Remaining buoyant

Executive summary

- Enterprise Risk Management (ERM) may be in fashion, but how do you assess its value and how do you implement it? Research commissioned by AIRMIC (the Association of Insurance and Risk Managers) shows that ERM does improve decision-making, but only if you set about it in the right way.

DOES ENTERPRISE RISK MANAGEMENT IMPROVE DECISION-MAKING? **PAUL HOWARD** REPORTS ON THE LATEST RESEARCH.

The recession represents an opportunity and a threat in equal measure for anyone involved in risk management. While the downturn allows an even sharper argument to be made for the ability of enterprise risk management (ERM) to help companies remain buoyant when the going gets tough, the pressure on costs may persuade firms to save money by downsizing their risk management investment. It is essential that everyone involved in risk management should be able to demonstrate and communicate the value of their role.

Risk management professionals do not make anything or provide any services to customers. To justify their existence, they must constantly translate their theoretical skills into practical benefits in a way that is widely understood by colleagues and can be shown to support business objectives.

It was this need to provide tangible evidence that lay behind the decision by AIRMIC (the Association of Insurance and Risk Managers) to commission research into whether it is possible to demonstrate and quantify the value of ERM.

DEFINING ERM An important first step was to define ERM. Ask 10 different people what ERM means and you may well end up with 10 different answers.

HM Treasury, for example, puts it like this: "All the processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them and monitoring and reviewing progress." The ACT, on the other hand, prefers: "ERM is designed to enhance corporate decision-making, with tools being developed and implemented to support actions ranging from optimisation of the insurance programme to analysis of overseas expansion plans, business mix or capital allocation."

In fact, these apparently divergent definitions are two sides of the same coin. If you have identified, assessed and judged the risks that

Figure 1: Key components of successful ERM

Proportionate	The risk management initiative must be proportionate to the level of risk faced by the organisation. In high-risk organisations, the appointment of a chief risk officer may be appropriate. However, such a post may not be necessary nor appropriate in a lower-risk undertaking.
Aligned	ERM activities need to be aligned with the other activities in the organisation. For example, the risk assessment workshop should be timed so that the outputs are available for budget planning purposes.
Comprehensive	In order to be fully effective, the enterprise risk management initiative must be comprehensive – that is, all parts of the organisation should be involved, so that all significant risks are identified and managed.
Embedded	Risk management activities need to be embedded within the organisation.
Dynamic	ERM activities must be dynamic and responsive to emerging and changing risks. One of the difficulties with producing a risk register is that it can become a static record of risks rather than a dynamic tool for proactively managing significant risks.

Source: AIRMIC-DNV

Figure 2: DLA Piper case study

DLA Piper is a global legal services organisation that uses risk management to realise an ambitious development and growth strategy. "The firm has an entrepreneurial culture," explains chief risk officer Julia Graham. "The better we manage risks, the more risks we can take." The firm's risk management group helps ensure that growth is achieved with proper control and caution.

DLA Piper International, which encompasses the DLA Piper operations outside the US, employs almost 50 risk management professionals. This high number is proportionate to the ambition of the corporate strategy, and reflects the scale, nature and complexity of the firm.

Emphasis is placed on embedding risk management in business practices. Graham says: "Our aim is to embed risk management into everything we do." For instance, risk management and quality management are integrated, with compliance assessments carried out to control preventable legal process surprises. Lawyers are involved in risk management across the firm. In 2007 around 140 lawyers each contributed to the identification and management of risk at a strategic and tactical level.

At the strategic level, the board undertakes risk reviews, and due diligence assessments are carried out for potential new hires, startups and mergers. At a system level, sound risk management practices are embedded in core processes, including business continuity plans which are developed and tested throughout the firm. The philosophy behind all these activities is that prevention is better than cure.

The key benefit of risk management in DLA Piper is the ambitious growth (through managing the downside risk of opportunities), which would not have been possible without the supporting risk management. In the last three years, DLA Piper has opened more than 20 offices.

In addition, the total cost of risk is being steadily reduced, with the cost of risk management offset by reductions in losses and insurance premiums.

your organisation faces (as in HM Treasury's definition), then you will be able to make better decisions (as in the ACT wording).

At least that is the theory, but as far as we could tell no one had ever carried out independent, in-depth, ground-up research into whether ERM really does what it is supposed to do. If it does, under what circumstances does it do so? What are the hallmarks of best practice? And does ERM genuinely reduce an organisation's risk exposure and by how much?

These were the main questions that we asked researchers at Det Norske Veritas (DNV) to investigate. Their brief was to look at the subject from the bottom up by investigating what happens in practice and to produce a warts-and-all assessment of ERM. As far as we are aware, DNV's study was, and still is, the only research into ERM ever to take this approach.

DNV eventually focused on five case studies, involving DLA Piper (a rapidly expanding global law firm), Nestlé, Solvay (the global chemicals and pharmaceuticals group), BT Group and a large government agency. The case studies were supported by analysis of another 20 organisations from the private and public sectors.

THE BASIS OF SUCCESSFUL ERM DNV found that ERM can indeed reduce risk exposure, improve decision-making and bring far-reaching benefits, but only if you set about it in the right way. Provided you do so, ERM enables organisations to become more enterprising because, once you have understood and reduced your risks, you have the knowledge and confidence to do new things.

In all, the report identifies 13 hallmarks of successful ERM. They include the need for any ERM exercise to be well-defined, with the desired benefits set out in advance and progress measured against a series of targets. It must also be proportionate to the level of risks involved, enjoy the wholehearted buy-in of senior managers and be allocated sufficient resources.

MEASURING EXPOSURE The DNV report did not attempt a cost-benefit analysis of ERM, but it did assess the extent to which it can be shown to reduce risk exposure. There is insufficient space here to discuss the findings in any detail, but in terms of the organisations under scrutiny the top-line conclusions were as follows:

- **DLA Piper**: Total cost of risk reduced from approximately 2.7% of turnover in 2006 to a projected 2.2% in 2010.
- **BT**: BT Wholesale, the unit with the longest experience of ERM, reduced net risk by 15% between 2005 and 2007, while simultaneously facing 20% more gross risk.
- **Nestlé**: The reduction in risk exposure, as a result of risk management, for the 51 projects studied was estimated at 85%.
- **Solvay**: DNV did not produce a group-wide figure for the effects of ERM on risk exposure, but demonstrated instead how risk assessment can act as an enabler. For example, the report highlighted how a risk-profiling and mitigation exercise made it possible to go ahead with a major joint venture construction report.
- **Government agency**: DNV estimates that financial exposure from significant risks that have been managed down since 2005 has dropped by about 70%.

As this summary implies, there is no single right way to implement ERM or even to measure its effectiveness, but the projects shared a number of common threads. All had a clear idea of what they were trying to achieve, all were communicated effectively to colleagues and all had the proactive support of the board.

But above all, they succeeded because risk management was introduced comprehensively, intelligently and in a way that reflected their differing businesses and organisational characteristics. ERM can and does bring huge benefit as long as it is approached with clarity and discipline.

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