The Enterprise Risk Management Seminar:

Topic: Hedging Enterprise Risk and Corporate Values

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Uphold public interest

Presentation Agenda

❖ Background

❖ Risk Culture

❖ Aspects of a Risk Culture

❖ Assessing Risk Culture

❖ Case Studies

❖ Conclusion

Background

Definition of ERM

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.

COSO Enterprise Risk Management – Integrated Framework

Understanding Corporate Values

❖ The **fundamental beliefs** upon which your business and its **behaviour** are based.

❖ They are the **guiding principles** that your business uses to manage its internal affairs as well as its relationship with customers.

It's not just about coming up with your values. It's about living them. This really is culture.
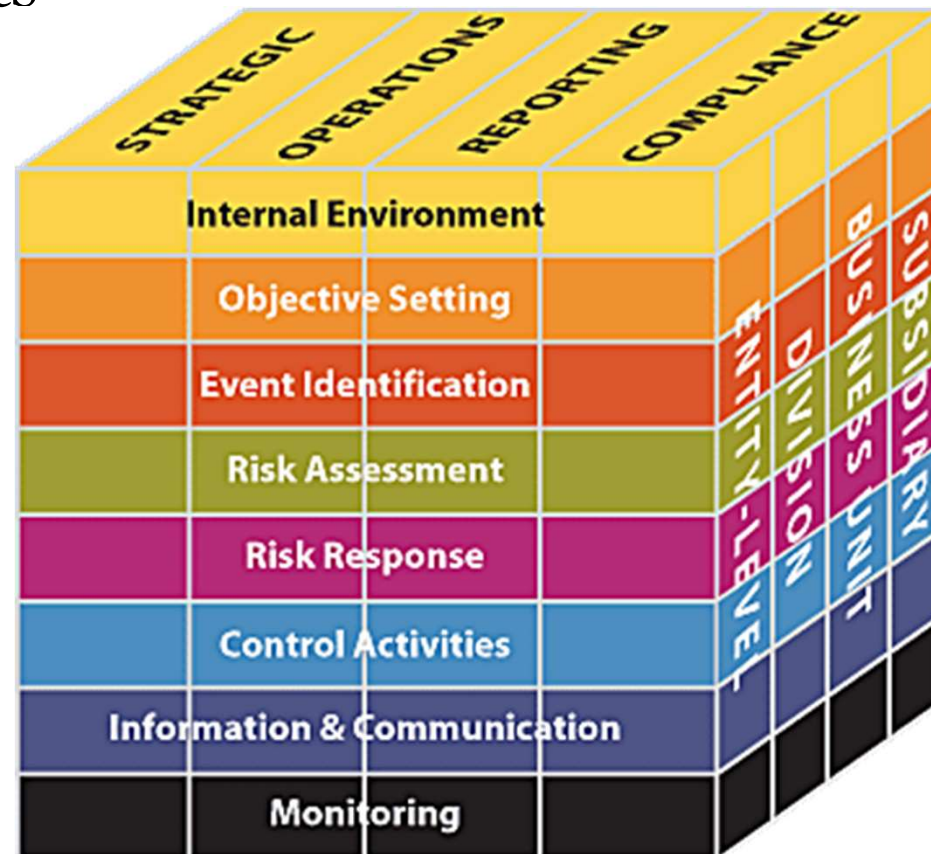
What is Culture?

'the way we do things around here'.

COSO ERM Framework

The eight components of the COSO *ERM* Framework are interrelated ...

The Internal Environment

❖ The internal environment is influenced by an entity's history and **culture**.

❖ It establishes an entity's risk management philosophy: the set of **shared beliefs and attitudes**.

❖ The impact of an ineffective internal environment can be far-reaching, possibly resulting in financial loss, a tarnished public image, or a business failure.

ISO 31000:2018

Principles of Risk Management, Risk Management Framework & Process
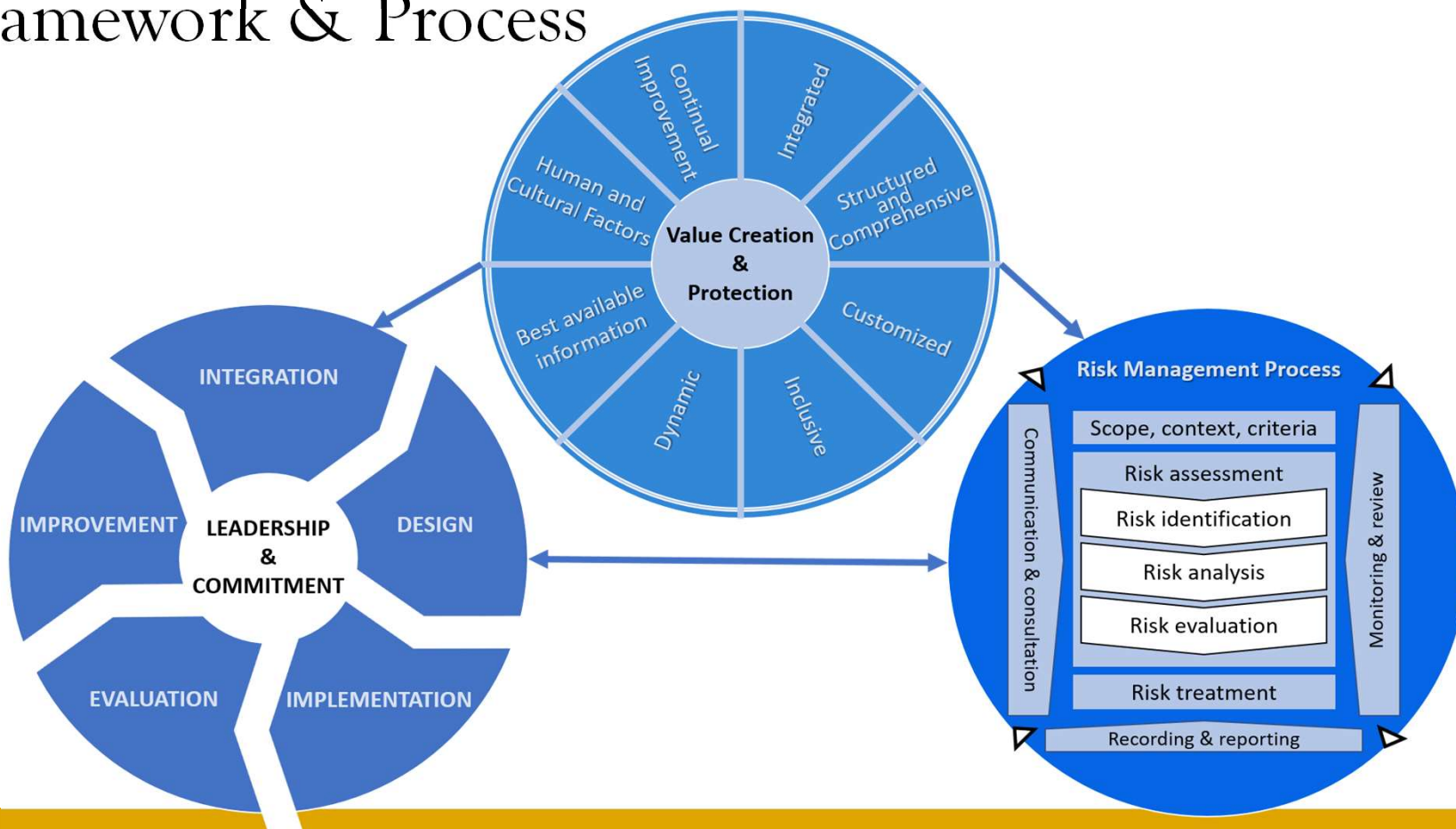
Human and Cultural Factors as a Principle of Risk Management

❖ Human **behaviour and culture** significantly influence all aspects of risk management at each level and stage.

❖ The responsibility for risk management should be clearly defined and those responsible held accountable for the risks they are required to manage.

Risk Culture

Risk Culture: How to Get it Right

The Chartered Institute of Management Accountants (CIMA) published a paper on Risk Culture; in partnership with other Organizations in 2018.

Risk Culture

A company's "norms and the collective **attitudes** and **behaviours** of its people that influence risks and impact outcomes."

Key terms in defining culture:

Values - Principles or standards of behaviour. ***A judgment of what's important in life.***

Attitude - A settled ***way of thinking or feeling*** about something.

Risk Culture....

Risk Culture....

The Institute of Risk Management uses an A-B-C approach to understanding how risk culture works in practice:

- The **Culture** of a group arises from the repeated **Behaviour** of its members;
- The **Behaviour** of the group and its constituent individuals is shaped by their underlying **Attitudes**;
- Both **Attitudes** and **Behaviour** are influenced by the prevailing **Culture** of the group

Risk Culture….

Risk culture is the **foundation** upon which any successful enterprise risk management (ERM) programme is built. Without a good risk culture, even the best **frameworks, policies and processes** will not pre-empt adverse outcomes for a company.

It's said that **"Culture eats strategy for breakfast."**

Building a Good Risk Culture

- Businesses should develop their own risk culture which best **aligns with their purpose and goals**.

- Establishing a good risk culture can help the business leader ensure that the entire company acts in a **consistent** and **systematic manner** which is deemed as responsible and acceptable behaviour.
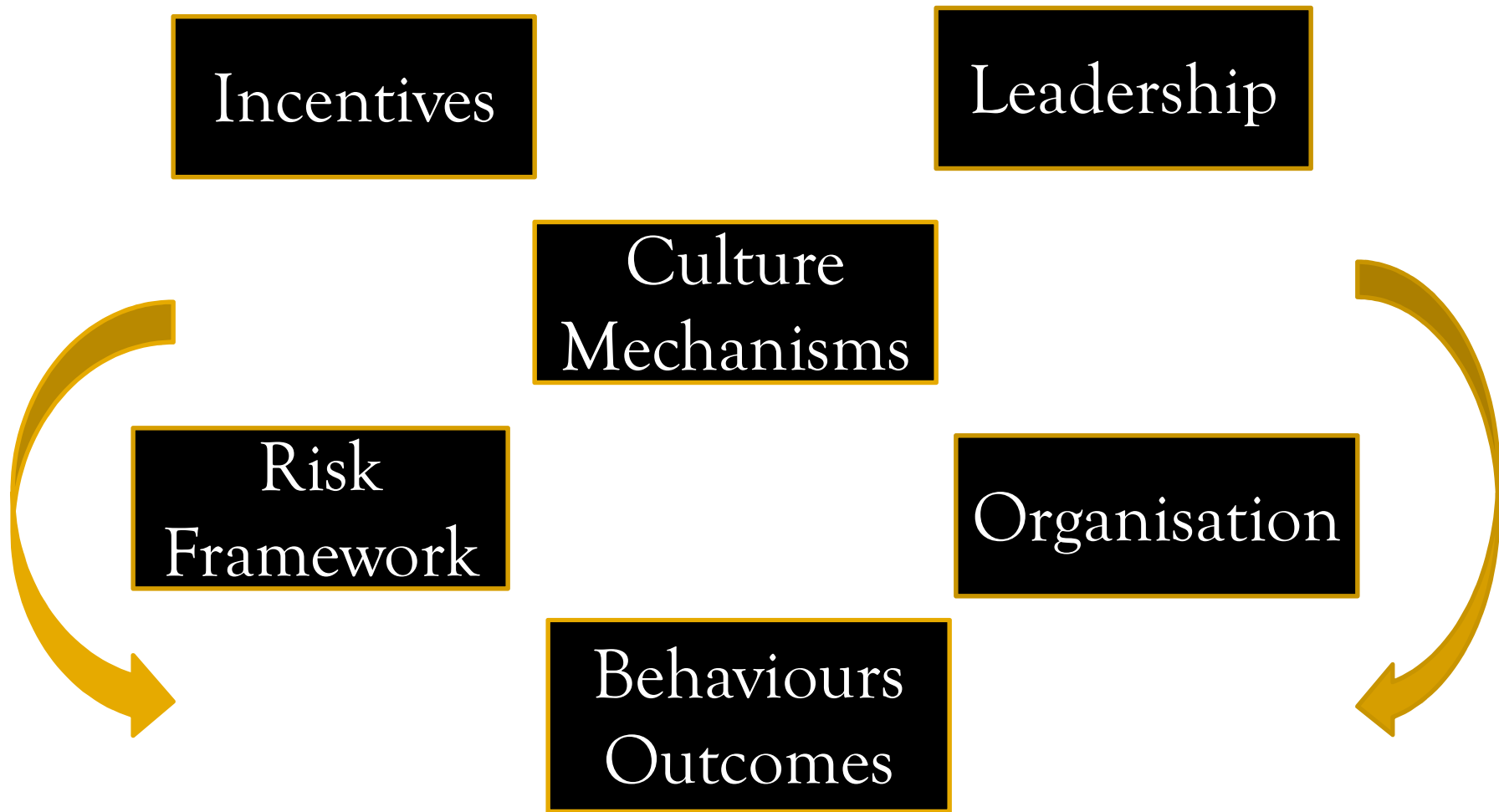
Building a Good Risk Culture ……

❖ To build an appropriate risk culture, a variety of **hard and soft mechanisms** often need to be in place.

❖ When they function effectively, these mechanisms contribute towards delivering the desired **attitudes and behaviours**.

❖ In turn, these attitudes and behaviours provide a positive feedback loop for such mechanisms, thereby creating a **virtuous circle**.

Interaction of Hard and Soft Mechanisms ...

- ❖ Structures are the necessary hard mechanisms, but they are not sufficient by themselves.

- ❖ A good risk framework is not a magical cure-all.

- ❖ Structures do help, such as in improving transparency with the way things work in a company.

- ❖ Soft mechanisms, in the form of attitudes and behaviours, are also important in building a good risk culture.

Interaction of Hard and Soft Mechanisms

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Incentives

Leadership

Culture
Mechanisms

Risk
Framework

Organisation

Behaviours
Outcomes

Interaction of Hard and Soft Mechanisms …

❖ Culture mechanisms and behaviours outcomes reinforce each other through a virtuous circle.

❖ Culture mechanisms in themselves are underpinned by **incentives, leadership, risk framework and organisation**

Interaction of Hard and Soft Mechanisms ...

❖Behaviour outcomes comprise the traits of being:

❖Responsible and accountable;

❖Collaborative;

❖Ethical and compliant;

❖Communicative;

❖Adaptable;

❖Able to advocate for good outcomes; and

❖Able to analyse and interpret what the best decisions for the company are.

Attitudes

Frank and open discussions

There should be a willingness on the part of the company leadership to accept contrarian views to add to the robustness of decision making. The company leader should acknowledge that risk is multi-faceted, and that no one person knows everything, or what is best.

Attitudes .....

Communicating risk appetite and risk tolerance

❖A clear definition of what are desirable behaviours and actions, and what are not is necessary for a good risk culture.

❖A **risk appetite statement** sets out the type and amount of risk that a company is willing to take in order to meet its strategic objectives.

❖A **risk tolerance statement** more narrowly sets out the acceptable level of variation around the company's objectives

Behaviors

❖These are externally observable messages, decisions, and actions that Management and staff project

❖The behaviour of the company leadership are crucial to signalling to all staff the company's attitude towards risk.

❖There should be clear consequences for individuals found to have breached the expected ethical behaviour.

Structures and Processes

There is an interlocking, interdependent relationship between attitudes & behaviours and structures & processes.

Alignment of remuneration with behaviours

The assessment of KPIs and the eligibility for rewards should include how well a staff member manages risk, rather than just generating ever greater revenues or achieving targets.

Structures and Processes ...

Whistle-blowing and feedback channels

Having safe whistle-blowing channels, as well as feedback channels more generally, will allow wrongdoings to be reported more easily without fear of negative repercussions.

Structures and Processes ...

Education and training

❖ Structures and processes may already be in place within a company but are not functioning properly

❖ Education and training to familiarise and create awareness why the structures and processes are necessary enhances understanding of the rationale for those frameworks

❖ A team that understands can then confidently say *"this is how we do things here"*

Assessing Culture

Assessing Culture

There are a variety of tools and mechanisms to support the establishment of a good risk culture within a company. These include:

❖Analysis and assessment of the mechanisms in place, through the use of interviews, group sessions and the review of documentation.

❖Use of a questionnaire focused on the behavioural elements, to be answered by the organization's employees.

Assessing Culture ...

The results give an insight into the current risk culture maturity level and indicates if any behaviours are below the desired standards which would then need further attention.

Risk culture dimensions include:

❖ Tone from the top: Managing risk is top of mind for senior executives.

❖ Behavioural model: Seriousness is demonstrated in actions where comprise on operational standards is unacceptable at whatever cost.

Assessing Culture ...
Risk culture dimensions ...

❖ **Roles and responsibilities:** Consistency in effectively managing risk is through clarity on roles, responsibilities and accountabilities.

❖ **Governance:** Risk management is both formally and informally kept top of mind.

❖ **Risk appetite:** Clearly articulated and cascaded throughout the organization.

❖ **Risk transparency:** People have no hesitation in raising issues knowing they will be dealt with appropriately.

Assessing Culture ...
Risk culture dimensions ...

❖ Employee life cycle: People's aptitude for risk management is considered at recruitment, performance review, promotion and learning.

❖ Rewards: Motivation, assessment and reward of people ensures consistent delivery of good risk outcomes for the organization, its customers and stakeholders.

Case Studies

The Case of Ford

- When Alan Mulally took over the top job at Ford in 2006, the 100-year-old carmaker was on the road to insolvency.

- When he retired eight years later however, he left behind a business in robust financial health.

- "I knew that if we were to be successful with our plan, we had to break through the culture, where there was little sharing and where people were afraid to share how things really were,"

The Case of Kodak

Good Risk Culture is not Risk Aversion. Taking calculated risks is healthy, and risks should be part and parcel of business management and innovation.

Kodak's film and camera business was obliterated by digital photography. A Kodak staff member Steven Sasson, who built the first ever digital camera, back in 1973 was faced with the disinterested response of his company, which insisted that none of their customers were complaining about conventional cameras.

The Wells Fargo case

Despite Wells Fargo's reputation as a "paragon of risk management" that had all the necessary risk management measures in place, it was its **culture of a high-pressure sales environment** that was responsible for the wrongdoings. That was the conclusion of the post-scandal independent investigation.

In September 2016, Wells Fargo was issued a combined total of US$185 million in fines for creating over 1.5 million checking and savings accounts and 500,000 credit cards that its customers never authorised.

The Titanic Disaster

https://youtu.be/yxdRTaAp5Fw

Conclusion

In Conclusion

❖ A good risk culture can be a source of competitive advantage in the market.

❖ While most aspects of culture are internal and invisible – and hence hard to measure precisely and monitor – they are nevertheless a critical component of the effectiveness of any risk management systems put in place by a company.

A Quotable Quote

"Business people need to understand the psychology of risk more than the mathematics of risk."

— Paul Gibbons.

Interactive Session

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