

# CONCEPTS OF STRATEGIC RISK AND MANAGING STRATEGIC RISK

Presentation to the Strategic Planning Task Force

By

Joanne Curtis Taylor, Chief Audit Executive

# Concepts of Strategic Risk and Managing Strategic Risk

## Presentation Objectives

- ▣ Why is Internal Audit here?
- ▣ Concepts (Enterprise Risk Management, Strategic Risk, Strategic Risk Management, etc.)
- ▣ Summary

# Concepts of Strategic Risk and Managing Strategic Risk

## Why is Internal Audit here?

- ❑ Rather than assuming management's role in strategic planning, Internal Audit wanted to introduce the concepts of strategic risk and strategic risk management, offering to consult with management in its strategic risk management process.
  
- ❑ The Institute of Internal Auditors (IIA) defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

# Concepts of Strategic Risk and Managing Strategic Risk

## Enterprise Risk Management (ERM)

Before we can understand Strategic Risk Management (SRM), we must first understand Enterprise Risk Management (ERM).

### Definition of ERM:

- ▣ A process performed by an entity's Board, management and other personnel
- ▣ Process is applied in a strategy setting and across the entire enterprise
- ▣ Designed to identify potential events or risks that may affect the entity
- ▣ Risk is defined by the IIA as the possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.
- ▣ Allows the entity to manage risk to be within its risk appetite (the level of risk an organization is willing to accept)
- ▣ Provides reasonable assurance (**not absolute assurance**) regarding the achievement of entity objectives

# Concepts of Strategic Risk and Managing Strategic Risk

## Enterprise Risk Management (ERM)

- ▣ ERM focuses on the achievement of an entity's objectives
- ▣ Most entity objectives can be broken down into four broad categories for ERM:
  1. Strategic
  2. Operations
  3. Reporting
  4. Compliance
- ▣ A particular objective may overlap certain categories
- ▣ Allows an organization to focus on these separate objectives for the purpose of ERM
- ▣ Strategic objectives are one of the components of ERM

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Objectives

Strategic objectives are defined as:

- ▣ High-level goals
- ▣ Aligned with and support the goals of the organization
- ▣ Core and backbone of the organization's strategy
- ▣ Provide guidance on how the organization can fulfill or move toward the high-level goals
- ▣ More specific and cover a more well-defined time frame

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Objectives

A strategic objective should be:

▣ Measurable.

There must be at least one indicator (or yardstick) that measures progress against fulfilling the objective

▣ Specific.

This provides a clear message as to what needs to be accomplished

▣ Appropriate.

It must be consistent with the vision and mission of the organization

▣ Realistic.

It must be an achievable target given the organization's capabilities and opportunities in the environment in which it operates. In essence, it must be challenging but doable

▣ Timely.

There needs to be a time frame for accomplishing the objective

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk

As an organization attempts to achieve their strategic objectives, both internal and external events and scenarios can inhibit or prevent an organization from achieving their strategic objectives. This is known as *strategic risk*.

Strategic risk can be further defined as:

- ▣ Exposure to loss resulting from a strategy that turns out to be defective or inappropriate
- ▣ Risk associated with future plans and strategies, including plans for entering new services, expanding existing services through enhancements and mergers, enhancing infrastructure, etc
- ▣ Current and prospective impact of strategic decisions made by management arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk

Strategic risk is a function of the compatibility of an organization's strategic goals, the business strategies developed by management to achieve those goals, the resources deployed against these goals, and the quality of implementation.

The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes and challenges.

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk

### Common Strategic Risks

<b>External Risks</b> <ul style="list-style-type: none"><li>• Competition</li><li>• Market changes</li></ul>	<b>Human Resource Risks</b> <ul style="list-style-type: none"><li>• Knowledge</li><li>• Staffing</li><li>• Employee theft</li></ul>
<b>Financial Risks</b> <ul style="list-style-type: none"><li>• Cash flow</li><li>• Capital</li><li>• Price or cost pressures</li></ul>	<b>Structural Resource Risks</b> <ul style="list-style-type: none"><li>• IT systems</li><li>• Proprietary information</li><li>• Regulatory actions</li></ul>
<b>Physical Resource Risks</b> <ul style="list-style-type: none"><li>• Disasters</li><li>• Bottlenecks</li></ul>	<b>Relationship Risks</b> <ul style="list-style-type: none"><li>• Reputation</li><li>• Vendor performance</li></ul>

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk Management

### Components of SRM:

- ❑ A process performed by management for identifying, assessing and managing risks and uncertainties, affected by internal and external events, scenarios and risks that could impede the organization's ability to achieve its strategy and strategic objectives
- ❑ The ultimate goal is successful implementation of the strategic plan while creating, enhancing and protecting the organization and stakeholder value
- ❑ Primary component and necessary foundation of the organization's overall Enterprise Risk Management (ERM) process
- ❑ As a component of ERM, it is effected by the decisions made by the Board, management, and others
- ❑ It requires a realistic strategic view of risk and consideration of how external and internal events, scenarios and risks will affect the organization to achieve its objectives
- ❑ It is a continual process that should be embedded in and part of strategy setting, strategy execution, and strategy management

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk Management

Methods of managing strategic risk:

- ❑ Avoid.

However, you probably will not achieve your strategic objective by not taking some risk.

- ❑ Transfer.

This is the purpose of insurance. There is probably no insurance company willing to issue a policy that would indemnify an organization for not managing strategic risk.

- ❑ Accept at existing level.

The “I’ll take my chances” mindset could be detrimental to the organization and cause the strategic plan to fail.

- ❑ Reduce to an acceptable level.

## Which method are you going to choose?

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk Management (SRM)

### Basic Steps in the Strategic Risk Management Process Performed by Management:

- ▣ Communicate and share information across business and risk functions
  - Intranet, University website, monthly/quarterly newsletter, global email announcements, etc.
- ▣ Break down risk management silos
  - Risk in one area could affect other areas
- ▣ Identify and assess possible risks
  - Consider severity, probability, timing, impact, likelihood
  - Prioritize the organization's strategic risks
  - Consider the organization's risk appetite
- ▣ Identify potential positive consequences of risks
  - A risk can be turned into an opportunity
  - Risk is inherent to an organization embracing areas of opportunity and change
- ▣ Monitor and manage the risk
  - As new strategic objectives are developed, new strategic risks will emerge
  - Develop risk mitigation strategy
- ▣ It is a continual process that never ends
  - Not a one-time event
  - Management must do regular analysis and updates
  - Performed in conjunction with regular strategy reviews

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk Management (SRM)

### Benefits of SRM:

- ▣ Preparation for a major risk enables mitigation of that risk and promotes stability of the organization
- ▣ If you prepare better for risks than your competitors, you will have a competitive advantage
- ▣ Tool for thinking systematically “outside the box” about the future and identifying risks and opportunities
- ▣ Turn strategic threats into growth opportunities allowing the organization to move from the defense into the offense
- ▣ Better utilize resources and reduce costs

# Concepts of Strategic Risk and Managing Strategic Risk

## Strategic Risk Management (SRM)

### Limitations of SRM:

- ▣ Certain risks may occur and cause irreparable damage despite anticipation and preparation (“Acts of God”)
  
- ▣ No organization can anticipate all risk events
  
- ▣ This is not a box-checking exercise. There are substantial costs and efforts involved with SRM

# Concepts of Strategic Risk and Managing Strategic Risk

## Summary

- ▣ A strategic risk is the possibility of an event or scenario that could be both internal and external that inhibits or prevents an organization from achieving their strategic objectives
- ▣ Strategic risk is measured in terms of impact and likelihood
- ▣ Strategic Risk Management (SRM) is a process performed by management for identifying, assessing and managing risks and uncertainties, affected by internal and external events, scenarios and risks that could impede the organization's ability to achieve its strategy and strategic objectives
- ▣ SRM has benefits and limitations
- ▣ SRM is a continuous process performed by management that requires regular analysis and updates

# Concepts of Strategic Risk and Managing Strategic Risk

Some notable quotes involving the concept of risk:

“Progress always involves risks. You can't steal second base and keep your foot on first.” ~Frederick B. Wilcox

“You'll always miss 100% of the shots you don't take.”  
~Wayne Gretzky

“Go out on a limb. That is where the fruit is.”  
~President Jimmy Carter

“He who is not courageous enough to take risks will accomplish nothing in life.”  
~Muhammad Ali

# Concepts of Strategic Risk and Managing Strategic Risk

## References

- ❑ The Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF).
- ❑ “What Is Strategic Risk Management?” by Mark Frigo and Richard Anderson, Strategic Management, April 2011, p.21-22, 61.
- ❑ “Strategy Risk Management: The New Core Competency” by Mark Frigo, Harvard Business Review Balanced Scorecard Report, January –February 2009, p.3-6.
- ❑ “Understanding Strategic Risks” by Bob Stephen , Director of Financial Advisory Services for Wipfli LLP, Insight Article, June 2007, p.1-2.
- ❑ “Value Added Business Propositions” presented by Dennis Svitek at IIA Mid-Atlantic District Conference, October 20, 2011.

# Concepts of Strategic Risk and Managing Strategic Risk

## References

- ❑ “Understanding Strategic Risks” by Richard Anderson, The Institute of Internal Auditors Audit Executive Center, December 2011, p.1-18.
- ❑ “Strategic Risk Assessment by Mark Frigo and Richard Anderson, Strategic Finance, December 2009, p. 25-33.
- ❑ “Risk Management: A Look Back and a Look Forward” by Protiviti Consulting, The Bulletin, vol. 4, issue 6, April 11, 2011.
- ❑ “Strategic Objectives” by Greg Dess, G.T. Lumpkin, Marilyn Taylor, Strategic Management, 2 ed. New York: McGraw-Hill Irwin, 2005.

## Concepts of Strategic Risk and Managing Strategic Risk

# Do Have Any Questions???