The Value of Enterprise Risk Management in Strategic Planning

Presented by
Kristina Narvaez, MBA
President & CEO
ERM Strategies, LLC  www.erm-strategies.com
What we’ve got here is
Failure to Communicate
What is Enterprise Risk Management?

- Provides an organization wide risk framework
- Helps identify particular events or circumstances relevant to strategic goals
- Assess risks in terms of likelihood and magnitude of financial impact
- Determine a response strategy
- Monitoring of risk information
ERM Improves Traditional Risk Management

ERM focuses on a global array of risks:
- Strategic
- Operational
- Financial
- Environmental
- Human Capital
- Reputation
- Technology
- Compliance

ERM is able to improve strategic decision making by addressing:
- Strengths
- Weaknesses
- Threats
- Opportunities

Integrates risk management into the strategic planning process.
Integrating Risk Into Strategic Planning

Deployment of ERM in strategic planning:

- Seeks to maximize value when setting goals
- Find an optimal balance between performance goals and targets to related risks
- ERM also considers how one strategic initiative might introduce risks that are counterproductive to goals associated with another strategy
- ERM may reveal areas where the organization is being too risk averse or ineffectively responding to some of their risks
Benefits of ERM in Strategic Planning

- Enhance Decision Making
- Increase Profitability & Sustainability
- Reduce Volatility
- Improve Ability to Meet Strategic Goals
- Increase Management Accountability
- Break Down Business Silos
- Develop Business Continuity
Failure to Use ERM in Strategic Planning

Ford Motor Co. shocked Wall Street with $1 billion write-off of palladium. The CFO stated, “Purchasing department didn’t check with engineering department about their shrinking need of palladium.” February 6, 2002 - The Wall Street Journal

Mattel recalled nearly one million toys in the U.S. because the products are covered in lead paint. According to Mattel, all toys were manufactured in China. August 2, 2007 - New York Times

Glaxo-Smith-Kline paid $750 million dollar FDA fine for selling contaminated baby ointment and ineffective antidepressant medication. October 26, 2010 - New York Times
Six Step Approach

1. Risk Identification
2. Risk Assessment
3. Risk Analysis
4. Implementation
5. Monitoring
6. Evaluation
“Enable faculty, staff and students to be able to identify and manage risk associated with their activities, consistent with the University’s mission goals of teaching, research and public services.”

The mission of the University of California’s Office of Risk Services

- Articulate philosophy regarding risk management, risk appetite and risk tolerances
- Focus Area includes ERM Steering or Work Group and Risk Policy
- Project Description uses input from Steering Committee to identify, assess, measure, respond, monitor and report risks
- Deliverables are the formalization of ERM Steering Committee and ERM Charter
- Define when these objectives will be in place
- Rate the Maturity Level of ERM program
UC’s ERM Work Plan

The University of California has developed an ERM Work Plan for its employees. The enterprise risk management framework is geared to achieving objectives in four categories:

- **Strategic**
  - High-level goals, aligned with and supporting their mission

- **Operations**
  - Effective and efficient use of their resources

- **Reporting**
  - Reliability of reporting

- **Compliance**
  - Compliance with applicable laws and regulations
Risk Culture is the attitude towards taking on risk in relation to the risk appetite and tolerance level of the organization.

**Risk Appetite**
The manner in which an organization and its stakeholders collectively perceive, assess and treat risk

**Risk Tolerance**
Requires a company to consider, in quantitative terms, exactly how much capital it is prepared to put at risk
Safeway Risk Culture

Suggestion box in each store to report good safety practices of employees conducted by co-workers

Risk Culture at Safeway
(# 60 of Fortune 100)

Three separate assessments for proper hygienic and food safety practices conducted by independent contractors

Quality Assurance and Consumer Protection Policy for all vendors working with Safeway
Define the internal and external content of your organization to the current economic environment.
Dakota County, Minnesota SWOT Analysis

Three Perspectives

**Stakeholder’s Perspective**
Strategic goal is to provide a safe, healthy and productive environment

**Financial Perspective**
Strategic goal is to deliver cost effective solutions

**Internal Perspective**
Strategic goal is to capitalize on innovation
Determine Your Critical Risks

- The likelihood of the risk occurring (1-5)
- Consequence if the risk were to occur (1-5)

After you have determined the challenges in meeting your strategic goals, prioritize those challenges from the greatest to least risks. Determined by a combined score of:

The critical risks will be those 20 to 30 risks that have the greatest financial impact.
## Causes of Risk

### Three Basic Causes

<table>
<thead>
<tr>
<th>Physical causes</th>
<th>Human causes</th>
<th>Organization causes</th>
</tr>
</thead>
<tbody>
<tr>
<td>A tangible or material item failed in some way.</td>
<td>People did something wrong or did not do something required.</td>
<td>A system, process or policy that people use to make decisions in doing their work is faulty.</td>
</tr>
<tr>
<td>Brakes stopped working on a car.</td>
<td>No one checked the condition of the brakes.</td>
<td>No procedure for the maintenance of the cars.</td>
</tr>
</tbody>
</table>
Root Cause Analysis

Methods

- The “5-Whys”
- Barrier Analysis
- Change Analysis
- Parent Analysis
- Fault Tree Analysis
- Management Oversight and Risk Tree
- Failure Mode Effect Analysis
- Causal Factor Tree Analysis
- Fish-Bone Diagram or Ishikawa Diagram
Fault Tree Analysis

Positive Fault Tree Analysis
Will identify the events necessary to achieve a top desired event for example no accident in manufacturing facility

Negative Fault Tree Analysis
Constructed to show those events or conditions that will lead to a top undesired risk event such as a fire in the manufacturing facility
On Friday, March 17, 2000 - A lighting bolt struck a Philips semiconductor plant in New Mexico, causing a fire in the plant that made chips for both Nokia and Ericsson and presented similar supply chain risks to both companies.

Nokia quickly noticed the problem with the supply of the parts even before Philips told them. The potential impact could have impacted 4 million handsets which represented 5 percent of the company’s sales. They found an alternate supplier.

Ericsson reacted far more slowly, didn’t have an alternate supplier, and lost market share. It sold its cellular handset business to Sony in 2001.
Lessons Learned

- Link the potential impact of supply chain disruptions to revenue and earnings to prioritize and manage risk.
- Build in the necessary levels of redundancy and backup and maintain supply chain intelligence and relationships.
- Continuously monitor supply chain performance measures to quickly identify problems so that countermeasures can be taken.
- Quickly share information at the first instance of a problem.
Key Performance Indicators (KPIs)

KPIs help you understand how well you are performing in relation to your strategic goals and objectives.

In order for KPIs to be effective, they need to be measurable.

- Percent of customer attrition
- Percent of employee turnover
- Rejection rate
- Meantime to repair IT problems
- Customer order waiting time
- Profitability of customers by demographic segments
Key Risk Indicators (KRI) 

KRI are leading indicators of risk to business performance. They give us an early warning to identify a potential event that may harm continuity of the activity or project.

<table>
<thead>
<tr>
<th>% of suppliers with no business continuity management</th>
<th>% of mission-critical recovery plans not exercised with the last 12 months</th>
<th>% turnover of mission-critical IT personnel</th>
<th>% of mission – critical business processes with a backup and recovery architecture</th>
</tr>
</thead>
</table>

## Risk Champions and Risk Centers

### Risk Champions

- Accountable for ensuring accuracy within their department or business unit around the identification, assessment, management and monitoring of risk
  - They are the eyes and ears of risk information for the risk manager who is in charge of assessing risk across the enterprise
  - Not necessarily responsible for performing the actual risk management activities

### Risk Center

- A department or unit within the organization charged with the risk exposures that are related to their duties and responsibilities
Intuit Case Study

“When we talk about growth strategies for the company, we talk deliberately about both risks and opportunities.”

Janet Nasburg
Chief Risk Officer, Intuit

CRO and ERM program office have ownership and accountability for Intuit’s ERM program and drive Intuit’s ERM capabilities

Ownership and accountability for identified risks are shared by executive and business unit level leaders

Risk communication is not only to report progress, but also so that business units can share and leverage risk knowledge
## Critical Risk Mitigation Plan

### Critical Risk: Mitigation Plan

<table>
<thead>
<tr>
<th>Project name</th>
<th>Project Impact Phase</th>
</tr>
</thead>
<tbody>
<tr>
<td>RISK Identified by</td>
<td>PM</td>
</tr>
<tr>
<td>Risk type/source</td>
<td>Risk Coordinator</td>
</tr>
<tr>
<td>Risk No.</td>
<td>Risk owner</td>
</tr>
<tr>
<td>Open date</td>
<td>Risk Score</td>
</tr>
<tr>
<td>Risk Statement</td>
<td>(3 C's format - Condition, Cause, Consequence)</td>
</tr>
<tr>
<td></td>
<td>Most likely Cost</td>
</tr>
</tbody>
</table>

### Closure Criteria/Closure Statement

<table>
<thead>
<tr>
<th>Closure Date</th>
</tr>
</thead>
</table>

### Mitigation action (Preventive)

<table>
<thead>
<tr>
<th>Actionee</th>
<th>Action Deadline date</th>
<th>Action Deadline phase</th>
</tr>
</thead>
</table>

### Change Control Approved

Yes or No (circle one)

Use the chart below to show the risk score before and after mitigation.
Key drivers of success and risks in the company’s strategy

Crafting the right relationship between the board and its standing committees as to risk oversight

Establishing and providing appropriate resources to support risk management systems

Monitoring potential risks in the company’s culture and incentive systems

Developing an effective risk dialogue with management

Guidance principles for board risk oversight

National Association of Corporate Directors report, “Risk Governance: Balancing Risk and Reward”
The Executive Risk Committee Provides the Board of Directors with:

A structure that provides the board with the appropriate information that defines the firm’s risk profile

A system that provides an audit of the effectiveness of the risk management process

A system that affords an evolving understanding of key risks to the company

“Boards are now finally asking management about the nature of the risk information process that is in place. Boards want to gather information about new or emerging risks and the extent to which these risks require a more in-depth analysis. This is being done to ensure future opportunities and threats to the company’s performance are appropriately managed.”

John Bugalla, James Kallman, Chris Mandel and Kristina Narvaez

The Corporate Board, May/June Issue 2012