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**EXCERPT FROM
INTEGRATING THE CORPORATION**

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INTEGRATED RISK MANAGEMENT: AN OVERVIEW

Value and Risk

A comprehensive approach to managing shareholder value must include the protection of this value. Risk management must become part of the shareholder value management process.

This means that risk management must be embedded in both the strategic planning process as well as in the operations of the business.

At the enterprise-level, the risk management function must address all of the factors that affect value. Risk management systems must include the protection of business cash flows. A company's risk management function is expected to lower cost of capital (lower risk, lower cost of capital). Risk management systems are also designed to protect all the assets of the business, including reputation - hence, market sentiment concerning the company.

This means that a strategic approach to managing stakeholder value must include not only directly managing for incremental gains but also in protecting everything that affects value: cash flows, physical assets, distribution systems, relationships, reputation, etc.

Planning for Robustness

As strategy needs to be dynamic, one thing managers can do is to look at the competitive situation and consider how this could change in the future. They can then review their existing capabilities in order to develop a plan for ensuring that they are working towards building capabilities that would be appropriate for the future. When this is done, it is important for management to anticipate the ways in which competition might deal with these future changes.

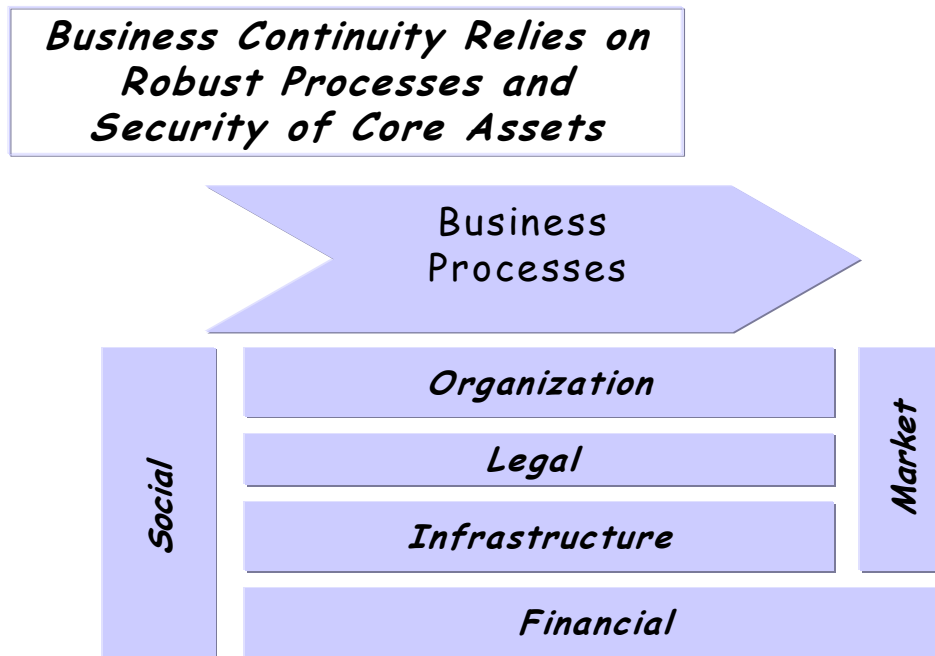
Finally, it is important to test the strategy for robustness as well as optimality.

Both the environment that allows the company to create value, the assets that are used to create value and the processes that create value must be reviewed for vulnerability to major uncertainties. Also, it is important to ensure that the company has identified opportunities that may occur should certain events occur. A complete risk management program must be designed to manage the upside as well as the downside.

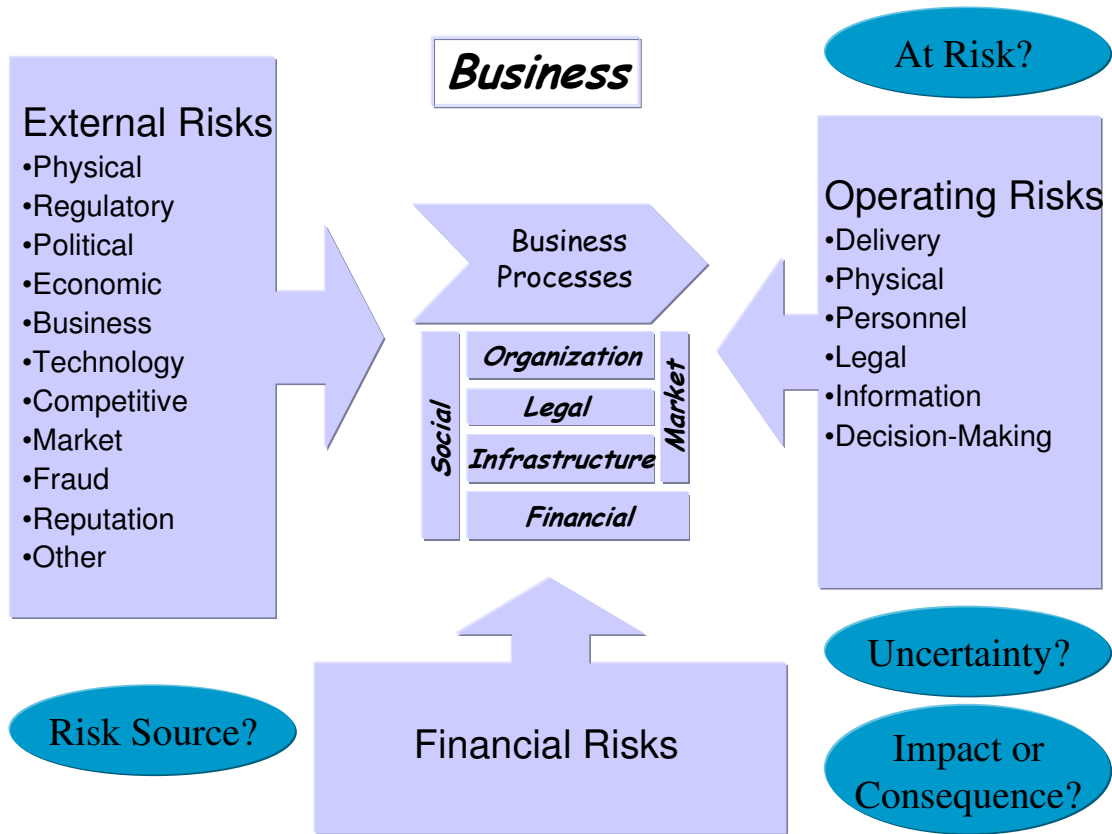
The risk management process is a three stage process: a) identification and assessment; b) management; and c) monitoring.

For risk management purposes, it is often easier to collapse the company's asset map into the larger categories of: financial, infrastructure, market, organization, legal and intellectual and social.

During the risk identification phases, it is important to understand that both processes and assets can be at risk. Assuring business continuity requires both that process be robust and that assets be secure

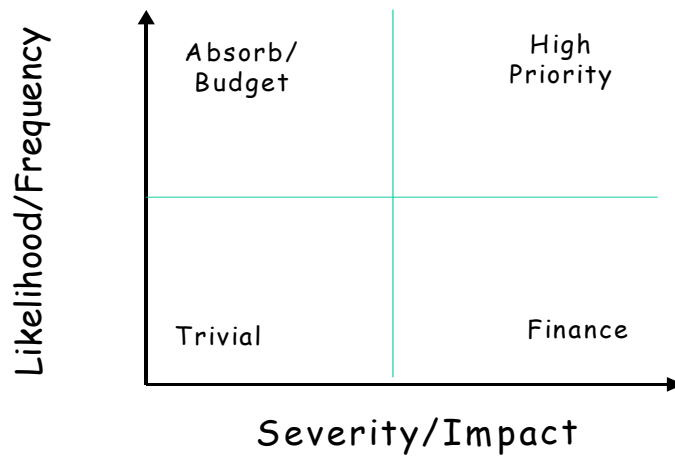


Risks can typically be classified into three: a) External Environment; b) Operating and c) Financial. In reviewing risks, the corporation must be able to identify the risk or uncertainty (i.e. what could happen?) as well as the process or asset at risk. Also, it is important to understand the source of the risk as well as the degree of impact of the consequences of a risk event occurring.



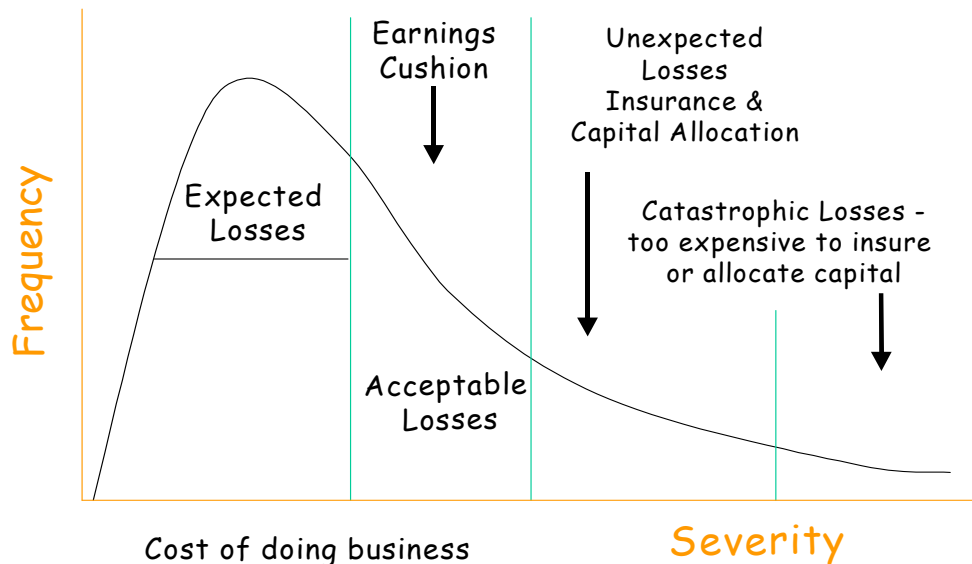
Once risks are identified, it is useful to assess and prioritize them through a simple likelihood vs. impact map. Both opportunity as well as loss events should be mapped.

Risk Mapping



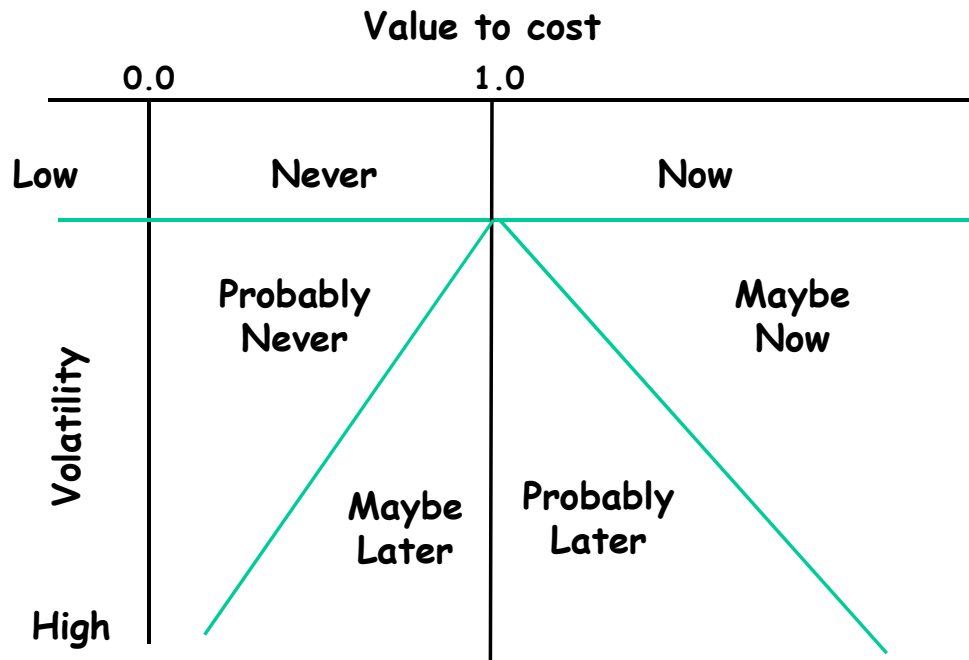
Loss events can then be managed through mitigation. Mitigation can address likelihood or impact or both. Mitigation at both the preventive as well as the contingency levels are useful in creating robustness. Residual risks can either be accepted or financed.

Financing the Downside



While the focus for managing loss events is to decrease likelihood and impact, the focus for opportunity events is to increase likelihood and impact. Like loss events, contingency plans must exist. For opportunities, one of the most important contingency plans is the mobilization program – both financing, infrastructure and organization plans must exist for the highest priority opportunities.

The risk management plans must then be implemented and monitored. The monitoring program is crucial as the degree of impact is often heavily influenced by early detection. The value of opportunities is also heavily reliant on the timing of the decision to invest. A monitoring program must exist to ensure that the opportunities are mined when the value creation opportunity is highest.



Risk management must be embedded in the full strategic planning exercise. While it is clearly included in the external and internal scanning phase, it is important to do a final check once the strategic and operating plans are drafted because those plans also have their own set of uncertainties.

It is also at this phase when management can ensure that the full risk management processes and indicators are embedded in its plans and in its performance indicators. This provides management with the foundation for understanding both the cost as well as the protective value of risk management activities.

The wide availability of powerful analytic tools now allow management to model alternative strategies not only for expected value creation but also for robustness. Each strategic alternative can be reviewed not just for expected value created but also for the range of possible values given the range of possible scenarios. These ranges are developed using stochastic simulation. This is particularly helpful in industries that are exposed to major systemic fluctuations such as, for example, oil companies that are vulnerable to oil price fluctuations or even insurance companies that are vulnerable to both interest rate fluctuations as well as pandemics.

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