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WEBINARS

KEY LEARNING SUMMARY

# Leading Risk Culture Change

*featuring* **Linda Conrad**, **Paul Walker**, *and* **Johan Willaert**

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# Leading Risk Culture Change

## OVERVIEW

Enterprise Risk Management (ERM) is no longer an option; it is a fiduciary responsibility of the board of directors. But ERM can be crippled by a company culture in which risks are downplayed and C-level executives fail to communicate.

For employees at every level, the C-suite must instill new attitudes toward risk awareness, assessment, and mitigation. These are positive strategic components that improve corporate decision making, protect the balance sheet, and allocate capital wisely.

## CONTEXT

This panel of insurance, industry, and academic risk experts discussed their experience changing company cultures surrounding risk.

## KEY LEARNINGS

In too many organizations, business risk fails to receive the top-level attention it merits. Companies often have a "good news only" environment which makes middle managers reluctant to report risks. As a result, risk management is shunted to compliance and audit groups.

But in an era of increasing internal and external risks—from currency fluctuations to reputational damage (see Figure 1)—this traditional cultural attitude renders a coherent corporate response difficult or impossible. Those risk factors that are not actively monitored and managed can bring a company down.


**Figure 1**
The Enterprise Risk Wheel.

## CONTRIBUTORS

**Linda Conrad**
Director of Strategic Business Risk, Zurich

**Paul Walker**
Zurich Chair in Enterprise Risk Management, St. John's University

**Johan Willaert**
Corporate Risk Manager, Agfa Corporate Center

**Angelia Herrin (Moderator)**
Editor, Special Projects and Research, *Harvard Business Review*

Leading companies understand that:

- **The entire organization must be risk-aware.** Until everyone is accountable for recognizing and managing risk, the company can miss threats. Improved transparency can potentially reduce both a firm's total cost of capital and its earnings volatility.
- **ERM must be consistent across the enterprise.** Although risk profiles may differ among business units depending on market, financial, and other factors, senior management needs a common language and set of metrics to report and manage risks.
- **A strategic approach to risk leads to tactical competitive advantages.** Once risks are evaluated, organizations can make better decisions, prudently increase risk tolerance to profit from growth opportunities, hire the right executive talent, and deliver stronger results.

Ideally, this change in the risk culture is in place or underway before an enterprise risk framework is fully implemented.

**Selected responses from a recent HBR-AS/Zurich/FERMA/PRIMO survey of European companies**

| | |
|---|---|
| What areas of risk management are most important to emphasize? | • Financial risk<br>• Strategic risk<br>• Legal and regulatory risk<br>• Brand reputation risk<br>• IT data privacy<br>• Technology |
| Where does direct responsibility for risk lie in your organization? | • CRO/Risk Manager (34%)<br>• CEO or CFO (27%)<br>• Board of Directors (14%) |
| Communication between CRO and C-suite is comprehensive. | 17% |
| My organization has not set up a cross-functional risk committee. | 40% |
| Risk management is a tool for making better strategic decisions. | 20% |
| Risk management is a tool to help drive profitability by facilitating objectives. | 16% |

### Senior leadership must endorse, lead, and review strategic ERM initiatives.

Because most managers tend to view risk as a negative, ERM is unlikely to take hold in an organization unless the CEO and board of directors explicitly and proactively tie risk analysis to strategic objectives as well as individual goals and incentives.

Before they proceed, however, these C-level executives must first recognize their individual attitudes towards risk, explore how the team can reach consensus on a corporate risk approach, and then drive that understanding into the business.

Going far beyond "executive sponsorship," ERM leadership follows a five-step sequence:

1. **Gain support from C-suite management.** Even though many companies have a risk function, or even a chief risk officer (CRO), the entire C-level team and board of directors

> "It's important that the C-suite talk as much about risk management as it does about profit, growth, and customers, because all of these are obviously interrelated."
>
> **—LINDA CONRAD**

must stay involved in monitoring and addressing risk. This is particularly crucial over a three-to-five-year planning horizon.

2. **Define and communicate the initiative's scope.** Companies are at different spots on the road toward comprehensive risk management, so senior management must explain to all employee levels precisely which key risk indicators (KRIs) are being tracked, how individuals are expected to participate, and why this matters to company success. This approach sets a positive corporate "tone from the top" toward risk.
3. **Map key strategic risks and vet with stakeholders.** Each business has a unique set of risks that can be mapped on a two-by-two matrix, with increasing severity along the X-axis and increasing probability along the Y-axis.

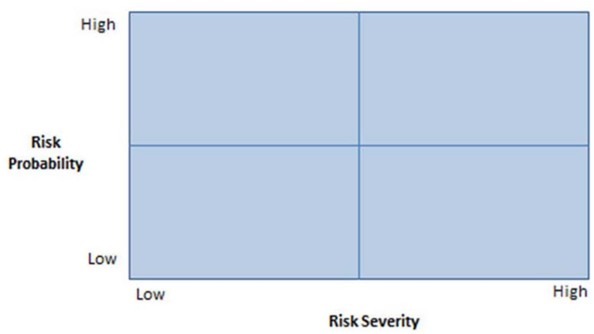


**Figure 2**
Mapping Key Strategic Risks

Color-coding the individual risk types as Strategic, Market, Financial, Operational, or People further highlights risk clusters. For example, several operational risks—supply chain, product liability, and regulatory—might all fall in the high-severity/high-probability quadrant. Once stakeholders agree on the mapping, larger budgets can align with greater risk exposure.

4. **Conduct risk assessments to prioritize risks and opportunities.** "Total risk profiling" develops scenarios from interviews with business leaders and workshops with the board. This process identifies vulnerabilities, defines likely trigger events, examines consequences, and establishes responses. The triggers, in turn, can form the basis for early-warning KRI metrics.
5. **Set a sustainable action plan and regularly review it.** Once an ERM process is in place, senior management must continue to review and, if necessary, revise it to reflect what the organization is learning over time. These learnings can form the basis of competitive thought leadership.

### Although corporate boards are legally responsible for risk oversight, they often can't get good information.

A 2010 Securities and Exchange Commission regulation, Rule 407(h), mandates that corporate boards oversee risk management in their companies and disclose their findings to shareholders.

Although this would appear to make ERM essential rather than optional, board members nevertheless often complain that they don't receive timely or accurate risk information from the CEO. Information is often "cleansed" before it reaches the board, and 15-minute presentations from the CRO to the board are insufficient.

Even when the C-suite says that it is implementing ERM, the reality is that each business silo has its own approach to risk management. While a broad-based, cross-functional risk committee is a critical component, the board is still ultimately responsible.

Almost all boards need to become more engaged in risk oversight. Simply listening to brief presentations from the CEO or CRO is inadequate to understand the specific risk landscape facing the company; the board must ask hard questions and press the C-suite to implement true ERM and report back with complete information.

> "The question for most boards is, are they getting good information? If they're not, it's their job to create an environment where they do."
>
> **—PAUL WALKER**

### An independent risk committee needs the board's support.

For companies new to ERM, even those with audit and compliance teams in place, a separate risk committee drawn from all business units is an excellent way to:

- **Set the organization's risk agenda.** The committee works with the board and the executive committee to establish detailed goals and priorities aligned with the firm's risk analysis and appetite—as well as its bottom line.
- **Strengthen communications channels.** The risk committee is well-positioned to communicate its findings and advice up to the board, down to front-line employees, and laterally to internal auditors. By the same token, the committee can act as a sounding board that encourages staff to safely discuss perceived risks without being blamed for them.
- **Align risk management with internal culture.** It is crucial that any ERM implementation reflect and respect the existing, unique culture. The risk committee can help articulate existing attitudes toward risk and determine appropriate incentives for changing those attitudes.

> "Every company culture is different, and it depends on the culture of the company how you implement ERM."
>
> **—JOHAN WILLAERT**

## OTHER IMPORTANT POINTS

- **Zurich Risk Room.** An award-winning tool, Zurich Risk Room illuminates the variety of interconnected global risks faced by businesses. Visit www.zurich.com/riskroom and www.supplychainriskinsights.com.
- **Risk apps.** Search for the Zurich Risk Room in the iTunes or Google Play store.

### Case Study: Turning Risk into Results at Zurich

Zurich implemented an ERM framework that switched from an asset-based to a risk-based approach to quantify operational risk.

For one business unit, that change immediately reduced operational risk-based capital (RBC) consumption by 21.7%. To follow up, the unit identified additional high-risk exposures, performed a deeper assessment, and put mitigation measures into place. The following year, the unit experienced a further 28.9% reduction in risk capital consumption.

Zurich used this freed-up risk capital to fund new growth.

## BIOGRAPHIES

### Linda Conrad

***Director of Strategic Business Risk, Zurich***

Linda Conrad is Director of Strategic Business Risk for Zurich. She leads a global team responsible for delivering tactical solutions to Zurich and to customers on strategic issues such as business resilience, supply chain risk, Enterprise Risk Management (ERM), risk culture, and Total Risk Profiling. Linda also addresses enterprise resiliency issues in print and television appearances, including CNBC, Fox Business News and the *Financial Times*, and is featured in a *Wall Street Journal* site at: www.supplychainriskinsights.com.

Linda holds a Specialist designation in ERM, and serves on the board of the Institute of Risk Management in London. Linda is deputy member of the ERM Committee of RIMS, sits on the Supply Chain Risk Leadership Council, and was Chairwoman of the Asian Risk Management Conference. She has taught at University of Delaware Captive program and in the Masters on Supply Chain Management program at University of Michigan's Ross School of Business, where she also serves on the Corporate Advisory Council. Linda studied at the Graduate Institute of International Studies in Geneva, Switzerland, and Fox Business School.

### Paul Walker

***Zurich Chair in Enterprise Risk Management, St. John's University***

Professor Paul L. Walker is the Schiro/Zurich Chair in Enterprise Risk Management. He is a CPA and a member of the AICPA, IMA, IIA, and FEI. Paul has extensive experience in banking, public accounting, and auditing, and is a fraud expert witness and consultant. He also served as a visiting fellow at the London School of Economics Centre for the Analysis of Risk and was a consultant to COSO on their Enterprise Risk Management framework. In 2011, Paul was selected as a 2011 Deloitte CFO scholar.

Paul co-developed one of the first courses on Enterprise Risk Management (ERM) and has done ERM training for executives and boards around the world. He has written extensively on risk and ERM including the books *Improving Board Risk Oversight through Best Practices*, *Making Enterprise Risk Management Pay Off*, and *Enterprise Risk Management: Pulling it All Together*. He has also authored and coauthored several articles in professional journals.

He holds a Ph.D. from the University of Colorado Boulder and a BBA from the University of Texas Arlington.

### Johan Willaert

***Corporate Risk Manager, Agfa Corporate Center***

Johan Willaert is Corporate Risk Manager of the Agfa Corporate Center. He designed and is in charge of worldwide insurance programs as well as risk management since 2001. He formerly worked with the Insurance Brokerage and Consultancies within the Sedgwick Organization. Johan studied law at Universiteit Gent.

### Angelia Herrin (Moderator)

***Editor for Research and Special Projects, Harvard Business Review***

Angelia Herrin is Editor for Research and Special Projects at *Harvard Business Review*. At *Harvard Business Review*, Herrin oversaw the re-launch of the management newsletter line and established the conference and virtual seminar division for *Harvard Business Review*. More recently, she created a new series to deliver customized programs and products to organizations and associations.

Prior to coming to *Harvard Business Review*, Herrin was the vice president for content at womenConnect.com, a website focused on women business owners and executives.

Herrin's journalism experience spans twenty years, primarily with Knight-Ridder newspapers and USA Today. At Knight-Ridder, she covered Congress, as well as the 1988 presidential elections. At USA Today, she worked as Washington editor, heading the 1996 election coverage. She won the John S. Knight Fellowship in Professional Journalism at Stanford University in 1989–90.