THE ERM CONFERENCE

A Leap into the Future: Corporate Strategic Plans That Anchor Risk Management

Presentation by:

CPA KIMEU, J. Musyoki

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GAMAX Ltd

Content

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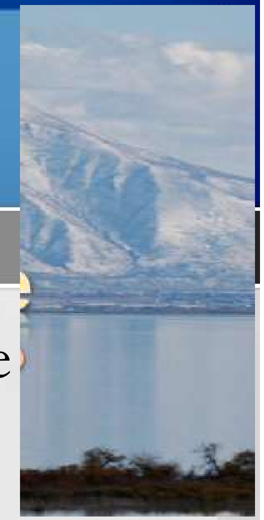
Introduction (Quotes)



- "The best-laid plans of mice and men often go awry," wrote Robert Burns (in translation).

- "When men speak of the future, the gods laugh," says a Chinese proverb.

- "Prediction is very difficult, especially if it's about the future," declared Niels Bohr.
- But you don't have to be a philosopher to know that strategic planning is **simultaneously important** and **daunting** -- and that planning for the future is no guarantee you'll get the future you expect. *It's not unusual, in life or business, to invest a great deal of energy into a desired future state that simply doesn't pan out.*

Definitions…

Strategic Planning: - A systematic process of envisioning a desired future, and translating this vision into broadly defined goals or objectives and a sequence of steps to achieve them.

Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. It may also extend to control mechanisms for guiding the implementation of the strategy.

Risk Management: Coordinated activities to direct and control an organization with regard to risk.

- Aim achieve best balance of risk and opportunity and not to eliminate risk.

Introduction

- **Corporate goal setting** and **performance management** and **measurement** are the cornerstones of almost all types of organizations with a mission, whether they are private or public sector, for-profit and not-for–profit.

- While strategic planning is good corporate governance; both of these 'management' concepts are tied into effective risk management practices.

- Moreover, if risk or impediments to goals are not properly contemplated and assessed there is no viable strategic management, and frequently poor outcomes or results.

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Key Considerations….

Michael Porter wrote in 1980 that formulation of **competitive strategy** includes consideration of four key elements:

1. Company strengths and weaknesses (SW);
2. Personal values of the key implementers (i.e., management and the board);
3. Industry opportunities and threats (OT); and
4. Broader Societal Expectations.

Strategic Management….

Strategic Management Framework

Purpose & Values

Formulation → **Implementation**

Analysis	Strategy Formation	Goal Setting	Structure	Control & Feedback
Remote External Environment	Diagnosis Opportunities Risk assessment Scenarios	Guiding Policies	Organizational Structure & Leadership	Budgets & Financial Plans
Industry Environment	Strategic Decisions Competitive advantage Generic strategy Portfolio management Geographic scope Market positioning Value Chain Core Competence	Objectives Corporate Business Functional	Initiatives, programs & investments	Incentives
Internal Assessment		Measures & Scorecards	Mergers, Acquisitions & Divestitures	Review & Evaluation

Five Key Steps to Strategic Planning…

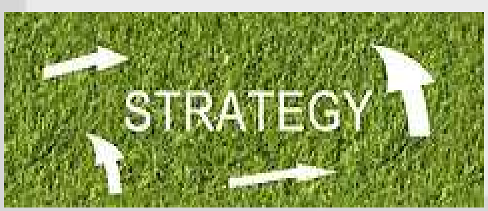
Determine where you are

Identify what's important (Mission, Vision)

Define what you must achieve (objectives)

Determine who is accountable (strategies, action plans, budgets)

Review, Review, review (Quarterly)



Todays Business Environment…

- A **dynamically changing** business environment.
- **Stakeholders' expectations** have necessarily climbed much higher with both more sophisticated stakeholders or investors and more activist Boards.. **Recent Changes (***risk management-related regulations & standards or practices)***;**

- **A dynamically changing risk profile**
- **Increased rules and regulations** (greater government intervention)
- Credit crisis / economic crisis / meltdown
- Increased corporate governance expectations
- **Market expectations**
- **Competition**
- Confidentiality rules (privacy laws)
- Technology & business recovery

- Sarbanes–Oxley requirements
- International Basel 2 capital accords (banking)
- **International financial reporting standards (IFRS)**
- Environmental compliance and reporting
- Foreign Corrupt Practices Act
- **Anti-money laundering**
- Terrorism, natural and man-made disasters
- Climate change

Trend

- While strategic planning has always been hard, it has been getting harder. According to Geoffrey Colvin's October 2, 2006, Fortune article, "Managing in Chaos," a recent study of S&P 500 companies showed that **overall risk levels -** risk to a company's ability to achieve stable long-term earnings growth - **has more than doubled** since 1985.

- In that year, only 35% of the S&P 500 faced high risk and highly volatile long-term earnings growth.

- By 2006, that number had risen to 71%. During the same period, the number of companies enjoying low risk and volatility fell from 41% to 13%.

Recent EY Survey…..

1. **Four in ten** companies do not have formal processes to align risk management with corporate strategy;

2. Investment in risk management will increase substantially over the next three years (66% of companies responded to such an increase);

3. Further alignment needed between risk management functions and line management as well as across individual functions; and

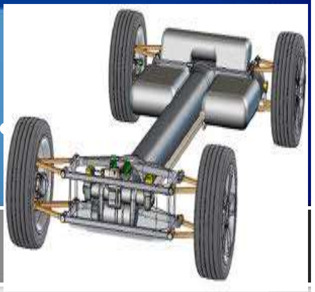
4. Risk management challenges over next 3-5 years include developing a **more integrated & systematic approach** - clarifying risk ownership & embedding a risk culture throughout organization

How Directors understand Risk

A fairly recent *Conference Board Study* of larger companies revealed the following:

1. Research found significant differences in how directors understand risk & how companies manage risk
2. 77% of directors say they fully understand risk/return tradeoffs of a given strategy
3. **73% of directors say their companies fully manage risk**
4. 59% of directors fully understand how business units interact in company's overall risk portfolio
5. 54% have clearly defined risk tolerance levels
6. 48% of Boards rank key risks
7. **42% have formal practices/policies in place to address reputation risk**

ERM Strategy & Organiz. Realignment…



Critical Success Factors driving risk management success;

- **Clear ownership** of risk within the organization
- Mechanisms, methodology to review, discuss and communicate risk
- **A formal process** to link risks to organizational objectives
- **Proactive board** and senior management level in both oversight and managing/monitoring risk
- **Specific policy** covering risk management as it relates to the organization's business and challenges

Alignment…..

The **improved communication** paradigm provides for better decision making and strategic planning as a result of risk management being aligned with organizational goals.

- Risk management and Internal Audit have the same vision of the company's mission and objectives
- A better understanding to see and appreciate risk in a wider context
- The overlap of processes and risk issues in different geographic regions and businesses become more transparent
- More accountability by various risk management champions or risk owners (CEO, HoDs, etc)
- There's more dialogue on key risk issues among Board members and strategic planning incorporates risk

Linkage between SP and ERM

Boards and management should do 3 things in their planning cycle:

i. Incorporate **risk appetite definition/assessment** as part of the planning process, including a candid assessment of the current risk profile. Stress test two or three scenarios that would impact the plan (positively and negatively) and determine what things can and should be done to manage those potential scenarios.

ii. **Quantify the key opportunities and risks and "append"** to financial projections and ensure they are linked to specific strategies and owners

iii. Risk management is **not meant to block initiatives but to foster discussion** on improving the upside while managing the downside. As such, it should be an <u>integral part</u> of the strategic planning discussion.

The symbiotic relationship between Risk Management & Strategic Planning

<u>Business Benefits</u>

- Enhanced management information and analytics for key decision makers
- Management's understanding of the risks associated with planned initiatives
- Preparedness to navigate through unexpected situations
- Appropriate incentive creation through risk-adjusted performance measurement
- Enhanced returns through capital optimization
- Full understanding of risk and opportunity

Risk & Uncertainty

- **This rise of risk and uncertainty appears to be fueled by two major factors: <u>speed</u> and <u>connectedness</u>.**

What is Enterprise Risk Management (ERM)?

- Provides an organization wide risk framework
- Helps identify particular events or circumstances relevant to strategic goals
- Assess risks in terms of likelihood and magnitude of financial impact
- Determine a response strategy
- Monitoring of risk information

ERM improves traditional Risk Management

ERM focuses on a global array of risks

- Strategic
- Operational
- Financial
- Environmental
- Human Capital
- Reputation
- Technology
- Compliance

ERM is able to improve strategic decision making by addressing

- Strengths
- Weaknesses
- Threats
- Opportunities

Integrates risk management into the strategic planning process

Integrating ERM into Strategic Planning

Deployment of ERM in strategic planning:

- Seeks to maximize value when setting goals
- Find an optimal balance between performance goals and targets to related risks

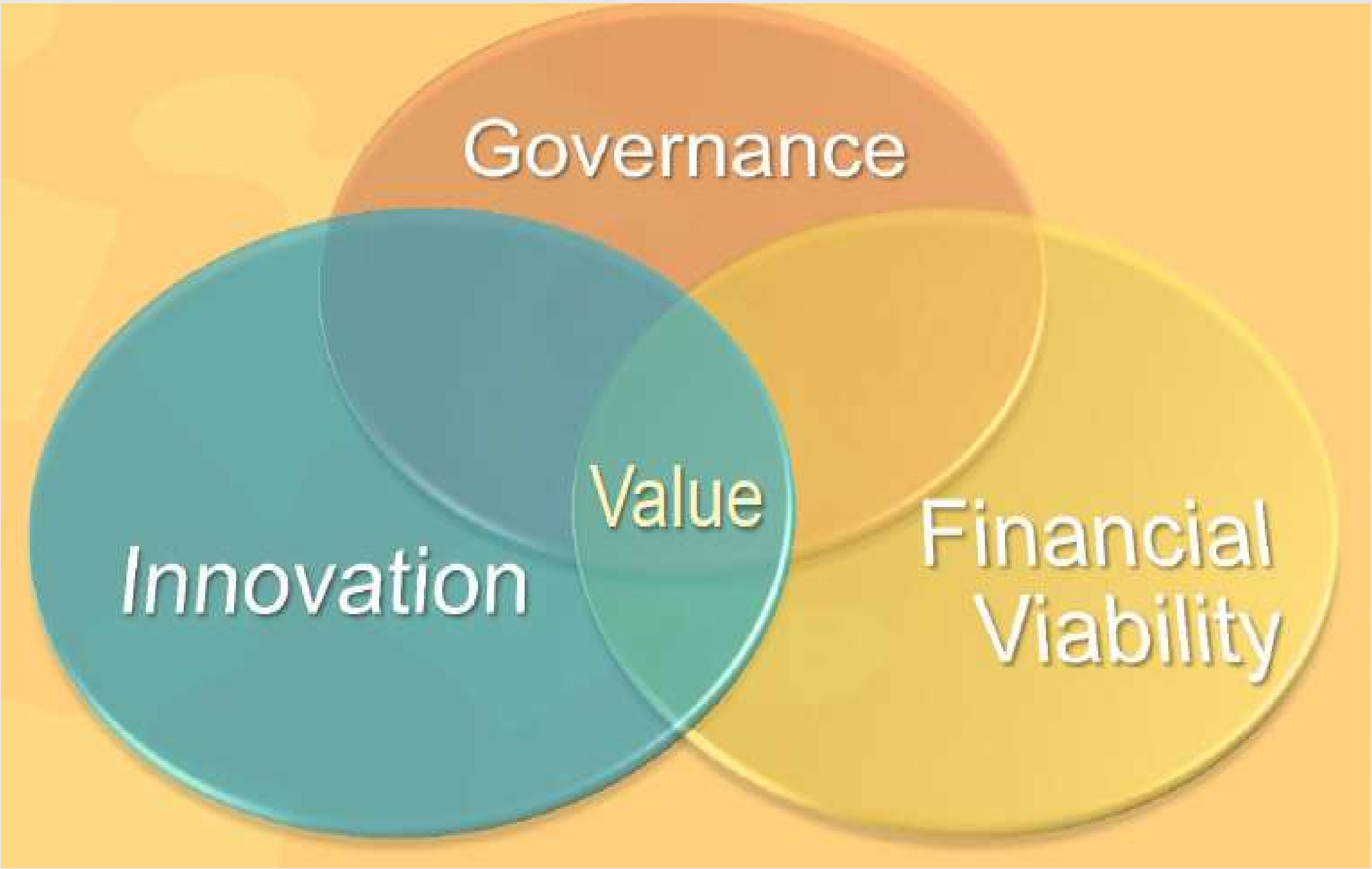
ERM also considers how one strategic initiative might introduce risks that are counterproductive to goals associated with another strategy

ERM may reveal areas where the organization is being too risk averse or ineffectively responding to some of their risks

Benefits of ERM in Strategic Planning

- Enhances decision making
- Increase profitability and sustainability
- Reduce volatility
- Improve ability to meet strategic goals
- Increase Management Accountability
- Breakdown Business Silos
- Develop Business Continuity

ERM Creates Value



Failure to use ERM in Strategic Planning

Ford Motor Co. shocked Wall Street with $1 billion write-off of palladium. The CFO stated, "Purchasing department didn't check with engineering department about their shrinking need of palladium." February 6, 2002 - *The Wall Street Journal*

Mattel recalled nearly one million toys in the U.S. because the products are covered in lead paint. According to Mattel, all toys were manufactured in China. August 2, 2007 - *New York Times*

Glaxo-Smith-Kline paid $750 million dollar FDA fine for selling contaminated baby ointment and ineffective antidepressant medication. October 26, 2010 - *New York Times*

ERM Framework….

The ERM Framework is geared towards achieving objectives in four categories as follows;

Strategic	Operations	Reporting	Compliance
High-level goals, aligned with and supporting their mission	Effective and efficient use of their resources	Reliability of reporting	Compliance with applicable laws and regulations

Risk Culture

Risk Culture is the attitude towards taking on risk in relation to the risk appetite and tolerance level of the organization.

Risk Appetite	Risk Tolerance
The manner in which an organization and its stakeholders collectively perceive, assess and treat risk	Requires a company to consider, in quantitative terms, exactly how much capital it is prepared to put at risk

Risk Governance…..

Key drivers of success and risks in the company's strategy

Crafting the right relationship between the board and its standing committees as to risk oversight

Establishing and providing appropriate resources to support risk management systems

Monitoring potential risks in the company's culture and incentive systems

Developing an effective risk dialogue with management

Guidance principles for board risk oversight

National Association of Corporate Directors report, "Risk Governance: Balancing Risk and Reward"

- **Public Finance Management Act, 2012 (PFMA, '12) & Regulations**
- **Mwogozo Code; Combined Code, etc**

Determine your Critical Risks

After you have determined the challenges in meeting your strategic goals, prioritize those challenges from the greatest to least risks. Determined by a combined score of:

- The likelihood of the risk occurring (1-5)
- Consequence if the risk were to occur (1-5)

The critical risks will be those 20 to 30 risks that have the greatest financial impact.

What you can do to get started…..

The first step in **integrating strategic planning and risk management processes**, is to actively engage the participants involved in both processes and generate excitement about the opportunity.

Additionally, like any other firm initiative, **achieving buy-in from senior management** is crucial for success.

What you can do to get started…..

Below are a **few action items** you can take to begin **developing the beneficial interrelationship** between strategic planning and risk management:

- Review current strategic planning and risk management activities to determine where information is shared between the two processes.
- **Analyze prior strategic plans** to identify initiatives that did not achieve desired results and identify the key risks that lead to the variance.
- Identify information that, if incorporated into previous planning cycles, could have made a difference in achieving desired goals.

What you can do to get started…..

Below are **a few action items** you can take to **begin developing the beneficial interrelationship** between strategic planning and risk management:

- Develop a process to document the risks associated with key initiatives and construct contingency plans in the event risks come to fruition.

- **Interview** senior management and strategic planning participants to identify risk information that would bolster their decision-making power.

- Identify **Key Risk Indicators** for use in monitoring key initiatives.

Conclusion…(Integrating ERM and SP)

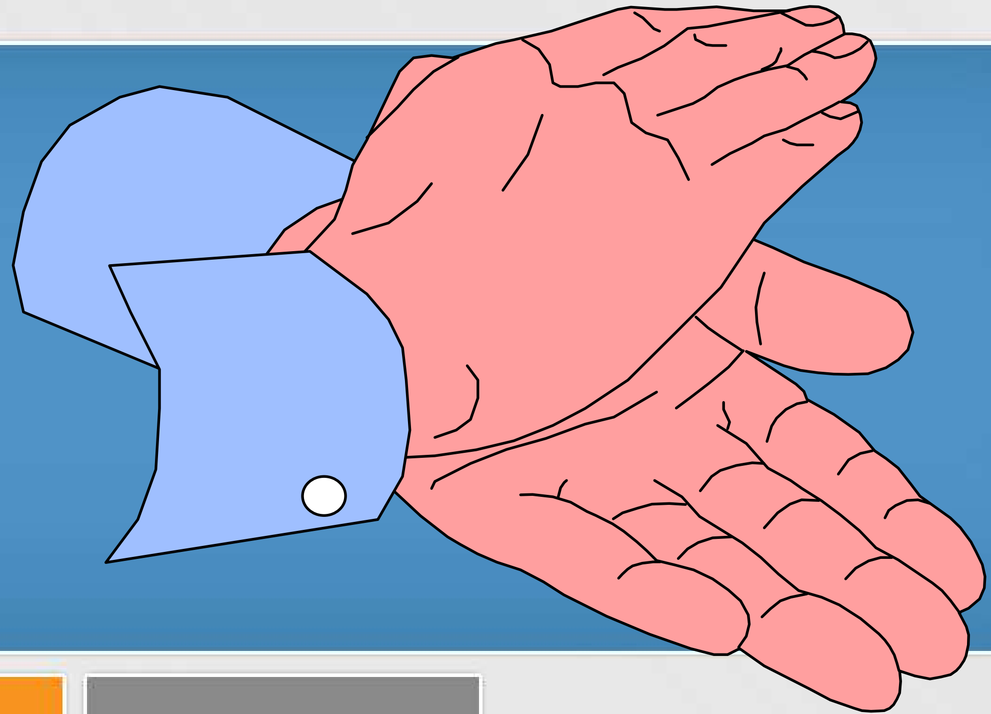
Creating a symbiotic relationship between risk management and strategic planning activities boosts your ability to execute your strategy and manage your risks.

With enhanced information, companies are more prepared and agile in adapting to changing circumstances.

Allows companies to have a balanced view of capital allocation due to a deeper understanding of risk and return trade-offs associated with different initiatives.

Having the courage to break down silos and integrate two traditionally separate processes yields immense benefits for your company and will position you to capitalize on and manage growth opportunities in the future.

Thank You



CPA KIMEU, J. M. {MBA, Bcom. (Hons), FCCA, CISA, CPAK}

GAMAX Ltd

+254 722 607157 # jones_kimeu@yahoo.com