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ENTERPRISE-WIDE RISK MANAGEMENT

The Art of Creating Value from the Intangible?

PRMIA/ISDA Seminar

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Merged and edited version of the original slides and script

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Agenda

1. The Surveys
2. The Connected Economy
3. Learning from the Entrepreneur
4. EwRM – Making Strategy Happen

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1. The Surveys

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The ‘Google Survey’

AREA	HITS
• Risk Management	1,670,000
• Enterprise Management	160,000
• Enterprise Risk Management etc	21,000

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Introduction

- Although hardly conclusive in a statistical sense, a 'survey' of relevant terms using the Google™ search engine suggests that 'risk management' and 'enterprise management' are not necessarily on the same agenda in the minds of many
- What I want to consider this evening are the following questions:
  - Can we achieve EwRM without a shift in perspective?
  - If not, how do we achieve the change?
- Finally, this is a big topic, so the approach taken in the presentation is necessarily high-level

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The Literature Survey

- Recent/current editions of journals such as FOW and Risk carry several articles on what one author terms 'The Holy Grail of Risk Management' – enterprise-wide risk management in financial institutions
- November 2002 alone is seeing three or four seminars or conferences on the topic convened by different industry organisations
- The overall impression gained by the neutral observer is:
  - organisations are made up of parallel communities consisting of the risk management function and the business i.e. full integration of risk management into the business still a long way off
  - that the issue is either technology driven or that technology remains a limitation
  - many risk reports are geared to high level management and/or regulatory reporting and (still) not usable by the business
  - EwRM is (1) an old issue, or (2) something new
- The reality is that EwRM has been an objective for over a decade, but ongoing failures suggest there is a long way to go

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Recent Lessons?

- One thing that is striking is the contrast with a decade or so ago in terms of the sources of 'black holes'
- In the late 1980s/early 1990s derivatives and related pricing models were often (wrongly) blamed for problems that surfaced
- Many more recent problems appear to have been caused or exacerbated by inappropriate application of more basic measures of economic value, notably accounting policies
- A formal policy for model approval, including independent oversight, has been seen as best practice for the management of financial portfolios for many years
- Is it now time for a similar policy, policed by the risk management function, to oversee the application of GAAP ?

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2. The Connected Economy

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The Connected Economy

- We live in an economy that is now ‘connected’ across many dimensions
- Barriers to monetary and capital movement are almost non-existent compared to 20 years ago, and systemic issues have again been highlighted during the recent sustained sell-off in the equity markets at a time of liquidity pressure on major investors such as insurers
- Supply chain management, outsourcing, joint ventures all bring their own risks
- Physical movement of people and voice-supported transactions are being replaced by e-communication and e-commerce

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EwRM in the Connected Economy

- Given these issues, EwRM takes on a particularly important aspect
- In many ways our current approaches to market and credit risk attempt to manage the symptoms of good or bad EwRM
- In particular, a loss due to counterparty risk is a loss due to a failure of the EwRM of the counterparty
- The impact of this grows in a connected economy, with supply and value chain management increasing dependency between suppliers, customers, joint venture partners, and outsourcers (with communications technology growing as a critical dependency)
- In the future, management of an organisation’s own EwRM will increasingly depend on an understanding of that of its partners and clients, together with an ability to manage the source of risk – business processes – in a dynamic manner

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3. Learning from the Entrepreneur

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Learning from the Entrepreneur

- Taking a step back, it is seductive to conclude that there may be lessons to be learned in these respects from the entrepreneur (ironically one of the few contexts – 'he/she is a risk taker' – where 'risk' and 'enterprise' get on the same agenda in a positive context)
- If an organisation has survived in a competitive world, then by definition it has largely got its EwRM correct
- Most organisations began their existence with a few founders who at some stage had to put a business plan into action, and quickly learned that some ideas created value and others did not
- To survive, they changed or rejected the processes that destroyed value and did more of those that created value
- In other words, the business model was adjusted to stay in tune with the strategic requirements of the organisation

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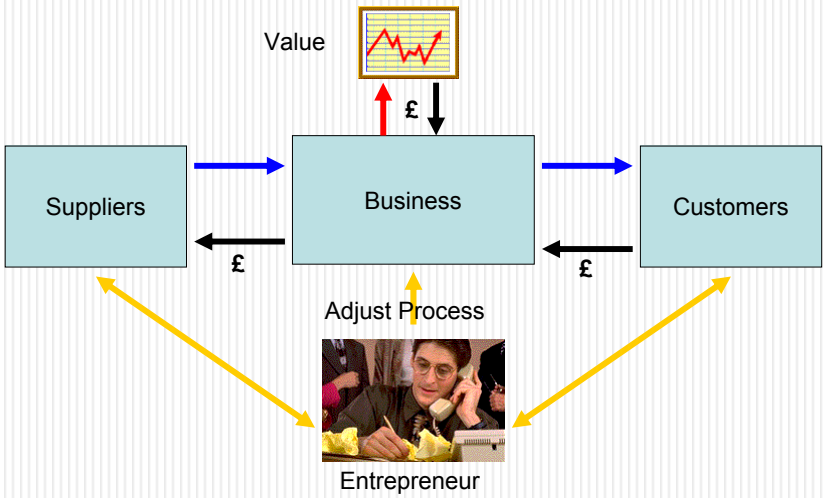
Process Adjustment



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Evolutionary Issues

- At some point in their evolution many organisations seem to lose this ability to self adjust
- As the organisation grows, senior managers must delegate, and it is almost inevitable that at least some degree of bureaucracy creeps in
- Processes over which the founders once had end-to-end oversight become ring-fenced into departments
- Communications between those formulating strategy and those interfacing with key external stakeholders (and with the stakeholders themselves) may become muted
- The business model becomes less flexible, and ultimately quantum change may become necessary
- Is the key to EwRM an ability to maintain this communication and maintain or re-introduce this business model flexibility?

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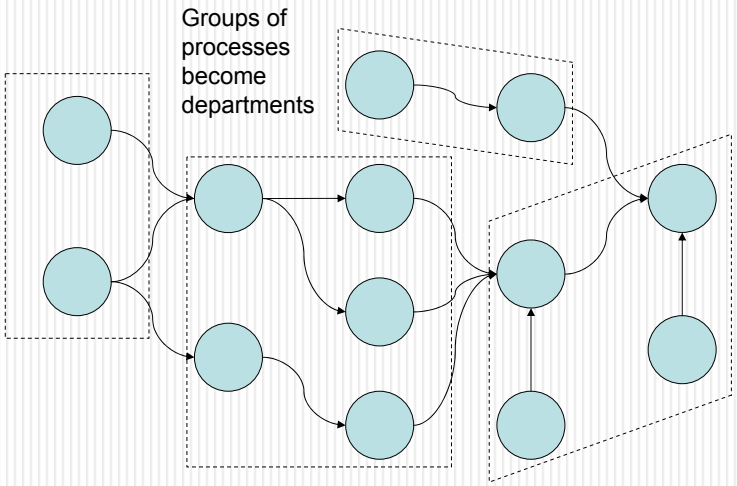
Evolutionary Issues



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4. EwRM – Making Strategy Happen

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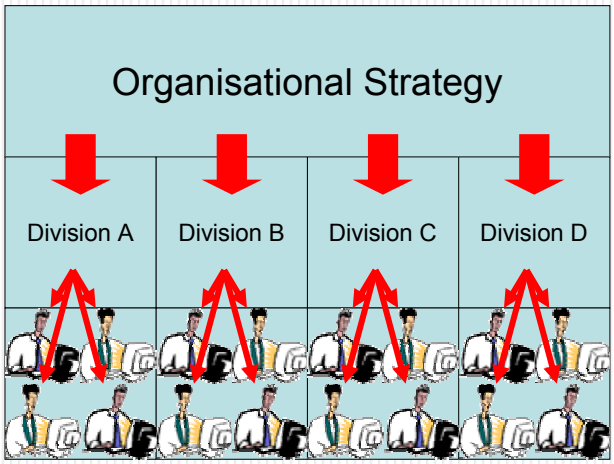
Making Strategy Happen



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Making Strategy Happen

- There are several proprietary approaches to managing firms in respect of some form of value-oriented goal
- One common aspect is the theory that the achievement of strategy can be broken down into devolved goals and objectives that if collectively delivered ensure that strategy is delivered
- In practical terms this will work only if the tasks and processes i.e. the business model can adjust to changing internal and external factors

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Turning Strategy into Tasks

Sum total of delivery by individuals equals delivery of strategy …

… but only if business model can adjust to changing requirements

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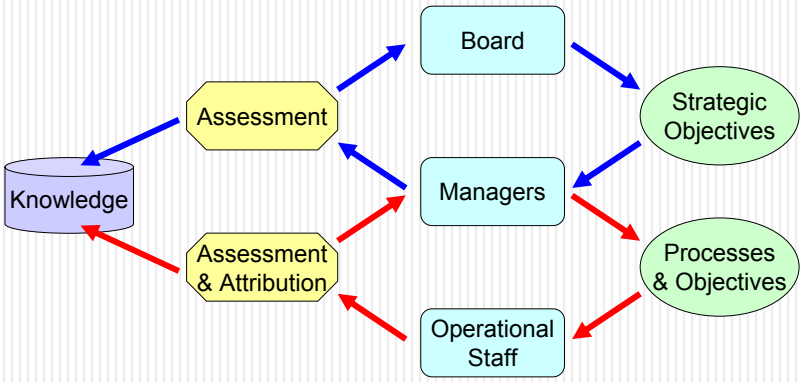
Linking EwRM & Strategy



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Linking EwRM & Strategy

- Appropriate linkage of this approach to process-based assessment, and attribution to appropriate performance and risk indicators, has a role to play
- Not only does this align the interests of the business and risk communities along the axis of value creation/destruction, but it can also be a key component in the management of knowledge capital
- Other output includes a heightened awareness of critical processes, and staff competency requirements
- A natural by product is thus a framework to underpin the management of key intangible assets
- Ultimately these indicators must be formally linked to some measure of financial value, hence the need to underpin the integrity of the financial framework as discussed earlier
- Such an approach could be accommodated alongside or as part of operational risk initiatives, and provides benefits in other process related areas traditionally seen as disparate issues

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Other Process Solutions

Area	Solution from EwRM?
Governance	✓
Operational Risk	✓
Competency Analysis	✓
Business Continuity	✓
CRM	✓
Strategic Risk	✓

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