RISK TAKER vs. RISK MANAGER

Building a Bridge Between Strategy and Risk Management

by Jessica Wasserman

RIMS Executive Report
The Risk Perspective
RISK TAKER vs. RISK MANAGER

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As the preeminent organization dedicated to advancing the practice of risk management, RIMS, the Risk Management Society™, is a global not-for-profit organization representing more than 3,500 industrial, service, nonprofit, charitable and government entities throughout the world. Founded in 1950, RIMS brings networking, professional development and education opportunities to its membership of more than 11,000 risk management professionals located in more than 60 countries. For more information on RIMS, visit www.RIMS.org.
INTRODUCTION

We all know the stories that have shaped the professional world in which we live. Enron and WorldCom are brought down by financial misstatement and subsequent bankruptcy in 2001 and 2002, respectively. Bear Stearns and Lehman Brothers become casualties of the housing crash and economic collapse of 2008. The Deepwater Horizon explosion in the Gulf of Mexico kills 11 workers and results in $20 billion worth of fines for BP. In 2015, Volkswagen is sued by the U.S. government for up to $48 billion for allegedly violating environmental laws in an emissions scandal.

As risk managers, these stories become our stories. They help explain our purpose and justify our actions, reminding business leaders that the risk management function is there to help the organization identify, assess, manage and monitor risks. And many risk managers focus on doing just that.

The risk management process, as it stands, demonstrates an inherent bias towards risks with increased negative impact and decreased positive reward. Part of that bias results from the nature of traditional risk management, which relies on the purchase of insurance to cover financial losses. The other part stems from business history and those stories that shape our profession.

After the collapse of Enron and Arthur Anderson, the U.S. government passed the Sarbanes-Oxley Act of 2002 (SOX). SOX placed increased requirements and responsibilities on organizations’ boards, management and auditors. SOX also increased penalties for fraudulent activities and misconduct. As a result, many boards and management teams took an increased interest in their organization’s defense functions (or lack thereof): namely, risk management, compliance and internal audit. Despite all this focus on risk, there remains a gap that goes unnoticed or untouched by many risk managers: the positive side of risk.

Executives have their own stories that they live by. Mark Zuckerberg creates The Facebook as a sophomore at Harvard University after a previous site, FaceSmash, is shuttered by the institution. Howard Schultz left Starbucks after the original owners dismissed his idea of a coffee bar, only to open Il Giornale, which later bought and merged with Starbucks to become the institution we know today. Indra Nooyi directed the divestiture of Yum! Brands and oversaw the acquisition of Tropicana and the merger with Quaker Oats and is currently working to address change in the marketplace and pivot PepsiCo into a brand that provides customers with healthier food options.

These stories are the stories of growth, innovation and change. They are the stories of risk takers.

Traditionally, risk managers are tasked with addressing risks that can impede the organization’s ability to meet its goals and objectives. Risk takers, on the other hand, are tasked with setting the organization’s vision and addressing strategic goals and objectives. While these two views carry different and distinct responsibilities, there are opportunities for collaboration.

In order to add value to the risk takers in our organizations, we must first delve deeper into our own understanding of both taking and managing risks. To get a “seat at the table,” risk managers need to do a better job of understanding the value of risk and its positive impact in the workplace. Then, we can examine ways to build and strengthen relationships with formal and informal leadership increasing the value proposition of both the risk manager and the risk management function as a whole.

This report will help you build that bridge of understanding between the risk taker and risk manager. It is this bridge that will support organizations in realizing their visions, accomplishing their missions, and meeting their goals and objectives.

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3 Schultz, Howard. Yang, Dori Jones. Pour Your Heart Into It: How Starbucks built a company one cup at a time, Hyperion. Published 1997. pp 63,86, 90
4 http://www.pepsico.com/company/leadership; Accessed online on 11/30/2015.
PART 1 | A BASIC UNDERSTANDING OF RISK AND BUSINESS

To set the stage, risk managers need to understand the relationship of business and risk. For many, risk is a difficult concept to grasp. Usually risk is defined as the possibility of loss or injury, but the idea of risk is more complicated than that. Risk can result in positive or negative outcomes so a more neutral risk definition would be “an objective that is accompanied by uncertainty.”

Understanding, addressing and taking risk is a subjective process. Despite efforts in business to establish a logical relationship with risk, there will always be an element of risk-taking or decision-making that is tied to perception and emotion and influenced by a person’s experience and knowledge. Research conducted by sports psychologist Terry Schneider, for example, concluded that the “more experience people have, the more likely they are to take big risks. But they no longer consider their actions risky.” Her findings tie the understanding of risk to a person’s mental state.5

With this in mind, a smart risk taker is one who uses an active decision-making process that includes deep consideration of risk, including both positive and negative impacts, and then develops a strategy based on that analysis.

Other common perceptions can also influence risk-taking philosophies. For example, businesses and organizations travel through lifecycles similar to those biological ones we all experience. While there are a number of different versions of industry and business lifecycles, businesses typically encounter the following four phases: formation, growth, maturity and decline. Not every business encounters the same four-phase lifecycle. Some businesses do not make it to maturity. Other businesses experience revival during their descent that throw the businesses back into the growth and maturity phases. Despite variances in business lifecycles, research concludes that businesses are more willing to take risks when they are young and growing then when they are mature. This is due to factors like internal and external stakeholders, organizational value, and founder involvement. People adopt a similar view of risk when it comes to their own careers. A person may be more willing to take risks earlier rather than later in his or her career. Reasons for this observation center around young professionals’ responsibilities and investment in a particular job or industry. As a person ages, they may become less willing to take risk when it comes to money and career. Older CEOs may be more willing to hold the status quo if they will be retiring soon. This attitude is seen throughout many organizations today, and poses a risk to the organization.6

This may be changing, however. Thanks to the digital revolution and globalization of business, we are seeing an increase in innovation, disruption and competition. Holding onto the status quo is becoming a more difficult proposition for organizations.

DISCLAIMER
Due to the subjective nature of risk-taking, a risk manager should not assume these statements to be true of his or her organization. In order to build a better organizational profile, risk managers should work to understand the culture of an organization and priorities of the executive team. This can be done through conversations with appropriate stakeholders and reviews of annual reports and statements and third-party articles or white papers. Smart risk-taking requires research and a well-thought-out approach.

PART 2 | THE RISK TAKER

Risk takers are innovators. Risk takers are change makers. Risk takers are leaders.

In a 2001 Harvard Business Review article titled, “What Leaders Really Do,” John P. Kotter, retired Harvard Business School professor and founder of Kotter International, explained that there is a distinct difference between the functions of leaders and managers. Leadership is about “coping with change,” while management is about “coping with complexity.”

Both functions involve activities like “deciding what needs to be done, creating networks of people and relationships that can accomplish an agenda, and then trying to ensure that those people actually do the job. But each accomplishes these three tasks in different ways.” Leaders set direction, align people, and motivate and inspire. Managers plan and budget, organize and staff, control activities and solve problems.7

Over the past few decades, we have seen changes in the marketplace and workplace such as increased disruption from technological innovations; decreased loyalty among employers, employees and customers; and easier access to global markets and resources. In addition, CEOs of public companies face the threat of activist investors, hedge funds or other investment companies that buy up large stakes in companies and then push for changes ranging from divestitures to stock buybacks.8 These changes are requiring executives and their organizations to take more risks.

For example, McDonald’s and other fast food restaurants are experiencing disruption on multiple fronts. Changes in customer food preferences have led to the rise of “better burger” chains and other fast casual restaurants like Five Guys and Shake Shack. In addition, McDonald’s and its franchisees face a substantial rise in costs due to changes in healthcare regulations and efforts to increase the minimum wage.

In response, McDonald’s has been taking risks in order to address the significant challenges that the company faces. In his 2014 annual report letter to shareholders, president and CEO Steve Easterbrook said that the company plans to reset the business in terms of “how we think, how we make decisions, and how we

organize to put consumers at the forefront of everything we do.”’ McDonald’s introduced McCafe in 2009 to address the growing demand for coffee, smoothies and shakes. More recently, the company instigated all-day breakfast options to appeal to the customers that love their Egg McMuffins. In order to address the strategic risks McDonald’s faces, Easterbrook has actually encouraged the organization to take more risks.

Executives like Steve Easterbrook understand that taking risks is an important part of their roles as leaders within their organizations.

CURRENT PROCESS FOR TAKING RISKS

If you ask a CEO or other executive to explain the process they use for taking risks, you will most likely hear about a process that sounds very similar to the enterprise risk management (ERM) process. The executive identifies the opportunity. The executive then researches the opportunity by speaking to key stakeholders and other subject matter experts. The executive will consider organizational tolerance (e.g., financial tolerance, alignment with vision, etc.), likelihood of success and/or failure and impact to the organization, and ways to mitigate the risk of failure (e.g., exit strategy). This process tends to be more informal than an ERM process and may involve select individuals.

Executives and functional leaders certainly look at and think about risk, but it is often a more intuitive process. “It’s like a person who skis,” said Glenn Brady, a PwC advisory partner specializing in operations, risk and compliance. “A skier doesn’t conduct a full assessment of skiing conditions and risks before they step onto the lift. An experienced skier may make a mental note of the patch of snow under the shaded tree to the right which may be icy. He may look at the group of young children taking ski lessons at the bottom of the mountain. Rather than developing specific course of actions to mitigate these risks, he may look respond to them in a broader sense and decide to avoid skiing anywhere near the tree or the kids.”

According to Brady, leaders also tend to innately think about risk. “They think about business and options in a broader scope,” he said. “For instance, if a company wants to enter India, when making the strategic decision, a leader may consider different needs to accomplish his or her mission. Do we have the appropriate legal advisor and structure to enter the market? Do we have the needed licenses to operate in the country? While executives address risk through these considerations, they are not using the ‘risk’ label to discuss the strategy and operations of the organization. They don’t look at the opportunity and decision through a red, yellow, green dashboard.”

Matt Wenger, CEO of ThinkTank, a digital workplace collaboration software provider, brings together ThinkTank’s executive team to discuss risk-taking opportunities. He consults with leaders from finance, technology, marketing and sales, and operations. He says that taking risks requires more consideration as companies grow and build business.

In addition to taking risks, executives and organizational leadership address top risks that can prevent the organization from executing its vision, strategy and mission. Wenger categorizes the types of risks he addresses in his leadership role in three ways: 1) risks as they relate to the organization’s strategy; 2) risks that fall under operational opportunities; 3) day-to-day operational risks that are inherent in every business. While he outlined his approach to addressing risk, he typically does not start off by thinking about risk. He starts off thinking about opportunities for the organization.

Wenger’s comments reveal that the risk-taking process for executive leaders in an organization can be a very structured and thought-out process.

New York University Leonard N. Stern School of Business Professor Aswath Damodaran reinforced the idea that leaders and employees should engage in smart risk-taking. Damodaran said that there are a few key elements that successful risk-taking organizations have in common. First, interests are aligned between decision makers and business stakeholders. Second, these organizations select or align the best people to complete the task. Third, there are appropriate reward mechanisms in place to encourage the good and discourage the bad risk decisions. Last, organizational leadership establish an organizational culture that is “conducive to sensible risk taking.”

One leader that has established a corporate culture that values sensible risk taking is the LEGO Group’s CEO Jørgen Vig Knudstorp. Knudstorp joined the LEGO Group in 2001 and took over as CEO in 2004. At the time, the company was in a bad position. “By 2004, when I became CEO, things had gone awfully wrong at LEGO Group,” Knudstorp said in a 2009 Harvard Business Review article. “To survive, the company needed to halt a sales decline, reduce debt and focus on cash flow. It was a classic turnaround, and it required tight fiscal control and top-down management.” As a result, the company had to be risk averse during that period. But once they brought the company back to a healthier position, they were able to focus on strategy and growth, which required taking greater calculated risks.

In 2006, leadership asked Hans Læssøe, then a LEGO Group strategic controller, to explore and advise on strategic risk management. Læssøe expanded the company risk management program to include an explicit strategic risk management process. “It is my job to ensure risks and opportunities are balanced,” Læssøe said. “It is just like parenting. As a parent, it is not your job to ensure that your children do not get hurt, but only to ensure they do not suffer permanent injuries. It is cynical perhaps, but being hurt from time to time is the only way to learn and grow.”

To help provide management with more insight and information around strategic risks, Læssøe leveraged more quantitatve tools like scenario planning and Monte Carlo simulation. “It did help me where, just one or two years after I started [as SRM director], I presented an analysis based on the Monte Carlo simulation tool to our corporate management. My CEO, who holds a Ph.D. in mathematics, acknowledged the analysis and approach and then stated that now we can, as he said, ‘stop discussing whether or not my efforts create value to the company.’ This supported the buy-in and backing of our C-suite,” Læssøe said.

In an organization, the risk manager role has steadily grown in importance over the past two or three decades. While the idea of, and activities relating to, risk management have been around for hundreds, if not thousands of years, the modern-day risk management organizational function is relatively young in comparison. Risk management functions initially focused solely on insurance operations and risks with financial impact that could be transferred through the purchase of insurance.

In the 1970s and 1980s, academics and practitioners started tossing around the idea of a more holistic approach to risk management, one which would later become known as enterprise risk management. ERM focused on addressing all risks that an organization faces. By 2010, different organizations like the Committee of Sponsoring Organizations of the Treadway Commission and the International Organization for Standardization published guidelines and principles addressing ERM. With the collapse of Enron, WorldCom, Lehman Brothers, and Bear Stearns, leadership realized that their respective organizations that attempt to identify and address those risks that could result in significant negative impact to the organization.

The result was the creation of a new function to, as John Kotter put it in his Harvard Business Review article, help organizations manage control activities and solve problems. Boards and leadership now look to ERM functions to provide an additional level of assurance that risks are identified, assessed and managed. (For an example of ERM in action, see the University of California sidebar on pg. 5)

STRATEGIC RISK MANAGEMENT

As ERM evolves, there is this realization that ERM and risk professionals can add further value as organizations develop and execute strategies. Most recently, mature ERM functions are looking to build out complementary strategic risk management (SRM) services for their respective organizations that attempt to identify the intersection of risk management and strategic planning and execution to not only reduce uncertainties, but seize opportunities and create value.

While ERM typically includes the identification and management of strategic risks, the value that an ERM program can provide is limited due to the scope of organizations’ risk portfolios. By focusing on strategic risk management, organizational risk programs are taking an even more proactive stance to addressing risks as well as helping leaders take smarter risks.

SRM can take many forms depending on the needs and processes of individual organizations. But while the LEGO Group and Caterpillar, Inc., for example, implemented SRM activities in different ways (see the LEGO Group and Caterpillar sidebar on pg. 6), there are a few common conditions that need to be met in order to have a successful program. According to Hans Læssøe, senior director of strategic risk management at the LEGO Group, and Dr. Eng Seng Loh, manager of strategy and business risk management at Caterpillar, executive support is required for success.

When implementing SRM at the LEGO Group, Læssøe had to embrace the upside of risk. A fundamental part of organizational growth requires businesses to take risks. SRM is really about focusing on that growth and determining how the organization will get there. Conversations with management had to be positive and proactive. Læssøe obtained full buy-in from company executives, which was important in building out this new SRM initiative, and he worked with the executive team to further understand the LEGO Group’s strategy and its development, implementation and execution.

Likewise, Caterpillar’s executive team also supports the process and appreciates the results the come from its business risk management (BRM) program, which consists of both ERM and SRM activities. When hired, new department leads accept risk management as part of their roles. The BRM process also includes leadership risk assessments. Leaders across the organization come together every year for an in-depth discussion of risks facing the business.

This leadership support comes in handy when embedding ERM into business operations. Both organizations emphasized that responsibility and accountability for risk management

ERM IN ACTION: UNIVERSITY OF CALIFORNIA

The University of California (UC) system has a robust ERM program to help ensure that risks are identified, assessed and mitigated across a complex system of 10 campuses, five medical centers and three laboratories. The system-wide UC ERM function is led by Carrie Frandsen, ERM program manager, and supported by an organized group of councils, committees and working groups. Each campus develops and submits an annual risk plan that reflects their key organizational risks and most of the ERM risk process activity is managed through committee networks.

Campus leadership reviews and approves the plans, allocates resources, and assigns mitigation activities to the appropriate risk owners. Risk, compliance and internal audit offices strive to coordinate risk activities. For instance, once management has developed controls for an identified organizational risk, internal audit may include the new controls in their audit plan. Risks that are complex and affect many functional areas are escalated to different leaders throughout the UC system to develop risk management protocols and some are raised to the audit committee or full Board of Regents. In addition, some risks are identified outside a formal risk assessment structure through less formal processes where conversations about risks bubble up to the attention of UC management and leadership.

System-wide, UC Risk Services works to provide UC risk managers and others with risk-related guidance, tools and resources that are tailored to their business needs. The Risk Services Office also hosts an annual, two-day Risk Summit that helps UC’s risk practitioners share best practices, refresh or learn new skills, and discuss key risks affecting the higher education industry.

As the ERM field becomes more data-friendly, Frandsen has also begun to incorporate new tools and technology, such as benchmarking and GRC platforms. The UC system also leverages business intelligence, metrics and scenario-planning to better understand risks.
and monitoring exist with the business units and functions. The LEGO SRM team reports out on the organization’s risk profile, but stays detached when it comes to risk activities and monitoring of those risks assigned to the business risk owners. Similarly, Caterpillar’s BRM process focuses on leaders identifying top risks that impact business unit and organizational strategy.

This ability to separate the risk management functions from the day-to-day activities and monitoring activities allows risk management functions to focus on other value-add activities (e.g., Monte Carlo simulation, trough planning, scenario planning).

Læssøe believes that the evolution of ERM and SRM will continue to move businesses forward. “An organization cannot build a competitive advantage on cost savings,” he said. “The number of changes to business and the world in the next decade will be more than those that have occurred over the past 50 years. An organization’s ability to move right or left, speed up or slow down will be a competitive advantage.”

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## SRM IN ACTION

### LEGO Group

- **Established**: 1931
- **Employees**: 17,000+
- **Revenue**: 35.8 billion (DKK)

**Program Overview**

- **Structure**: The LEGO Group ERM Program consists of operational, financial, hazard, IT, legal, as well as strategic risk management. The LEGO Group also conducts proactive risk management, which consists of “Active Risk and Opportunity Planning (AROP)” and “Prepare for Uncertainty” activities.

- **Owners**: Business unit leaders and managers. Executives own top risks.

- **Process**: The LEGO Group ERM process occurs on a continual basis. The ERM risk profile consists of around 100 risks. Risks are reviewed on a semi-annual or bi-annual basis. Timing of the review depends on type of risk. Around 40 risks are updated every six months. Risks are prioritized on likelihood and impact and prioritized using a heat map. When reviewing the risks, the SRM team asks risk owners and selected challengers about their knowledge regarding risk management and monitoring activities.

- **Tools**: Excel spreadsheets, Monte Carlo simulation. Used for consolidation of risk exposure, understanding of risk taking vs. defined tolerances, credit risk portfolios.

- **Strategic/Project Risk Management**
  - **Active and Opportunity Planning**: When the LEGO Group considers a new project, a business case is presented that must address both risks and opportunities for the project. The SRM team created a spreadsheet tool and a process (AROP) that drives the collection, prioritization, treatment and reporting of this project information.
  - **Preparing for Uncertainty**: The LEGO SRM team makes sure that the organization considers future trends and changes in the marketplace. They drive a focused workshop where a leadership team defines key uncertainties related to their strategy, describes the resulting four scenarios, and derives “so what” questions for the issues. Then they use a PAPA model (Prepare, Act, Park, Adapt) to determine the organization’s strategic response.¹⁴

### Caterpillar, Inc.

- **Established**: 1925
- **Employees**: 100,000+
- **Revenue**: 47 billion (USD)

**Program Overview**

- **Structure**: Caterpillar’s Business Risk Management Program consists of ERM and SRM activities. The BRM team has also incorporated trough planning and supplier/dealer risk assessment activities into Caterpillar’s BRM Program.

- **Owners**: Business unit leaders and managers. Executives may own top risks.

- **Process**: Caterpillar’s ERM process is an annual process. The process consists of three core phases. At the start of the fiscal year, the BRM team initiates ERM assessments at the business unit level. Each business unit identifies around five to seven top risks that could impact the business unit’s strategy. Those risks roll up to the Group Presidents level. They are reviewed by leadership and between 15 and 20 risks are selected to roll up to enterprise leadership. Enterprise leadership reviews the risks and selects the top eight to 10 risks for the organization. Leadership assesses risks on velocity, impact and likelihood. Business unit leaders and senior management have to certify that risks are addressed through implementation of the strategy for the unit/division. Business unit leaders are responsible for reporting out progress in addressing and monitoring risks.

- **Tools**: Archer Platform, Online Surveys, Turning Point voting technology, Excel spreadsheets. Used to consolidate results from surveys and run analysis.

- **Strategic/Project Risk Management**
  - **Scenario Planning**: Stress test enterprise initiatives.
  - **Trough Planning**: Sets the organization up to deal with onset of a trough period. Caterpillar’s goal during the onset of a trough is to remain profitable throughout the year. To meet this goal, leaders are encouraged look for cost adjustments to make during a downturn in order to turn a profit.

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PART 4 | BUILDING THE BRIDGE

While there are concrete differences between the risk taker and risk manager roles within an organization, there are also concrete actions that risk managers can take to help build that bridge between the two roles. To reserve that seat at the proverbial table, risk managers need to show the range and depth of value that they can bring to the table.

All too often, risk managers rely on direct value that stems from having a risk management or enterprise risk management function that is concerned with protecting the organization from downside risk and thinking about the issues that others do not want to think about.

Many times ERM is referred to as a defense function, along with internal audit and compliance, that is responsible for detecting and addressing risks and other threats. However, risk management plays an organizational role similar to a midfielder on the soccer field (see Figure 1). Midfield soccer players assist in both defense and offense activities on the field. Midfield soccer players can run up the field to assist the forwards in making goals or they can hold back and provide an extra layer of protection to the goalie. Similarly, risk is a flexible function that can play defense or offense.

Utilizing a specific SRM approach can be leveraged to help an organization’s “offense” functions accomplish those strategic goals. In order to reach some of those strategic and operational stakeholders, risk managers should focus on three key areas: knowledge, communications and output.

KNOWLEDGE

One of the benefits to working in ERM and SRM is the knowledge base that risk managers develop through their various interactions with risk owners and other organizational stakeholders. Because ERM programs report out on a wide variety of risks (e.g., strategic, operational, compliance, information technology, etc.), risk managers tend to learn about the inner workings of different departments and functions throughout the organization. When it comes to those leaders, this holistic insight is highly valuable.

In the book Strategic Risk Taking: A Framework for Risk Management, NYU’s Damodaran states that there are four different advantages an organization or person has when they want to exploit risk. The first advantage is an organization’s access to better and more timely information.
As events occur, organizations can better respond to the prevailing situations. The second advantage is the speed to which an organization responds to changes in circumstances, modifying how and where you do business. The third advantage is the knowledge that an organization and/or individual has from past experiences. This is an advantage that is equivalent to “learning from one’s mistakes (or successes).” The fourth advantage revolves around access to resources (e.g., cash, capital, human capital, etc.) when crises occur. Two of the four different types of advantages organizations have when taking risks revolve around knowledge and information.

“Leaders have to make quick decisions using minimal information,” Damodaran said. “Human instinct is to wait and collect as much information as possible to make the decision. However, leaders do not make impulse decisions. Leaders need to be surrounded by people willing to tell them the truth.”

In order to connect more with executives and other organizational leaders, risk managers should focus on collecting information that is holistic, strategic and timely and ask the following questions:

- **Holistic:** Do I have a holistic overview of the process or function? When reviewing the information gathered, are there any gaps (what, when, where, why and how)?

- **Strategic:** What is the organization’s vision, mission and strategy? Do the business and functional units have strategies that align with the organizational strategy? What are the key risks that can impact the organization from meeting its strategic goals?

- **Timely:** Is this information current? How has the process, initiative, task changed over the years? How is this information going to change in the future? Are there any upcoming plans to change the process, initiative or task?

**COMMUNICATIONS**

Communication is a very important aspect of the ERM and SRM process. Not only does it play an essential part in the identification, assessment, management and monitoring of risks, but it is also key to the risk manager’s value proposition. The risk manager helps break down organizational silos through communication with multiple departments and stakeholders.

The risk manager also communicates top risks to senior management and/or the board. For more effective communications, especially when it comes to communication with leadership, risk managers should consider the following best practices:

**Keep an eye on the big picture.** Enterprise risk management is a function that focuses on the detail. When speaking with risk owners, discussions can quickly turn to the nuances of a particular function or role. When speaking to leadership and management, a risk manager’s role is to weed out those details that are of little concern to the organization. However, in order to understand what is and what is not of concern to the organization, risk managers need to have some frank discussions with organizational leaders. “Ultimately, the company is judged based on financial results” Damodaran said. “The organization’s end game is to increase the value of the business. If you can’t connect ERM to this notion, then you will not make it to the table.”

When describing a good risk taker’s traits, Damodaran also accounts for failure. “They allow for the possibility of losses, but are not overwhelmed or scared by its prospects; in other words, they do not allow the possibility of losses to skew their decision-making processes. They are able to both keep their perspective and see the big picture even as they are immersed in the details of a crisis. In terms of decision-making, they frame decisions widely and focus on those details that have large consequences. Finally, they can make decisions with limited and often incomplete information and make reasonable assumptions about the missing pieces.”

**Be concise.** Executives and organizational leaders tend not to have a lot of time to discuss risk management. They expect information packaged in a way that is concise and gets to the point. If a risk manager tends to be more detailed-oriented, he or she should practice providing information in a clear and simple manner. “You need to recognize the risks that matter and those that don’t,” Damodaran said. “There is a good chance that around 90% of risks pass through the organization. For example, executives and investors of Royal Dutch Shell should not be obsessed about oil price risk, since there is little that they can do about it and furthermore, it is the risk that investors in the company want to see passed through to them. Hedging oil price risk will do little good for Shell’s value, if the company does not face the risk of default or point to substantial tax benefits from the hedging,” Damodaran recommends focusing on those risks that matter. When a company conducts an acquisition, there are typically two or three big risks affiliated with the transaction.

“The business risk management program is geared toward identifying the high probability risks,” Caterpillar’s Dr. Loh said. “We talk about risks up to five years out. It is harder to go out farther than that. There needs to be that sense of urgency.”

**Stay positive.** Risk managers should think about positioning their conversations in a more positive manner. No one wants to develop a “Chicken Little” reputation where the sky is always falling. “If you think back to what risks destroyed the greatest amount of shareholder value over the years, it isn’t those dealing with fraud and compliance, said Christopher Dann, principal with PwC’s Strategy and Consulting Group. “To better understand strategic risks, you have to ask those types of questions that get to the issues that matter. For example, a personal computer manufacturer identifies a risk for major disruption at its southern China plant. ERM managers typically look toward developing a mitigation plan for that type of risk. However, the actual question they should be asking is ‘Why does 100% of the company’s products travel through the port of Los Angeles? Should the company contract with three or four different ports?’” Dann’s recommendation to risk managers is that they need to better convey a value proposition to decision-makers.

As a practical measure, PwC’s Brady advises risk managers to, “focus the conversation on growth strategy and outlook moving forward. If people can focus the conversation to ask questions like, ‘How are you going to do it?’ and ‘Where are you going?’ and ‘What do you need to get there?’ then you can introduce different risks and how to mitigate as the conversation continues. You are creating an understanding with the other person.”

It is also worth noting that as good practice, if risk managers want more interaction with those organizational leaders, then they should look to mirror the leader’s soft skills (e.g., emotional intelligence and executive presence). According to research conducted by the Center for Talent Innovation, gravitas, or the ability to project confidence, poise under pressure and decisiveness is the core characteristic of executive presence.16

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Proof of program effectiveness depends on the output produced by risk managers. Whether the output is a report to management or an internal training deck, it has to add value to its target audience. Program output should be planned in advance and revisited periodically to ensure that documentation of objectives and activities meet and/or exceed audience expectations. When planning output, it is important to consider the following aspects:

**Support data.** Historically, the ERM process focused on qualitative aspect of risk. Traditional risk management dealt with quantifying the financial impact from risk and understanding the statistical probability of a risk event occurring. ERM came about as a way to address and report on operational, process-oriented risks and relevant controls. The typical ERM process allows for risk owners to assess and prioritize risks using somewhat subjective criteria (e.g., best educated guesses for impact and likelihood). Now, with the Information Age in full swing, organizations are looking for risk managers to provide more quantitative support for ERM and SRM activities. Some might argue that quantitative data support for many risks is hard to come by, but while the task may be difficult, it is not impossible. The key is to think through processes surrounding risks and identify those key performance and risk indicators.

**Functional partnerships.** By aligning the ERM and SRM processes to an organization’s budget and planning process, organizations can better plan for risks and the implementation or update of controls. Partnering with the budget and/or strategic planning offices helps further connect the ERM function with the goals of the organization.

Risk managers should also set up partnerships with finance, accounting and treasury functions. While the budget and planning process can inform risk managers about the future, these functions can provide insight into the past. These functions are typically involved in gathering data for annual reporting processes (e.g., external audits, annual reports, annual tax filings, etc.).

Lastly, risk managers should partner with the compliance and internal audit functions. These functions can provide information regarding instances of non-compliance and internal audit findings.

Building inter-departmental partnerships is a great way to not only obtain additional information, but to also access individuals with different skillsets. For example, if a risk manager does not have a Microsoft Excel expert on staff, then he or she can leverage a partnership with another office to obtain a resource with those Microsoft Excel skills needed to complete the task.

**Decision and risk analysis.** In order to move beyond ERM and into a more strategic role, risk managers must become familiar with the data analysis tools that leaders and decision-makers use. “If its meaningful, its quantifiable,” Dann said. Examples of tools that can help risk managers quantify risks are scenario analysis, Monte Carlo simulations, deterministic sensitivity analyses and tornado diagrams (see below).

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**DATA ANALYSIS TOOLS FOR RISK MANAGERS**

**SCENARIO ANALYSIS**

Scenario analysis is an activity that promotes the consideration of different scenarios when making decisions. At the most basic level, one would identify best- and worst-case scenarios. Multiple scenario analysis consists of identifying a few key factors that situational outcomes are based on and then identifying different scenarios for each factor. If possible, one can also assign probabilities to each scenario.

**SENSITIVITY ANALYSIS**

Monte Carlo simulations are used to model the probability of different outcomes in a process that cannot easily be predicted due to the intervention of random variables. 17 The most common way to conduct Monte Carlo simulation is to use an add-on in Microsoft Excel.

**DETERMINISTIC SENSITIVITY ANALYSIS/TORNADO DIAGRAMS**

A type of analysis that helps identify the most important factors that influence a decision’s outcome. The tornado diagram is one of the most popular ways to display analysis results. 18

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CONCLUSION

With more and more ERM functions looking to expand into strategic risk management, a new set of stories will need to be created that reflect the full value risk managers bring to the table. Leaders and risk managers play distinctly different roles within an organization. As organizations face an unseen level of change and complexity, leaders and risk managers will need to come together to address both upside and downside risks.

In order to build that bridge of understanding with leaders, risk managers should focus on advancing their knowledge, communications and output. Risk managers should broaden their knowledge to not only provide in-depth insight, but also to provide that holistic overview that leaders desire. Risk managers should also focus on developing a better understanding of the organization’s strategy and strategic objectives. This information should be timely and up-to-date. When communicating this knowledge, risk managers should focus on providing information that considers the big picture and is concise and positive. Lastly, risk managers need to consider the output that the function or program produces and understand its value to the organization. To strengthen the function’s output, risk managers should incorporate supporting data for activities and leverage that data to conduct risk and decision analysis. Building strong relationships and partnerships is vital to advancing output quality.

The following are some key take-aways from the risk managers featured in this paper:

- Work to convey a strong value proposition to decision-makers. (Christopher Dann, PwC)
- The ERM discipline has an opportunity to evolve towards strategic risk management. A step that ERM practitioners can take is to build their decision analysis capabilities to better engage and support senior leadership with strategic decision making. (Carrie Frandsen, University of California)
- Focus on the risks that matter and understand how the risks flow to organizational value. Leaders need to make quick decisions on minimal information. (Aswath Damodaran, New York University)
- Focus on high probability risks. These risks come with a sense of urgency built in. Constantly work on improving your process and delivering value. (Eng Seng Loh, Caterpillar)
- Focus the conversation on growth strategy and outlook moving forward. (Glenn Brady, PwC)
- Give executives an offer they cannot refuse. Focus on what is in it for the executive and describe concrete value that you can offer. It is not about avoiding risks—it is about taking risks, and managing the risks you are taking. (Hans Læssøe, LEGO Group)