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Corporate Treasurers Council®

CTC GUIDE TO

Enterprise Risk Management
Beyond Theory: Practitioner Perspectives on ERM

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Introduction

This is not the typical Enterprise Risk Management (ERM) guide. Often, when financial executives read guides about ERM, those reports are in the form of a best-practices list under headings such as Oversight, Governance and Structure, and include checklists for factors such as Risk Identification and Assessment. This guide focuses instead on the experiences of five companies and their ERM programs (see Case Studies on page 14). Based on extensive interviews with corporate risk practitioners and experts and including quantitative data, this practitioner's guide presents detailed examples of the ways in which companies have approached ERM and how their efforts provide valuable insight into leading ERM practices.

"A lot of organizations shy away from ERM because they can't see how it provides [anything] other than just a list of the exposures they're already aware of," said a risk practitioner who built the ERM program for a major airline. At the time, he said, "we had a consultant who was talking about an ERM program and they [sic] had some interesting slides." But at the end of the presentation, the CFO asked what the program would look like. "They had lovely bullet points, but how do you make it real? That's the challenge."

The companies highlighted in this guide offer views into how that challenge can be met. Their risk champions carry different titles. Some programs are more complex than others. But all of them exhibit several or all of these differentiating factors:

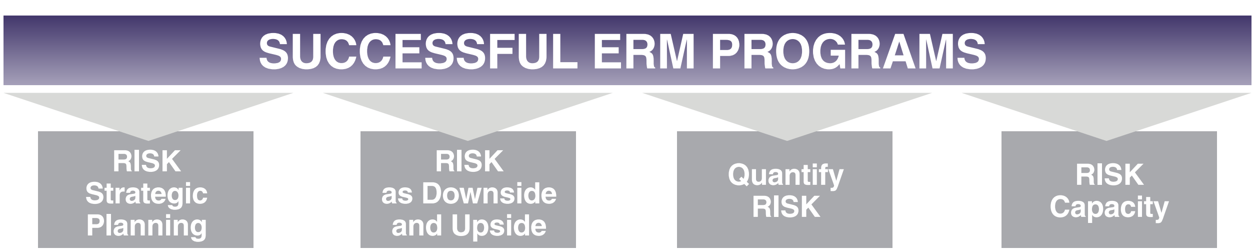
- They connect risk and strategic planning
- They think about risk as downside and an upside
- They put numbers around risk
- They consider risk capacity

According to Peter Frank, Partner at PricewaterhouseCoopers (PwC), whether or not there's a formal ERM program is a separate question than whether or not a company is successfully managing its risks. Some companies have very sophisticated risk cultures and do not necessarily overlay those cultures with an explicit ERM process. "The companies that do [ERM] well have to combine a cultural appreciation for risk with rigor of process," noted Frank. Certainly companies in industries such as chemicals, oil and banking have a history of developing sophisticated risk awareness programs. Yet, some of the most spectacular risk failings in recent history have occurred within such organizations. "A forensic review typically indicates a failure in risk management," said Frank. For ERM to work, he said, "There needs to be a culture and a process, and general sophistication of risk. Without all three there's not going to be success."

What success looks like

Each of the companies in this guide is in a very different phase of what they all call a journey, from the earliest stages of ERM to the most mature programs, based on the rigor of the program and how embedded ERM already is into their strategic planning process.

- At a **very large industrial equipment dealer** (see Case Study 1: The ERM Pivot on page 14), a recent enterprise resource planning (ERP) implementation gone "bad" spurred a rethinking of risk management in the company. That led to the hiring of a VP-level risk executive, a former consultant. According to this ERM practitioner, there are various ways ERM can add value. "From our perspective," he said, "the emphasis is going to be on being more proactive



about risk. That's where we're driving the program." Of course before you can get to that level, "you have to have all the foundational things," this risk professional said, e.g., a common language, rating scales, etc. "That's what we're on right now. Down the road, I'd like to broaden out [the program] to include policies around risk. That's where I want to take it." According to this ERM expert, having a sense of what the "end state" would look like is critical to taking the right steps going forward.

- At **HCA Healthcare** (see Case Study 3: HCA Holdings, Inc. on page 19) the ERM program began small and grew over time. "In our company, ERM is a tool for executive management," said David Hughes, HCA's Assistant Vice President, Enterprise Risk Management and Business Continuity Planning. "If it's too detailed and drills down too deeply, you can lose that connection and it doesn't really translate into executive management decision-making," he said. "You can always get more detailed later. It's easier to start at a high level and get some early successes. That's how we started." With ERM, "people start thinking about risk differently," Hughes said. Initially, risk was viewed as a way to say "no." Now, noted Hughes, "it has evolved into people considering risk as we start new initiatives," he said. "This has made it okay to think about what our risks are within the strategy, and how to mitigate and manage those risks so we can make sure the strategy is successful," he said.
- **IAMGOLD** (see Case Study 2: IAMGOLD Corp. on page 16), a mid-size Canadian gold-mining company had a strong ERM program long before it made revisions to its policies and procedures in 2012. According to a team of senior executives at IAMGOLD, "ERM is not a one-time program, it's a process." There's always been a form of ERM displayed in the way the business is managed; however, "having the process more formalized helps with the communication with the directors and the investment community."

  The risks the company identifies through its process are integrated into the highest level of management decisions as well as day-to-day operations at the site level. "We look at risks to the business and the strategic plan. We identify mitigating activities for any risk that might prevent us from achieving those plans," the executive team explained. "We go through this level of rigor at the project level. It gives us insight into risk management not just at the corporate level. ERM goes into every aspect of the business including managing our balance sheet and capital structure."
- At $43 billion automotive company **Johnson Controls** (JCI) (see Case Study 4: Johnson Controls on page 22), ERM is baked into the strategic planning process. Since 2007, the company's ERM initiative has been owned by the VP of Strategy, John Sibson. That the vice-president of strategy "owns" ERM is unusual, but it makes perfect sense given today's realities. Sibson pointed to a study by the Corporate Executive Board (CEB) showing that in 80 percent of cases, the reasons behind a significant market capitalization decrease are not compliance or legal. "The real drivers are basic strategic issues," Sibson explained, including "poor post-M&A integration, competition, price wars and bad products, which supported the concept of strategic planning ownership."

  To ensure risks are properly identified, ranked, mitigated and managed within the big picture, the company pursues a very structured process using a simple, web-enabled tool that allows participants to rank risks based on a four-dimensional model. The ERM and Strategic Planning processes move in unison, and decisions about reducing and taking on additional risk are managed within an explicit risk-tolerance framework.
- At **Zurich USA** (see Case Study 5: Zurich in North America on page 27), Chief Risk Officer Barry Franklin sits at the intersection of risk and business. The U.S. arm of the Swiss insurance giant has a long ERM tradition that shows what best practice ultimately may look like. "When I look at the foundation for a company such as ours, you have to have a mature program that rests on the company's entire financial management and capital management discipline," Franklin explained. At Zurich, "ERM is first and foremost about effectively managing capital. Second, it's about encouraging and supporting risk based-decision making. And third, it's about supporting and encouraging a risk-aware culture."

Measuring Enterprise Total Cost of Risk™

Back in the 1990s, Gary Bierc – now CEO of rPM3 Solutions LLC – built what was then called an Holistic or Integrated Risk Management program as an assistant treasurer and risk director at Moore, then a Toronto-based midsize business forms company that has since been acquired. The program had some quick successes. In 15 months, it took Moore's lowest performing business unit and turned a loss into an operating profit. "The ERM strategy is why we were doing better," Bierc said. But while that made intuitive sense to Moore's board, the board wanted a way to quantify it. That's what sparked Bierc's initial interest in putting numbers around ERM's value.

By 2010, Bierc won a patent for a new methodology to create what he calls the "fifth financial statement." It is essentially an expansion of the four traditional statements which focuses on risk; it strips out the cost of risk from the cost of doing business and makes it possible to incorporate real metrics at the outset – when making decisions – and at the end, to measure business and program performance based on the Enterprise Total Cost of Risk™ or ETCOR™.

"There's core business spending and there's risk spending," said Bierc. The core cost of business is the cost of business in a risk-free environment. The cost of risk is any cost added because risk exists. "We can measure the cost or risk signature on a business every single period. More importantly we can tie risk assessment work and proactive risk management activity, and meld that into the forecast," he said. At the other end, performance can be tracked based on risk investment.

Bierc's company's software tool, called ARQ Technology™ (or Aggregate Risk Quantification™), allows companies to "plug in" their trial balance or GL information and get a view into the variance between "risk-free" and "risk-loaded" performance and view it in real time. They can also use ARQ Technology™ to make proactive decisions, and look at historical trends to assess past performance.

While he concedes this approach requires a true shift in how many companies think about decision-making and performance, Bierc has seen increased interest from some big potential clients. "We're not asking you to replace but add to what you're doing," he said. Otherwise, "You're not getting a complete picture of performance."

About the Author

Nilly Essaides is Director of Practitioner Content Development at the Association for Financial Professionals. Nilly has over 20 years of experience in research, writing and meeting facilitation in the global treasury arena. She is a thought leader and the author of multiple in-depth AFP Guides on treasury topics as well as monthly articles in AFP Exchange, the AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).

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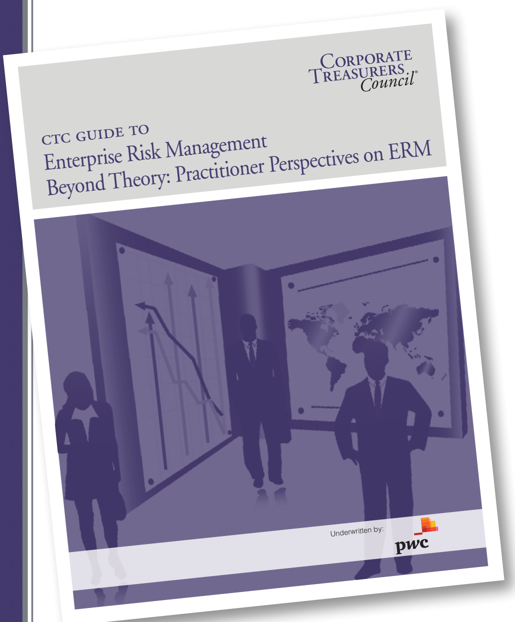

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