REPRINT

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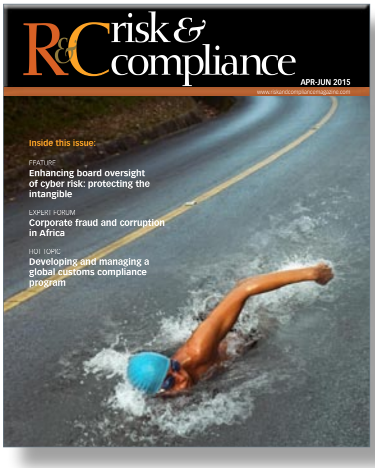
REPRINTED FROM:
RISK & COMPLIANCE MAGAZINE
APR-JUN 2015 ISSUE



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Crowe Horwath.

Published by Financier Worldwide Ltd
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PERSPECTIVES

CAPTURING VALUE AND STAYING COMPETITIVE WITH SUSTAINABLE RISK MANAGEMENT

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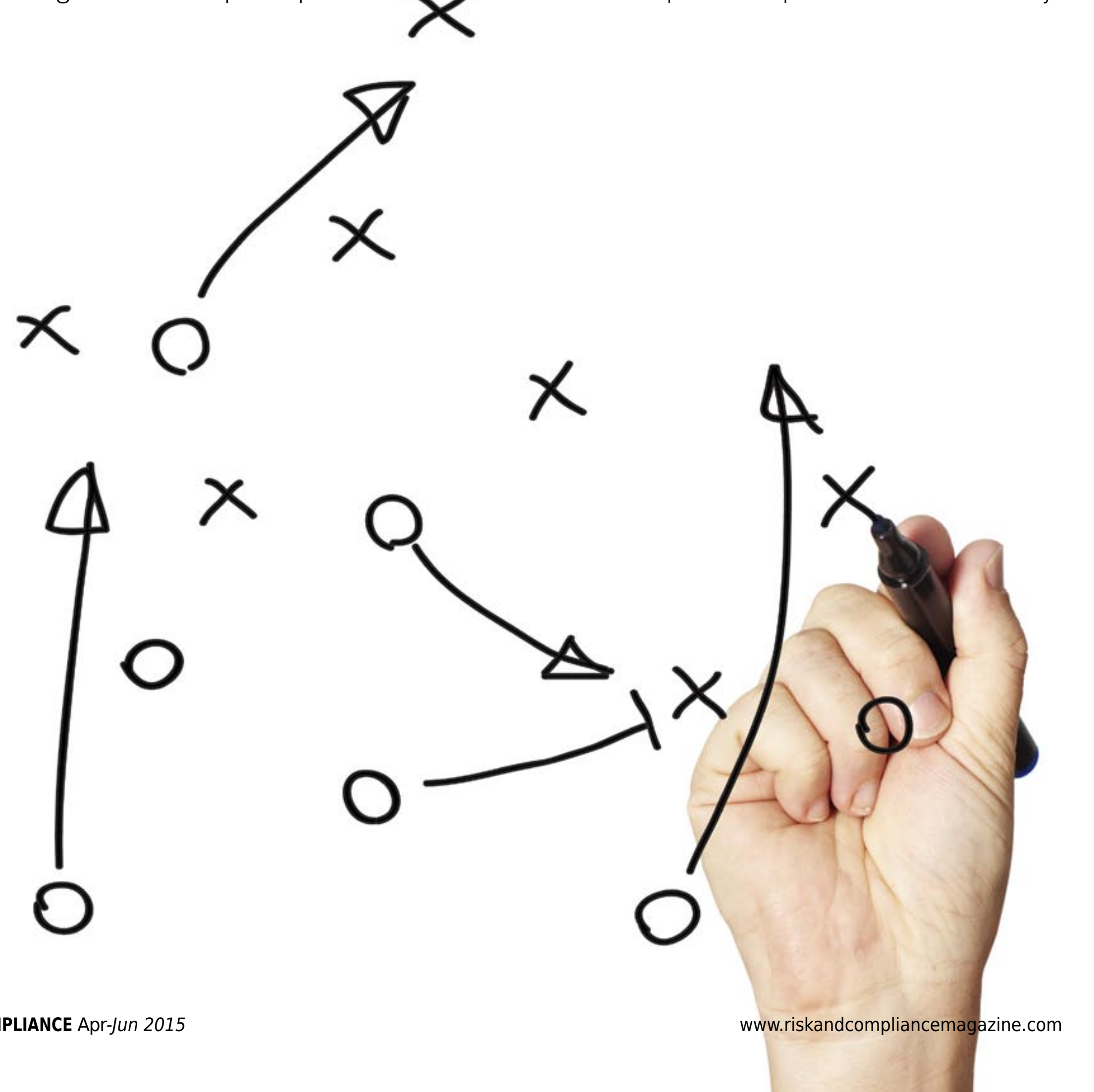
The entire organisation is well prepared and able to perform with confidence and agility in the face of unpredictable events and shifting economic conditions. Emerging technologies, surprising moves from competitors, market uncertainties, natural disasters, even potential internal scandals, are managed timely and effectively. From the board of directors and C-suite executives to frontline employees, people understand the risks the company must deal with and apply that understanding to make decisions. Employees are updated regularly on fresh insights and shifting business conditions that affect operations. They must work collaboratively and are asked for solutions to missteps, not blamed or punished for them. Management, starting with the board, consistently demonstrate through their own actions and behaviours, the importance of risk awareness, management and collaboration.

This is what a sustainable risk management process looks like. We use the word 'process' intentionally because successful sustainable risk management (SRM), as opposed to the garden-variety, and far more common enterprise risk management (ERM), is not a project or a program with a defined beginning and end. SRM is an integrated attitude and set of policies, procedures and measured outcomes that are embedded deeply and thoroughly enough in a company to become second nature. For many companies, the ability to sustain risk management can require a profound holistic cultural shift across the enterprise. And that is why SRM is so valuable.

The fate of ERM

ERM is hardly a new concept. For years, federal agencies, insurance companies and debt ratings services have required companies to show that they



include risk management in their goals and decision-making processes. Many companies have responded by establishing risk management officers and departments that report regularly to management. These reports are used, to widely varying degrees, to help reach operational and strategic decisions and objectives.

Disturbingly, however, we find that ERM is becoming a management orphan. In too many enterprises, it is not being sustained as a vigorous, highly regarded program; in fact, often it is barely alive, existing as an isolated effort to satisfy regulatory compliance or insurance requirements.

In our recent online poll of several hundred ERM practitioners, internal auditors, compliance officers, chief risk officers, and other managers, participants were asked to describe their ERM efforts. Just 21 percent said that in their organisations ERM consistently provides the information stakeholders need to make decisions. Forty-seven percent said that ERM is managed in silos in their organisations or is not visible to the workforce.

On the other hand, the poll respondents seemed to know what would strengthen their programs and enable them to provide the real-time, real-world value that effective risk management can produce. They said that ERM must be an efficient process for identifying risk, instead of providing routine, formulaic reporting, for example, and must be integrated into existing business processes rather than operating in isolation. An effective risk management function, they said, must be backed strongly by company leadership and the insight it provides consistently included in enterprise wide decision-making.

Symptoms and reasons for declining ERM effectiveness

The symptoms of eroding effectiveness of the ERM function often become apparent only over time. Risks might not be discussed at leadership meetings, for example, and risk status reports to leadership might be irregular or even perceived as irrelevant. Employees might consider risk management primarily the responsibility of the risk officer or department and be unaware of any role that they should play. Leadership might not see risk management as having any impact on company performance and competitiveness.

Any or all of these symptoms are red flags for management, a warning that the full value of the ERM process is not being captured.

There are many possible reasons for the disintegration of the ERM function. Perhaps the process began without clearly defined strategic objectives, or maybe those objectives were not communicated throughout the enterprise. ERM initiatives are often launched in response to a crisis or a compliance issue, and, once the initiating event is over, risk management is allowed to languish until the next crisis.

ERM may falter for lack of financial and human resources. When it is not seen as a source of value and continuous improvement for the organisation, management might not devote effort to better understanding and managing risks. Management might even see ERM as an annoyance. Consequently, risk management leaders might be excluded from the executive management team and the decision-making process. Perhaps most important, a company and its leadership could simply be unprepared to make the important cultural shift and manage the organisational change to support ERM in an ongoing and sustainable way.

> **"Sustainable risk management helps to align people, assets, processes and technology with the organisation's business strategies."**

Reviving and sustaining risk management

The solution is a risk management process that is sustainable because it is fully integrated into the company's decision-making at all levels. And the starting point is a fair and frank assessment by management of the unique character and culture of the organisation. The leadership then establishes the vision and business objectives, designs the organisation, and allocates the necessary resources to communicate and execute that vision and those objectives as they exist and as they change.

A sustainable risk management program is designed to protect as well as nurture the organisation's core business objectives. But risk management leaders can do their job effectively only if they are part of the executive management team and are included in the organisation's decision-making process.

Management must then sufficiently allocate the resources, people and funding to make it all work. How the leadership team deploys these resources directly affects the sustainability of the ERM process. To create the collaborative environment essential to enterprise management of risk, the leadership team must place capable people in well-defined roles. Clear communication from the team is required so that the organisation's top risks are transparent and known across the enterprise and that everyone understands his or her role in helping to mitigate those risks.

The critical underlying principle of sustainable ERM is that the responsibility for risk management falls collectively on the organisation's members who must work collaboratively to sustain it. This requires a no-blame environment, a collaborative process in which personnel work together to assess and solve problems without fear that their careers will suffer. A frank and constructive assessment of an operational failure, for instance, is possible only when instead of trying to find fault, the evaluation surfaces solutions to keep the failure from happening again. This approach is not common enough in modern corporations. By removing blame from their culture, organisations eliminate a significant obstacle to sustaining risk management.

Lasting benefits

These incremental, and perhaps dramatic, changes are tall orders but worth the effort. Companies may need to enlist third-party facilitators to help define and kick-start the process. But, when embedded in the organisation, a sustainable risk management process can lead to better strategic and operational decisions, more accurate assessments of the competitive environment, and an enhanced ability to respond effectively to unexpected events. It helps direct the right resources to the right jobs at the optimum time. It also improves the organisation's ability to monitor, anticipate and recognise risks, both known and emerging.

Our experience shows that sustainable risk management offers continuing opportunities for cost savings and improved productivity. It can reduce operational and material losses and waste, lower insurance premiums and spotlight process improvements. Sustainable risk management helps to align people, assets, processes and technology with the organisation's business strategies.
And it provides assurance to the board and the organisation's stakeholders that compliance issues are being addressed and their investments and reputation are being protected. R&C