STRATEGIC RISK MANAGEMENT

Ken Doughty CPRM CISA CRISC CRMA CBCP

kdoughty44@gmail.com

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Strategic Risk Management Definition:

Strategic Risk Management is a process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios, that could inhibit an organization’s ability to achieve its strategy and strategic objectives with the ultimate goal of creating and protecting shareholder and stakeholder value. It is a primary component and necessary foundation of Enterprise Risk Management[1]

[1] Strategic Risk Management: A primer for Directors and Management Teams – Mark Figo and Richard Anderson (Strategy and Execution 2010).

Introduction

- No organisation operates in a risk-free environment, and risk management does not create such an environment.
- Organizations over the last 10 years have heavily invested in implementing Enterprise Risk Management (ERM).
- This ERM implementation has been operationally focused with in recent years tactically. However, it failed to address strategically.

Introduction

- The global financial crisis (GFC) has provided a once-in-a-generation opportunity to develop support amongst key decision makers that a *strategic* view of risk management actually does matter
- The Board and management must focus risk management on *creating* value as well as *protecting* value.
- Organizations that have implemented an ERM framework, have done so while continuing to see “risk management” and “strategy development” as two distinct and separate processes.

Introduction

- Risk management tends to be something tacked on at the end of a strategic planning cycle rather than being an **integral** part of the process
- One may often hear a Chief Risk Officer claiming that he or she has a “seat at the table” when the organisation is developing it’s strategies.
- Organisation’s Boards and management need to have both knowledge of the concepts of risk and an understanding of how organizations actually go about creating and developing strategy for ***value creation***.

Strategy Development

- The starting point for strategy development is the need to answer a simple question: ***What is the purpose of the organization's existence?*** Defining "purpose" provides the organization with a sense of what goals it is attempting to achieve.

- The purpose of business has been historically been to maximise profits for shareholders. Increasingly, however, this is being redefined to include the organization's ***stakeholders***.

Strategy Development

The key questions to ask in any organization are:

- What ***value*** do we need to deliver to each of our key stakeholders in return for the resources and support that are supplied by these stakeholders?
- How much ***risk*** is the stakeholder prepared to take in providing this support?

Risk then, for strategic purposes, is in fact taking a view on the risk attitudes of each it's stakeholders!

Therefore, a Stakeholder Analysis is to be undertaken.

Stakeholder Analysis

Stakeholder	Value Required	Stakeholder's Risk Attitude
Retail shareholders	Regular high dividends, capital preservation	Stable profits required to afford regular high dividends suggests a lower risk position is desirable
Employees	Career growth, increasing salaries and bonuses	High growth to create career opportunities, so higher risk activity required
Customers	Innovative, state of the art products – branding/image is important to customers	Innovation and new product development required. Product failures likely so higher risk
Bankers	Payment of appropriate level of interest and secure capital	Lower risk as provider of debt capital is conservative
Regulators	Compliance with laws and expectation that the organisation will "self-regulate" to a large extent	Environmental footprint of organization requires low risk activities as non-compliance could easily ignite public opinion and therefore regulators

Strategy Development

It is important to understand how strategies are developed within organizations as strategic risk management processes are more effective if consideration is given to how strategic decisions are made.

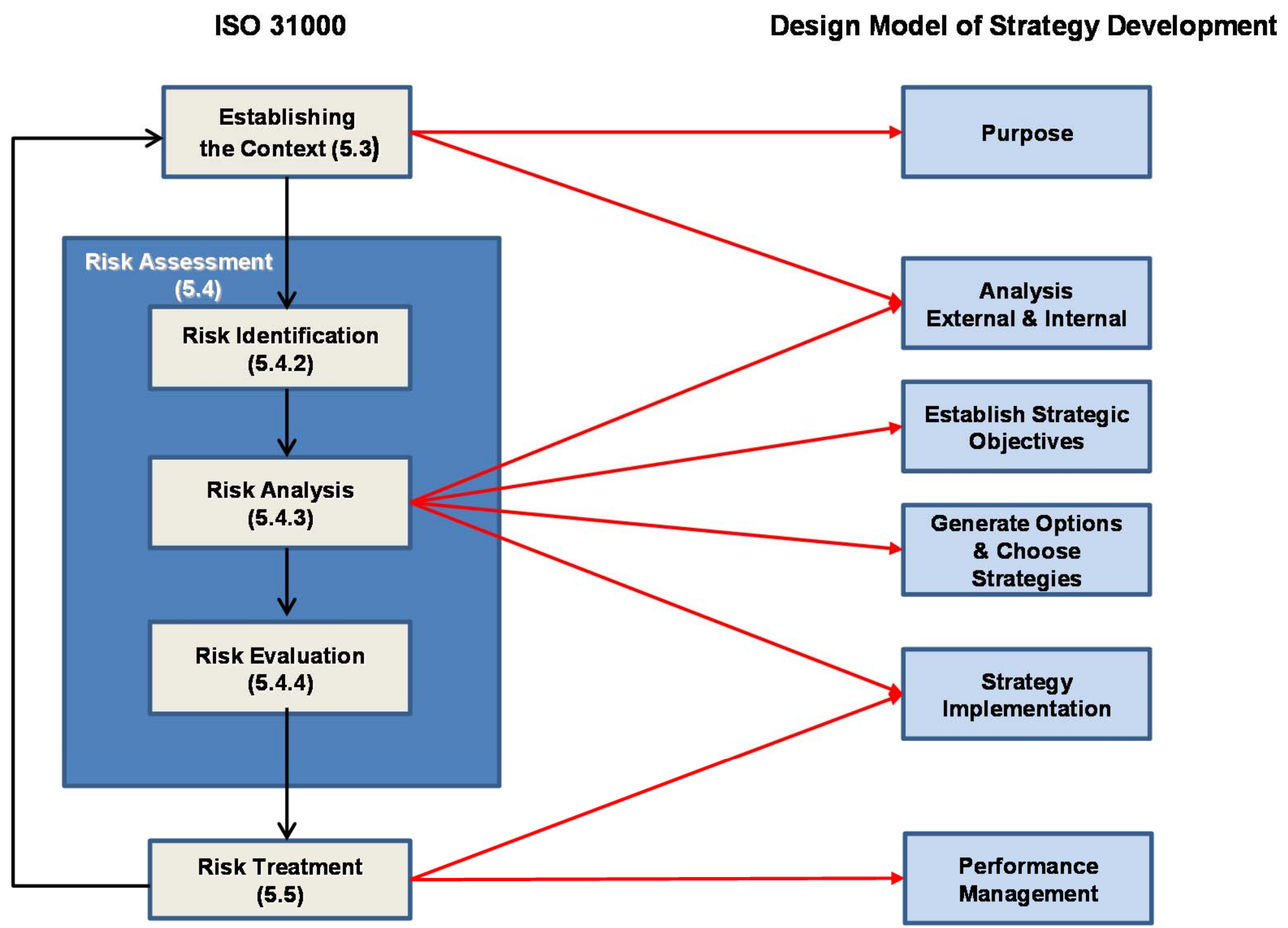
Strategy by Design

- A ***design*** approach is used by most organisations because it is a rational, analytical, and logical approach to strategy.
- It takes a formal, planned view of strategy that has as it's foundation that "knowledge" resides at the top of organization.
- The ISO31000 Risk Management Standard lends itself to integration with the design approach.

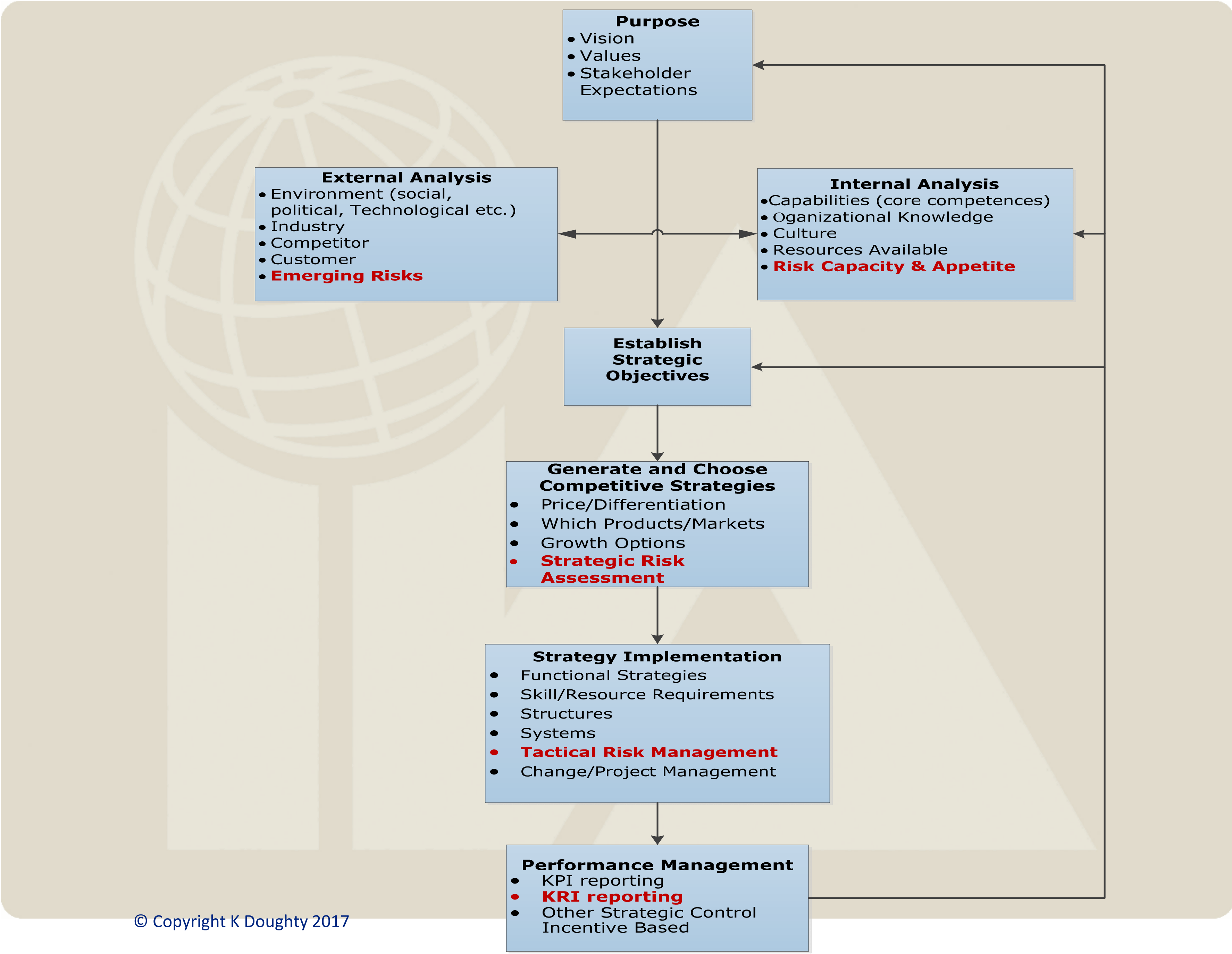
Strategy by Design

The design approach will have logical milestones where risk management can clearly be included. There is usually three options:

1. The organization has already determined it's strategy and risk management is subsequently implemented prior to implementation.
2. The organization has determined it's strategy, but allows for its risk management processes to identify and to provide feedback, so that strategies are then altered or not pursued at all if risks are too great (e.g. ***exceed risk capacity***).
3. Risk management is performed as part of the strategy development phase and risks are identified ***during*** the decision-making process itself.


ISO 31000
Design Model of Strategy Development
Establishing the Context (5.3)
Risk Assessment (5.4)
Risk Identification (5.4.2)
Risk Analysis (5.4.3)
Risk Evaluation (5.4.4)
Risk Treatment (5.5)
Purpose
Analysis External & Internal
Establish Strategic Objectives
Generate Options & Choose Strategies
Strategy Implementation
Performance Management

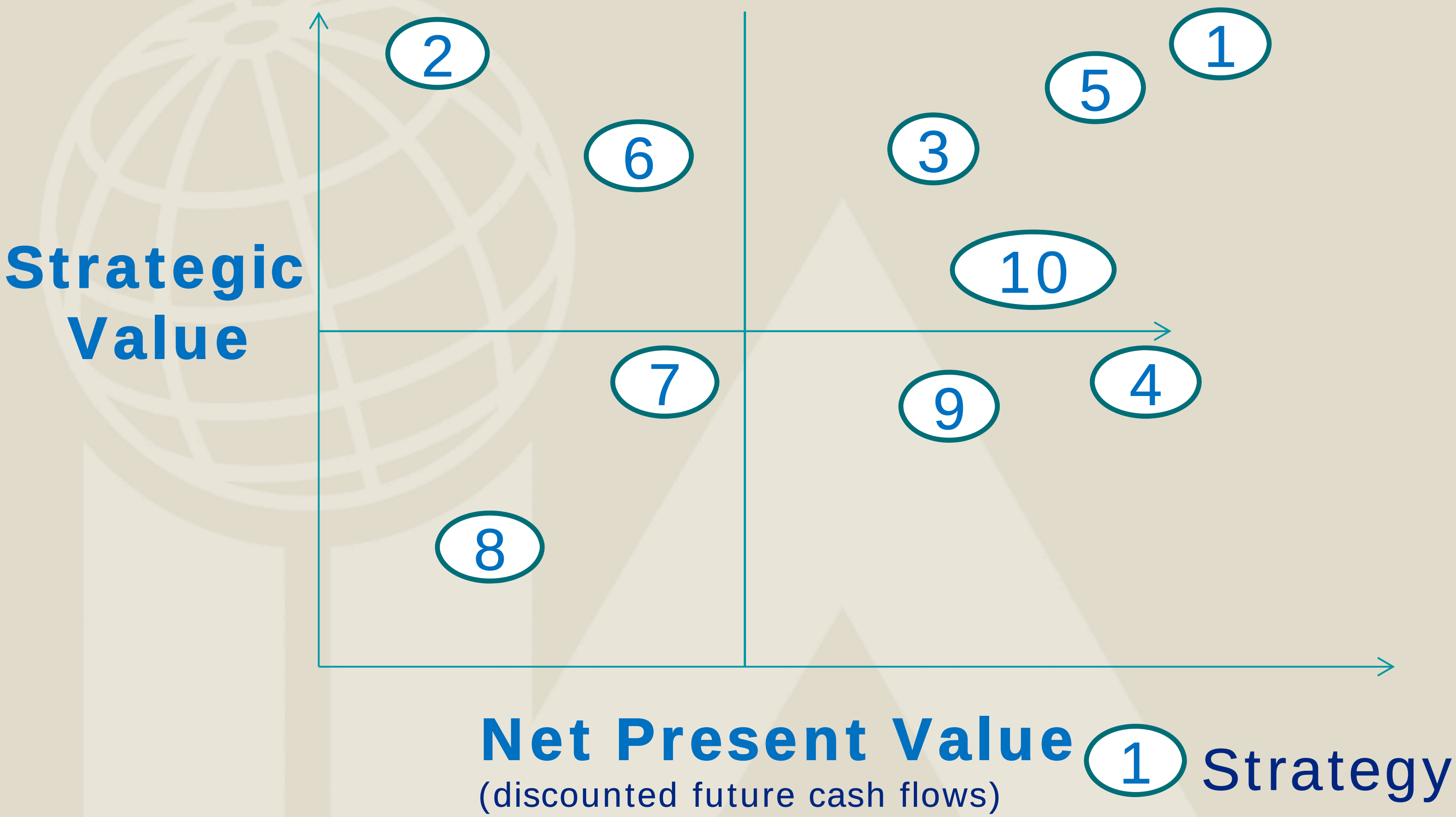
A Typical Design Model with Integration of Risk Management



Problems within the Design Model

- The design model is most appropriate for relatively stable, predictable environments. This allows the key decision makers to monitor and analyze the environment to allow them to make the appropriate strategic decisions. The risk of the design model is an ***over simplification*** of the real world in which the organization operates.
- The strategy that is "intended" to be implemented within, say, an annual strategic planning cycle, may not be that which is eventually "realised". There are numerous reasons why e.g:
  - The external environment changes such that competitors react differently to what was anticipated.
  - There is a change in regulatory regime.
  - Competing strategies become road blocks to implementation.
  - Natural events.
  - External or internal cultural inconsistencies, etc.

Strategic Risk Assessment



Strategic Objective:
To achieve 20% market share for product Platinum within 3 years

Strategic Risk Assessment

Strategic Objective:

To achieve 20% market share for product Platinum within 3 years

Identification		Inherent Risk Assessment (Risks in an uncontrolled environment)			Risk Capacity Impact	Mitigation
Objective (Initiative / Activity)	**Risks** (Describe risk in terms of Impact)	**Likelihood** (Rate the probability of the risk actually 0ccurring)	**Consequence** (Rate the severity of the impact of the risk upon the achievement of the strategic objective)	**Rating** (Red, Amber, Yellow or Green)	(Determine the impact upon the organisation's risk capacity if the strategic risks were to occur)	**Planned Action and Estimated Cost** (What risk treatment can be undertaken to mitigate within the risk appetite and what cost?)
To achieve 20% market share for product Platinum within 3 years	**Environmental & Market** Describe the key risks faced by the business. Derived from Market Outlook / Drivers of Change slides. For example, market movements, recession, etc.					
	Business / Strategy Describe the key risks faced by the business generally and those relevant for specific initiatives. For example, Capability Gaps, Resourcing, etc.					
	Operational Risks Describe the key risks faced by the business by implementing the strategy. For example, Competition for IT resources, system architecture, process complexities, etc.					

Notes:

1. **There may be a number of risks for each Strategic Objective, not just the 3 as per the example above.**
2. **Refer to ISO3100 for Risk Assessment Likelihood and Consequence to correctly rate the inherent risks**

The purpose of completing this template is to identify those inherent strategic risks that will reduce the likelihood of the delivery of the strategic outcomes.

Strategic Drift

- An example of strategic drift is Eastman Kodak. The inventor of the digital camera, the company ultimately filed for bankruptcy as it did not recognize the rise of the importance of digital photography.
- When it did try to change, it was too late. Eastman Kodak is just one where the risk of strategy drift is the need to quickly catch-up with the changed environment.
- And, the transformational change that many organizations have to ultimately undertake is highly risky.
- How is strategy drift prevented? ***This is the most important strategic risk facing any organization.*** How can it be detected that the existing strategy is achieving poor results not simply from some cyclical or temporary external downtown, but because it is simply the wrong strategy?

Summary

This presentation canvassed a number of key attributes of a strategic management framework. Key themes include:

- The critical nature of risk management policy that guides all strategic management processes within the organization
- The need to analyze stakeholders who are the true reference points when considering the purpose of the organizations and subsequent risk policy settings; and,
- The importance of considering the appropriate strategy development method (design or emergent) when designing a strategic *risk* management framework.
- The need to perform a strategic risk assessment as part of the strategy development process.
- Engagement from the beginning and not at the end!

Note:

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