Measuring the Value of Risk Management to Your Organization

ERM005

Speaker:

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A Couple of Disclaimers .......

I speak a foreign language known as:

Straylian

I come from a country where this is formal wear:

And our former Prime Minister is seen in public like this

So please be gentle with me
Learning Objectives

At the end of this session, you will be able to:

• Define performance indicators for your risk program
• Demonstrate the links between risk management and other organizational governance programs
• Adopt a methodology that allows you to demonstrate and quantify risk management benefits
The Risk Management Paradox….

“The task of managing risks effectively is confounded by a classical paradox. That is, if risks are being effectively managed as a matter of routine, there will be very few surprises. Nobody becomes aware of just how effective careful risk-management actions have proven to be. Nobody slaps the manager on the back and congratulates them for a job exceedingly well done. In stark contrast, however, if risks are managed poorly, the whole world lines up to say so”.


What does this tell us?
The Risk Management Paradox....

• So what does the risk management paradox tell us?

  • Being a risk manager is a thankless job and may also lead to being a scapegoat when things go wrong
  • You cannot prove a negative and in risk management there is only a chance that something is going to happen so when it doesn’t – is that a result of good risk management?
  • It is very difficult to measure the effectiveness of the risk management program because if nothing is going wrong, management will put it down to their superb management initiatives and not to sound risk management
  • If you are a risk manager and you are expecting a ticker tape parade you are going to be sadly disappointed
Measurement

• We often hear the term ‘bang for our buck’ or ‘return on investment’ and for so many parts of an organization’s operations, the task of determining whether the activity is adding value to the organization is relatively straightforward.

• Many organizations commit significant resources to their risk management program, but is risk management contributing to successfully achieving the organization’s outcomes and objectives?
Measurement

• The task of measuring the benefits risk management brings to an organization is a challenging one. Unlike finance reporting or human resource reporting, it is impossible to enter data into a software application to come up with a result that risk management within organization XYZ is 72.34% effective or has resulted in a 4.2% increase in profit.

• Whilst there is no software application that is able to do that, there is a way of gaining an *indication* as to the value that risk management is making to the organization.

• *So how do we do it?*
So Let’s Start at the Very Beginning

A Risk is defined as:

“…effect of uncertainty on objectives”

(ISO 31000:2009)
The Premise ……

• For us to be able to measure the value of risk management to our organization:
  • We need to understand our objectives
  • We need to be able to measure performance against our objectives
Developing Objectives and Performance Measures

**VISION**

What do I want to be when I grow up?

**MISSION**

What am I here to do?

What do I look like when I grow up?

What does success look like?

**CRITICAL SUCCESS FACTORS**

(i.e. The categories against which we measure Consequences for our risks)

- Financial
- Reputation
- Safety
- Compliance
- Performance
- Environmental
- Political

<table>
<thead>
<tr>
<th>What we Measure Performance Against</th>
<th>How we Measure Performance</th>
<th>Level of Performance When we Achieve our Vision</th>
<th>Level of Performance Being achieved now</th>
</tr>
</thead>
<tbody>
<tr>
<td>KPIs (Future)</td>
<td>KPIs (Current)</td>
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Measurement – the Methodology

• The measurement of risk management performance can be divided into three distinct categories:
  • Compliance. This measures whether the organization is complying with its own risk management policy directives
  • Maturity. This measures the maturity of the risk management program within the organization against industry best practice
  • Value Add. This measures the extent to which risk management is contributing to the achievement of the organization’s objectives and outcomes
Measurement - Compliance

• Like all programs within an organization the risk management program should be subject to compliance auditing

• This auditing is aimed at ensuring that the fundamental requirements detailed in the organization’s Risk Management Policy are being adhered to

• To do this, we first need a goal, some objectives and performance measures for the risk program
Specifying Risk Management Goals and Objectives

• The goal of the risk management program within the organization may be:
  • To ensure that the risks facing the organization are appropriately managed in order to protect the interests of the organization and its many stakeholders and to assist in the decision making process.
Specifying Risk Management Objectives

• Examples of Risk Management Objectives may include:
  • All personnel to be trained in the risk management requirements of Acme Corp by Q4 2017
  • All functional areas are to have developed risk registers by Q3 2016
  • All functional areas are to review risk registers at least quarterly
  • All risks outside the risk target for the organization are to be escalated to the appropriate level of management for acceptance within 24 hours of assessment
  • All current controls relating to risks with Severe or Major consequences are effective with evidence available to support this rating
  • All treatments are implemented within the specified timeframes

• From these objectives we can develop Performance Measures and Key Performance indicators
### Developing Performance Measures and Key Performance Indicators

**Goal:** To ensure that the risks facing the organisation are appropriately managed in order to protect the interests of the organisation and its many stakeholders and to assist in the decision making process

<table>
<thead>
<tr>
<th>Objectives</th>
<th>Performance Measure/s</th>
<th>KPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>All personnel to be trained in the risk management requirements of Acme Corp by Q4 2017</td>
<td>% personnel trained in the risk management requirements of Acme Corp</td>
<td>95% by Q4 2017</td>
</tr>
<tr>
<td>All functional areas are to have developed risk registers by Q3 2016</td>
<td>% of functional areas that have developed risk registers</td>
<td>100% by Q3 2016</td>
</tr>
<tr>
<td>All functional areas are to review risk registers at least quarterly</td>
<td>% of quarterly reviews conducted</td>
<td>100% once all risk registers are developed</td>
</tr>
<tr>
<td>All risks outside the risk target for the organisation are to be escalated to the appropriate level of management for acceptance within 24 hours of assessment</td>
<td>% of risks outside the risk target for the organisation are to be escalated to the appropriate level of management for acceptance within 24 hours of assessment</td>
<td>100%</td>
</tr>
<tr>
<td>All treatments are implemented within the specified timeframes</td>
<td>% of treatments implemented within specified timeframes</td>
<td>90%</td>
</tr>
</tbody>
</table>
Measurement - Compliance

- So we audit and we find we are complying:
  - All functional areas have a risk register ✔
  - All functional areas are reviewing their risk registers quarterly ✔
  - Top 10 risks are being reported to the Executive/Board monthly ✔

- But does this mean we are adding value or are we simply DOING RISK MANAGEMENT rather than MANAGING RISK?

- It is actually conceivable that an organization has 100% compliance against all of the risk management policy requirements and yet risk management is not contributing to the achievement of effective outcomes
Measurement - Maturity

- Risk maturity applies an audit/health check approach to determine the level of effectiveness of the Risk Management Framework
- It does not measure outcomes as such – just how the program compares against ‘best practice’
- The process needs to be one that is repeatable as maturity needs to be reviewed on a regular basis
Measurement - Maturity

Level 1 - Awareness

Level 2 - Understanding

Level 3 - Initial Application

Level 4 - Embedded

Level 5 - Mature
Case Study Local Council

So, as an organization, we are becoming more mature in our risk management efforts – but does it necessarily follow that risk management is adding value and contributing to the achievement of our objectives?

How do we measure the value proposition given the issues surrounding the risk management paradox
Measurement – Value Add

• The most difficult aspect of risk management measurement is demonstrating that the risk management program is actually value adding to the organization.

• We may be compliant and our maturity may be improving, but if our CEO was to say to us .. “prove to me that the money I am spending on risk management is improving performance” what would you say?

• Unfortunately – “trust me it’s all good” is not likely to suffice.
Measurement – Value Add

• So let’s go back to the beginning:
  • Risk is the effect of uncertainty on objectives

• We measure achievement of our objectives through:
  • Performance Measures and Key Performance Indicators

• If we are managing risks effectively then it should follow …..
  • We are seeing less uncertainty that would impact our objectives or we are better equipped to deal with the uncertainty as it arises

• Which means …..
  • We should be seeing improvement in our Key Performance Indicators
For us to be able to do this effectively, we need to identify a number (in the order of 2-5) of performance measures for each of our Critical Success Factors.
# Measurement – Value Add

<table>
<thead>
<tr>
<th>Financial</th>
<th>Compliance</th>
<th>Safety</th>
<th>Reputation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit &amp; Loss</td>
<td>Number of Reportable Compliance Incidents</td>
<td>Number of Safety Incidents</td>
<td>Customer Satisfaction</td>
</tr>
<tr>
<td>Earnings before Interest and Tax (EBIT)</td>
<td>Number of Punitive Findings from Regulators</td>
<td>Worker’s Compensation Payments ($)</td>
<td>Customer Complaints</td>
</tr>
<tr>
<td>Return on Investment (ROI)</td>
<td>Lost Days to Injury</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Share</td>
<td></td>
<td>Ratio of Negative to Positive Press</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Staff Satisfaction</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Staff Turnover</td>
</tr>
</tbody>
</table>
The first time we measure risk maturity we also benchmark our performance against our Key Performance Indicators.

<table>
<thead>
<tr>
<th>Performance Measure</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Safety Incidents (annual)</td>
<td>20</td>
</tr>
<tr>
<td>Staff Turnover</td>
<td>27%</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>73%</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>4.5%</td>
</tr>
<tr>
<td>No of reportable Compliance Incidents</td>
<td>8</td>
</tr>
<tr>
<td>Fines for compliance breaches</td>
<td>$850k</td>
</tr>
<tr>
<td>Average time to fill vacancies</td>
<td>10 weeks</td>
</tr>
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</table>
Measurement – how it Works

<table>
<thead>
<tr>
<th>Performance Measure</th>
<th>Performance</th>
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</thead>
<tbody>
<tr>
<td>No Safety Incidents (annual)</td>
<td>12</td>
</tr>
<tr>
<td>Staff Turnover</td>
<td>19%</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>84%</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>6.5%</td>
</tr>
<tr>
<td>No of reportable Compliance Incidents</td>
<td>4</td>
</tr>
<tr>
<td>Fines for compliance breaches</td>
<td>$250k</td>
</tr>
<tr>
<td>Average time to fill vacancies</td>
<td>6 weeks</td>
</tr>
</tbody>
</table>
Measurement – how it Works

- And again
- What we should see over time is an improvement in our performance against the Key Performance Indicators as risk maturity improves

<table>
<thead>
<tr>
<th>Performance Measure</th>
<th>Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>No Safety Incidents (annual)</td>
<td>6</td>
</tr>
<tr>
<td>Staff Turnover</td>
<td>14%</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>92%</td>
</tr>
<tr>
<td>Profit after Tax</td>
<td>9.7%</td>
</tr>
<tr>
<td>No of reportable Compliance Incidents</td>
<td>1</td>
</tr>
<tr>
<td>Fines for compliance breaches</td>
<td>$50k</td>
</tr>
<tr>
<td>Average time to fill vacancies</td>
<td>4 weeks</td>
</tr>
</tbody>
</table>
Measurement – Value Add

• This is not an exact science as a direct relationship cannot be proven – but it does provide an excellent indication of a causal relationship

• If the performance against a specific metric improves after the implementation of risk treatment strategies – then there is some evidence that there has been a value add

• What this means is that if you measure the maturity of your risk framework – you must, at the same time, measure performance against KPIs
So the Challenge

- We must have sound, measurable objectives
- We must have a sound performance measurement framework
- We must continue to measure performance
- We need a way to measure the maturity of our risk management program that is repeatable
- We need to measure performance against our performance measures each time we measure maturity

- If we do not have these things in place, we will NEVER be able to confidently answer our boss’ question
Questions