CHAPTER 34

Leveraging ERM for Growth

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INTRODUCTION

From its beginnings, the value proposition of enterprise risk management (ERM) has been described as enabling companies to take upside risks confidently in pursuit of corporate goals and objectives. ERM was often likened to having brakes on an automobile. Just knowing that ERM acts as a brake pedal that limits downside risks (losses, waste, and underperformance), gives organizations the confidence to step on the accelerator pedal and pursue upside risks (growth and innovation).

Research into the state of ERM practice[1] demonstrates that ERM programs have achieved a high degree of success in providing the brake, that is, embedding a defensive stance against exposure to risks that would cause major losses or impede the achievement of objectives. Yet few ERM programs have been able to connect ERM to the accelerator pedal in a way that inspires the confident risk taking necessary for growth and innovation. When ERM is a strong brake with a weak link to the accelerator, it actually can become a drag on value.

We believe that the failure to embed a risk lens into decision making is the main reason that ERM has not yet lived up to its full potential to help organizations maximize the value they create. In this chapter, we present a rethinking of risk through a growth lens and explore ways the ERM discipline can be a much stronger contributor of value to organizations.

RETHINKING RISK THROUGH A GROWTH LENS

Defining Growth

Let’s begin with a definition for growth:

Growth = Value creation

Every organization exists to create value by achieving its goals. The nature of the value created can be *financial* (e.g., profit for shareholders—the focus of corporations), *public good* (e.g., serving citizens and protecting the public—the focus of government), or *social service and societal transformation* (the focus of not-for-profits). Whatever its goals or the nature of the value it strives to create, an organization’s stakeholders expect its leaders to produce a good return on the resources entrusted to it. Growth is another word for that return on investment of resources.

For corporations, growth in value typically means enhanced financial returns and an expanded capital base. For government organizations, growing value will be reflected in better and broader delivery of services and stewardship of "public goods" such as infrastructure. For not-for-profits, growth in value can mean providing broader and better services to vulnerable members of society and indeed transformation of society.

Where ERM Fits in the Growth Cycle

To understand how ERM can contribute to value creation and growth, we begin by introducing the concept of the ***growth cycle***.[2] Exhibit 34.1 shows the three phases of growth typically seen in organizations:

- Phase 1 is ***strategic visioning*** to decide how the organization will generate value. It typically includes defining the business model and strategies that will position the company for success in the future. This phase is the focus of the strategic planning discipline.
- Phase 2 is ***transitioning*** the organization from its existing business configuration to an evolved one as envisaged in Phase 1. It involves choosing and resourcing investments, projects, and initiatives. This phase is the focus of the decision analysis discipline.
- Phase 3 is running the ***ongoing business***. It involves delivering on corporate objectives. This phase is the focus of the enterprise risk management discipline.

While the cycle lays out these phases in a sequential manner, most organizations will carry on some activity in two or more phases simultaneously.

To gain a better understanding of how ERM typically contributes to value creation, in late 2018 Risk Wise conducted an informal survey of 67 ERM leaders from

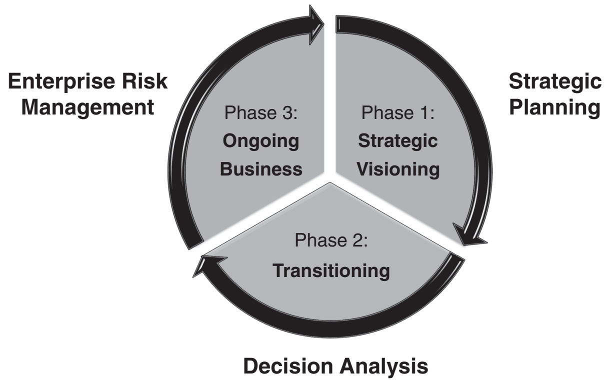

Exhibit 34.1 The Growth Cycle

Source: Adapted from NavIncerta.

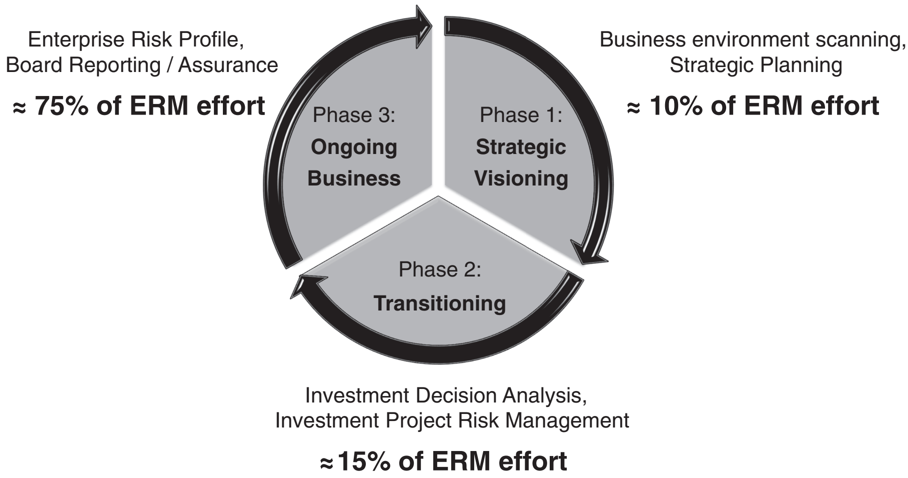

Exhibit 34.2 How ERM Is Typically Applied to the Growth Cycle
Source: Adapted from NavIncerta.

48 organizations about the main activities of their ERM programs and how those activities contribute to the growth cycle. The organizations in the survey sample were all from Canada, with 58 percent from the corporate sector, 23 percent from the government sector, and 19 percent from the not-for-profit sector. As illustrated in Exhibit 34.2, the survey revealed that, on average:

- 10 percent of ERM efforts were applied in the strategic visioning phase, mainly to provide a risk lens to the organization's processes for environment scanning and strategic planning.
- 15 percent of ERM efforts were applied in the transitioning phase to understand and evaluate the risks of potential investments, initiatives, and projects.
- 75 percent of ERM efforts were spent on the ongoing business phase, reflecting the primary focus of most ERM programs, that is, conversations and analysis to support the generation of an annual corporate risk profile and quarterly reporting. This risk monitoring mainly provides assurance to executive management and the board that the risks to the current objectives are being identified and managed.

The results of Risk Wise's survey into how ERM leaders allocate their time across the growth cycle corroborate other data collected in the longest-running annual global ERM survey that indicate ERM programs primarily serve in an assurance role focused on the risks to the company's current strategic objectives. Indeed, when asked on the most recent survey if they viewed their organization's risk management process as a strategic tool, nearly two thirds of respondents (62 percent) said "not at all" or "minimally."[3] The survey report authors also commented that this result is consistent with what they observed in prior years, shedding light on how risk management is viewed in those organizations.

While addressing the risks to the achievement of corporate objectives in the ongoing business phase is table stakes for any ERM program, it has only limited potential to contribute to the overall growth cycle. This is because the ongoing business phase is focused on the present whereas the strategic visioning and transitioning phases focus on creating future value. Given the heavy focus of ERM programs on the ongoing business phase, it is unsurprising that they are sometimes perceived as not providing much value, particularly by executives who must weigh large uncertainties about the future in their strategic decisions in the strategic visioning and transitioning phases.

THE UNREALIZED POTENTIAL OF ERM

ERM's Inflection Point

The concept of ERM's *inflection point* is illustrated in Exhibit 34.3, which maps the arc of value that ERM programs generate over their lifetime. Let's explore this value creation trajectory further as it is also a reflection of the evolution of the ERM discipline.

The left-hand side of the chart shows the initial phase in which the goal is to establish ERM as "risk reporter." This is where the ERM program is initiated and capabilities to identify, assess, and monitor risks are established. Typically, the focus is on near-term risks to the achievement of corporate objectives that flow from the organization's strategic plan. In this first stage of ERM development, clarity is gained about the organization's critical risk exposures and its readiness to handle them. The emphasis is on reporting to management and the board. This first phase of ERM provides substantial value compared to having an ad hoc approach to risk by generating transparency about critical enterprise risks, establishing a common language regarding ERM, and in some organizations, also introducing a risk appetite framework.

However, eventually organizations reach ERM's inflection point, when the approach of ERM as risk reporter has provided maximum value. At this point on the ERM journey, ERM monitoring and reporting is generating good awareness but not compelling action among recipients of ERM information. ERM's inflection point is the fork in the road of the ERM journey where organizations must decide whether they want to continue to focus on transparency and persist with the "ERM as risk reporter" approach or if they wish to more directly support decision making and expand ERM's role to become "ERM as enabler of risk action."

The right-hand side of the chart in Exhibit 34.3 shows the trajectory of the two potential paths that organizations can take when they reach ERM's inflection point. As the chart illustrates, if the "risk reporter" route is selected, the value delivered by ERM diminishes.

The chart also shows a dotted line indicating that if ERM programs go the route of expanding to also become enablers of risk action, they can increase the value they deliver. As one risk thought leader puts it, "risk management must transform itself from an inherently reactive management of risks . . . to becoming a proactive decision support tool."[4]

We have observed that organizations that go the route of risk reporter and standard setter have difficulty sustaining ERM and integrating it into organizational

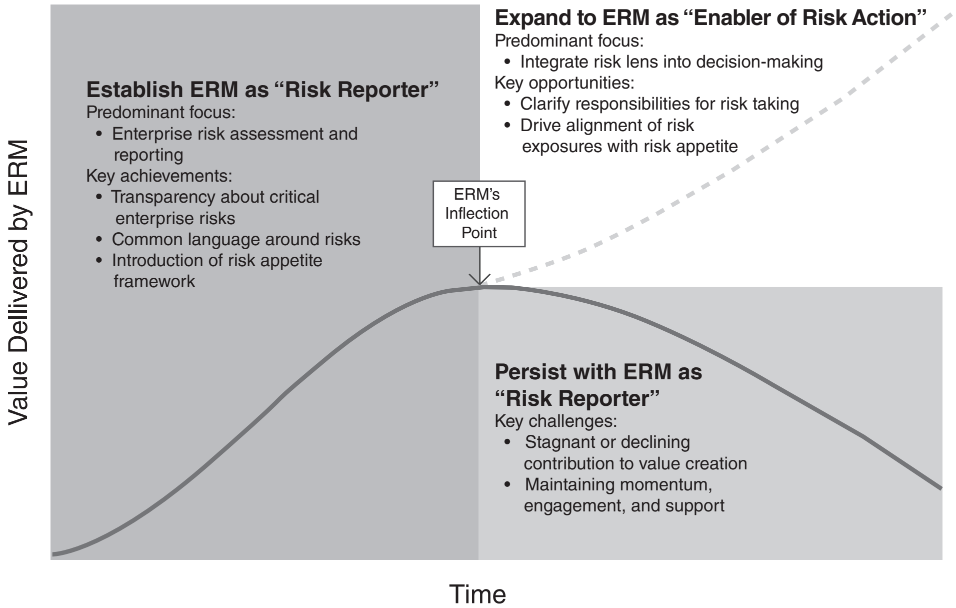

Exhibit 34.3 Value Delivered by ERM from Inception to Maturity

culture and decision making. We believe this is the main reason that they see a fall in the value delivered by ERM. We have also observed that organizations that move in the direction of ERM as an enabler of action are able to capitalize on opportunities to integrate ERM thinking into the strategic visioning and transitioning phases of the growth cycle.

While the ERM role as an enabler of risk action presents a tremendous opportunity for delivering value to the organization, we believe it requires a different mindset than the one that preceded the ERM inflection point. To establish ERM and achieve risk transparency, the emphasis is typically on what can go wrong or what might prevent the achievement of objectives. While this produces a level of transparency and accountability and reporting structures for risk identification and risk quantification, the focus on potential losses also decouples risk and reward and this creates what we have coined the *Risk Paralysis Trap*™.

Understanding the typical path to the ERM inflection point, and the choice that organizations face when they reach it, sheds light on whether ERM can increase its contribution to the growth cycle. To deliver more value and truly become an enabler of risk action, ERM leaders have the potential to bring tremendous value to those phases by supporting the organization to integrate a risk lens into important decisions involving the formulation and execution of strategy.

Phases 1 and 2 represent the biggest opportunities for ERM to increase the value it provides for a couple of reasons. First, because ERM is not currently a big player in those phases, there is lots of room for improvement. Second, because many organizations haven't yet developed strengths in strategic foresight (for Phase 1) or structured decision analysis (for Phase 2), ERM can help to bring a strong risk lens to help decision makers understand and weigh the uncertainties in making strategic bets on the future and then following them through to completion.

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In the next section, we explore what it takes for an ERM leader to serve as an enabler of risk action, regardless of whether they are just starting their ERM journey or already have a well-established ERM program and are at ERM's inflection point.

COMPONENTS OF INTEGRATING ERM INTO STRATEGIC DECISIONS

In this section we explore the key things that ERM leaders can do to be an enabler of risk action.

Recognize That Now Is a Good Time to Start

The shift to enabler of risk action can start at any point on the ERM journey and we believe the sooner the better. However, there are distinct advantages and challenges for organizations that are just starting their journey versus for those who have a well-established ERM program.

The biggest challenge for leaders of established ERM programs is, to quote the title of a bestseller, "What got you here won't get you there."[5] To make the shift to enabler of risk action, leaders of established programs have to think about doing some new things such as introducing new activities and habits to help people weigh the risks in their decision making. It will be equally important for ERM leaders to recognize that they need to stop doing some of the things that brought them success in the era of transparency. For example, a narrow emphasis on transparency often degenerates into a checkbox approach that feels like a compliance burden to others in the business. Existing activities that engender resistance to ERM are good targets for change or removal altogether.

Of course, ceasing familiar and established habits of thinking and interacting with others in the organization can be an especially tall order. Leaders of established ERM programs will have to not only change their own behaviors, but also work to change how others in the organization perceive them and the value they bring to the table. For example, ERM leaders are sometimes referred to as "Dr. No" by others in the organization who see them as challenging or vetoing decision alternatives that the proponents believe have great potential to deliver value. ERM leaders may have to relinquish their gatekeeper role and instead empower decision makers by giving them the tools and skills to be able to properly weigh risks themselves, including building a challenge function into decision processes.

Leaders who are at or near the beginning of their ERM journey have the advantage that they are starting with a blank slate. They can set the goal of becoming an enabler of risk action and from the outset of their ERM journey can, even in small ways, support the organization to embed risk thinking into decision making.

A big challenge for leaders who are just setting out on the ERM journey is to resist thinking that they must follow a sequential route, that is, where they first establish the era of transparency and then and only then can they begin to expand their role to that of an enabler of risk action. With a little attention to how they want to be perceived and the value they want to ultimately deliver, ERM leaders can establish habits of thinking and of interacting with others in the organization that provide a strong foundation for embracing their role as an enabler of risk action from the earliest days of the ERM program.

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Now that we have established that there's no time like the present to integrate ERM with decision making, let's turn our attention to how that can be accomplished.

Promote a Growth Mindset

We believe the first thing required to be an enabler of risk action is to shift away from the traditional defensive mindset of ERM leaders and programs, because it is overly focused on eliminating and minimizing risks and can therefore lead straight to the Risk Paralysis Trap™. Instead we recommend cultivating a more open mindset when it comes to risk taking, akin to what Carol Dweck has coined as a *growth* mindset.[6] In this context, growth refers to the enhancement of individual and organizational capabilities rather than increased profit.

Dweck's research argues that, when it comes to learning, there are two fundamental mindsets, a *fixed* mindset and a *growth* mindset, each at the opposite ends of a spectrum. "People with a fixed mindset believe that human abilities are simply givens. They are not qualities that can be developed, but rather endowments, bestowed upon some but not others."[7] On the other hand, individuals with a growth mindset believe that talents, abilities, and intelligence can be expanded through effort, teaching, and persistence "and so they spend their time learning and creating environments where others can learn."[8]

We have observed that leaders with a growth mindset, while proud of their accomplishments, are always looking for ways to improve their abilities and performance. Contrast that with leaders with a fixed mindset who are always looking for ways to "to broadcast their abilities" proving they "are among the lucky few" who possess a massive amount of innate abilities. Because it is so important for people with a fixed mindset to be superior, something else sets in—biased attention toward events that confirm superiority, and away from events that do not.[9] And this cultivates a sense of infallibility that can lead fixed mindset leaders to make unwise choices and sometimes even take "outrageous risks that bring their companies, even entire economies, to the brink of disaster."[10]

Dweck asserts that "most experts and great leaders agree that leaders are made, not born, and that they are made through their own drive for learning and self-improvement. Creating organizations that value a growth mindset can create contexts in which more people grow into the knowledgeable, visionary, and responsible leaders we need."[11]

Dweck explains that all of us exhibit elements of both of these mindsets in different situations. One can see that healthy risk taking and risk management can benefit from a growth mindset characterized by humility and a habit of continually seeking to improve how we handle risk and uncertainty in our decisions. Indeed, for any organization that wants to enhance its ability to take risk action, a growth mindset is essential.

For ERM leaders, the concept of the growth mindset is about continually learning and developing knowledge, skills, and culture to:

- **Embrace risk taking as essential for value creation.** ERM leaders need to recognize that opportunity and risk are two sides of the same coin. This means embracing the idea that the organization must take calculated risks to generate value and sustain performance and growth potential over the long-term. Far too many risk professionals see their role as minimizing risk exposure rather than optimizing it. Carolyn A. Wilkins, Senior Deputy Governor at the Bank of Canada, characterized the imperative to take risks this way: "When the world is moving around you, standing still is a risky strategy."[12]

- **Become an enabler of risk action**. This means helping decision makers throughout the organization to confidently take enough calculated risks to ensure that the organization can achieve its goals and objectives and make the best use of the resources entrusted to it. Enabling risk action can include socializing risk appetite to help decision makers better align risk exposures with the organization's appetite and tolerance for risk. For ERM leaders, it can also mean working with peers in other management disciplines to embed risk thinking into Phases 1 and 2 of the growth cycle. For example, this may include collaborating with internal experts in *strategic planning*, *scenario planning*, and *decision analysis* or taking the lead in developing these kinds of capabilities if they don't already exist within the organization.
- **Cultivate a forward-looking view of risk.** This means understanding how the business landscape is transforming and what emerging risks mean for the organization's future. This includes constantly scanning for changes and trends and updating one's understanding of the associated threats and opportunities and the implications for the organization's performance and survival over the short and long term. These are activities that most risk departments do to some extent. However, to be an enabler of risk action, ERM leaders need to get better at helping decision makers to think ahead. For example, when decision makers identify the potential impacts of emerging risks, they are then much better positioned to get out in front of risk and develop strategies to exploit potential opportunities and mitigate potential threats.
- **Evolve the organization's capabilities to provide a risk lens to decision making.** For example, this could include conducting post-mortems on decisions to identify opportunities to reinforce and strengthen good processes and strategies for enabling risk action. It can also include benchmarking against leading practices to identify potential areas for improvement. By assessing and tracking the effectiveness of risk management practices, ERM leaders can help to continually enhance and grow their organization's capability to take informed risk action.

For ERM leaders, cultivating a growth mindset will incorporate several traits such as: *humility* to acknowledge that there is always potential to learn and develop, *curiosity* to seek out ways to improve (e.g., borrowing from or integrating with other decision support disciplines), *courage* to experiment with new concepts and tools, and *persistence* to confront shortcomings and failures as a source of lessons to be learned.

Collaborate to Build on Existing Strengths in Strategic Decision Making

Becoming an enabler of risk action will inevitably require collaboration between ERM leaders and their colleagues in other disciplines that support the formulation and execution of strategy. Each ERM leader will have to determine the best place to focus efforts to collaborate with other departments and decision-support functions in their organization. As with any culture change initiative, to chart the path forward several factors need to be considered, including: (a) where the best opportunities are for ERM to generate value for the organization by collaborating with other disciplines to integrate a risk lens into decision making, (b) the readiness of others to collaborate, and (c) the level of executive leadership support for integration.

In the following sections, we delve into potential areas where ERM might integrate with other areas of the organization to become an enabler of risk action. We believe that the following disciplines represent the best opportunities for ERM to provide more value: strategic planning, scenario planning, decision analysis and decision quality, investment analysis, and day-to-day operations. Not all organizations will have formal processes or dedicated staff in all of these decision-support disciplines—in which case, there may be an opportunity for the ERM team to take the lead on introducing one or more of these decision-support disciplines into their organization's practices.

Any integration effort will have a higher chance of success if handled in a collaborative way with all parties working collegially toward common goals. We recommend beginning by connecting with other leaders in the organization with responsibilities in each of the three phases of the growth cycle to find out how they support decision making, how they deal with risk, and what they see as the challenges and opportunities around enabling *risk action* in the organization, and then exploring how ERM may be of service to address the challenges and opportunities identified. The following three sections describe some potential opportunities for ERM leaders to collaborate with others to enable risk action by integrating a risk lens into decision making in each of the three phases of the growth cycle.

Providing More Value to the Strategic Visioning Phase of the Growth Cycle

The strategic visioning phase is concerned with the formulation of corporate strategy. The goal of strategic visioning is to define a path that will enable the organization to grow and deliver on its value creation potential over the long-term. Given that ERM leaders spend only 10 percent of their time on this phase of the growth cycle, this represents a big opportunity for them to add more value. In this section, we take a closer look at the opportunities for ERM to integrate with two key disciplines that support *the strategic visioning* phase: strategic planning and scenario planning.

Strategic Planning

Strategic planning is defined as "a systematic process of envisioning a desired future, and translating this vision into broadly defined goals or objectives and a sequence of steps to achieve them.... Strategic planning begins with the desired end and works backward to the current status."[13] It is a disciplined effort by the organization's leaders to define the goals and direction of the organization and how it will achieve them, with a focus on future growth.

The Process

The strategic planning process cycle typically starts with two activities: a definition of the *desired strategy* and an assessment of the *current state*, that is, a scan of the internal and external business environment. This is followed by analysis to compare the current state to the future state envisaged in the desired strategy and to identify desired outcomes. This analysis typically considers strengths, weaknesses, opportunities, and threats. The outcomes of this comparison will include both opportunities and gaps to potentially be addressed in the strategic plan. The next step is to select a few *strategic priorities* that will move the organization from the current state to the future state envisaged in the desired strategy. Next, strategic projects/initiatives are defined that will enable the organization to achieve its strategic priorities. Finally, the projects are usually sequenced over a three- to five-year time horizon.

Typically, the results of the entire process are captured in a strategic plan document that forms the basis of communication to align all relevant stakeholders around the strategy. Most organizations generate a new strategic plan every three to five years and may tweak it each year to reflect progress and make any necessary course corrections.

Potential Opportunities for Integration with ERM

Integrating ERM with the strategic planning function would seem a logical step as it has the potential to deliver reciprocal value to both functions. The ERM function can assist the strategic planning function during the current state assessment by providing a solid understanding of the risks and some of the trends in the business environment. When it comes to defining the desired strategy and strategic initiatives, the ERM function can facilitate the articulation of the organization's appetite and tolerance for risk taking, both of which are critical inputs to help management and the board formulate strategy. In the comparison of the current state to the desired strategy, the ERM function can also provide a helpful perspective in the analysis of strengths, weaknesses, opportunities, and threats. In turn, the strategic planning function provides the ERM function with clarity about the organization's objectives for which the ERM function will facilitate the analysis and monitoring of the risks to achieving those objectives.

While the vast majority of organizations have a strategic plan, not all have in-house strategic planning experts. For organizations that do have in-house strategic planning experts, there is an opportunity for collaboration between the ERM and strategic planning functions on an ongoing basis as well as during the formulation of the strategic plan. For organizations that do not have in-house strategic planning capabilities, ERM leaders can seek to collaborate with the external strategic planning consultants who are hired to facilitate the formulation of a new strategic plan every three to five years. Whether or not internal strategic planning capabilities exist, ERM leaders can certainly add value by providing ongoing updates to the organization's environmental scan and help identify issues.

Despite a growing trend to integrate ERM with the strategic planning function, survey data indicate that there remains marked room for improvement. For example, "despite the higher percentages of boards that discuss risk exposures in the context of strategic planning for the largest organizations and public companies . . . just over one-third of those organizations are having these kinds of discussions." The survey authors make the astute observation that "given the fundamental relationship between risk and return, it would seem that these kinds of discussions should occur in all organizations. Thus, there appears to be a continued disconnect between the oversight of risks and the design and execution of the organization's strategic plan."[14]

Scenario Planning

The discipline of scenario planning informs a longer-term (e.g., 10 to 20 years or more) view of the organization's ability to sustain its growth trajectory. In this sense it provides complementary strategic planning by picking up where the typical medium-term (e.g., three- to five-year) strategic planning cycle leaves off. In the conventional view of ERM, the focus is on managing the risks to the medium-term strategic objectives associated with the strategic plan, whereas scenario planning is used to think much further into the future to explore strategies to sustain growth over the long term.

Scenario planning has famously been used in the corporate sector by Shell to enhance the company's ability to make better strategic decisions. In this context, the term "strategic decisions" means very large investments that have implications over long time horizons; for example, decisions such as the acquisition of an oil field or the development of a refinery would require multimillions or billions of dollars of investment and would be expected to have a life cycle of 25 to 50 years or more. Scenario planning has typically been embraced by entities that make similar large-scale strategic decisions such as companies in the resource, pharmaceutical, and technology sectors. Some governments have also adopted scenario planning; for example, Singapore is frequently cited in the literature.

The Process

Scenario planning involves the consideration of distinct alternative futures of the business or societal environment. For this approach, a scenario is defined as an alternative future that describes how relevant driving forces and uncertainties or risks in the future external environment may materialize in a logical, coherent way. Scenario planning is the analysis activity that is associated with developing and using scenarios. It is not about predicting the future; rather, it is rooted in the idea that one can better plan if a thorough understanding of the potential future business environment has been attained.

Potential Opportunities for Integration with ERM

We have observed an increasing interest in applying scenario planning to ensure that the organization remains relevant and viable for decades to come. Thinking long-term is critical to avoid *corporate fade*[15]—a fate that befalls many organizations that achieve success but then are not able to sustain it. By imagining a range of potential futures, leaders can begin to explore questions[16] that define the fundamentals they will need to win in the future, including:

- Who are the right customers to serve?
- What are the right performance metrics?
- How do we position competitively in our industry?
- What is the right business model?
- What capabilities will we need in our employees and partners?

Application of scenario planning can be considered a natural extension of the enterprise risk management process, with current risks and trends as critical inputs to the scenario planning process. ERM leaders can enhance the value they deliver by collaborating in scenario planning efforts or by initiating them in organizations that don't yet use them.

Scenario planning is not as widely adopted as strategic planning, with one study finding that although scenario planning was the most popular tool for thinking about the future, fewer than 35 percent of companies surveyed used it.[17] This is despite the tremendous value it has provided for those organizations that do use it. While it is true that organizations that have successfully applied scenario planning to sustain their growth potential tend to be large, the techniques can be applied in a scaled-down manner to also help smaller organizations prepare for tectonic shifts in their business environment.

Providing More Value to the Transitioning Phase of the Growth Cycle

The *transitioning* phase typically involves choosing and resourcing the major initiatives (e.g., acquisitions, projects, and programs) to move the organization from its existing business configuration to an evolved one as envisaged in the strategic plan. Given that ERM leaders spend only 15 percent of their time on this phase of the growth cycle, this phase also represents a big opportunity for the ERM function to add more value. Let's take a closer look at the opportunities for ERM to integrate with two key disciplines that support the transitioning phase: investment analysis and decision analysis.

Investment Analysis

Investment analysis is widely used by the finance function to analyze the profitability of a projected investment or project and to compare the potential returns of various alternatives. Two common methods used to evaluate potential investments in the context of capital budgeting and investment planning are net present value (NPV) and discounted cash flow (DCF).

The Process

NPV analysis calculates the difference between the present value of cash inflows and the present value of cash outflows over a period of time. DCF analysis utilizes projections of future free cash flows and then discounts them to estimate a present value. Both NPV and DCF assign a discount rate to account for risk and uncertainty in the investment or project. Determining that discount rate is as much art as science. It is not a simple empirical calculation. Rather, it involves the application of a great deal of judgment since decisions about strategic investments tend to be characterized by complexity and high levels of uncertainty associated with the future business environment. This is far from ideal because if risks are overestimated, good opportunities may be discarded. Conversely, if risks are underestimated, unworthy alternatives may be pursued.

Potential Opportunities for Integration with ERM

While many internal stakeholders may weigh in on investment decisions, the analysis process is often led by individuals in the finance department who may not have a strong grounding in risk assessment. Consequently, risks are not always adequately considered. For example, a survey of leaders who serve in chief financial officer or equivalent senior executive positions revealed that less than a third (29 percent) of respondents indicated that risk exposures are "mostly" or "extensively" considered in making capital allocations to functional units and less than half (41 percent) of respondents believed that existing risk exposures are considered "mostly" or "extensively" when evaluating possible new strategic initiatives.[18] This would indicate that the enterprise risk management function can potentially offer analysts in the finance department a more fulsome perspective on the uncertainties and risks in the firm's internal and external business environment and work with them to understand the implications for capital allocation choices.

However, if ERM leaders wish to help their finance colleagues better reflect risk when they set the discount rate for NPV or DCF analyses, they too will have to embrace quantitative assessment tools. Survey data also reveal that "the majority of organizations appear to be fairly unstructured, casual, and somewhat ad hoc in how they identify, assess, and monitor key risk exposures." Recent survey data show that "when organizations formally assess risks, most do so in a predominantly qualitative manner or by using a blend of qualitative and quantitative assessment tools. Thus, the use of robust quantitative risk assessment techniques is not that common across most organizations. While quantitative techniques might be used for certain types of risks (e.g., risks related to investment portfolio management), quantitative techniques are not used on a widespread basis across all types of risks."[19]

Decision Analysis and Decision Quality

The decision analysis (DA) discipline evolved to ensure that major decisions are made in a structured and coherent manner, with increasing rigor as the importance of the decision rises. It is applied to many types of decisions, including strategic choices, capital investments, acquisitions and divestments, marketing, research or innovation projects, operations, management of human resource initiatives, or other programs. Although the concepts of DA were developed for "big-bet" strategic decisions, the principles hold true for smaller decisions, and can be applied in a scaled-down format.

Decision quality (DQ) combines DA principles with insights from behavioral decision-science research "to help organizations deal effectively and efficiently with the practical challenges of complex decisions."[20]

The Process

DA includes many procedures, methods, and tools that are aimed at building cogent models that answer decision makers' questions and that can compel action. Graphical methods such as influence diagrams and decision trees are used to represent the alternatives available to the decision makers, the uncertainty they involve, and the evaluation of how well objectives would be achieved by each alternative. Uncertainties are typically represented through probabilities. The decision makers' attitude to risk (what ERM practitioners would call an appetite and/or tolerance for risk) is represented by utility functions.[21]

DQ is defined as a set of elements required to make a quality decision. These elements are defined slightly differently depending on the environment in which the organization operates, but typically cover:

- *Frame*. Framing sets the context for the decision. A decision frame defines an overview of the set of considerations that are relevant for the decision to be taken and sheds light on which of the other decision elements require additional attention.
- *Alternatives*. The generation of a set of deliberately developed creative and doable alternatives/options to choose from.
- *Evaluation*. The gathering and analysis of relevant information to provide an objective comparison of alternatives that also captures the uncertainties and risks. This includes presenting the evaluation results as clear discussion points, overviews, tables, diagrams, and any other form of communication to provide decision makers with the objective insights needed to make trade-offs and arrive at a decision.
- *Values and trade-offs*. The weighing of values and risks associated with different alternatives with a view to choosing the preferred option.
- *Stakeholders*. The understanding of the needs, issues, and concerns of parties possibly affected by the decision but not (directly) involved in making it.
- *Readiness*. The engagement of the people who will make the decision, those who will provide resources and support the implementation of the selected alternative, and the people who will lead the implementation in order to build true commitment and readiness to carry out the decision.

Potential Opportunities for Integration with ERM

Like scenario analysis, DA tends to be applied in organizations that are making large investments with significant uncertainties and risks. We have observed that organizations that have built an internal DA function tend to be large firms in the high-tech, pharmaceutical, energy, and mining sectors. There are also companies across a broad range of sectors that hire specialized consultants to apply the DA discipline to decisions on a one-off basis. However, many large organizations and the majority of small and medium-sized organizations have not yet embraced DA techniques.

For those organizations that use internal or external DA resources to support strategic decision-making investment decisions, ERM leaders can provide insight by identifying and evaluating the risks of strategic alternatives. This is an opportunity for ERM leaders to leverage the knowledge captured in risk assessments and in their ongoing monitoring of emerging risks.

For organizations that have not yet developed capabilities in decision analysis (and this is the majority), ERM can champion or lead the introduction of the powerful tools of the DA discipline and of the related discipline of DQ. In particular, introducing the *framing* element to investment decisions can move the needle significantly on the quality of an organization's decisions because it applies a risk lens early in the decision process. Two other elements of decision quality that are also a natural extension of risk management are *evaluation* and *trade-offs*, as these DQ elements also involve risk conversations.

Providing More Value to the Ongoing Business Phase of the Growth Cycle

The *ongoing business* phase involves running the business to deliver on corporate objectives. Given that ERM leaders typically spend 75 percent of their efforts on this phase of the growth cycle, it may appear that this phase represents a smaller opportunity for the ERM function to add additional value compared to the other two phases of the growth cycle. However, our research also indicates that ERM leaders tend to focus their efforts on their monitoring role, dedicating most of their efforts to generating an annual risk profile and quarterly risk updates to senior management and the board. Risk reporting is a foundational ERM activity that brings valuable awareness and transparency to risk exposures. However, the value of that awareness and transparency pales in comparison to the value produced when risk information is transformed by business managers into a risk lens that drives risk-informed action.

Following are examples of strategies ERM leaders can apply to integrate a risk lens into day-to-day decision making across the organization in the ongoing business phase of the growth cycle.

Shift ERM Leader's Mindset Regarding Their Primary Role

The first strategy is squarely within an ERM leader's control and an essential precursor for all the others. It is a change in mindset by the ERM leader regarding how they view the balance between the dual roles[22] of the ERM function.[23] While the ERM function's traditional monitoring role is essential, it is not sufficient to fully deliver on the promise of ERM. Indeed, when ERM leaders focus exclusively on their monitoring role, others in the business begin to view ERM as a check-the-box exercise that produces "credenza ware,"[24] not as a provider of risk intelligence to help them navigate the risks they face.

Integrating a risk lens into decision making requires ERM leaders to step fully into their role of supporting the management of risk. Working collaboratively with leaders across the business to enhance the organization's capabilities to make risk-informed decisions about ongoing business operations is an excellent opportunity for ERM leaders to increase both the value ERM delivers to their organization as well as the internal profile of the ERM function.

Clarify the Organization's Risk Appetite

A second strategy for integrating a risk lens into ongoing operations involves working with the organization's leaders to help them clearly articulate and apply the organization's risk appetite. We think of risk appetite as the expectations for risk-taking and risk-management behavior. Once the organization's leaders articulate the desired (and undesired) behaviors around taking and managing risks, they can communicate them to their people and establish a clear reference point against which to provide feedback to drive alignment to the desired risk appetite. The ERM function can help by:

- Supporting management and the board to have sufficient dialogue to develop a shared view of the organization's risk appetite that is compatible with its goals, values, and resources.
- Helping management translate the risk appetite into clear guidance for action and decision making in the operational context. This could include facilitating the development of guidance on what does (and doesn't) constitute desired and acceptable risk taking, as well as articulating tolerable limits for risk exposures.
- Assisting operations managers to identify incentives and disincentives that can be deployed to effectively drive desired risk-taking behavior, that is, to continually align risk exposures to the desired risk appetite and tolerance.

Support Leaders to Drive Risk Action

A third strategy for integrating a risk lens into ongoing operations involves supporting leaders across the organization to establish and strengthen management feedback loops that drive risk action that enhances performance. ERM leaders can help key stakeholder groups to systematically apply the risk intelligence that the ERM program generates. In other words, ERM leaders can make sure the organization is taking enough of the right risks to achieve its value creation objectives while also staying within its risk tolerance limits to avoid the destruction of value. To strengthen the risk lens across the range of feedback loops that exist at different levels in the organization, ERM leaders can engage with key stakeholders, including:

- *The board* to gauge how well ERM information and conversations support them to both discharge their oversight duties and to look forward to set, reaffirm, or course-correct the organization's strategic direction. Understanding the board's risk information needs sets the stage for a fulsome discussion of opportunities to strengthen the risk lens in feedback loops between the board and management.
- *Executive leaders* to gauge how clearly they are communicating the tone from the top and reinforcing the behavior of their people, to ensure that the organization's risk exposures are aligned with its risk appetite. This may also include gathering information to understand how well executives' intended messages are getting through to employees.

  Gaining clarity on what executives' expectations are for risk management behavior and how well those expectations are understood and acted upon by people across the organization provides a good starting point for a meaningful discussion of opportunities to strengthen the risk lens in management feedback loops between executives and the operational managers who report to them.

- *Risk owners* to gauge how well ERM reporting helps them to focus their attention and optimally deploy risk management resources, as well as to ensure that their risk response strategies are working. In too many organizations, the ERM process ends with risk owners being assigned the task of coordinating the response to the risk, typically some combination of prevention and mitigation efforts.

  In many organizations, other than monitoring the implementation of the risk mitigations, there is rarely any analysis of the effectiveness or efficiency of the response to individual risks, let alone across the portfolio of risks the organization manages. Helping risk owners to think more systematically about the effectiveness and efficiency of the strategies they employ to respond to their risks they are responsible for can create the basis of a powerful feedback loop between risk owners and the business managers they serve.
- *Managers* to gauge how well ERM information helps them to achieve their performance targets. For example, do risk indicators and thresholds trigger communication to escalate action to minimize value destruction and maximize value creation? This will increase the organization's success in executing its strategic objectives and delivering on its full potential to create value and to sustain its growth trajectory over the long term.

These techniques will require that the ERM function support the business in applying risk intelligence to develop corporate strategies, set priorities, and coordinate deployment of resources. Embracing a support role will require ERM leaders to expand the scope of their conversations with others in the organization beyond the current emphasis on *gathering* risk information to a collaborative conversation on how to improve the *application* of risk information. This doesn't mean abandoning the monitoring role. It does mean enabling managers across the organization to take the information contained in risk reporting and turning it into insights that they can apply to enhance the organization's performance.

Champion the Debiasing of Risk Assessments

A fourth strategy for integrating a risk lens into ongoing operations involves enhancing the quality of the information produced by risk assessment processes. A criticism that is often leveled at ERM is that the qualitative assessments of risk it produces are largely subjective and opinion-based rather than objective and evidence-based.[25] The typical qualitative ranking approaches used, such as a heat map or risk matrix, can produce risk assessments that are rife with bias if not carefully managed. Indeed, many an organization has been taken by surprise by events or circumstances that their qualitative risk assessment process had discarded as highly unlikely or of having little potential to impact the organization's value. When that occurs, especially repeatedly, it undermines the credibility of the ERM discipline in the eyes of managers and senior executives.

While there will always be some element of subjective judgment in assessing risks—risk is about the future, after all—it behooves ERM practitioners to lead the way on guarding against bias. This is essential to earn and maintain the confidence of senior leadership teams and boards of directors. To be clear, when we use the term bias, we are referring to cognitive biases, which are thinking flaws that are hard-wired into the human brain (e.g., confirmation bias) or that arise when we interact with others (e.g., groupthink). Dozens of biases have been identified and there are many excellent resources that describe them and how they affect risk assessment and decision-making.[26,27]

There are a number of potential strategies for debiasing risk assessments.

As with many issues, the first step is awareness. It is helpful to provide education on common biases and how they typically distort risk assessments. This will enable risk assessment participants to notice when they may be falling prey to biases.

ERM leaders can help to minimize bias through the design and application of the organization's risk assessment processes.[28] Since much risk assessment work is done in a group setting through workshops, care must be taken to guard against biases such as groupthink, anchoring bias, and decision fatigue.

Employing evidence-based risk assessment techniques is a powerful way to help participants in a risk assessment process to distinguish between what is a verifiable fact versus what is a belief, opinion, or assumption. In addition, clearly articulating what is and is not known about a risk can also help decision makers to calibrate their judgment of a risk.

A qualitative approach is an efficient way to quickly make a ranking of risks. However, for important and large risks, it should be the first stage of the risk assessment process, not the final word.

Advocate for the Enhancement of Capabilities in Risk-Informed Decision Making

A fifth strategy for integrating a risk lens into ongoing operations is to enhance the organization's capabilities to effectively take decisions and actions under uncertainty and risk. The ERM function can work with operations managers to identity areas where business processes can be fine-tuned to ensure systematic integration of ERM considerations into business decisions and activities. The ERM function can also advocate with colleagues who are responsible for training and organizational development to help ensure that people across the organization get the tools and training they need to be able to effectively identify and weigh risk in their day-to-day decisions.

CONCLUSION

For ERM to live up to its full potential, a stronger connection needs to be forged between ERM and activities aimed at generating and sustaining growth in an organization. This means shifting the primary focus of ERM from identifying and monitoring enterprise risk exposures to supporting the organization to take risk-informed decisions and actions. Making that shift will require ERM leaders to change their mindset and approach to ERM.

In this chapter, we have shared a wide range of strategies that ERM leaders can adopt to enhance collaboration between ERM and other functional and operational areas of their organizations in order to embed a risk lens into decision making and drive sustainable growth.

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NOTES

1. Our reading of the ERM literature draws heavily on the ERM Initiative of the Poole College of Management at North Caroline State University, which has published an annual survey on The State of Enterprise Risk Oversight since 2009. We also reviewed the results of many studies and surveys into ERM practices across a wide range of economic sectors conducted by professional organizations (including Financial Executives International, Global Risk Institute, Institute of Risk Management, Risk and Insurance Management Society, etc.) and several consulting firms.
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7. Ibid.
8. Ibid.
9. Joyce Ehrlinger, Ainsley L. Mitchum, Carol S. Dweck, "Understanding Overconfidence: Theories of Intelligence, Preferential Attention, and Distorted Self-Assessment," *Harvard Business Review*, 2012.
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11. Ibid.
12. "Bank of Canada Focuses Strategic Plan on Innovation, Says Senior Deputy Governor Wilkins," press release, Bank of Canada, November 13, 2015.
13. http://www.businessdictionary.com/.
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15. David R. Koenig, *The Board Member's Guide to Risk* (Northfield, MN: (b)right governance publications, 2020).
16. We have adapted these questions based on the five fault lines for identifying when to reinvent a business defined by Mark Bertolini, David Duncan, and Andrew Waldeck, "Knowing When to Reinvent," *Harvard Business Review*, December 2015.
17. Jay Ogilvy, *Scenario Planning and Strategic Forecasting* (Forbes, 2015).

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18. Beasley, Branson, and Hancock, *2020 The State of Risk Oversight*.
19. Ibid.
20. Carl Spetzler, Hannah Winter, and Jennifer Meyer, *Decision Quality: Value Creation from Better Business Decisions* (John Wiley & Sons, 2016).
21. Utility functions are a concept from economics to plot on a curve an individual's preferences for goods or services beyond their monetary value. Decision analysis (DA) employs utility functions to calculate the desire for various decision options when they involve risk. DA typically defines one of three utility functions to account for the decision maker's risk attitude: risk averse, risk seeking, and risk neutral.
22. In its Three Lines of Defense Model, the Institute of Internal Auditors defines two roles for the second line of defense (i.e., the risk management function). One role is to provide "complimentary [to managers in the first line whose role is the delivery of the organization's products and/or services] expertise, support, monitoring, and challenge related to the management of risk." The other role is to "provide analysis and reports on the adequacy and effectiveness of risk management (including internal control)."
23. "The IIA's Three Lines Model: An Update of the Three Lines of Defense," The Institute for Internal Auditors, 2020.
24. Credenza-ware is a satirical name for reports that are neither read nor discussed and certainly not used in business decision making. Instead they adorn a credenza or a shelf in case an auditor or board member asks for them.
25. Douglas W. Hubbard, *The Failure of Risk Management: Why It's Broken and How to Fix It* (John Wiley & Sons, 2009).
26. Daniel Kahneman, *Thinking, Fast and Slow* (New York: Farrar, Straus and Giroux, 2011).
27. Spetzler, Winter, and Meyer, *Decision Quality*.
28. Diana Del Bel Belluz, "The Neuroscience of Enterprise Risk Management," *Risk Watch*, journal of the Conference Board of Canada, 2017.

ABOUT THE AUTHOR

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