Better risk management and resilience

BY CALVIN JACOB

Bad risk management has often been the reason to blame when things go wrong, from the Sept 11, 2001 terrorist attacks to the global financial crisis and more recently, the oil spill in the Gulf of Mexico. In fact, a friend once told me he was paying alimony through his nose because he did not manage his risk well!

Thinking about and having robust discussions on risk management are great. But such discussions often come about after things go wrong. Trying to recover reactively often has a higher cost to it. Risk management must be proactive to be effective. This involves identifying potential events that could impede business objectives and putting in place controls to reduce the likelihood of these events happening.

For some of the more uncontrollable risks, like natural disasters, controls should come in the form of early warning systems and pre-empted recovery plans that kick in to reduce their impact.

Risk management takes many shapes and forms. Different companies approach it in different ways. Some have annual discussions, some focus on just operational or credit risks, while others have complex tools for managing it. Then, there are companies that practise risk management without even realising it — a discussion on "challenges we are going to face" and "what are we going to do about it" is to some extent risk management.

Companies in Malaysia and abroad have also adopted global standards on enterprise risk management (ERM) like COSO, AS/NZS 4360 and ISO31000. We even have controls to risk so far embedded in our business processes that we forget it's there to manage a particular risk. For example, in a recruitment process, controls such as vetting the curriculum vitae, making reference calls, conducting numerous interviews and then putting the candidate on probation, are carried out to lower the risk of hiring a "lemon".

The world is changing, so must we (sounds like something my dad would say — but it's true!) Despite all the best practices and global guidelines, why do we still have surprises and risk events happening? And which significantly impact our business? The risk landscape is continuously evolving — PricewaterhouseCoopers' 15th Annual Global CEO Survey shows us just how diverse this landscape has become and how it correlates globally (see chart).

We are seeing rapid increases in the speed, impact and contagion of current risk events, especially in the convergence of economic and political turmoil, effects from natural disasters, advancing globalisation and rapid technological advances. This creates a riskier marketplace where complexity, unpredictable events and sudden changes are the norm. Existing risk frameworks and processes may no longer give the level of protection needed. There is also a sense that existing frameworks and practices actually slow down the business rather than allow it to be flexible. This has resulted in the abandonment or circumvention of risk management frameworks and practices currently in place.

While the risk landscape is changing, doubts over current risk practices should not detract organisations from the value that risk management brings. After all, risk management should be part and parcel of doing business. "More risk, more reward" — we just need to manage it better and diligently, in a manner relevant to the risk landscape today. Here are some key areas that need to be reinforced or incorporated into existing risk frameworks under the current risk landscape:

1. LOOK AT ALL THE KEY RISK CATEGORIES — OPERATIONAL, FINANCIAL AND STRATEGIC
Companies have been quite good at managing operational and financial risks but have paid less attention to strategic risks, largely because they regard risk and strategy as separate elements. Risks are potential future events that impede objectives and should not be separated from strategy. Strategic risks are also often associated with uncontrollable external events, so are often dismissed as "they are inherent to us". The solution to this lies in a concept called "reverse stress testing" — this approach accepts that it is no longer possible to forecast or prevent certain events, but focuses on devising internal responses to manage their impact or consequences.

2. RECOGNISE THAT RISKS ARE VIEWED AS THREATS, UNCERTAIN OUTCOMES AND OPPORTUNITY LOSS
Threats and uncertain outcomes are often the focus of risk discussions. Some call this the "downside" of risk. Many forget the "upside" of risk — addressing potential opportunity loss. All these risk views need to be considered from the perspective of both taking action and not taking action, for example, moving into a new region or not launching a new product line.

3. RISK MANAGEMENT NEEDS TO BE INCORPORATED THROUGHOUT THE ORGANISATION
Discuss risk as part of strategy development and diligently review your risk profile on a periodic basis. Embed these discussions in the agenda of periodic management and board meetings. Consider risks when making go/no-go decisions on all projects and new business ventures. Identify key value driving processes and adopt relevant global good practices — these have risk mitigants embedded in them.

4. ENSURE RISKS ARE OWNED AND ACTED ON
While identifying risks is important, what is also critical is assigning ownership to these risks, ensuring action plans are developed and its implementation monitored. Monitoring can be part of an agenda at a periodic meeting or be assigned to a specific function. Overall risk management must also be owned at the senior level, for example, by the CEO, CFO or a chief risk officer (CRO). The CRO role, commonly found in financial services firms, is becoming more prevalent and requires a person who is strategic, collaborative and has a commercial mindset.

5. INCORPORATE HR MECHANISMS TO INSTIL A RISK MANAGEMENT MINDSET
Some employees consider risk management as "someone else's responsibility" and a distraction from their "day job", when in fact it should be part of everyone's job — day and night. Basically, organisations need those involved in the day-to-day management of the business to continuously consider risks in decision-making and their actions. In order for this to happen, employees must be clear on how their risk decisions will impact them directly — especially their rewards and remuneration. Key performance indicators linked to risk management behaviour should be part of every employee's assessment.

6. DRIVE A RISK-AWARE CULTURE WITH A STRONG TONE-FROM-THE-TOP APPROACH
The board should always ask questions like: "What are our potential risks?", "What could go wrong?", "What are the implications of not proceeding with a particular initiative?" and "How do we plan to manage these risks/challenges?"
The board should seek these answers from the CEO, the CFO and senior management, cascading down the organisation. By constantly asking these questions, leaders send a strong message on the importance of risk in every decision and make sure that people habitually consider potential risks in their daily work. At the senior level, starting from the board, ensure that all proposals that come to you for approval have a section on risk and how it will be managed — if they don't, don't sign off on them!

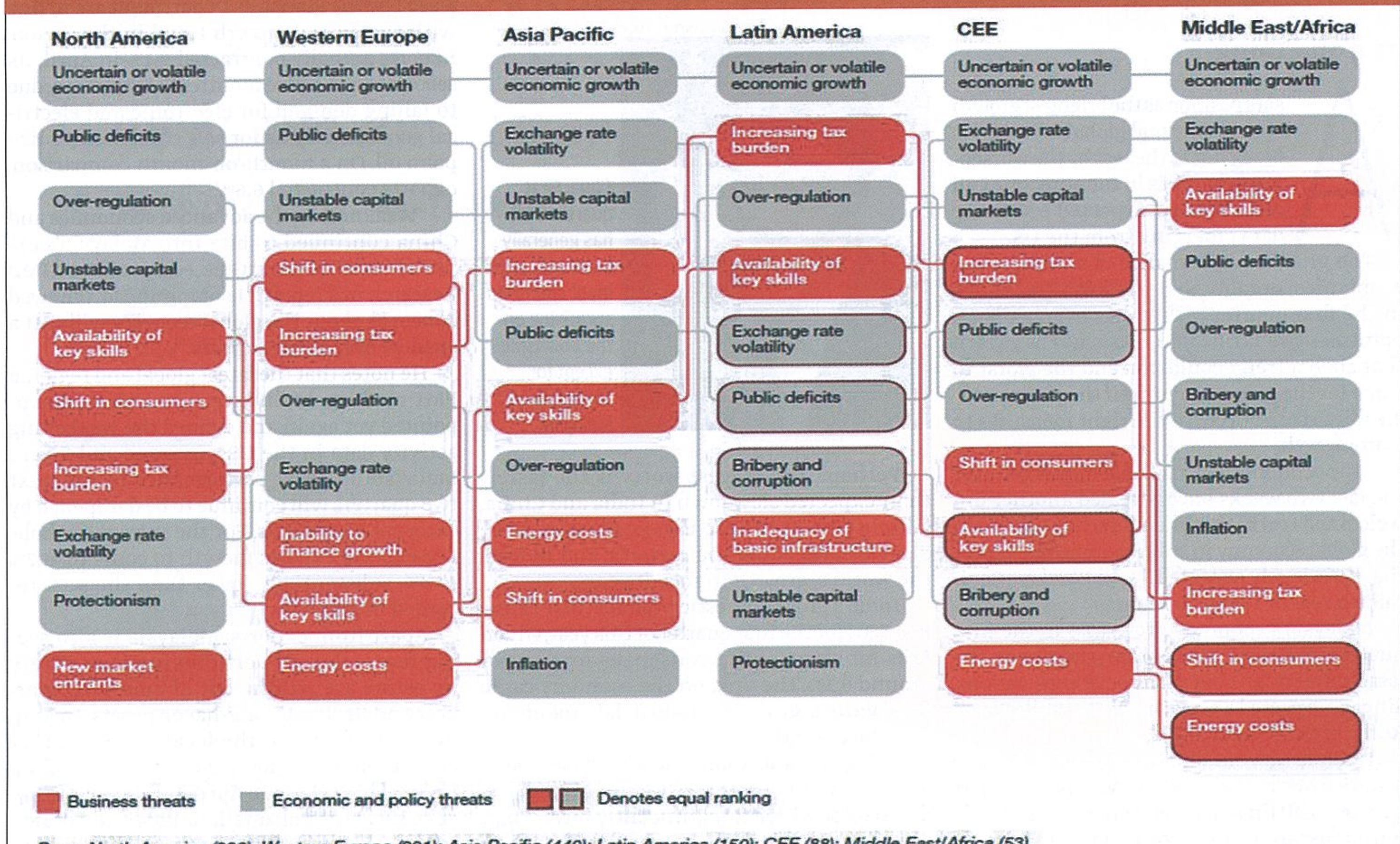
7. HAVE AN EXPLICIT FOCUS ON RISK APPETITE
The uncertainty of today's risk landscape means that just analysing historical data is no longer a reliable way of predicting future events or their impact. Organisations, driven by the board, need to be more explicit about their risk appetite when pursuing their strategy, and build awareness at all levels of what risks they are willing to bear. Clarity in risk appetite would help board and management effectiveness in preventing a scenario of being too risk averse, and help to ensure that risk management does not stand in the way of value creation.

The risk landscape, moving forward, will continue to evolve and affect organisations in different ways. There will never be a "one-size-fits-all" approach to risk management. However, the first step in the risk management process is to acknowledge the reality of risk. The areas covered so far are some of the critical areas that organisations must continuously place an explicit focus on to ensure that risk management is further integrated into the organisation's business strategy and embedded in its working culture.

At the end of the day, it's not about risk management being irrelevant for today's business environment, but how diligently we practise it and adapt it to suit our organisation. E

Calvin Jacob is an associate director at PricewaterhouseCoopers' Risk & Governance team. This is the third of six fortnightly articles by PwC Malaysia's Advisory Practice. The series seeks to challenge businesses to push back the boundaries and evolve their core strategic processes to stay relevant. The next article will address the topic of growing significant regional presence for Malaysia via successful deals.

Global economic uncertainty remains the top threat to growth prospects



Base: North America (236); Western Europe (291); Asia Pacific (440); Latin America (150); CEE (88); Middle East/Africa (53)
Note: Rank of top threats, by % of somewhat or extremely concerned
Source: PwC 15th Annual Global CEO Survey 2012