

Risk Management Made Simple

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

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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 2: Assess Risk and Its Implications for Performance

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

In this article, I'll share tips on **how to assess the implications of risks on enterprise performance and stakeholder value**. This is the second article in a 4-part series on risk management basics. The series introduces the **Risk Wise ERM Implementation and Organizational Learning Cycle** of the 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 ERM Implementation and Organizational Learning Cycle** moves beyond a narrow focus on how much **STRUCTURAL capital** (i.e., ERM framework and processes) an organization has developed. It contains important information on how to build the **HUMAN capital** (i.e., ERM knowledge skills and culture) and the **RISK INTELLIGENCE capital** (i.e., the flow of information that drives optimal organizational results) required to bring your ERM structures to life.

The second step of the *ERM Implementation and Organizational Learning Cycle* is about understanding the implications of risk on future performance. **Are you having difficulty demonstrating the value of your ERM program?** If so, you probably have not yet established a measurable link between enterprise risks and organizational performance.

ERM ensures there is an explicit consideration of the risks that affect:

- **Organizational performance.** Knowledge about risks to the achievement of corporate objectives helps you to ensure success in the near-term.
- **Performance capabilities.** Knowledge about the risks that threaten your organization's ability to strategically position itself to deliver stakeholder value helps you to ensure sustainability of the organization over the long-term.

The main task of the second stage of the *ERM Implementation and Organizational Learning Cycle* is to **integrate risk analysis with performance forecasting and performance management by:**

- **Identifying risks**, i.e., determining the events or conditions that drive uncertainty in expected enterprise performance or organizational sustainability.
- **Assessing the magnitude of risks**, i.e., estimating the size and likelihood of the potential impacts of those risks on performance.
- **Evaluating risks**, i.e., deciding if risks are adequately managed or if they require more (or less) management attention.

Here are three tips on how to link ERM and performance management and build the ERM capital (structural, human, and risk intelligence) needed in implementing the second stage of the ERM cycle.

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Tip #1. Gauge the Influence of Risks on Objectives

To identify their enterprise risks, most organizations brainstorm on the question: *What could harm us?* This taps into the knowledge and experience of the team involved, but the **brainstorming approach fails to:**

- **Substantively quantify the impacts (positive or negative) on the organization's ability to achieve its objectives.** In fact, most risk registers don't indicate the relative importance of individual risks relative to the overall achievement of objectives.
- **Capture the interdependencies between risk factors.** Risks that can influence the achievement of the strategic objectives of the organization can often be linked or connected to each other. Because the brainstorming approach evaluates each risk in isolation, it does not enable you to systematically explore how risks might combine or cascade.

To understand the interrelationships between risks and gauge the impact on objectives, apply objective-oriented risk identification. This can be achieved with risk models that are qualitative (e.g., influence diagram technique) or quantitative (e.g., Monte Carlo technique).

The influence diagram methodology graphically maps the interrelationships between risks and **immediately communicates the complexities of how risks can influence an objective.** It enables the visualization of how risks can occur in combination or in sequence. It also pinpoints the factors that need to go right to achieve the objective, **providing important insight into the adequacy of the organization's performance capabilities.** See this month's **Bonus Resource** for a *How-to Guide for the Influence Diagram Technique.*

Tip #2. Cross-examine Your Risk Estimates

Once enterprise risks have been identified, they are assessed or sized. Most organizations use a version of the Delphi method to determine the potential likelihood and impact of each risk. While they do capture the assessment team's judgment and experience, **qualitative risk assessment approaches are extremely prone to bias and blind spots.**

The most effective way to guard against bias is to **cultivate openness and inquiry in the risk assessment process.** To achieve this culture:

- Distinguish between the facts and assumptions that underlie assessments of risk.
- Test assumptions and revise them accordingly.
- Encourage your people to raise concerns about the assessed level of any risk or the viability of any risk response strategy. Silence can be very dangerous.

See the **July 2009 Feature Article** for nine tips on how to achieve more robust and transparent risk estimates.

Tip #3. Shift Your Risk Response Mindset from Risk Reduction to Risk Alignment

Once risks have been identified and sized, the next step is to evaluate them to decide what, if anything, needs to be changed in your risk response strategies and actions.

Many executives mistakenly focus all their risk management resources on the risks with the highest combined rating of likelihood and impact. When considered narrowly from the *defensive* ERM stance of value protection (i.e., minimizing exposure to threats), this approach makes sense.

But, **when managers fail to consider the organization's appetite and tolerance for risks, they preclude the offensive ERM stance of value creation** (i.e., exploiting opportunities) that is necessary to pursue strategic objectives and advance the organization's mission. If your risk response strategies are exclusively focused on reducing risk, consider shifting to a mindset of continually aligning risk exposure with risk appetite.

You can quickly refocus how you evaluate risks by asking **How well does our current risk exposure align with the organization's risk criteria** (appetite and tolerance for risks)? A thoughtful answer to **that question will give you the information you need to set effective and efficient priorities, targets and timelines for risk response actions.**

The Risk Wise bottom line... A critical ERM success factor is to **establish a measurable link between enterprise risks and strategic objectives.** This will keep your ERM program focused on supplying and applying the risk intelligence that is crucial for meeting organizational performance targets, enhancing resilience and ensuring long-term sustainability.

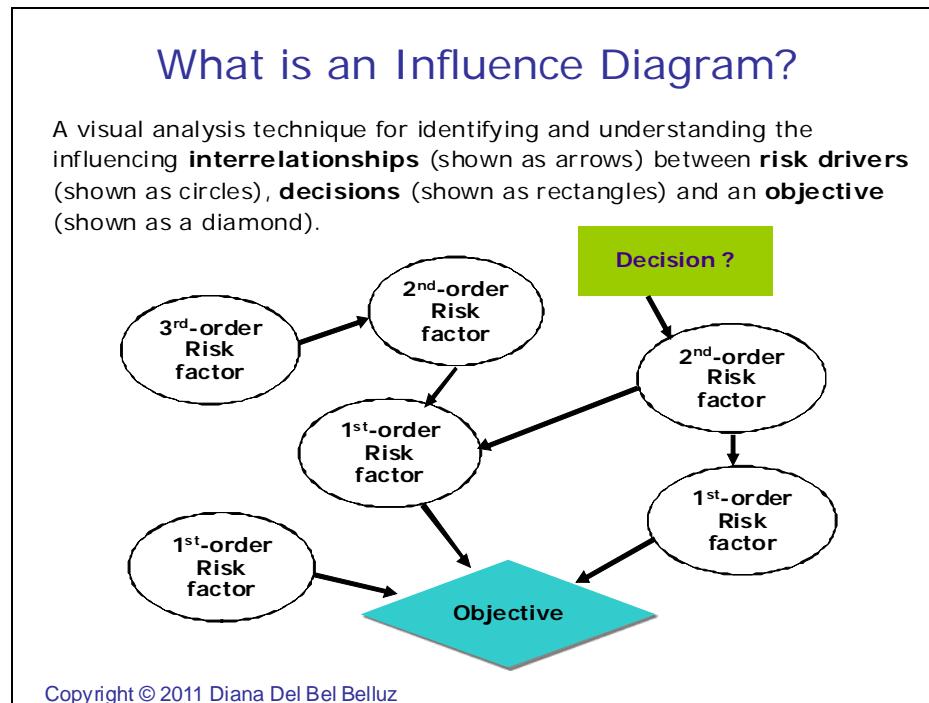
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I've coached many clients on how to apply these techniques. If you need **help in measuring the link between risks and enterprise performance**, contact **Diana Del Bel Belluz** at **Risk Wise**: Diana.Belluz @ riskwise.ca or by telephone at (416) 214.7598

Pass it on!
Please share this Advisory
with people in your network.

BONUS RESOURCE: The Influence Diagram Tool for Analyzing the Cause-Effect Relationships Between Risks and Objectives

The Influence Diagram is a tool to understand and evaluate the cause-effect relationships between risks and objectives. This figure shows the components of an Influence Diagram.



Because it's a structured approach, **the Influence Diagram technique offers many advantages**:

- Due to its pictorial nature, **it is intuitive to use**.
- It **systematically identifies the factors that drive risk** (uncertainty) to achievement of the objective.
- It **highlights what needs to go right** (i.e., performance drivers) to achieve the objective, not just the factors that could go wrong (i.e., downside risks). This helps to pinpoint vulnerabilities in performance capabilities.
- It **provides insight into the interrelationships between risk factors**, that the kind of simple list of risks produced by the traditional brainstorming exercise does not. This is extremely important for addressing major risk scenarios, which research shows, typically involve the interaction of 2 or more risk factors.
- It **provides a higher degree of certainty that key risks will be identified** than brainstorming alone. At **Risk Wise**, we frequently find that clients realize that certain risks that appeared to be small when they considered them in isolation were actually significant because they are amplified due to their position in the chain of cause-effect relationships between risk/performance drivers and their objective. Our clients also discover they can spot weaknesses in the ability of their risk mitigation strategies to handle cascading risks that they couldn't see when they considered risks individually.
- It **can be used prospectively** to explore where risks will be in three to five years. This kind of forward-looking analysis helps you to identify where you need to build resilience to ensure the sustainability of the organization. This may include making adjustments to your capabilities to manage the risks that are within your control (people, processes, and systems) and your strategies (e.g., awareness, influence, response) to deal with external factors that are not within your control.
- Thanks to the availability of commercial software the influence diagram **can easily be converted to a probabilistic risk model** (e.g., by applying the Monte Carlo method) to rigorously explore the full range of potential risk values. This type of approach enables the analyst to quantify the 'thickness' of the arrows, i.e., the magnitude of the influence that each factor has on the achievement of the objective being analyzed.

Get step-by-step instructions of how to construct an influence diagram and an illustrated example at:

<http://www.riskwise.ca/advisory-tips/influence-diagram-how-to-guide.html>

Upcoming Events and Special Offers*

December 5-6, 2011

The Conference Board of Canada's

Enterprise Risk Management

Conference: Taking ERM to the Next Level

Sheraton Centre Toronto Hotel
Toronto, Ontario

Hear practical advice and tips on how to improve ERM

The past decade has demonstrated that the initial ERM focus on identifying, monitoring, and avoiding potential threats was too narrow, and ERM programs ended up disconnected from the value creation cycle.

Join your peers, senior executives and leading risk experts who will share how they're enhancing ERM capabilities to **better recognize and respond to enterprise risks** in a complex, uncertain, and rapidly changing business environment. **Learn how ERM pioneers are integrating risk, strategic planning, and performance management.** Find out how to **articulate risk appetite to improve attitudes toward risk taking.**

SPECIAL OFFER: \$440 off* of the total registration fee for *Risk Management Made Simple* E-Zine subscribers.

Risk Management Training Courses from Wiltshire Consulting.

SPECIAL OFFER: \$100 discount for *Risk Management Made Simple* E-Zine subscribers on:

- **MODERN RISK MANAGEMENT 1 (Introductory)**
 - November 15-16 in St. John's
- **MODERN RISK MANAGEMENT 2 (Advanced)**
 - November 17-18 in St. John's
 - November 29-30 in Regina

* For details on the above events and offers, visit: <http://www.riskwise.ca/events.html>

About Us



Diana Del Bel Belluz

President
Risk Wise Inc.

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



1 Yonge Street
Suite 1801
Toronto, Ontario
Canada M5E 1W7
T 416.214.7598
www.riskwise.ca