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MÉNÈS CONSULTING GROUP

Taking Enterprise Risk Management (ERM) to the Next Level

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Overview

We have all witnessed the dramatic pace of change in the business landscape that occurred in recent years which resulted in organizations' Management focusing on, among other items, their critical business risks. Risk is a reality of doing business. Boards are requesting Management to answer risk-based questions, such as:

- Do we know which risks are critical and may impact our business?
- What are we doing about them?
- Are we remaining proactive?
- Are we taking advantage of the opportunities that risks represent to enhance the organization's value?

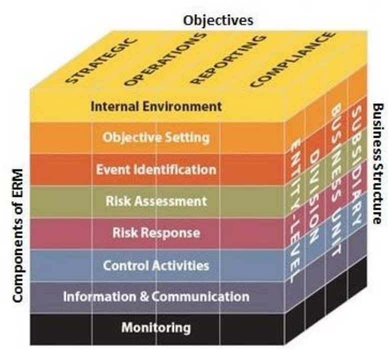
Management is expected to focus namely on growth, opportunities, return on investment, competitive advantage, market share and profitability. Managing business risks can be a source of opportunity to gain a strategic advantage. So how can Management reconcile divergent expectations, while handling their most critical business risks?

We believe that customized risk management allows organizations to assess opportunities and create value by taking appropriate risks.

What is ERM? [1]

In September 2004, COSO issued the Enterprise Risk Management – Integrated Framework (ERM Framework), which establishes a Framework for enterprise risk management and provides guidance to business and other entities to help them develop and apply their enterprise risk management activities. It identifies and describes eight interrelated components necessary for effective risk management.

The *ERM Framework* defines enterprise risk management as **a process, effected by an entity's board of directors, management and other personnel, applied both in strategy-setting and across the entity, designed to identify potential events that may affect the entity, to manage risk and to provide reasonable assurance that the objectives of an entity will be achieved.**



Why ERM?

An organization that cultivates an environment of accountability and responsibility in risk management with their employees is taking a step in the right direction. An effective ERM program can protect organizations from the many negative effects of unexpected events. Furthermore, an organization can acquire substantial benefits when Management is able to make sound risk-based strategic decisions.

[1] COSO. *Enterprise Risk Management – Integrated Framework, Application Techniques.* Durham, NC: AICPA, 2004. Print.

Implementing a robust ERM solution translates into going beyond an exercise of initial risk identification and assessment. It will involve methodology, change-management capabilities and risk management-centered processes. We believe these competencies will be the cornerstone to provide organizations with a tangible competitive advantage.

We noted that organizations have focused significantly more on ERM since the 2008 financial crisis and recession. However, there's still work to be done to establish an effective risk-aware culture within the organization.

Lessons Learned [2]

A *Harvard Business Review Analytic Services* study revealed five important lessons:

1. Risk management needs to have a clear "owner" to be effective.
2. Risk management and corporate goals must be integrated.
3. Companies must manage risk proactively.
4. Companies must look deeper and wider to determine what their most serious risks will be in the long run.
5. Companies must break down silos and managerial bottlenecks.

Respondents overwhelmingly cited "tone at the top" – the degree of support from the Board and the C-Suite – as critical to establishing an effective ERM process. Particularly, executives stressed the need for clear upward reporting to non-executives on the audit or risk committees.

Rethinking Risk Management

Risk is constantly evolving due to ongoing changes in the organization's internal and external environments. Regardless of the change – predictable or unpredictable; internal or external - an organization with a strong ERM strategy will review their risk profile and risk program to allow management the opportunity to respond and adapt to these changes.

Due to these changes, some risks may have been overlooked or underestimated in the past by organizations. Consequently, entities must take a more comprehensive approach in identifying risk events that could potentially affect the achievement of business objectives. To do so, companies are encouraged to think differently: consider all possible incidences on the organization, as well as other factors that could influence the risk profile.

Quantifying risks can be challenging, especially for emerging risks that contain very little available historical data. This can become an obstacle to complete an ERM program, as all significant risks need to be captured and incorporated into the organization's framework, to allow the organization to better manage risks – which is the foundation of an effective ERM process.

So what can be done?

Managing high impact or high likelihood rare risks is often viewed as the most challenging part of ERM. One solution is to use a risk profile, where risks are ranked on the basis of likelihood and impact, through a collegial workshop with the appropriate team members. Following this exercise, an analysis of the business risks can commence and risk actions be determined.

Moreover, scenario hypotheses can assist organizations better analyze the impact and/or likelihood of the identified risks over a given timeframe. During the scenario process, organizations are encouraged to revisit past events and identify potential future risks for the organization… and seek any potential correlations.

Lastly, as there may be an important new risk today that was not considered in the past, completing a diligent scenario process will be integral in the ongoing organization's business risk management.

[2] Harvard Business Review. *Risk Management in a Time of Global Uncertainty*. Watertown, MA: Harvard Business School Publishing, 2011. Print.

Using ERM to Identify Strategic Opportunities

It is not our view that ERM be used to eliminate risks. We believe that risks (often viewed as “negative”) should also be viewed as potentially positive. Through risk acceptance and management (and a solid ERM process), organizations will have the ability to measure the potential reward a given risk may signify. Consequently, they have the opportunity to maximize shareholder value and maximize profits, by exploiting the “right” risks.

Risk tolerances should be established to meet the organization’s strategic objectives and communicated to the entire business. It will allow everyone to better understand which type of risks are acceptable to take and critical to the success of the enterprise. Risk must be understood, measured and monitored regularly to allow for better decisions. However, lest we forget, with potential opportunities, there are possible undesirable outcomes. The future success will depend on the ability to weigh the reward versus the risk. ERM will assist organizations to better analyze (and understand) their business risks, as to exploit and avoid the pertinent risks.

This process must be regularly updated and should measure the risks taken in regards to the expected results… in conjunction to the organization’s overall risk profile and risk tolerance.

Closing Remarks

ERM is a forward-looking process that provides companies with valuable business intelligence to make better informed decisions. When correctly implemented, ERM provides organizations with the “risks toolkit” to perform better as a whole and to establish a competitive advantage to become a market leader in their industry.

Implementing a robust ERM process isn’t necessarily easy and will demand some investments; in time and resources. However, for organization that decide to implement (or enhance) their ERM process, we believe the benefits of their investment today will be reaped for a long time.

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