

Center for Excellence in ERM White Paper

The Clunky Dance Between Strategy & Risk[i]

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WINNING STRATEGIES ARE FULL OF RISK. SO ARE LOSING STRATEGIES. COMPANIES MUST GET BETTER AT SEEING THE RISK AND UNCERTAINTIES IN THEIR STRATEGIC CHOICES. HERE'S HOW MAJOR ORGANIZATIONS SEE THE CHALLENGES AND THE BEST PRACTICES IN CONNECTING THE DOTS BETWEEN STRATEGY AND RISK.

Managing the Risk and Uncertainty around Strategy is not Optional

Not managing strategic risk and uncertainty can lead to major losses in value, cash flows, market position, and even bankruptcy. Numerous studies have highlighted how strategic risks are the number one risk that destroys value. Some believe that once that value and mismanagement of strategic risk is lost that it cannot be made up (i.e., competitors don't wait for you to catch up). And yet getting strategy and risk on the same page is somewhat of a clunky dance with neither group taking the lead in ensuring excellence along all dimensions.

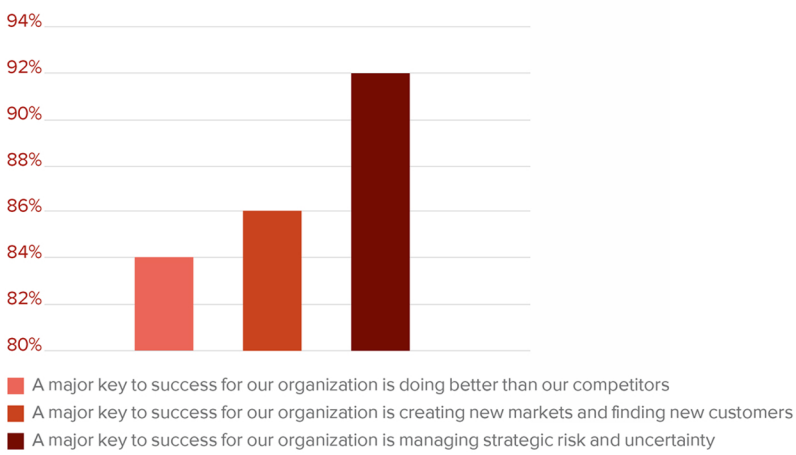
A recent ERM Summit was held by St. John's University's Center for Excellence in ERM, part of the Tobin College of Business and the School of Risk Management. The Summit hosted risk and strategy executives from around the country to do a deep dive into these issues. Additionally, the Summit participants participated in a pre-Summit survey to uncover some of the keys in this area.

[i] The concept of calling the link between strategy and risk a clunky dance was first brought to my attention by the Neu Group.

Beyond Just Competing

When the participants were asked about the keys to future success some very traditional answers came up about competition and new markets. For example, 84% agreed that beating competitors was a major key. Additionally, 86% agreed that finding new customers and markets was a major key. The non-traditional insight that came up was surprising. While more than 80% (noted above) agreed about the importance of competition and new markets and customers, 92% agreed that a major key to success is managing strategic risk and uncertainty.

Keys to success

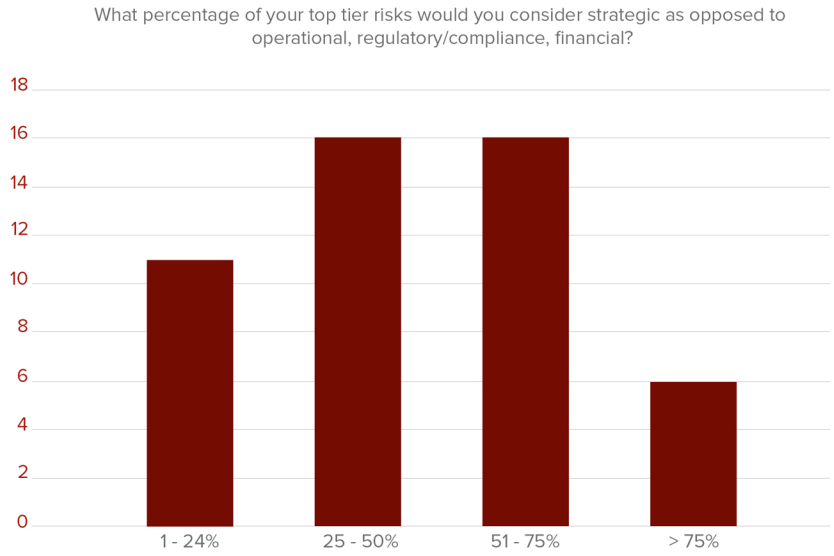


One interpretation is that organizations cannot just set strategy, try to beat the competition (via better products or services), or simply find new markets. Rather, in a seriously disruptive, fast-paced world, the results suggest that many believe that the missing ingredient in strategic success is aggressively identifying and managing the risk around the strategy.

MOST TOP RISKS ARE STRATEGIC.

Anecdotal evidence suggests that their concern is valid. For example, a large percentage of organizations revealed that most of their risks are actually labeled or categorized as strategic risks. Specifically, almost half (45%) of organizations stated that strategic risks make up over 51% of their identified risks. Another 32% stated that strategic risks make up between 25-50% of all identified risks. The data suggest that as organizations examine their top risks, they are examining strategic issues and uncertainties (versus more traditional financial risks or compliance risks).

Stragetic risks make up almost half of all risks



Leadership Seeks Help with Strategic Risk

It is not just the ERM and risk executives that see these strategic risks and have concerns about their critical impact on future success; top leaders seem to also be taking notice.

Evidentially, most of the organizations believe their leaders (both executives and boards) see these strategic risks as important issues. Interestingly, boards seem to want more help than executives. When asked if leaders want more help with strategic risk and uncertainty, 62% said their executives want help but, a larger percentage, 71%, said their boards want help with strategic risk and uncertainty.

Leader Effectiveness

The need for help may come from the disruption and change in the market and it may come from a company's own sense of how effective they are at navigating risky waters. The data below show that approximately 70% of organizations said their leaders were somewhat effective or very effective at both setting strategy and strategic execution. That is partially good news. Unfortunately, only 19% stated their leaders were very effective at both setting strategy and strategic execution and almost 30% fall into the neutral or ineffective categories for both setting and strategic execution. One can only speculate that this partially explains why boards are looking for help at a higher rate than leadership. Of course, it also sets up the opportunity for improvement – ERM leaders that can provide insights into strategic risk and uncertainty should be in high demand by boards and leaders.

ERM LEADERS THAT CAN PROVIDE INSIGHTS INTO STRATEGIC RISK AND UNCERTAINTY SHOULD BE IN HIGH DEMAND.

Leader effectiveness

How effective is leadership at your organization at keeping the organization focused and disciplined to deliver on strategy (strategic execution)?

How effective is leadership at your organization at setting and developing strategy?

	Very ineffective	Somewhat ineffective	Neutral	Somewhat effective	Very effective
Very effective				12%	19%
Somewhat effective		2%	10%	29%	10%
Neutral		2%	7%		
Somewhat ineffective	2%	5%			
Very ineffective	2%				

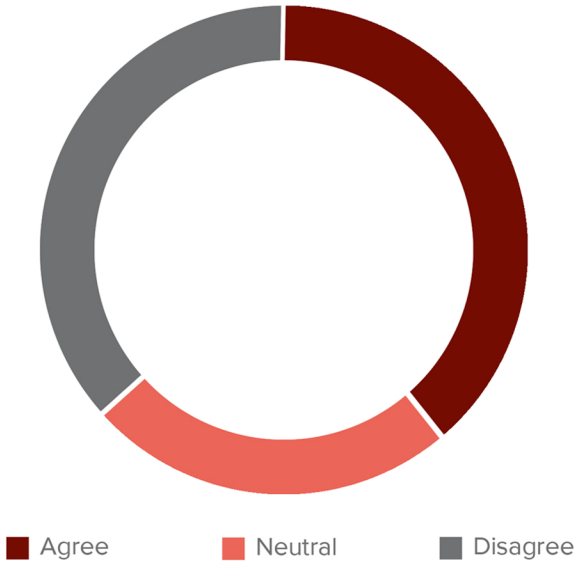
BOARD MEMBERS SHOULD ASK THEMSELVES HOW CONFIDENT THEY ARE THAT ALL THE STRATEGIC RISKS HAVE BEEN IDENTIFIED.

Not Confident

Perhaps the need to get better at strategic risk is best understood when ERM executives are asked how confident they are that all strategic risks have been identified. This is certainly a critical question because strategic risk cannot be managed if not identified. The results are striking - only 38% agreed with the statement that they were confident that all strategic risks are identified! It's no wonder boards are looking for someone to step up to the plate and offer to help with strategic risk and uncertainty.

Not confident that strategic risks are identified

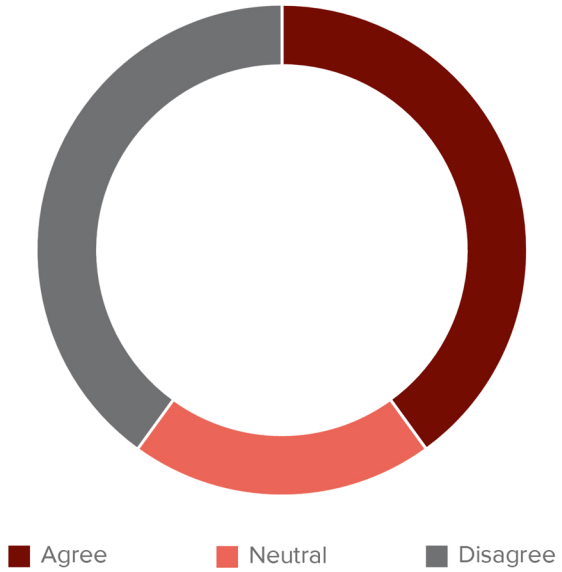
We are confident we have all of our strategic risks identified.



The reasons for the lack of confidence are unknown at this point but perhaps part of the problem is the approach and toolset. For example, only 40% of organizations do a separate strategic risk identification. That potentially leaves 60% that approach their most critical risk with the traditional risk identification techniques (e.g., risk surveys) in a world with business models and innovation moving at breakneck speed.

Separate strategic risk identification

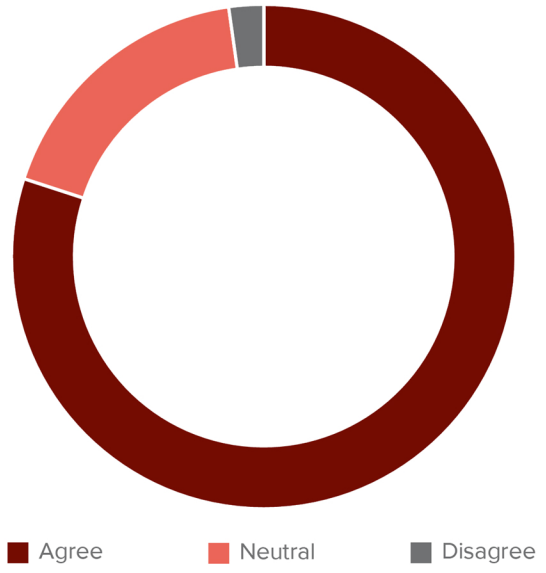
We conduct a separate strategic risk identification?



Furthermore, the overwhelming majority (98%) agree that better strategic risk tools are needed, furthering the need for companies to do a separate strategic risk identification. Doing a strategic risk analysis may be a necessary but not sufficient condition for future success.

Strategic risk tools are needed

Better tools, techniques, and solutions are needed for strategic risk identification and analysis.



DOING A STRATEGIC RISK ANALYSIS MAY BE A NECESSARY BUT NOT SUFFICIENT CONDITION FOR FUTURE SUCCESS.

Challenges in the Clunky Dance

Managing the clunky dance between ERM and strategy is not without challenges and several were highlighted during the Summit. The challenges primarily fell into five areas:

- leadership,
- strategy setting processes,
- ERM processes,
- the ERM team, and
- overall culture.

Leadership challenges included not having executive commitment and leaders not being accountable for strategic risk identification. Challenges here also included getting the time and attention of the leadership team and adding value without being viewed as bureaucratic. Challenges dealing with how strategy is set and communicated down the ladder were also mentioned, especially when there is not an executive member with specific risk responsibility. Some organizations noted that strategy is set in too many places for ERM to help while others mentioned that strategy is a closed process to only a select few. Another challenge noted was that strategy setting involves too many moving parts or that the strategy team is not aware of the risk expertise available to them. Not having someone own "risk" within strategy was also a concern.

How ERM is viewed is critical (as well as the level of respect for the ERM team and their skill set). The "stigma" of being viewed as traditional risk management can also get in the way. If ERM programs are viewed as protective or mitigation-only programs (with a history of focusing on non-valued added activities), then helping with strategic risk is difficult. A need for a common language to guide the link was mentioned as a necessity. If ERM only reports on risks that have already occurred then they may have missed half the battle. This challenge occurs when ERM is not included up front and only gets "looped in" afterwards. ERM teams with insufficient resources or skill sets challenge the dance as does a lack of focus in this area and the need to step out of "day to day fire drills."

Finally, the culture of the organization was mentioned as a challenge numerous times. Shedding silos around strategy

and ERM processes were mentioned as a continuing challenge too, especially if it hinders needed communications about the strategy and risk connections. Data from the Summit support these final concerns in that only 43% agreed that risk and uncertainties around strategic risk are communicated to leadership on a timely basis. A little more conversation might lead to an improved clunky dance.

Strategic Risk Approaches

A couple of organizations shared how they were approaching the clunky dance between strategy and risk. One organization shared how they converted their ERM team into a strategic risk management team and tried to get closer to embedding risk into decision making and reporting. Having their board support helped them with the transition. This organization focused on a more forward-looking approach that got their organization to consider risk in the business model, structure, and emerging disruption or trends. In an effort to capture all strategic risks they analyzed risks in external changes not yet part of strategy, risks related to current leadership strategy discussions, and risks from executing current business plans. Their strategic risk toolset included a blind spot analysis workshop, an interconnected analysis approach, wargaming on competitor actions, game theory, pre-mortems, and design thinking methods to better understand and connect with management.

Another approach shared was using sophisticated internal and external data and analytics in scenario planning workshops that focused on scenarios, scorecards, and course correction. Risks and opportunities were identified, scenarios defined, and contingency plans were developed. These all helped drive strategic decisions. One key was to track changes in the market against strategic assumptions. Leading indicator scorecards were considered important especially when tied to management dashboards and when they included trigger points for action or escalation. Key data was critical for the scorecards and course correction included root cause analysis of failures.

Other Best Practices

In addition to these approaches numerous best practices were shared during the Summit. Some of the practices were:

- Making an effort to figure out the best way to get to the C suite
- Being great at the basics of documentation and analysis
- Identify emerging risks that are not already managed
- Strategic alignment with the emerging risk framework
- Looking for risk in unusual places and having risk conversations with non-traditional stakeholders
- Continual benchmarking with other companies in this area (avoiding being the last to begin a new practice)
- Working with the risk committee
- Embedding risk as a core element of the operating plans
- Integrating risk into long-term planning and processes
- Enabling a "fail fast" framework
- Leveraging brand/reputation initiatives to identify key risks
- Communicate, communicate, communicate
- Reviewing strategic plans and providing risk feedback
- Making strategic risk sessions engaging (versus using templates)
- Offering something to ensure getting invited to the strategy sessions, and
- Increasing the ERM acumen for executives and managers by using external trainers.

A View from the Chief Strategy Executive

A couple of NYSE chief strategy executives joined the Summit and offered numerous additional insights for improving the strategy risk connection including:

- growing and supporting the core business as much as possible

- paying close attention to the market trends that diminish the current business model
- constantly rethinking and challenging the business model
- looking for strategic risks and opportunities in trends, technology, AI, big data, augmented reality, etc.
- looking for strategic risks and opportunities by focusing on customer needs and alternate dimensions (green, convenient, secure, etc.)
- analyzing the competition from various dimensions to help see all the risks, and
- seriously considering non-traditional competitors as a strategic risk.

One chief strategy executive noted that he believed their company was good at the known strategic risks but added, "Strategy executives are not very good at the unknown risks." ERM executives and other leaders may need to develop their skill sets for "unknowns."

Getting strategy and risk together is a clunky dance and faces many challenges. What is clear is that there is a need (and even an apparent request from leaders) for ERM executives to step it up. It will, however, require some new skills and some rethinking and repositioning of the ERM efforts.

Special Thanks

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Graduate Students:

Graduate Students in the MS ERM and MBA ERM at St. John's contributing to the Summit and this white paper included:

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