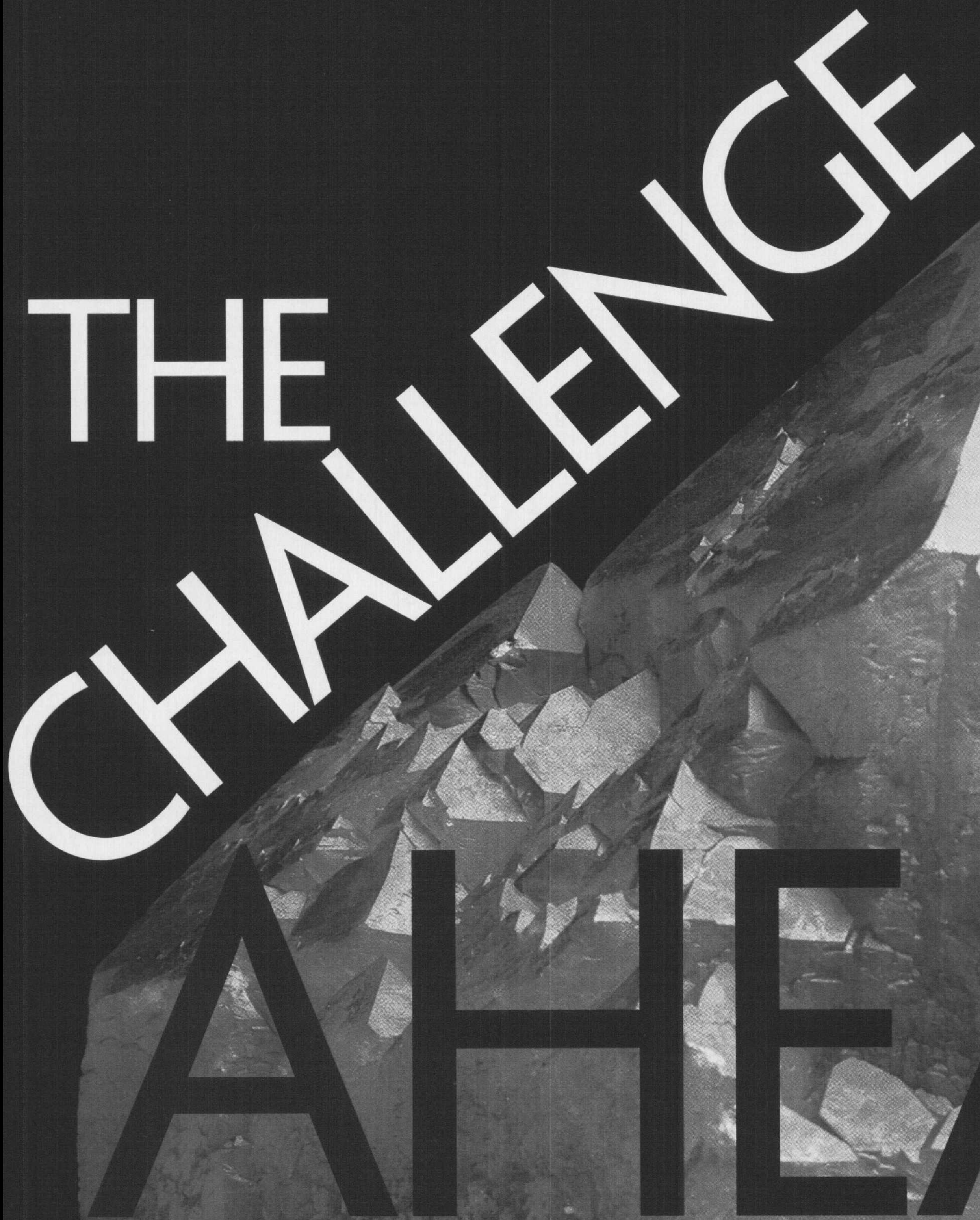
The challenge ahead: Adopting an enterprise-wide approach to risk
Busman, Evan R;Paul Van Zuiden
Risk Management; Jan 1998; 45, 1; ProQuest
pg. 14



Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

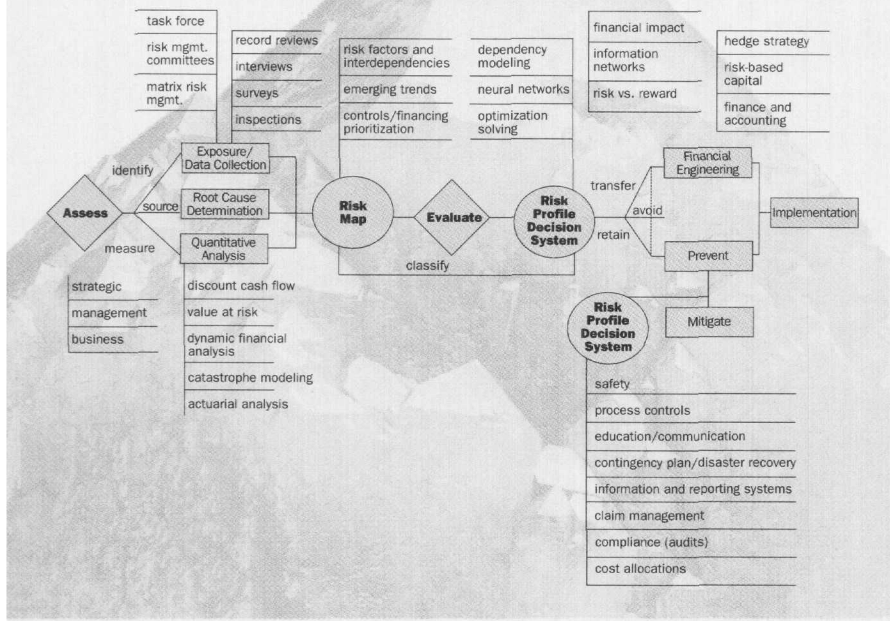
Adopting an Enterprise-Wide Approach to Risk

A fundamental change is taking place in the way organizations manage risk. Known variously as "integrated," "strategic" or "enterprise" risk management, this new approach allows organizations to achieve competitive and strategic advantages through farsighted anticipation of critical events and rapid implementation of optimal decisions.

An integrated approach to managing risk represents a dynamic process for optimizing the level of risk that a firm assumes in pursuit of business goals. Rather than concentrating solely on hazard risks, an integrated framework seeks to establish consistent processes for addressing all events or actions that can adversely affect an organization's ability to achieve its objectives. Process consistency is built on traditional risk management precepts of assessment, control and finance, even though specific managerial methods and techniques may be vastly different for specific exposures. What's important is that individual risks are assessed, controlled and/or financed in coordination with established organizational strategies. ➢

Evan R. Busman is a vice president of Near North Insurance Brokerage and Paul Van Zuiden is the central region practice leader for Watson Wyatt Worldwide. Both are based in Chicago.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.



For risk managers accustomed to managing hazard risks, this movement represents both a threat and an opportunity. The threat is that the risk manager's traditional function will be absorbed into a strategic role for a newly created senior management position. The opportunity is to apply traditional risk management principles, processes and tools to the larger framework of risks faced by an organization, enhancing the firm's ability to achieve its business objectives.

A Larger Environment

Historically, a variety of risk management processes and risk financing tools have evolved to help organizations manage and respond to different types of risk. For example, insurance and the various forms of self-insurance are generally limited to hazard risks such as fire, liability and similar exposures. Options and other hedging tools are used for commodities, currency and interest rate risks. Various forms of credit are used as a device for guarding against unexpected impacts from market forces or operating setbacks. Unfortunately, risks do not always fit into categories quite so neatly. For example, a business interruption at a plant has financial, marketing and reputational implications beyond the effects on production and the applicability of the property insurance policy.

There is a growing recognition that coordinating and financing all facets of organizational risk effectively is critical to maximizing success, whether that success is measured by shareholder value or, in the case of not-for-profit, educational or governmental institutions, by the range and quality of provided services.

In many ways, this drive for effective organizational risk management is being propelled by the increasing speed of change in today's business environment. There are a variety of factors that motivate organizations to react and adapt more rapidly, such as increased customer demands, a global marketplace, continuous and accelerating technological advances, changes in the regulatory environment and, in much of the world, new governments with different agendas than their predecessors. With change itself being about the only constant, yesterday's approaches to managing risk are no longer sufficient.

An Evolving Role

For most organizations, risk management has been a disconnected function with different individuals performing rather narrowly defined specialties. The traditional risk manager handles hazard risk; treasury focuses on credit and monetary risk; strategic business units develop controls for operational risk; and marketing and public relations personnel focus on reputational risk. Additionally, the human resources department addresses employment risk while senior management and the board of directors focus on strategic challenges. Throughout the enterprise, each individual has an implicit responsibility to manage risks within his or her sphere of influence.

This segregated approach is being replaced as more organizations recognize that embedding a consistent culture of risk management throughout the enterprise can improve its ability to change rapidly as well as to manage its overall risk reduction efforts more effectively. This recognition, and the resulting need to coordinate the organization's disparate risk management efforts, at a high-ranking level, is leading to the recognition of a need for a senior risk officer position.

Also known as a chief risk officer, the person holding this position will define consistent approaches to the management of risk. Specific responsibilities might include establishing, maintaining and implementing:

- organization-wide awareness of risk management;
- channels for communicating risks;
- methods, tools and practices for managing risk;
- ways to measure operational and financial risk;
- an organizational risk map;
- risk financing mechanisms; and
- measurements of risk management effectiveness.

The new risk officer will not attempt to be expert on all risks to which an organization is exposed. Rather, the executive holding this new position will seek to improve information flows so better decisions can be made and implemented. Risk officers will be adept at developing strategies and solutions that integrate, rather

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

There is a growing recognition that coordinating and financing all facets of organizational risk effectively is critical to maximizing a firm's success.

than compartmentalize, the operational and financial management of the firm's exposures to loss.

This raises questions about the role of the traditional risk manager. Will he or she grow into this new position or will today's practitioners become overwhelmed by the complexity of a broadened role? While this can only be answered in individual instances, one thing is clear: Those who seek the elevated position will be challenged to learn new skills, better understand the mission and culture of their organization and function effectively in an increasingly matrix-oriented (rather than hierarchical) structure.

Improved Decisions

An integrated approach to managing risk comprises three organizational systems: strategic, management and process.

Strategic systems form the basis for an organization's risk management goals and the corresponding risk management philosophy. Effective strategic systems facilitate the formulation and alignment of business risk strategies within the organization and help executives monitor changes in the external environment (such as customers, competitors, markets and regulations).

A strategic system seeks to identify significant exposures and determine the root causes of loss. For example, a pharmaceutical company would focus on the potential for the recall of a specific ingredient in its products. By continuously assessing the validity of key assumptions, the strategic system is kept dynamic.

Management systems form the basis for communication of established risk management goals by disseminating business risk assessment and control methods throughout an organization. Within a management system, human resources are acquired and allocated, accountability is established and information networks (electronic and otherwise) are formed. In this context, risk management efforts are centered around:

- establishing boundaries for empowerment, accountability and decision-making authority;
- selecting, developing and retaining the best people (while addressing issues of employee commitment, behavior and turnover; reengineering and change; and the corporate culture) and
- sharing information, strategies and results through formal and informal systems.

Finally, *process systems* establish a common language of risk, anticipate critical operating exposures and lead to effective risk control and financing techniques. Within an effective business process, the organization's exposures to loss are assessed through identifying, sourcing, measuring and mapping techniques.

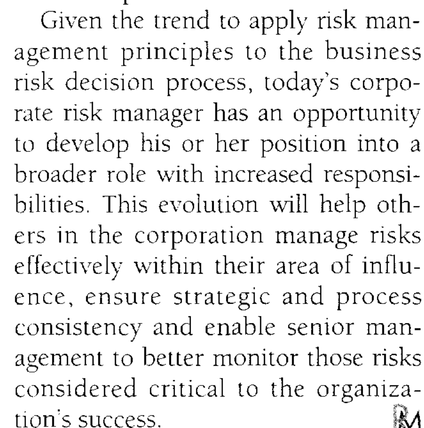
The creation of a formal organizational risk map, which visually depicts key risk factors and interdependencies, emerging trends and current risk control and financing techniques, represents the conclusion of the risk assessment phase.

With the risk map complete, an evaluation process, based on the organization's risk profile and established decision-making criteria, establishes a unique decision support system. Finally, with each and every exposure assessed and evaluated, detailed risk control and financing programs can be designed and implemented.

Exhibit 1 highlights the business systems process.

A New Approach

Senior executives and boards of directors are beginning to recognize the value of adopting an enterprise-wide approach to managing risk. Developing an integrated risk management framework reduces the organization's reaction time, creates a positive risk culture that empowers people and continuously improves risk reduction processes.



Given the trend to apply risk management principles to the business risk decision process, today's corporate risk manager has an opportunity to develop his or her position into a broader role with increased responsibilities. This evolution will help others in the corporation manage risks effectively within their area of influence, ensure strategic and process consistency and enable senior management to better monitor those risks considered critical to the organization's success. RM

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.