

# Enterprise Risk Management: Addressing the Organisation's Opportunities and Threats

With both global and national economies headed for uncertain times, the need for Enterprise Risk Management is at an all time high. This article examines how simple techniques can be applied by organisations of all sizes to address uncertainty. Calculated business decisions can be made, taking advantages of opportunities as they arise within a framework commensurate with the organisation's appetite for risk.

## Enterprise Risk Management (ERM) – Background and Definitions

The majority of organisations were established to take advantage of a perceived opportunity in the market place. However, there is rarely 100% certainty and hence with this perceived opportunity there is an element of risk. Thus, to a degree, all such organisations implicitly have some appetite for risks. Even organisations without a profit motive, such as in the public sector, can take advantage of, for instance, new technologies which may come with risks attached. In any case, these organisations should have a duty to optimise their risk profile.

Management of risk as traditionally interpreted, means putting the brakes on, curbing exuberance, avoiding losses. It is a defensive move and a narrow interpretation of risk that belies the importance that the discipline can have in actually driving performance, and profits, forward.

Risk management strategies should in fact address three separate goals:

- To build and maintain the confidence of stakeholder groups;
- To teach organisations how to cope with uncertainty and doubt; and;
- To encourage opportunism.

To assist in the identification of risks and opportunities four generic categorisations can be recognised with classifications which include:

<p><b>Strategic</b></p> <ul style="list-style-type: none"> <li>• Competition</li> <li>• Customer wants</li> <li>• Demographic trends</li> <li>• Technological trends</li> </ul>	<p><b>Financial</b></p> <ul style="list-style-type: none"> <li>• Price</li> <li>• Liquidity</li> <li>• Credit</li> <li>• Inflation/purchasing power</li> </ul>
<p><b>Operational</b></p> <ul style="list-style-type: none"> <li>• Business operations</li> <li>• Empowerment (eg leadership)</li> <li>• Information technology</li> <li>• Integrity (eg management fraud)</li> </ul>	<p><b>Hazard</b></p> <ul style="list-style-type: none"> <li>• Fire and other property damage</li> <li>• Theft and other crime</li> <li>• Personal injury, disease, etc</li> <li>• Business interruption</li> </ul>

The classifications facilitate the movement away from considering risks in silos at a functional level. The matrix is only a tool to gather information – capturing the risk is more important than an exact categorisation.

In summary, the following definition has been developed for ERM:

*“ERM is the process by which organisations in all sectors assess, control, exploit, finance, and monitor risks from all sources for the purpose of increasing the organization's short and long term value to its stakeholders.”*

## ERM Process

ERM is a continuous process. Once the initial activities of Step 1 and Step 2 have been completed, Step 3 to Step 6 is an ongoing cycle as implied in Step 7.

**Step 1 – Designing Approach and Assigning Roles and Responsibilities** It is vital to ensure that relevant information is identified, captured and communicated in a form and timeframe that ensures risk responses are effectively carried out. Everyone in an entity has some responsibility for ERM. The board of directors provides important oversight to ERM, and is aware of and concurs with the entity's risk appetite. Other managers support the entity's risk management philosophy, promote compliance with its risk appetite, and manage risks within their spheres of responsibility consistent with risk tolerances.

It is thus recommended that the first step in the formalisation of a risk management strategy is the establishment of a framework of policies and procedures. Risk management should be a function of the main board having specific director ownership with day-to-day responsibility delegated through a Risk Committee to a single individual.

**Step 2 - Establishing Context:** The role of the “Risk Manager” is to systematically coordinate the following Steps. The person should thus have a clear understanding of the present and anticipated internal and external conditions in which the organisation operates. Useful tools for examining and communicating context include Strategy Maps, Value Chain Analysis and Stakeholder Mapping.

**Step 3 - Identifying Risks and Opportunities:** This Step documents the **Conditions** and **Events** that represent material threats to the organisation's achievement of its objectives or represent areas to exploit for competitive advantage. Combinations of a variety of techniques can be used depending on the organisation's particular circumstances and include questionnaires, interviews and brainstorming sessions. We recommend a “bottom-up”

approach considering different aspects of the business before taking a strategic overview of the organisation. Furthermore, we find it more fruitful and comprehensive to take a multidisciplinary approach to examine in turn a sub-set of processes or projects, rather than an approach considering risks and opportunities at a functional level.

**Step 4 - Analysing Risks and Opportunities:** Analysis techniques range along a spectrum from relatively simple qualitative assessment to complex quantitative sensitivity, scenario and/or simulation modeling. For a Risk or an Opportunity to materialise a **Condition** or an **Event** has to be expected to occur, with an associated probability, and some associated Cost or Benefit arise. A Risk or an Opportunity can be quantified as:

$$\text{Risk/Opportunity} = \{(\text{Probability of Event Occurring}) \times (\text{Monetary Cost/Benefit of Event})\} + \{(\text{Stakeholder Perception})\}$$

The “Stakeholder Perception” element is not included in the traditional definition. It however recognises that the impact of stakeholder perception can sometimes be very difficult to quantify in monetary terms. For a qualitative assessment the “Probability of Event Occurring” and the “Monetary Cost/Benefit of Event” can be generically assessed. Appropriate guidance can be given in the ERM procedures as to the application of classifications given the enterprises appetite for risk and opportunity.

**Step 5 – a) Integrating and b) Assessing/Prioritising Risks and Opportunities:** For a qualitative assessment the events can be mapped on matrices such as those shown below.

		IMPACT			
		Negligible	Marginal	Critical	Catastrophic
PROBABILITY	Certain	High	High	Extreme	Extreme
	Likely	Medium	High	High	Extreme
	Possible	Low	Medium	High	Extreme
	Unlikely	Low	Low	Medium	Extreme
	Rare	Low	Low	Medium	High

More sophisticated applications of ERM split this Step into two discrete activities and may adopt techniques such as portfolio modeling which combine both quantification of risks and opportunities.

**Step 6 - Treating/Exploiting Risks:** Developing strategies for controlling or exploiting all the various risks and opportunities is not feasible for the majority of organisations. Priority should be given to those risks considered as “Extreme” and “High”. In the case of risks all techniques to manage the risk fall into one or more of four major categories:

<p><b>Avoidance (Eliminate)</b> Includes not performing or withdrawing from activity that could carry risk.</p>	<p><b>Transference (Outsource or Insure)</b> Causing another party to accept the risk, typically by contract or by hedging.</p>
<p><b>Reduction (Mitigation)</b> Involves methods that reduce severity of loss or likelihood of loss from occurring.</p>	<p><b>Retention (Accept and Budget)</b> Involves accepting the loss when it occurs.</p>

These risk management strategies can in turn form the basis of a business continuity strategy.

**Step 7 - Monitoring and Reviewing:** The identified risks and opportunities and the associated strategies for their treatment and exploitation should be proactively managed. We recommend the use of simple dashboard for the systematic reporting of risk across functions and up through the Risk Committee to the main board.

Risk	Ref No	Owner	Classification	Title	Status	Mitigation Action Plan	Comment
Extreme	A0023				■	■	
High	B0004				■	■	

It is emphasised again that ERM is a continuous process. Step 1 and Step 2 are worthy of review at appropriate timescales. Step 3 to Step 6 should be systematically repeated at more frequent intervals. It is recommended that all new business proposals should include a formal analysis of risks and opportunities with their broader impact considered and incorporated as necessary.

It is suggested that a pragmatic approach is taken as to moving between Steps. What is important is that at each stage a sufficiently comprehensive analysis has taken place to be able to assess the impact across the enterprise.

### Summary

In summary, even using simple techniques a systematic approach to the management of risk and opportunity can help position even the smallest of organisations to deal with the current challenges and uncertainty.

**For more information as to how Das Management Services SRL can assist in addressing your Enterprise Risk Management initiatives please contact us at [office@dasmanagement.com](mailto:office@dasmanagement.com). This article is one of a series at [www.dasmanagement.com](http://www.dasmanagement.com) relating to current business issues.**