Linking Strategy and Risk Management

Financial Services Solution limited Presentation

FSS- Creating Value Through People
Agenda

- Introduction
- Business Value Creation Agenda
- Leading Practice- Risk Management & Strategy Linkage
- Value Creation- Linking Risk & Strategy
- Strategy, Risk Management & Performance –Examples
- Enterprise Risk Management as a Strategic Tool - Prerequisites

❖ Questions & Answers
Introduction-Interactive Session #1 – 10 minutes

- Introduce yourselves to others at your table.
- Recap – Share something on personal experience in Risk management and highlight the expectation of this training.
- Pick 1- Identify a risk and link it to business goal – discuss it as both a threat, opportunity and response.
- Report to the large group-pick a spokesperson.
Introduction-Risk Governance Process Commentaries

Risk comes from not knowing what you are doing; if you don’t understand, then don’t do it. ‘Warren Buffet’

The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. ‘‘Sir Adrian Cadbury, UK, Commission Report: Corporate Governance 1992’’

The biggest risk is not taking any risk... In a world that changing really quickly, the only strategy that is guaranteed to fail is not taking risks. ‘Mark Zuckerberg’
Introduction - Basic Principles, Concepts, Definitions

RISK

Risk is ANYTHING that may affect the achievement of an organization’s objectives- ISO 31000

“ERM defined as ... a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”

Introduction - Top Five Business Issues (Gartner)

- Cost Constraints
- Innovation
- Managing Business Risk
- Security of Data and Privacy
- Stakeholder Returns
Introduction - Today's Global Challenge

Focus concurrently on key horizons:

Transform Today’s to Future Business
Identify and Realize the Full Potential
Present Business is Effective
Achieve Objectives in Complexity of Risk

Winning Enterprise

Attaining risk resilience help organization achieve winning performance. Skills, expertise knowhow borrowed from Risk Management Best Practices and calibrated to suit the specific business type and industry are key to achieve this footing.
Introduction - Risk Management Basis

Underlying Principles:

- Value is created, preserved, or eroded by management decisions in all activities, from setting strategy to operating the enterprise day-to-day.
- Every entity, whether for-profit or not, exists to realize value for its stakeholders

RM supports value creation by enabling management to:

- Deal effectively with potential future events that create uncertainty on strategy.
- Respond in a manner that reduces the likelihood of downside outcomes and increases the upside to strategy.
Value Creation Agenda - Risk and Strategy
Value Chain - Profitability Measures

- Revenue
- Sales
- Net Output
- Operation Profit
- Added Value (economic profit)
- Capital Costs
- Wages & Salaries
- Materials Costs
- Materials Costs
- Materials Costs

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Value Creation Agenda - Risk and Strategy

Shareholders & CEO
- Gain Market Share
  - Minimize risk of entering new markets
  - Extend market reach with multi-tier distribution channels

Marketing & Sales
- Increase Revenue Per Customer
  - Flexibly combine services to increase sales
  - Lead in innovation - Star products

Operations & IT
- Reduce Service Delivery Costs
  - Decrease service provisioning & support costs
  - Lower customer support costs

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Leading Practice in Linking Risk & Strategy
ISO 31000 Principal Dimensions

1. Risk Management Creates and Protects Value
Risk management contributes to the demonstrable achievement of objectives and improvement of performance in, for example, human health and safety, security, legal and regulatory compliance, public acceptance, environmental protection, product quality, project management, efficiency in operations, governance and reputation.

2. Risk Management is an Integral Part of all Organizational Processes
Risk management is not a stand-alone activity that is separate from the main activities and processes of the organization. Risk management is part of the responsibilities of management and an integral part of all organizational processes, including strategic planning and all project and change management processes.

3. Risk Management is Part of Decision Making
Risk management helps decision makers make informed choices, prioritize actions and distinguish among alternative courses of action.

4. Risk Management Explicitly Addresses Uncertainty
Risk management explicitly takes account of uncertainty, the nature of that uncertainty, and how it can be addressed.
Leading Practice in Linking Risk & Strategy Management Maturity Level

Risk Management

TRADITIONAL
- Risk Identification
- Loss Control
- Claims Analysis
- Insurance and Risk-Transfer Methods

PROGRESSIVE
- Alternative Risk Financing
- Business Continuity
- Total Cost of Risk
- Education and Communication

STRATEGIC
- Linking Risk to Strategy
- Enterprise-Wide Risk Management
- Indexing of Risk
- Use of Technology

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# Leading Practice in Linking Risk & Strategy

## Corporate Risk Universe

### ENVIRONMENTAL RISK
- Competitor
- Customer Wants
- Technological Innovation
- Sensitivity
- Shareholder Expectations
- Capital Availability
- Sovereign/Political
- Legal
- Regulatory
- Industry
- Financial Markets
- Catastrophic Loss

### PROCESS RISK

#### FINANCIAL
- Price
- Interest Rate
- Currency
- Equity
- Commodity
- Financial Instrument

#### EMPOWERMENT
- Leadership
- Authority/Limit
- Outsourcing
- Performance Incentives
- Change Readiness
- Communications

#### INFORMATION TECHNOLOGY
- Liquidity
- Cash Flow
- Opportunity Cost
- Concentration

#### GOVERNANCE
- Organizational Culture
- Ethical Behavior
- Board Effectiveness
- Succession Planning

#### INTEGRITY
- Management Fraud
- Employee Fraud
- Third Party Fraud
- Illegal Acts
- Unauthorized Use

#### OPERATIONS
- Customer Satisfaction
- Human Resources
- Knowledge Capital
- Product Development
- Efficiency
- Capacity
- Scalability
- Performance Gap
- Cycle Time
- Sourcing
- Channel Effectiveness
- Partnering
- Compliance
- Business Interruption
- Product/Service Failure
- Environmental
- Health and Safety
- Trademark/Brand Erosion

### INFORMATION FOR DECISION MAKING RISK

#### STRATEGIC
- Environmental Scan
- Business Model
- Business Portfolio
- Investment Valuation / Evaluation
- Organization Structure
- Measurement (Strategy)
- Resource Allocation
- Planning
- Life Cycle

#### PUBLIC REPORTING
- Financial Reporting Evaluation
- Internal Control Evaluation
- Executive Certification
- Taxation
- Pension Fund
- Regulatory Reporting

#### OPERATIONAL
- Budget and Planning
- Product/Service Pricing
- Contract Commitment
- Measurement (Operations)
- Alignment
- Accounting Information
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**Leading Practice in Linking Risk & Strategy**

**Risk Framework - Common Risk Types**

Each Risk is part of the whole – Driven by strategy

- **Strategic Risk**
- **Credit Risk**
- **Market Risk**
- **Investment Risk**
- **Liquidity Risk**
- **Operational Risk**
- **Regulatory Risk**
- **Project Risk**
- **Reputational Risk**

**Strategic risk** is the current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes. This risk is a function of the compatibility of an organization’s strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation.
Value Creation- Linking Risk & Strategy
Why Risk Management?

Increase Risk Awareness;
What could affect the achievement of objectives?
  What could change?
What could go wrong?
What could go right?

Increase Understanding of Risk – Sensitivities. What makes my risks increase/decrease/disappear?

Promote a “healthy” Risk Culture – It’s safe to talk about risk. Open and transparent.

Develop Common Language-Develop a common and consistent approach to risk across the organization. Not intuition-based.
Value Creation- Linking Risk & Strategy
Risk Management Basics

- Risk (uncertainty) may affect the achievement of objectives.

- Effective mitigation strategies/controls can reduce negative risks or increase opportunities.

- Residual risk is the level of risk after evaluating the effectiveness of controls.

- Acceptance and action should be based on residual risk levels.
Value Creation- Linking Risk & Strategy
How ERM adds Value

ERM Protects and creates value for firms stakeholders, including owners, employees, customers, regulators, and society overall.

Risk Management will:

1. Downside Risk Mitigated & Managed
2. Value Preserved –Revenue Leaks & Fraud Loss saving (and Optimization of Sales)
3. Risk Capital Reduced
4. Investor Confidence
5. Customer Confidence
6. Confidence in FR
7. Saved Litigation Cost
8. Reduced Reputation Risks
Value Creation- Linking Risk & Strategy
Risk Types Links to core Mandate (COSO ERM)

Strategic – *Goals of the Organization*
Operational – *Processes that Achieve Goals*
Financial – *Safeguarding Assets*
Compliance – *Laws and Regulations*
Reputational – *Public Image*

*Source – COSO ERM*
### Value Creation- Linking Risk & Strategy Risk

#### Common Linkages Focus Areas

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Definitions</th>
<th>Risk Factors</th>
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<tbody>
<tr>
<td>Business and Strategic Risks</td>
<td>Risks related to business factors such as macro-economics and other external conditions, and the company’s strategic response</td>
<td>Revenue Growth / M&amp;A</td>
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<td>Portfolio Shift</td>
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<td>Valuation enhancement</td>
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<td>Cost Management</td>
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<td>Business Continuity</td>
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<td>Financial Risks</td>
<td>Risks related to financial performance including future return on investment, financial statement integrity, and impact of divestitures and acquisitions</td>
<td>Financial goals realization</td>
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<td>Tax Planning / Tax Audits</td>
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<td>Liquidity</td>
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<td>Market / Credit Risk</td>
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<td>FX Risk / Interest Rate Risk</td>
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<td>Economic Factors</td>
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<tr>
<td>Operational Risks</td>
<td>Risks of loss resulting from inadequate or failed internal processes, people, and systems. Most of these risks are managed by central corporate support units and executed locally by the Divisions</td>
<td>Information Security</td>
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<td>Technological Advances</td>
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<td>Legal</td>
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<td>Employee Retention</td>
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<td>Ownership Interests / Conflicts</td>
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<td>Confidentiality of Proprietary Processes &amp; Data</td>
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<tr>
<td>Regulatory Compliance Risks</td>
<td>Risks of a regulatory environment that are managed by each business line and affect the ability to meet earnings targets. In addition, business units are exposed to overall reputation in the marketplace</td>
<td>Regulatory Oversight / Legal</td>
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<td>Privacy</td>
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<td>Geopolitical Risks affecting International Operations</td>
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Value Creation - Linking Risk & Strategy
Risk - Today's Risk Factors

Identified Priorities
- Organizational structure
- Effectiveness and security of outsourced operations
- Global contracting
- Information security
- Business continuity

Financial Risk Factors
- Technological advances
- Customer acceptance/ criticism
- Ownership interest conflicts
- Substantial indebtedness/ Liquidity
- Tax planning/ tax audits
- Financial GAAP changes

Business and Strategic Risk Areas
- Accelerate organic revenue growth (e.g., Global 3 screen strategy)
- Portfolio shift
- Cost leadership/ realization of cost savings
- Valuation enhancement to all stakeholders
- General economic conditions and demand
- Customer procurement patterns/ competing product offerings
- Customer consolidation

Operational Risk Factors
- Company wide integration and alignment to strategy
- IT disruption
- Fraud and Corruption
- Employee retention
- Service disruption
- Confidentiality of proprietary processes and data

Regulatory Compliance Risk Factors
- Regulatory oversight
- Geopolitical risks affecting international operations
Conclusion

- Managing of Risk is at the forefront of today’s economy.
- The impact of today’s Risk is on a large scale and often global.
- Currently, there is an under-investment in preparedness and mitigation of Risk.
- Applying ERM principles to Emerging Risk can help protect and create value and enhance performance (Financial and Operational excellence).
- Organizational agility to address Emerging Risk becomes a source of competitive advantage and survival
- Risk is relevant at an operational business unit level and most importantly at the executive, strategic planning level.
QUESTIONS???