ERM begins with an understanding of risk's impact on strategic aspects of operations, of the company's appetite for risk, and how risk fits into its strategy. Expectations for board engagement are at an all-time high.

- The recent financial crisis has highlighted that companies face more complex and potentially devastating risks. The financial crisis is viewed as being rooted in the failure of firms to identify and manage risk, and has led to increased regulatory focus on the board's role of managing risk.
- Board oversight of management includes assuring that the company has reasonable processes and appropriate resources for managing risk, assessing and monitoring management's performance and risk culture, and reviewing controls to ensure timely and accurate disclosures.
- The board's obligations for risk oversight are derived from state law, federal legislative emphasis on the role of management and audit committees, SEC requirements for risk factor disclosure and statutory safe harbors, NYSE listing requirements, and the Federal Sentencing Guidelines.
- Getting a sense of the corporate culture is one of the most difficult issues for potential members of the board. Board members often feel they need more contact with employees to be able to judge whether the company is making the right kinds of investment decisions.
- Models are emerging for the structure of the board's oversight of risk. The board, as a whole, retains primary oversight given its centrality to strategy and performance. The audit committee oversees risk management processes. Independent risk committees on the board are being proposed as an additional measure.

- Questions that boards should ask:
  - What process does management use to identify potential risks?
  - How is management dealing with the natural conflict between business unit and corporate views of risk?
  - What capabilities are needed to identify and address risks?
  - How can a discussion of risks become part of the board's regular routine and agenda?
- Cautions for management:
  - Take a fresh look at board composition and director competency.
  - Consider some form of independent board leadership.
  - Ensure risk oversight is on the board's agenda.
  - Exercise caution in adjusting compensation for missed performance goals.
  - Build risk management into CEO and senior executive evaluations.

Developing a Risk Lens: Identifying and Integrating Risk Management

Understanding the types and magnitude of risks faced by a company involves developing a risk "lens" through which to view critical business activities. Integrating risk management means incorporating acknowledgment of risk into decision making for strategic and operations planning, mergers and acquisitions, post-merger integration, new product assessment, budgeting, forecasting, and capital projects.

- Quantifying risk is essential. It helps management focus on potential risks, their impact, mitigating risk, and comparing risks across the enterprise. Risk is frequently measured in dollars, such as operating profit, although the use of dollars alone may give a false sense of precision.
- Risk velocity, the speed of approaching risks, is accelerating. To stay ahead, some companies said they have stepped up the frequency of risk reviews to weekly, monthly, or quarterly. Agility is also important – getting the right people to assess risk, make decisions, and do it quickly.
- Correlation of multiple risks from different parts of the business is important. Risks that occur simultaneously can have a larger collective impact. The correlation effect is an argument for integrating multiple perspectives from across the company.
- Risk culture can help or hinder risk management integration. It is the system of values and behaviors that shape risk appetite and risk decisions. Is transparency valued? Is it considered safe to speak of bad news? Is there a conscious awareness of risks across the organization?
- Risk-based decision making is evidence that integration has been successful. Decisions are based on explicit considerations of risks – strategic, operational, financial, and hazard. Management should take a cross-functional view of risks and understand the impact of risk on the balance sheet.
- Support from senior management is vital to successful ERM integration. Their ownership provides the platform and encourages the flow of information. ERM staff should be seen as a business partner, bringing solutions to the table, assessing risk and how to deal with it.
- In resourcing ERM, two companies discussed ERM structure within their companies. One has a separate function with defined resources and staff, while the other integrates ERM into every one of its businesses. ERM structure flows from the strategy and culture of the organization.

Emerging Risks and Opportunities: Supply Chain and Strategic Workforce Planning

Supplier risk has increased as result of the financial crisis, especially in terms of financial solvency risk. Suppliers are seeking help in financing, many to avoid bankruptcy.

- Companies that have used productivity improvement tools to improve their supply chains have also begun to apply ERM principles to their supply chain – focusing on governance, risk awareness, and training.
- A global systems company shared how it combined its ERM and supply chain organizations to form a matrix of risk, therefore developing a deeper understanding of its global risks and opportunities. ERM can bring fresh perspectives; for example, by asking managers and suppliers what the "perfect storm" of risk would be in various economic, geographic, and political climates.

Risk to human capital leads to business risk

- An aging workforce, a dwindling internal talent supply, and an ill-prepared external labor supply are risks to the enterprise. Other issues: increasing workforce costs relative to revenues, labor union demands, and risk to the protection of intellectual property due to a distant workforce.
- Strategic workforce planning (SWP) connects human resources strategy to business strategy, ensuring the company has the right people in the right place, at the right time, and at the right cost. It can produce information and insights to support strategic business decisions.
- Like ERM, SWP follows a four step process:
  - **Identification** What's our workforce supply today and in the near future?
  - **Assessment** What are workforce implications of changing business strategy?
  - **Integration** Given our business strategy, where are the most critical workforce gaps and gluts?
  - **Monitor and update** How will we address workforce gaps and gluts?
- SWP can provide workforce data and analytics to ERM. It can be used in strategic planning, such as in decisions on where to build facilities which may need specific talent pools, or to prevent the unintended consequences of arbitrary workforce reduction decisions.

Tools and Resources: How to Get Things Done

- Using risk scenarios can help communicate risks to executives and team members. They can be dramatic, instructive, and easy to understand. Consider two scenarios – an upside and a hazard scenario – to test plans, skills and resources.
- Getting to the root cause of a situation can be helpful in identifying risk. Asking why a situation occurred – and doing so multiple times – can lead to the root cause. True root causes should be understandable, not debatable, and actionable.
- Software tools can assist ERM, such as a governance, risk, and compliance (GRC) database platform. In selecting tools, focus on functionality that fits your methodology and approach. Ask vendors to demonstrate your scenarios. No one tool satisfies all ERM needs.
- One company developed a risk survey tool for its top 200 managers, asking "What keeps you up at night?" They generated and categorized responses, identifying 20 for further examination.
- Give business units a common view and dictionary for risk management, starting with definitions of "operating" and "emerging" risk. Develop tools such as heat maps and risk inventories based on executive and manager interviews; they can become a framework for discussion.
- To aid ERM integration at an operating unit, develop a risk dashboard from a list of risks that threaten a business initiative. List activities that could mitigate each risk and rank them according to probability of success. Update the dashboard quarterly, tracking performance.
- Start small: integrate one activity at a time. Consider introducing risk management into M&A and large capital projects, which are ideally suited for risk assessment. Balance qualitative and quantitative risks and mitigation efforts.

BENCHMARKS

Conference participants were polled on the following questions:

Chart 1

How long has your ERM program been in effect?

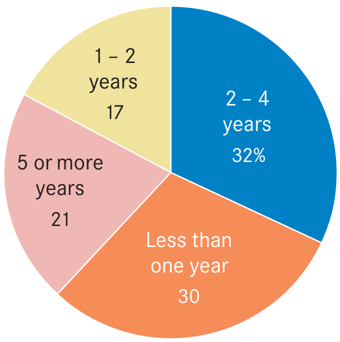


Chart 2

In the aftermath of the financial crisis, our risk management focus is:

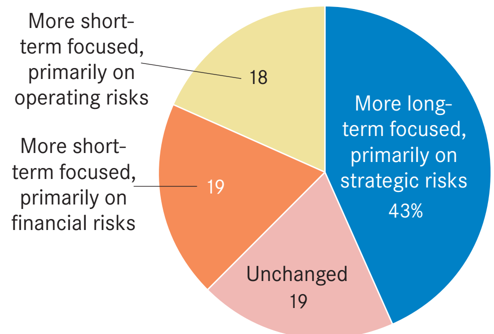


Chart 3

In the aftermath of the financial crisis, management has put ____________ resources toward managing risks.

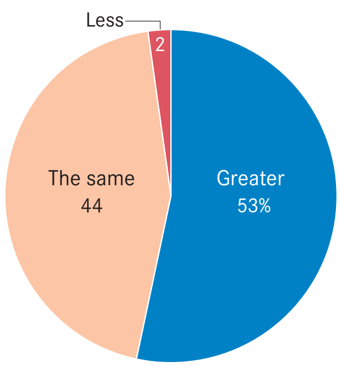


Chart 4

Our board of directors has put __________ emphasis on ERM.

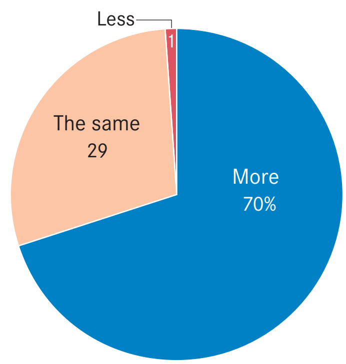


Chart 5

ERM champions at my company include:

(Choose all that apply)

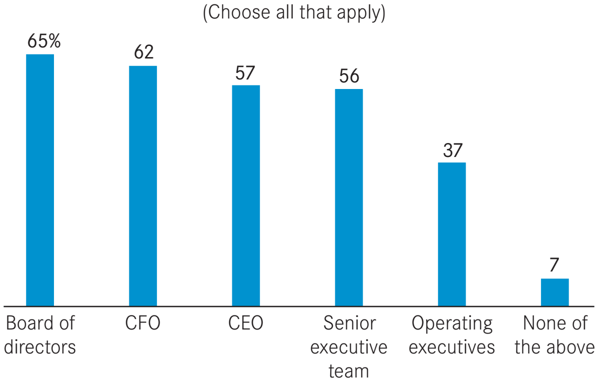
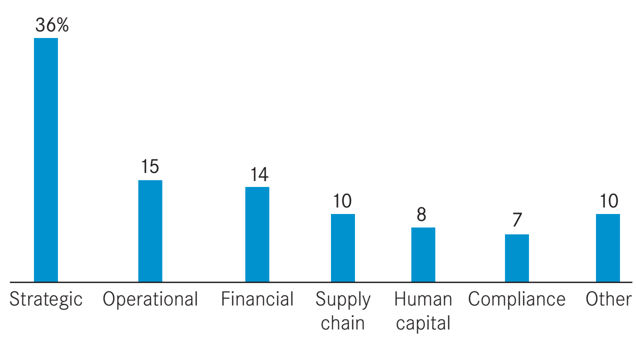


Chart 6

The most significant risk to my company is:

(Choose one)



[M&A execution = 0%]

ACTION PLANS

What actions will participants take after the conference? These answers to a post-conference "action survey" highlight a range of objectives.

Assessment

- Define risk appetite at our company in a qualitative way.
- Consider ways of aggregating risk across our several business units.
- Share with the board the highlights of pending regulations regarding the board's role in ERM.
- Investigate risk velocity; how to use knowledge management tools to report and identify risk.
- I am going to ask "why" a lot more in order to get to the root cause of our risk factors.
- Get copies of research papers on operational risk management since the financial crisis.
- Ensure our program maintains a practical, simple business approach.

Strategy

- Integrate into our ERM program a process for identifying emerging risk.
- Add more qualitative measures to our quantitative approach to risk management.
- Use some of the risk assessments tools/graphs presented at the conference to plot our key risks.
- Build risk quantitative capability to measure the impact of risk events to economic value.
- Keep in touch with some of the risk managers I met; share information on policy and programs.
- Meet my company's competitors to discuss how they are handling ERM risk issues.
- Improve board-level communication about our risk profile.
- Plan to change our ERM process to focus more on business process risk and less on external risk.

For more information

Tina Nahmias
Director, Logistics & Operations
U.S. Conferences
212 339 0264
tina.nahmias@conference-board.org

The Conference Board, Inc.
845 Third Avenue
New York, NY 10022-6600
United States
Tel +1 212 759 0900
Fax +1 212 980 7014
www.conference-board.org

The Conference Board China
Beijing Representative Office
7-2-72 Qijiayuan,
9 Jianwai Street
Beijing 100600 P.R. China
Tel +86 10 8532 4688
Fax +86 10 8532 5332
www.conference-board.cn (Chinese)
www.conference-board.org (English)

The Conference Board Europe
Chaussée de La Hulpe
130, box 11
B-1000 Brussels Belgium
Tel +32 2 675 5405
Fax +32 2 675 0395
www.conference-board.org/europe.htm

The Conference Board Asia-Pacific
22/F, Shun Ho Tower
24-30 Ice House Street, Central
Hong Kong, SAR
Tel +852 2804 1000
Fax +852 2869 1403
www.conference-board.org/ap.htm

The Conference Board of Canada
255 Smyth Road
Ottawa, Ontario K1H 8M7
Canada
Tel +1 613 526 3280
Fax +1 613 526 4857
www.conferenceboard.ca

Conference Board India
6F Vaswani Mansions
120 Dinshaw Vacha Road
Churchgate, Mumbai 400 020
India
Tel +91 9987548045
Tel +91 9820300749
Fax +91 2267464001
www.conference-board.org/worldwide/india.cfm

Other ERM Resources from The Conference Board

Research Reports

Building Risk Awareness into Performance: Integrating ERM and Performance Management
Report 1448, September 2009

Managing Reputation Risk and Reward
Report 1442, March 2009

Assessing Offshoring Risks
Report 1431, January 2009

Executive Action Reports

Recession Lessons for Mid-Market CFOs: Successfully Obtaining Loans in the New World of Credit
Executive Action 314, September 2009

The Role of the Board in Turbulent Times… CEO Succession Planning
Executive Action 312, August, 2009

Key Questions in Pandemic Planning
Executive Action 303, May 2009

The Role of the Board in Turbulent Times: Overseeing Risk Management and Executive Compensation
Executive Action 292, December 2009

Councils

Asia-Pacific Risk Management Council

Business Continuity & Crisis Management Council

Council of Chief Audit Executives

Council of Strategic Planning Executives

Council on Corporate Governance and Risk Management – India

European Council on Mergers and Acquisitions

European Council on Strategic Risk Management

Strategic Risk Management Council

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