

# Risk Management Made Simple **Advisory**

Welcome to the FREE Online Newsletter about **Systematic Risk Management**  
for **executives** and **management professionals**  
from **Risk Wise Inc.** and **Diana Del Bel Belluz**

## December 2011

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"I save and study each issue of the *Advisory*. I appreciate how **Diana gives very practical advice and links it to fundamental theories and best practices**"

**Sherrie Hyde, CA**  
Risk Manager  
Lutherwood

## FEATURE ARTICLE: Risk Management Basics – Step 3: Integrate ERM into Business Practices

By **Diana Del Bel Belluz, M.A.Sc., P.Eng.**

In this article, I'll share tips on **how to integrate ERM into business practices**. This is the third article in a 4-part series on risk management basics. The series introduces the **Risk Wise ERM Implementation and Organizational Learning Cycle** and its four essential steps for bringing ERM to life in any organization:

1. Define the context and criteria for enterprise risk management (ERM)
2. Assess risks and its implications for performance and stakeholder value
3. Integrate ERM into business practices
4. Close the learning loop to fine-tune & optimize ERM

The **Risk Wise** approach **moves beyond a narrow focus on how much STRUCTURAL 'capital'** (i.e., ERM framework, processes, and tools) **an organization has developed**. It contains important information on **how to bring your ERM structures to life by developing essential HUMAN 'capital'** (i.e., ERM knowledge skills and culture) **and RISK INTELLIGENCE 'capital'** (i.e., leadership to drive the information flows and behaviours that produce optimal organizational results).

**The third step** of the *ERM Implementation and Organizational Learning Cycle* **focuses on motivating actions that maximize the organization's:**

- effectiveness and efficiency in successfully exploiting risks that will help it achieve its corporate objectives and advance its mission, and
- resilience to risks that threaten its short-term health and long-term sustainability.

**Integrating ERM into business practices is all about driving appropriate risk-taking behaviour.** This includes traditional defensive risk management aimed at preventing downside risk events from destroying value.

**It also goes beyond traditional risk management** to enable the organization to take an offensive posture on value creation by fully exploiting opportunities for mission fulfillment. This requires taking action to align the organization's risk exposures with its risk appetite.

**Here are 3 tips for making ERM an integral part of your organization's business practices and culture.**

### Tip #1. Focus On Your People

A framework or process, no matter how perfect, doesn't manage risk. **People manage risk.**

To make the risk discipline part of your organization's culture and business practices you need to focus your ERM implementation strategies on **motivating managers to habitually and consistently consider risk in their decision and actions.**

**ERM cannot work** to manage risk more effectively, consistently and transparently, **unless your people have the knowledge, skills, and motivation to use the structures, processes and tools you provide.** Many ERM leaders learn the hard way that **you need to focus more on developing Human ERM Capital than on Structural ERM Capital.**

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There is no way around it, integrating ERM into business practices means asking your people to change their ways. **Whenever you set out to change behaviour, you will encounter resistance.** This is true whether you are seeking a major change (such as introducing a whole new accountability structure for risk management) or a minor change (such as asking people to make their intuitive risk management approaches a little more formal).

#### There are three main sources of resistance:

- **Rational** resistance stems from concerns about the quality and feasibility of the ERM implementation plan.
- **Emotional** resistance stems from an individual's feelings about how ERM will affect them personally.
- **Political** resistance is typically seen in leaders who fear that ERM could reduce their power.

For tips on **how to overcome resistance** see the 3-part series of **Feature Articles** I wrote on the topic:

- **Part 1: Know Who and What You're Up Against (July 2008)**
- **Part 2: Why You Can't Afford to Ignore Their Feelings (August/September 2008)**
- **Part 3: Breaking Through the Political Barriers (October 2008)**

**ASK YOURSELF: How can we help our people to cultivate the habit of weighing the potential risks of their decisions?**

#### Tip #2. Define Appropriate Risk-Taking Behaviour

Integrating ERM into business practices is about motivating people to take *appropriate* risks. That means selecting strategies that **strike the fine balance between taking enough risk to achieve your corporate objectives while avoiding excessive exposure to the potential downsides of actions.**

This is difficult, if not impossible, to achieve if people are not clear on what constitutes appropriate risk taking behaviour. **Your people need clear targets on what kind of risks the organization is willing to take** in the pursuit of its objectives; **what kind of risks it wants to avoid or minimize, and** for each category of risk **what constitutes too little or too much risk.**

See this month's **Bonus Resource** article **Getting Practical on Risk Appetite and Risk Tolerance** for tips on how to frame the risk appetite discussion.

**ASK YOURSELF: How can we strengthen our people's knowledge about the organization's appetite and tolerance for risk?**

#### Tip #3. Accentuate the Positive to Align Risk-Taking

Recent risk management failures shine a light on how inappropriately management incentives and disincentives

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that are **inappropriately conceived or applied can lead to perverse risk-taking behaviour** by managers and executives at the all levels of an organization.

**The consequences of misaligned risk-taking can catastrophic.** Think of the failed levees that multiplied the devastation of hurricane Katrina, the massive oil spill into the Gulf of Mexico, and the corporate meltdowns that occurred in the wake of the 2008 credit crisis.

If your leaders aren't actively using an appropriate mix of incentives and disincentives to guide their people toward appropriate risk-taking, you may well be courting disaster.

**Traditional risk management tends to focus on disincentives**, i.e., detecting and correcting breaches of risk controls. Inappropriate risk-taking should not be condoned or ignored. **However, a focus on incentives**, e.g., positive reinforcement of appropriate risk-taking behaviour, **is much more effective** for aligning individual and collective risk-taking with the organization's overall appetite and tolerance for risk.

**Incentives do not have to be monetary.** The saying "You catch more flies with honey than vinegar" also applies to ERM. The quickest and most effective way to integrate ERM into your business practices is by acknowledging appropriate risk-taking behaviour. This sends a strong message about what is expected.

**Your leaders need to engage in regular conversations about risk with their people** to encourage appropriate risk-taking decisions and actions (i.e., that align with the organization's risk appetite) and discourage inappropriate risk-taking behaviour (i.e., that takes too little or too much risk in a given situation).

**ASK YOURSELF: How can we incent our people to engage in appropriate risk-taking?**

**The Risk Wise bottom line... Embedding ERM into business practices is all about behaviour.** How people *apply* your ERM framework is more important than any detail of what is in the framework itself. To make ERM an integral part of your organization's business practices and culture, you need to **motivate your people to continually develop and apply their ERM knowledge and skills.**

\*

My forte is coaching executives on how to integrate ERM into their organization's unique business practices and culture. **If you need help in bringing ERM to life in your organization, contact Diana Del Bel Belluz at Risk Wise:** Diana.Belluz @ riskwise.ca or by telephone at (416) 214.7598

## BONUS RESOURCE: Getting Practical on Risk Appetite & Risk Tolerance

By Diana Del Bel Belluz, M.A.Sc., P.Eng.

Over the past year, I've helped many management teams and boards **get clarity about the concepts of risk appetite and risk tolerance**. They came to me because, although there is a lot of chatter on the topics of risk appetite and tolerance, much of the literature is so jargon-filled that it's a struggle to **find the practical application of the concept**.

Over the summer **Melanie Herman**, Executive Director of the **Nonprofit Risk Management Center**, invited me to co-author a white paper\* with her on the topic of risk appetite. I jumped on the opportunity to distill my practical experience into a **simple process that any organization can use to articulate its risk appetite and effectively integrate it in their decision-making**. Here are the 5 steps of the process:

1. Define parameters (principles) for risk-taking
2. Calibrate the organization's appetite for each major category of risk
3. Verify that the organization's risk taking culture is aligned with the risk appetite statement
4. Apply the risk appetite statement when evaluating risks
5. Review risk appetite statements on a periodic basis

There is only room to provide details on part of the approach in this article, so I've chosen to share **the first step in the risk appetite articulation process** because it **is essential for correctly framing the risk appetite discussion by the executive team and the Board**.

**Defining the parameters or principles for risk-taking involves reflecting on the organization's mission and its corporate strategies** aimed at achieving that mission. For example, a nonprofit whose mission is to help low-income residents of a rural community may decide its core strategy is to work through existing social services agencies rather than serve clients directly. An innovative partnership with a new agency would be mission and strategy-consistent. An innovative program to deliver services directly (eliminating the "middle-man") would not.

**Here are a few questions that you can use to define your organization's parameters for risk-taking:**

- **What must exist for risk-taking to be palatable?** For example:
  - promise of/potential for mission-advancement
  - consistent with tax-exempt purpose (for nonprofits)
  - commitment and clear strategies to learn from success or failure
  - calculation of the cost of failure and consideration of organizational responses if the risk doesn't pay off
- **What level of unrestricted net assets is available for risk-taking?** By risk-taking we mean doing something for which the outcome is highly uncertain but potentially mission-advancing.
- **What risks would the organization never take?** For example, the board of a professional society may decide that any risk-taking that could negatively impact the stature of members is unacceptable.
- **What is the Board's comfort with respect to the organization's reputation?** You'll want to begin by determining if the organization's current reputation is fragile, solid, improving, declining, etc. Then see if you can uncover what principles management and the board are currently or would like to apply for decisions that impact reputation. For example, an organization that is viewed by stakeholders as old-fashioned or out of touch may take bold risks to change that reputation, while an organization with a reputation for trustworthiness would never take a risk that might cause stakeholders to question its integrity.

Employees and managers need to understand the organization's parameters for risk-taking to ensure that their decisions lead to the most efficient and effective use of resources and balance potential upside and downside effects. **In the absence of a clear statement of risk appetite**, it is left to each manager and employee to infer what he or she *believes* is the organization's risk appetite. Invariably this **leads to inconsistent risk taking and situations where risk is either under- or over-managed**. Either case can result in sub-optimal organizational performance and resilience.

\* The complete white paper (including a more **detailed explanation of how-to articulate and apply a risk appetite framework**) is included in the second edition of ***Ready... or Not: A Risk Management Guide for Nonprofit Executives***, available at:

[http://www.nonprofitrisk.org/store/pub\\_detail.asp?id=227](http://www.nonprofitrisk.org/store/pub_detail.asp?id=227)

## Upcoming Event and Special Offer\*

- **Human Capital Risk Management Conference.** The Conference Board of Canada will present this event on **April 25-26, 2012** in Toronto, Ontario.  
**SPECIAL OFFER: \$455 discount** for *Risk Management Made Simple* E-Zine subscribers.

\* For details on this and other events and offers, visit: <http://www.riskwise.ca/events.html>

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## About Us



**Diana Del Bel Belluz**  
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**Diana Del Bel Belluz, M.A.Sc., P.Eng.**, is a risk management advisor who **helps executives in complex organizations to implement systematic and sustainable risk management practices.** Since 1990, Diana has been doing **leading-edge risk work** for a wide range of organizations in the corporate, government and nonprofit sectors.

In addition, Diana **advances the field of risk management** by **teaching** university courses and management training seminars, **speaking** at conferences and **authoring** publications on a wide range of risk management topics.

**To learn more about Risk Wise**, contact Diana Del Bel Belluz directly at: [Diana.Belluz@riskwise.ca](mailto:Diana.Belluz@riskwise.ca)



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