



ENTERPRISE RISK MANAGEMENT SEMINAR

Sarova Whitesands, Mombasa
Wednesday, 28 September 2016

ERM as a driver for competitive edge

Presented by:

CPA Phares Chege, MBA, CISA, CORP

Group Head of Internal Audit, Risk and Compliance



Video

Lessons:

1. ERM is a capability (not a function) to improve decision making while avoiding catastrophic risks
2. Playing solid defense (avoiding catastrophic risks) gives you an opportunity to participate in the offence (improved decision making)
3. Risk Philosophy - This is what we think about risk. Risk and reward must go hand in hand. Qualitative and quantitative risk appetite statements required.
4. You need a common Risk Language to marry Business & Risk - ERM has to be made simple but not too simplistic - Use the concept - What is a bad day?

Content

1

ERM and Strategy - Introduction

2

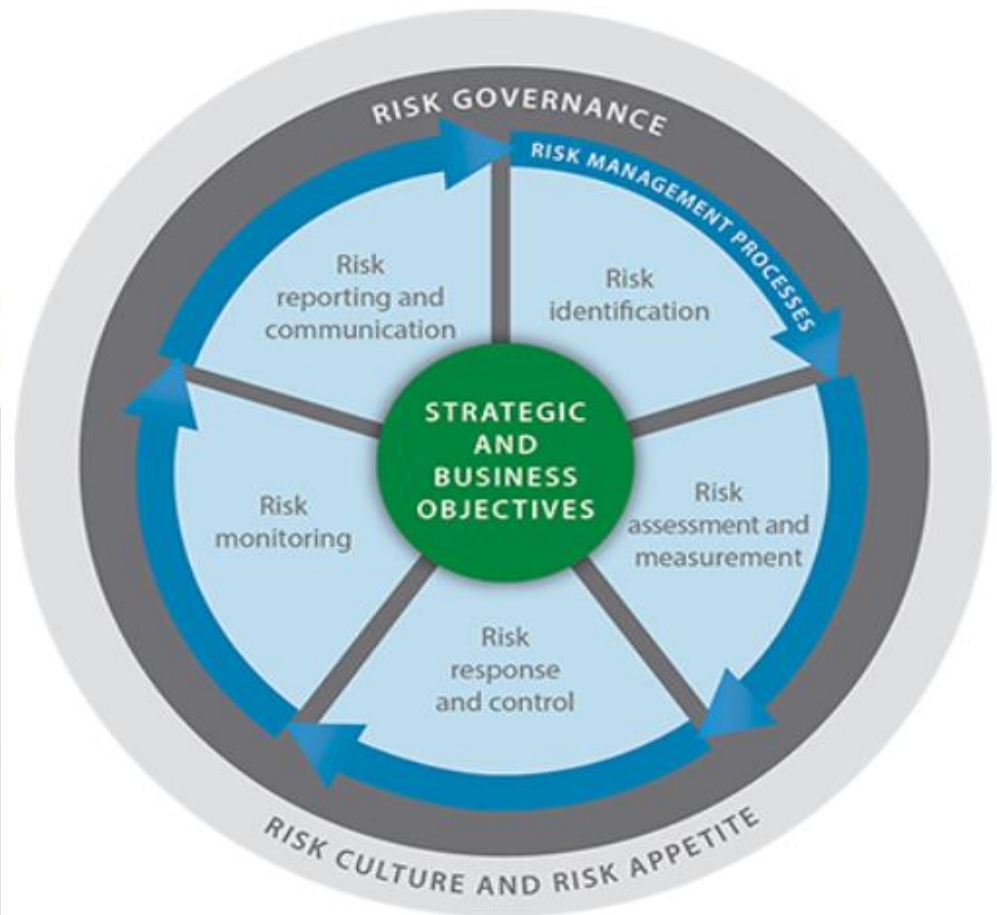
Value Driven ERM - How can ERM help an organization achieve competitive advantage?

3

Lessons from Milliman Risk Institute Survey on value creation from ERM



1. ERM and Strategy - Introduction



ERM definition

“... 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.”

ERM Objectives

Organizational objectives for pursuing ERM are:

1. To gain competitive advantage
2. To achieve strategic goals
3. To maximize shareholder value
4. To ensure transparency of management
5. To improve decision making
6. To achieve operational Efficiency



The shift to Strategic ERM

ERM: Safeguard
enterprise value - **DEFENSIVE**

FROM

- Compliance focused
- Extensive risk mapping – heat maps
- Risk mitigation
- Disconnected from strategic and operational decisions
- Lower level of staff activity – More risk activities by Risk & Audit staff

Necessary but low value adding activities
in the minds of Senior Management

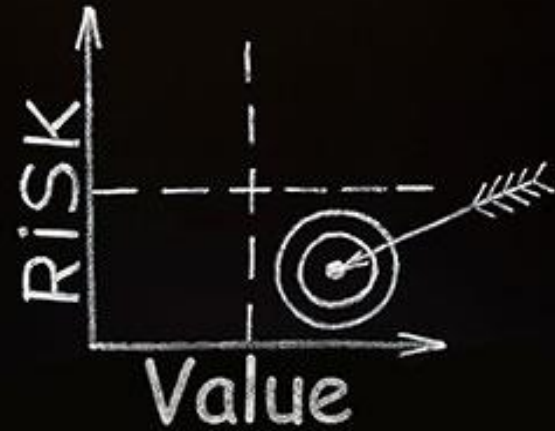
TO Strategic ERM: Maximize
enterprise value - **OFFENSIVE**

- Value-Focused
- Focusing on few key risks driving disproportionate gains/ losses
- Risk Optimization (Optimized mitigations)
- Core to strategic and operational decisions
- Line Function, facilitated by highly skilled staff

An organizational capability that drives
substantial value vs competition



2. ERM - How can ERM help an organization achieve competitive advantage?



The enterprise-risk-management framework illustrates an integral cycle of best risk practices.

Clear measurement and targeted interventions to foster a strong risk culture

Risk culture and performance transformation

From a backward-looking view by risk type to a forward-looking view integrated across existing and emerging risks

Risk transparency and insight

Enterprise risk management

Risk organization and governance

Risk appetite and strategy

Established risk-team roles and structures, greater involvement from board, clear roles and responsibilities across lines of defense and aligned with organization's structure

Risk decisions and processes

How much and which risks to take in pursuit of company goals, cascaded down to businesses and aligned with business strategy

Integrated view of trade-offs and timely integration of risk information into business-steering decisions

McKinsey



Value Driven ERM

How Do We Measure Value in a Firm?

Economic Performance

- Current Stock Price multiplied by outstanding shares
- Tobin's Q-Ratio of market to book value that tells how investors feel about the firm's assets as a means to create stock price value

Social Justice

- Customer satisfaction index
- Employee satisfaction index

Environmental Stewardship

- Environmental stewardship score
- Ratio of charitable contributions to earnings



Value Driven ERM

Key Questions Asked by CEOs

What new measurable value will be gained by this company using ERM ?

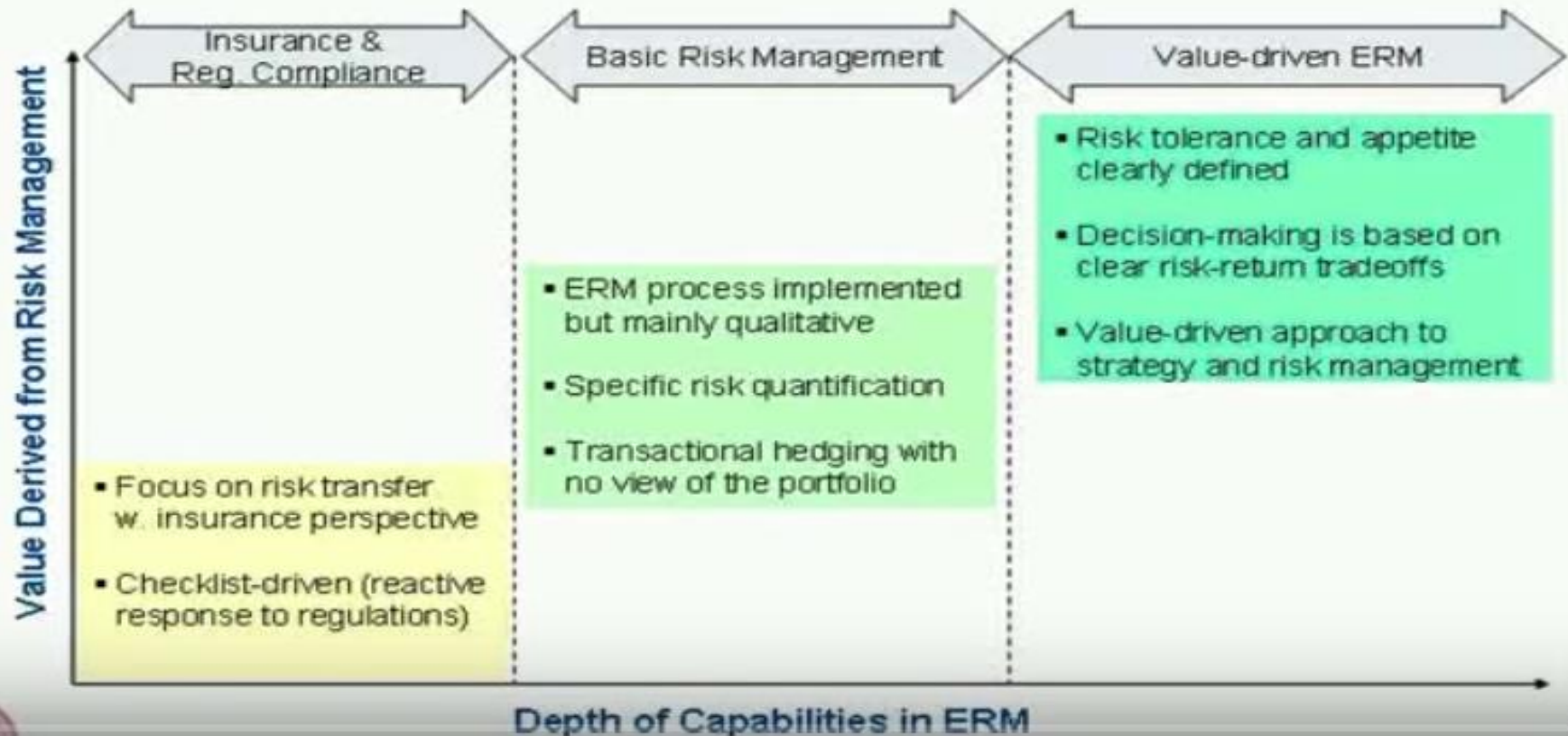
Will incorporating ERM into the strategic planning process give us a competitive advantage ?

How do we create value by using ERM ?



Depth of ERM Capabilities

Leading organizations are applying Enterprise Risk Management (ERM) as an integral part of value creation and delivery.





Depth of ERM Capabilities

Value-Driven ERM is a shift in focus ...

Control Focus

Silo-driven
Forensic
Deterministic
Checklist-driven
Qualitative
Solving a Crisis



Strategic, Value Focus

Enterprise-wide
Forward-looking
Probabilistic
Value orientation
Quantitative
Developing risk mitigation plans



Value Driven ERM

Key Elements of Value Driven ERM:

1. Are we truly **value driven**?
2. Are we truly **comprehensive**?
3. Are we **consistent** in **evaluating** different **risks**
4. Are we **consistent** in applying out **risk appetite**?
5. Where can we learn more?



Value Driven ERM

...Cont'd

Value-driven ERM aligns risk management with business strategy and embeds a risk management culture in the organization.

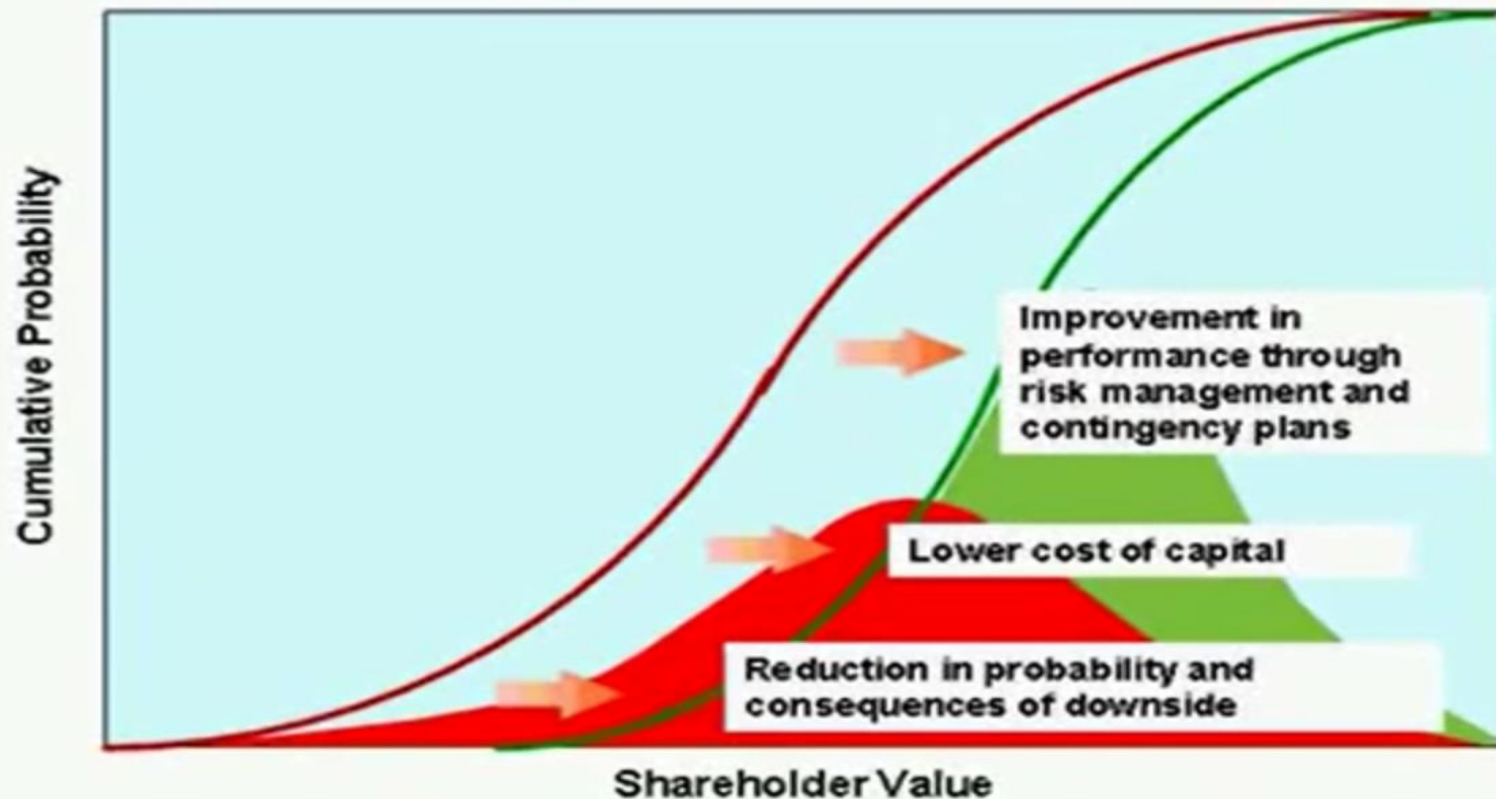
- The objective of risk management is not to eliminate risk – that would eliminate reward.
 - The objective is to identify, quantify, and manage risk in line with shareholder value creation objectives and risk-return tradeoff preferences.
- The right approach to ERM should effectively address:
 - Strategic, financial, and operational risks (the realm of value-driven ERM)
 - Hazards and event risk (the focus of traditional ERM)



Value Driven ERM

...Cont'd

The primary role of the board and executive management is to shift the risk-return profile of the business portfolio towards greater upside and reduce the overall uncertainty in shareholder value.





Value Driven ERM

...Cont'd

Optimally balancing value creation and value protection becomes a source of strategic advantage, particularly in periods of high market uncertainty.

- Balancing value creation and value protection requires:
 - Rigor in identifying, quantifying, and managing risk exposures
 - Clarity on risk-return tradeoffs
 - Integrated approach to strategy and risk management – risk management is not an afterthought
 - Alignment from the board to the front lines on risk management roles and responsibilities
- The banks that best survived the crisis and are thriving today (e.g., JP Morgan and Banco Santander) have done so not because they were better regulated, but because they were better managed.



Are we truly comprehensive?

We use five main categories of risks for the purpose of designing and implementing ERM:





Are we truly comprehensive? ...Cont'd

We use five main categories of risks for the purpose of designing and implementing ERM:





Are we truly comprehensive? ...Cont'd

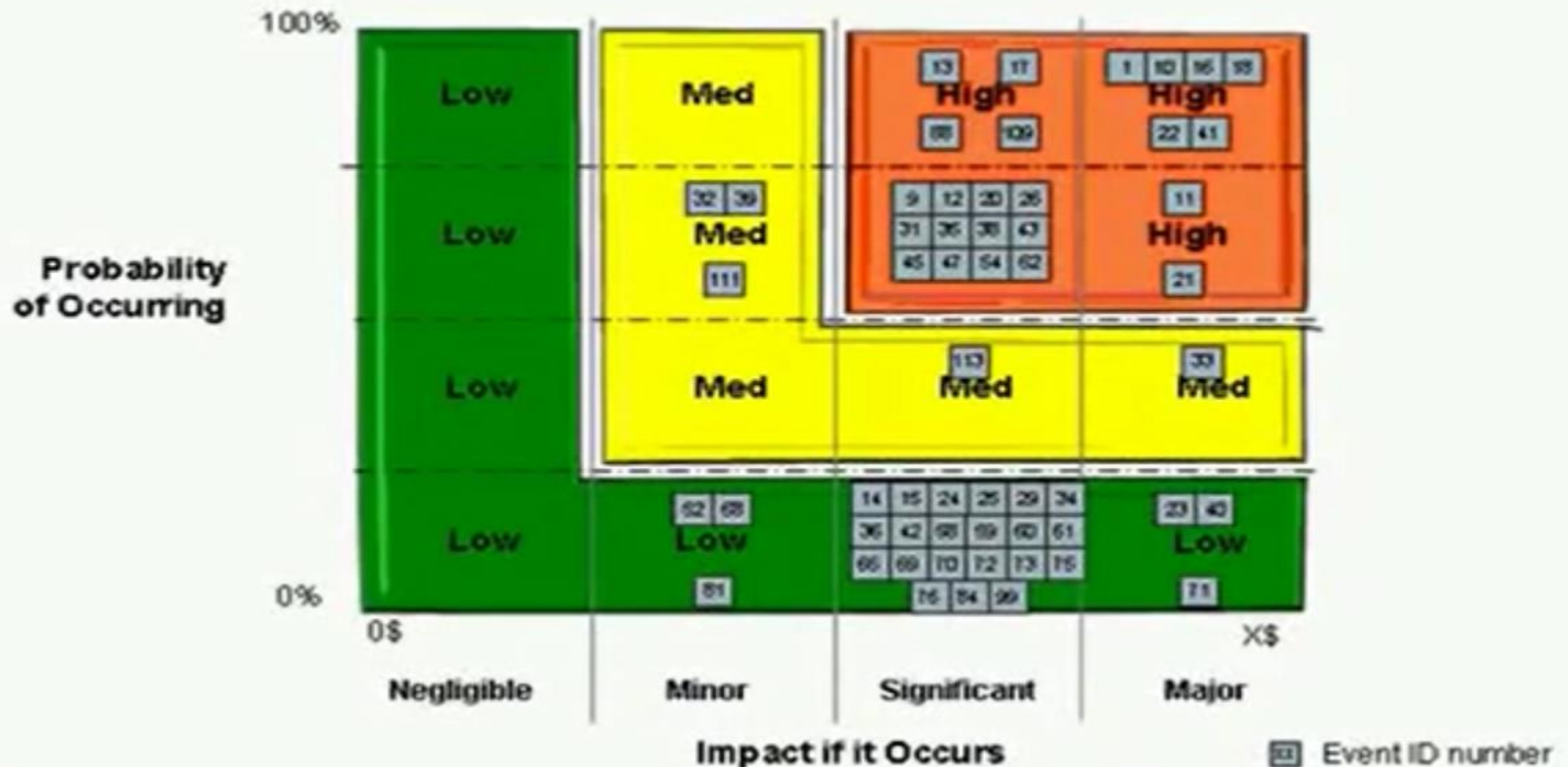
There are many sources of risk – and the easy ones to identify and quantify are usually not the most important!





Are we truly comprehensive? ...Cont'd

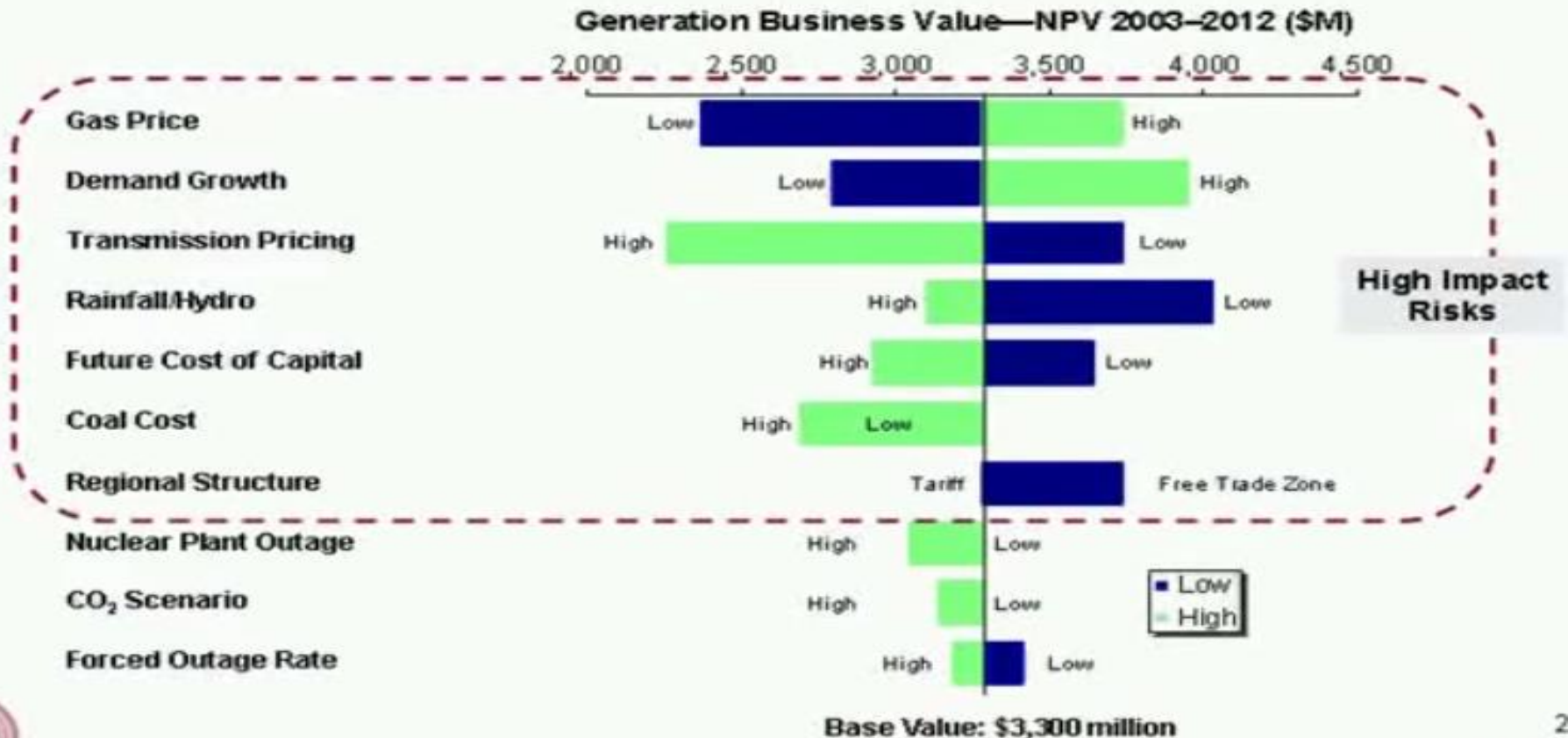
Heat maps do a good job at capturing low-probability, high-consequence *uncorrelated* risks.





Are we truly comprehensive? ...Cont'd

Risks driving the value of the business are harder to identify and quantify and need different methods.





Are we consistent in Risk evaluation?

We use quantitative models and data when appropriate to quantify some risks while using well-established expert assessment techniques for others.

Quantitative Models:

- Powerful tools for pricing and insight, but be aware of serious limitations
- Models are not reality (the map is not the territory)
- Back-test , benchmark to markets, and use only for applications where validity has been proven

Expert Assessments:

- Apply formal interview techniques that avoid anchoring , availability, and framing biases to extract actionable probability assessments
- Comparable in form and quality to quantitative model results

Risk Instrument Pricing:

- We never transact in derivatives or enter into insurance structures that we don't know how to price ourselves



Are we consistent in applying risk appetite?

Taking a CEO perspective, what is the biggest investment you would make?

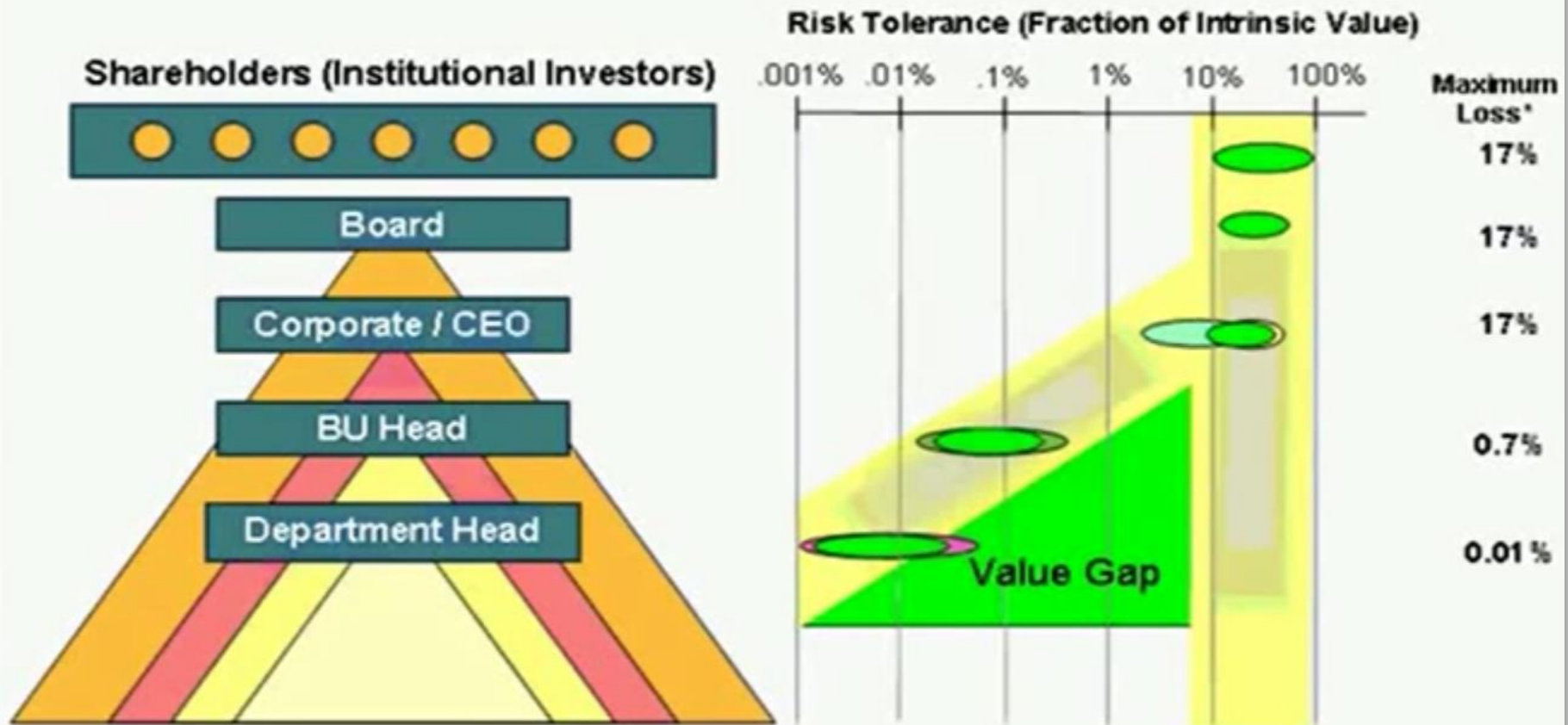


* Longer-term value of the company, around which the market capitalization fluctuates.



Are we consistent in applying risk appetite?

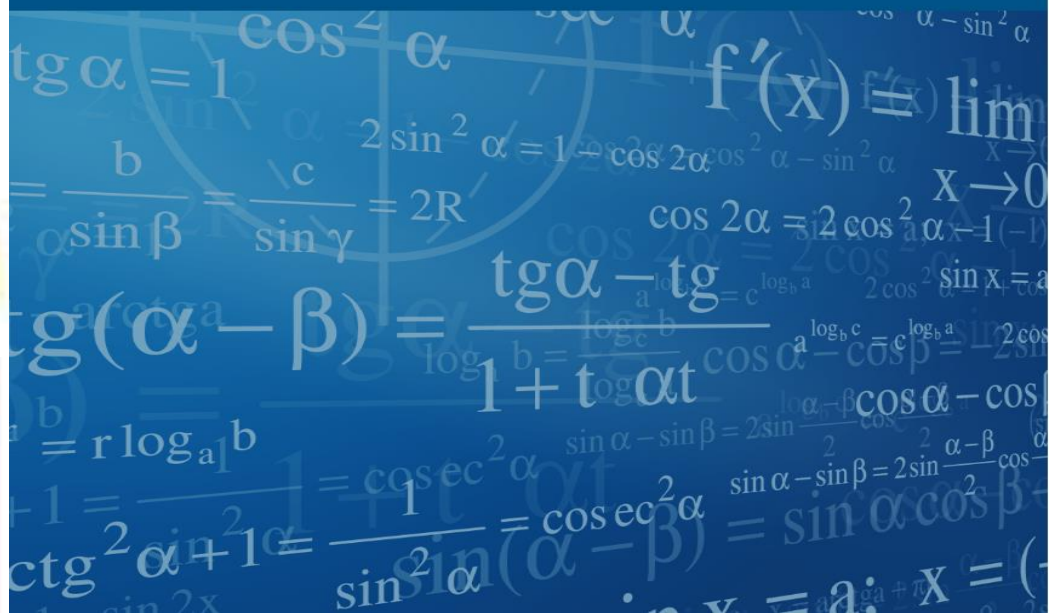
... creating a value gap.





3. Lessons from Milliman Risk Institute Survey on value creation from ERM

**Creating value through
enterprise risk management**

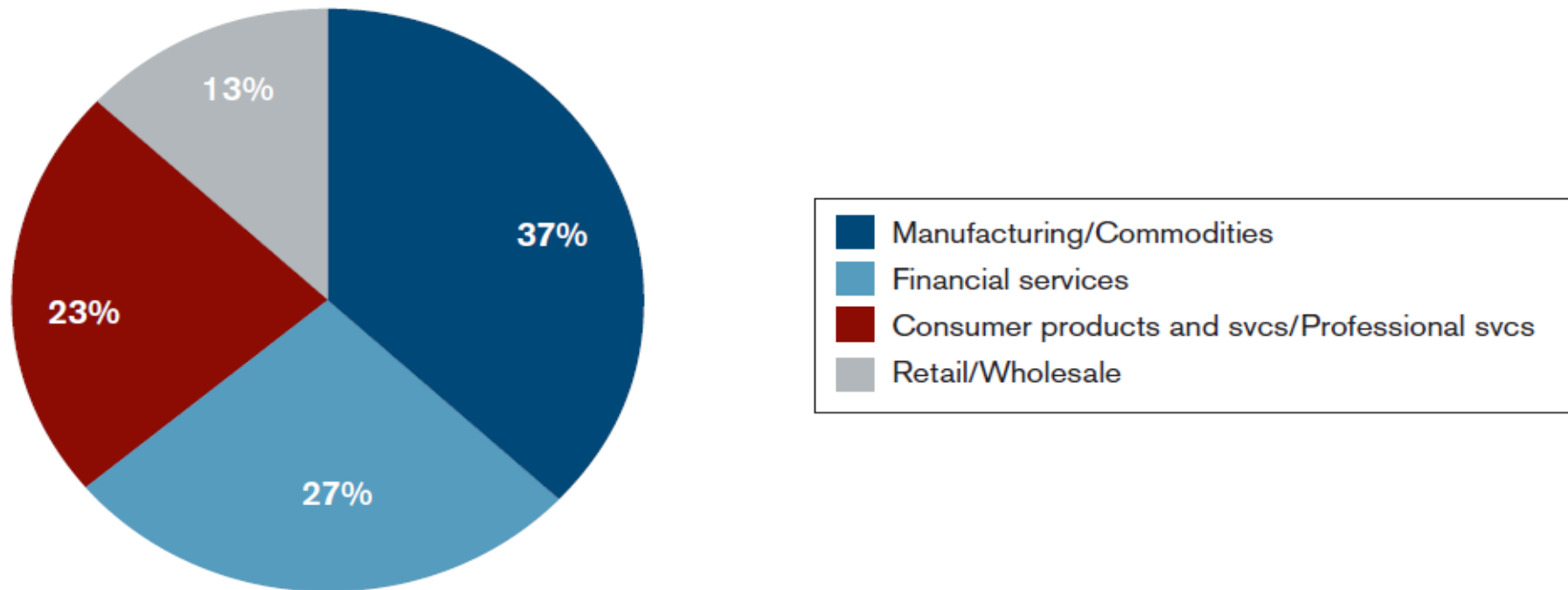


**“I see [ERM] as a way to
be successful. I see it as
a must-do in order to be
competitive on a global
basis and to respond to
our shareholders.”**

**— Brian W. Merkley, Global
Director, Corporate Risk
Management, Huntsman
Corporation**



Who took the part in the survey?



Responses were received from 125 risk professionals representing organizations with minimum turnover of USD 100M per annum in North America



What measures were used?

- Embedding ERM in the strategic planning process
- Implementing a proactive and forward-looking risk strategy
- Maintaining timely, high-quality data related to risk
- Linking corporate- and business-unit-level risk tolerances
- Giving ERM a strong role in the budgeting process
- Creating more data-driven ERM processes
- Collaborating closely with internal audit
- Integrating compliance across the organization



Key question 1: ERM & Corporate planning

To what extent do you agree with the following statements about your company's risk management practice? [scale of 1-5 where 5 is Strongly agree]

	Total	Trendsetters	Transitionals	Beginners
It is embedded in our strategic planning process	57%	94%	57%	32%
It is proactive/forward-looking	52%	88%	49%	40%
It maintains timely, high-quality data related to risk	50%	100%	50%	20%
It links corporate- and business-unit-level risk tolerances	48%	75%	46%	36%
It plays a strong role in the budgeting process	48%	31%	58%	24%
It is becoming more data-driven	41%	100%	38%	12%
It collaborates closely with internal audit and compliance	38%	88%	33%	20%
It is integrated across the organization	36%	81%	33%	16%



Who are the Trendsetters?

To define extent to which companies were creating value through ERM, differentiation of Question 1 was made. The scores were added across the 8 categories of risk proficiency from Level 1 (strongly disagree) to level 5 (strongly agree) to produce the following 3 groups.

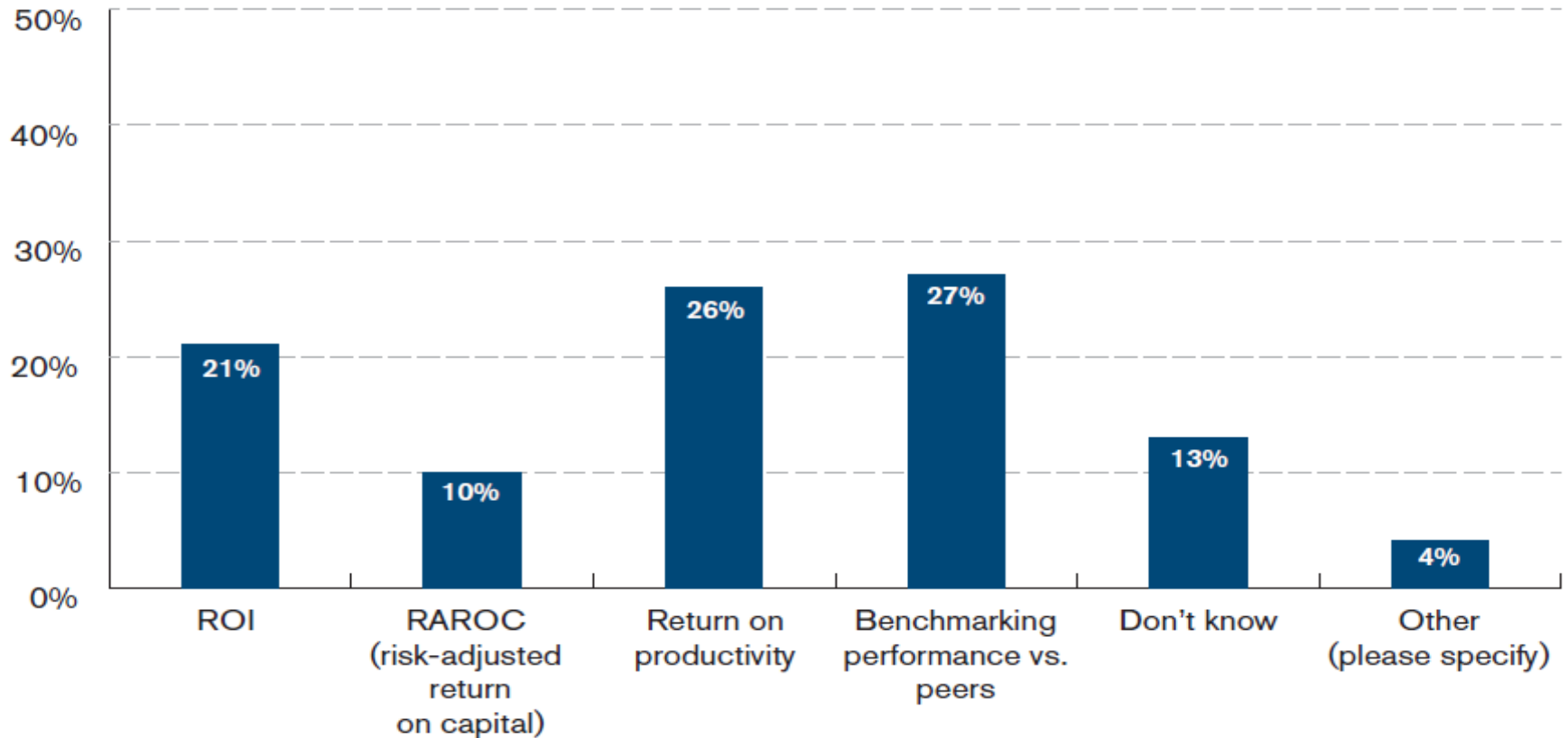
- Companies scoring 30 or higher we identified as Trendsetters; 16 companies qualified.
- Companies scoring 24–29 we identified as Transitionals; 84 companies qualified.
- Companies scoring below 24 we identified as Beginners; 25 companies qualified.

Over 2/3 of the trendsetters are financial services firms. Trendsetters were also majorly larger companies where over 62% reported \$2billion annual turnover



Key Question 2: Measuring ERM value

How does your company measure the cost benefit of its ERM program?





Measuring the value

From the survey companies were seen to be using at least one of the following to measures the value of ERM. However, no method has emerged as a best practice. The most widely used are:

1. Benchmarking performance against peers (27%)
2. Return on Productivity (26%)
3. Return on Investment (21%)



Key Question 3: ERM Execution

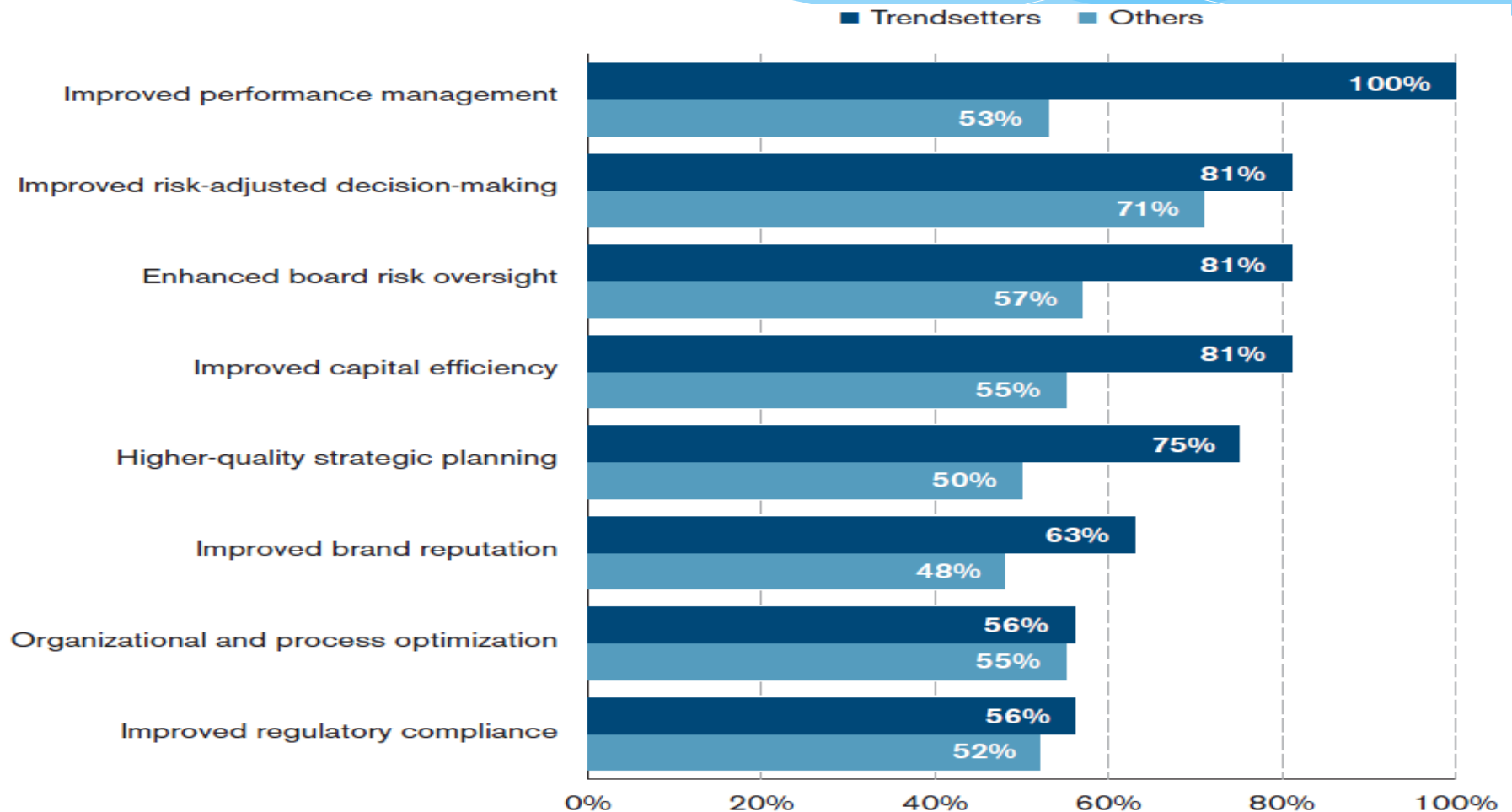
Which of the following statements about your company's management and Board do you agree with?

	Total	Trendsetters	Others
Have a decision-making framework for deployment of risk mitigation or control capital	56%	69%	54%
Have a contingency planning/crisis management process in place	54%	88%	50%
Regularly monitor or audit ERM program to evaluate its effectiveness	51%	81%	47%
Have a management- or board-level risk committee	42%	75%	38%
Embed a risk-aware culture throughout the organization	42%	69%	39%
Integrate ERM with performance management	35%	56%	32%
Require risk-adjusted budgets	33%	19%	35%
Model and understand the impact of a combination of catastrophic risk scenarios	31%	44%	29%
Require risk-adjusted capital requests	23%	19%	24%



Key Question 4: ERM Gains

To what extent does ERM create significant value for your company in the following areas:





How can your organization become a Trendsetter?

Closer attention to ERM implementation and adoption of a fuller spectrum of tools and techniques ERM makes available emerge as key differentiator between Trendsetters and Transitionals.

There are 6 main best practices that Trendsetters do differently to enable them turn more proficient ERM into greater success at value creation:

1. **Closer collaboration with top management**
2. **Better use of Risk Appetite statements**
3. **Linking risk tolerances at the corporate and business unit levels**
4. **Advanced tools and methodologies**
5. **More frequent ERM audits**
6. **Taking more proactive approach**

End note

As the world of risk & risk management continues to rapidly evolve, it is important to remember that ERM processes and activities can offer immediate value while iterating and becoming more mature over time.

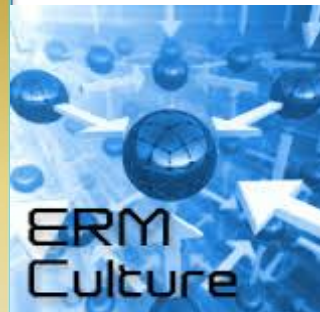
As Members, we challenge ICPAK to carry out a similar survey for Kenyan organizations to provide a basis of continued investment in ERM for value addition and competitive advantage rather than just for compliance.



4.0 Discussions, Questions and Answers

“Properly implemented, ERM can help organizations pursue strategic growth opportunities with greater speed, skill and confidence by aligning the organization’s risk taking with its core competencies and risk appetite..”

- Protiviti, 2016



My Contacts



Phares Chege

Head of Internal Audit , Risk and Compliance

Siginon Group

Head Office | Seaview Plaza, 3rd Floor,

Mama Ngina Drive | P.O. Box 99646-80107,

Mombasa – Kenya

T: +254 (0)20 2354076

M: +254 (0)721 411504 or +254 (0)733 411504

Email: pchege@siginon.com

Website: <http://www.siginon.com>

Thank you
for your participation!

