

Risk Management

Issue 5 April 2004

Price \$9.95 (GST inc)

ERM may be the answer to risk management vicious cycle

ADOPTING enterprise-wide risk management could combat what consultants call the vicious cycle of risk management.

Although risk management is high on the agenda at present, due to issues such as heightened regulatory pressure, corporate collapses and terrorism, it is likely to slip from the forefront of business leaders' minds, as economic and business conditions change. "When economic cycles change, companies do take a different risk posture," said Dean Kingsley, risk management partner at Deloitte. "When times are good, people are willing to take more risks."

Risk management-related issues have gained much publicity so far this year both at home and overseas. The fallout from events at National Australia Bank continues to ensure a high profile for risk management and while this is a good thing, it highlights the cyclical nature of the business community's thinking about the discipline, which goes hand in hand with the economic cycle.

"Following such events, operational risk becomes a top issue for senior management," said one risk management expert. "Some institutions ask 'why should we use operational risk approaches?' If something bad happens, the awareness goes from zero to 100 per cent.

"At the moment, risk management is high on the agenda – it hasn't had this level of exposure for some time. In this environment exposure is coming from a lot of places," Tony Harb, director of InConsult told Risk Management. "The biggest risk with risk management is paying lip service to it and ticking the boxes and thinking it doesn't add value. At the end of the day profitability comes under the microscope and people start asking what are we spending on risk management – do we need so much of it? Historically this cycle shows that we have short memories."

Although under current Australian legislation, all authorised insurers and financial institutions and Financial Services Reform Act licensed organisations must have a risk management strategy there are worries that firms are adopting a 'tick the box approach'. And outside of those industries, the situation may be different.

An insurance industry survey carried out late last year found that although 75 per cent of respondents had a formal risk management and measurement at the corporate level, only 15 per cent had enterprise-wide risk aggregation capabilities.

At the heart of the problem is the difficulty in calculating return on investment (ROI) from risk management activities. But enterprise risk management can solve this potential problem. ERM involves the integration of risk management activities across all business functions and units. "You must define how you measure risks and then integrate it into your business processes," said Harb. "If you build it into your business you will reduce your risk management costs and get greater ROI. Risk management should be owned by the business and should encompass the whole business."

A recent survey outlined that the biggest obstacles for firms wanting to implement ERM strategies were information and making sure people in the business have the right training to carry out the ERM framework organisation-wide. For this to be achieved, risk management must be recognised as a core business skill. "What needs to happen is a change in management skills," said Harb. "At present managers need leadership, communication and business skills but risk management skills are not seen as a core competency. Its not an overhead or a burden but makes business more efficient – there needs to be a balance.

Interest in ERM is increasing, but observers warn that it must be implemented properly. For example, National Australia Bank's 2003 annual report detailed its enterprise risk management model, but subsequent events have suggested it was not implemented correctly.