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Start ERM Right

Align It With Strategy to Realize Its Full Potential

ENTERPRISE RISK MANAGEMENT

You are the CFO of a large, multi-divisional firm. Under your direction, the company adopted the ERM process several years ago. But the implementation has been slow, mostly because operational managers perceive it as an adjunct compliance add-on—hardly central to their strategic core. And, they recognize it even less as a tool for cross-functional collaboration that could drive competitive advantage. The managers are now busy executing the risk management (RM) piece, and you want to add the *enterprise* piece to your efforts. When you get to a full ERM program, you—and the entire organization—will see risk management in a new light and create strategic business value.

ERM reaches its full potential when companies weave it into their strategic planning process. It becomes a business practice that drives collaboration and action pertaining to risks, opportunities, and uncertainties that affect organization-wide strategies and execution. ERM moves away from simple risk management—an audit, compliance, or risk mitigation function—and becomes an integrative tool that supports executive decision-making *before* actions are taken. In our own work, we refer to this level of ERM as the practice of strategic risk management (SRM).

SRM plays a powerful role in choosing a strategic position—making supporting investments and implementing strategies to achieve objectives. How well organizations adopt the features of ERM that play this strategic role determines its impact on overall decision-making, including a very real impact on future financial performance. We write this article to help you improve that implementation. We outline important initial steps to unlock the full value of your ERM program through strategic alignment.

REPOSITIONING ERM WITHIN STRATEGY

No risk management program—whether it's called traditional, enterprise, or strategic—can be strategic if it is buried in a control function such as an internal audit. Simply relocating the risk management box on the organizational chart—from audit or legal to strategic planning—represents a first step toward a more fundamental realignment. As ERM becomes a broader and deeper strategic function, executives can expect to encounter capability, infrastructure, and resource challenges. Addressing and resolving these gaps moves ERM to a function capable of the simultaneous execution of traditional downside risk mitigation activities and the new enterprise-wide upside dimensions.

The first step involves a careful gap analysis followed by a specific action plan to link ERM to the organization's core values.

FIRST STEP: CONDUCT YOUR GAP ANALYSIS

YOUR CURRENT STATE OF ERM AND CAPABILITIES

Before committing time and scarce internal resources to building an ERM program, executives need to assess and then address the gaps between existing risk management capabilities and what's needed to run the program successfully. A gap analysis can be deceptively simple and quick, and will work especially well with time-constrained C-suite executives.

Your gap analysis should begin with dividing your ERM framework into five general areas (see below) for thought; then drilling down with set of questions for each area. We have suggested some initial questions. However, depending at which stage your organization is with its ERM program, more questions could be added.

1. Risk Organization and Governance
- Where is our ERM function housed?
- What's the level of commitment to ERM from top management?

2. Risk Appetite and Tolerances
- Do we have a well-articulated risk appetite statement?
- How do we monitor different risk categories and profiles—e.g., financial, operational, ethical, and stakeholder?

3. Risk Metrics and Measurement
- How do we measure and report risk?
- How consistent are our risk metrics across the organization?

4. Risk Management Process, Procedures, and Controls
- How do functional risks translate to strategic ones?
- Which level of training and expertise do managers have regarding functional and strategic risks?

5. Risk Monitoring, Reporting, and Communication
- Do we have a risk management "dash board" that is available to relevant decision-makers?
- How often do we report on risks, losses, tolerances, and important changes?

WHAT'S NEEDED TO MOVE TOWARD A DESIRED STATE OF ERM

Once the current state of risk management is known, and before energy, money, and time are allocated to ERM, executives must decide—for each of the five areas—how fully they want to develop their ERM capabilities. Three options exist:

1. Basic/foundational (meets regulatory standards, creates little value)
- Individuals or groups with clear responsibility for compliance, audit, and control tasks.
- Silo- or function-based ERM organizations.
- Focus on not repeating past mistakes.

2. Common Practice (exceeds standards, maintains competitive parity)
- Clear statement of commitment to ERM from top management and board.
- Organization-wide risk officer who combines ERM with other functions.
- Focus on current risk profile and challenges.

3. Best-in-Class (outpaces competitors, creates real value)
- Functioning board-level risk committee.
- Established chief risk officer (CRO) in the C-suite.
- Focus on future risks and the opportunities they present.

We encourage all organizations to strive for best-in-class, as we've seen the power of ERM in proactively devising and shaping strategy. If a commitment to best-in-class is currently out of reach, attaining common practice should be the goal. Clearly, making the commitment to become best-in-class, and realizing the full value of ERM, requires executive commitment and energy, a dedicated budget, and the time to allow your investment in ERM to come to fruition. Which level an organization chooses as its final destination requires understanding of how risk and risk management fit with the overall values of the organization. Before proceeding with implementation, however, wise executives make sure that the goals and processes of ERM align with the core business values of the organization.

SECOND STEP: LINK ORGANIZATIONAL VALUES TO ERM

VALUES DRIVE BUSINESS

What really drives company performance? How do organizational members far removed from the C-suite know which initiatives really matter? They should be looking at the organization's values to make these critical decisions. Whether written in a mission statement or discussed over the water cooler, organizational values underlie all strategy decisions. Understanding and leveraging those values is central to heightening the value of ERM and making it truly strategic.

Values tell executives why and how to say "yes" to external opportunities and internal development investments. They also help executives decide on the people needed to turn those investments and opportunities into assets and processes that lead to a winning strategy. Values identify when and where to say "no." Every successful business is asked to do more by its customers, but good organizations know they can't pursue every opportunity. Values provide something stronger than financial metrics that help take a pass on potential activities that stretch the strategy too far.

BASIC PRINCIPLES TO ALIGN VALUES TO YOUR ERM PROGRAM

If ERM doesn't link to an organization's core values, it faces an uphill (almost impossible) fight to become best-in-class. There is no easy trick or one-size-fits-all way to align ERM with your company's core values. There are two principles, however, that seem to work over time.

First, the link must be authentic and represent the true beliefs of both the ERM team and the larger organization. Many banks and other financial institutions claim a concern about conservative investments and a responsible attitude toward risk. Yet, an examination of the portfolio often reveals an appetite for risk that exceeds conservatism. Bolting a prudent ERM function onto a culture of imprudent risk-taking means that executives will lack the commitment to become best-in-class over time.

Second, communication counts. Successful ERM practitioners evangelize their calling—every conversation becomes an opportunity to cement the link between ERM and core values. These practitioners also use internal websites, employee on-boarding, and performance reviews to help executives and employees to see—and remember how and why—that ERM is central to organizational strategy. They also write articles, post blogs, and present at industry and professional conferences to help establish their organization as a leader in leveraging the value of ERM to strategy.

CONCLUSION

The world we live in and the markets we compete in become more complex, sophisticated, and risky every day. Start your commitment to ERM the right way. Unlock its power by aligning it with strategy and practising the discipline of SRM. ERM professionals can then contribute more to the strategic conversations than ever before.

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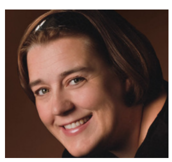

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