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Introduction to Enterprise Risk Management

"Is there something wrong with me because I am scared to take a risk?" Lila K.

It is not just the large, complex or regulated organisation that needs proper risk management–every organisation needs it.

Unforeseen events take place every day and in many unexpected ways: the global economic meltdown; Hurricane Katrina; the tsunami in Southeast Asia; Japan's catastrophic earthquake; the September 11 attacks; or the uprising against the political leaders of Egypt, Tunisia and Libya. Each of those events was unexpected, but having a proper risk management plan in place will help any organisation survive such catastrophic occurrences.

Enterprise risk management (ERM) extends to your everyday business decisions because employees take actions and make decisions daily that could have a detrimental effect on your profits and business's longevity and future. Employees make dozens of decisions daily, and any one of them could come back to bite you, even when the decision does not seem to have hidden or unknown ramifications.

That is why your organisation must have a protocol in place for identifying and mitigating all major business risk long before it is needed.

This easy-to-understand and innovative book will help your organisation jump-start the process of establishing an enterprise wide risk management programme. The best news is that a programme is not expensive. Your major investment consists of expanding your firm's planning and communication processes and getting employees involved in the effort. The real price of ERM is a shift in your cultural norms that, sadly, is a "cost" some executives are reluctant to pay.

The tools and ideas in this ERM road map will make your organisation flexible, which allows you to capitalise on pleasant and unexpected opportunities and survive major threats. Practising formal disciplined risk management is like training to run a marathon. Even if you never enter a race you are already capable of doing so.

That is what true risk management is about: your organisation owning the capability to handle any aspect of Murphy's Law, the well-known saying, "If anything can go wrong, it will."

Who This Book Is for

This book is written for business owners and key decision makers because they are often the ones who decide if a risk or an opportunity is worth taking. This book is also a guidebook for both risk takers and risk avoiders. Even in the upside of risk taking, costs must be assessed and weighed. This is what risk management is about and why we will most often address the costs and downsides. The tools I provide will address both sides of the cost-benefit ratio for taking risks.

When you have completed this book, in addition to knowing how to control or tame risk, you will have learned about

- yourself.
- how you view risk.
- what you value.

As you travel the road to proper risk management described in this book, you will experience the following:

- *Risk management tools.* These 21 ready-to-use tools will enable you and those who work for you to put into action what you have learned. Appendix A, "Roadmap," summarises each tool and organises them according to the five and one-half enterprise risk management steps that are woven throughout the book.
- *Principles of risk management.* These 15 sound bite truths help you remember and teach key elements of proper risk management.
- *Action plans.* At the end of each chapter you will be asked to apply what you have read. The quicker you do each one the faster your organisation or team will be able to lower the price tag of your opportunities.
- *Murphy's laws.* These are bits of cynical humour designed to demonstrate that even well thought-out plans can and do go awry.
- *Rhetorical questions.* Along the road, you will encounter questions that are indented and set in boldface italics. They are designed to create a pause to get in touch with your hard-won wisdom (because I believe that you already know much about navigating potholes, which is something you regularly do).
- *Illustrations and graphics.* Some readers are visual learners; therefore, these are to be used to summarise broad messages about risk management.
- *Stories and case studies.* Stories about how and how not to deal with risks are tools to communicate, learn and teach others. Our brains retain pictures and stories for a long time.
- *Self-tests and pop quizzes.* These are designed to provide you lasting insights into aspects of risk management.

It is my hope that, after reading this material, you will make a commitment of employing an ERM-driven strategic approach in running your organisation. When you reach the end you will know how to create a simple yet powerful risk management plan for your company, team and family.

Success Requires Commitment to Risk Management

Before you delve too deeply into risk management and how it will enhance your ability to achieve your goals and dreams, answer this simple quiz.

You and Risk Management Pop Quiz

In my initial meeting with Justin and Paul, the partners at PJ Investments we met in the introduction, I gave them this test. I urge you to take it, so you can see if you truly understand risk management.

When you hear or read the term risk management what do you automatically think of?

- ☐ Insurance
- ☐ Investments
- ☐ Gambling
- ☐ Opportunity
- ☐ Loss
- ☐ Danger or harm
- ☐ Profits
- ☐ (Other) ______________

Justin responded with insurance, gambling, loss and danger. Paul's choices were investments, opportunity and profits. This told me they had polar opposite views of risk.

If, like Justin and Paul, you checked at least one of the boxes for insurance, investments, gambling, loss, danger or harm, or profits, you really need to keep reading this book.

If you checked opportunity you have some understanding of risk management and probably want or need more.

Risk Management Defined

Real-world risk management is having a comfort level that whatever risks come your way, you have the ability to deal with them. This confidence comes from these three factors:

1. Murphy's law (if anything can go wrong, it will) is a reality. Risk management requires having a system or methodology in place to examine risks before you take them, and I stress the word *before*. All too often the business owner or manager worries about the impact of a major risk <u>after</u> the risk has been taken. This is why and when opportunities are frequently mishandled.
2. Your employees have tools to examine and measure the impact of a risk. They know how to use and apply them in their everyday decision making efforts.
3. Leaders or decision makers all across your organisation use insightful information to confidently (as opposed to rashly) step into the unknown.

As you journey through this book you will discover how to be a wise risk taker, even if, like Lila, who subsequently will be discussed, you do not see yourself as one right now. If you are a person like Paul who frequently jumps into the unknown, you will learn how to better size up your risks.

Stewardship and Risk Management

If you are a business owner, manager, supervisor, member of a board or leader of a team, one responsibility you have is to ensure everyone you lead is simultaneously on the watch for opportunities and risks. Doing so demonstrates that you are taking your stewardship responsibility seriously.

Risk management is a vital responsibility to show good stewardship when running and operating any organisation, such as

- a military unit,
- a small business,

- a government agency,
- an investment club or
- a family land and buildings venture.

It is even a primary responsibility for those who manage large publicly traded and international companies. Many organisations are choosing to implement an ERM process to ensure that a uniform approach to risk identification, measurement and treatment gets utilised in the organisation.

Cost and Risk Management

Risk management is a necessary aspect of stewardship because of this first truism:

> **First Principle of Risk Management**
>
> Every opportunity has a cost. Every opportunity carries a risk or downside.

Your cost or price in both a business and personal risk could be monetary or something intangible, such as your ego.

To explain the truism of the first management principle that every opportunity has a cost, let's look at the dilemma faced by High Road Institute client Lila.

Lila K. is a smart and talented woman who has a gift for innovative thinking and problem solving when working for someone else, but things changed when she became an entrepreneur. Lila was at a loss to determine why she suddenly became scared to take risks.

During a coaching session she told me, "I really could kick myself. Over the last four years I had several ideas for products that did not exist, but each time, less than a year later, someone else saw the same solution that I did and made a fortune from their idea. I'm angry because if I had been able to get even one of my ideas into the marketplace, I could very well be wealthy today. Ron, is there something wrong with me?"

This was my advice. "Lila, there is nothing wrong with you. Your view of risk, as with most business professionals, is a bit skewed because several times you saw an opportunity but did not feel comfortable taking the risk that is inherent in the opportunity."

Lila's cost was the potential profits she missed out on because she was unwilling to face the fear that someone else with a different risk appetite was willing to face. This other person with a similar idea was willing to take the risk, whereas Lila was not.

Lila asked another question. "Why do some people take a risk when others do not?"

The simple answer to this important question boils down to the price you must pay to take a risk or seize an opportunity.

When I say the word *cost* I am not referring to the concept of the price of something you buy, as in how much I pay for a loaf of bread. In risk management cost is the value that you place on something that you hold dearly yet could sacrifice or give up if you try to seize that opportunity.

In Lila's case her risk was putting money, time, reputation or something else on the line in order to turn her ideas into products. Her willingness or ability to seize the opportunity was superseded by the cost, which usually is based upon fear or something else that is considered too steep to pay. I gave Lila a copy of a favourite quotation from the author Win Borden, whose advice she could memorise and follow.

"If you wait to do everything until you're sure it's right,
you'll probably never do much of anything."

The Cost of Success

Success in both life and business requires taking risks. As the first principle of risk management will tell you, the "cost" or price when you strive for success is taking risks. Humankind's history is littered with tales about four sorts of people:

1. Unsuccessful people who never took risks, the vast majority of whom were unwilling to pay the price
2. Unsuccessful people who took rash risks and unconsciously paid the price
3. Successful people who took wise risks and unconsciously paid the price
4. Successful people who took wise risks and consciously paid the price

Justin and Paul were in the third group, and my job was to move them into the fourth group, which is where you also want to be. This book shows you how to become one of this fourth group who take wise risks and know the costs.

Sceptics Exist

According to a survey by the American Institute of Certified Public Accountants and the Chartered Institute of Management Accountants, 45% of companies with a median revenue of $50m lack an ERM programme and do not plan to implement one.

Source: http://www.aicpa.org/InterestAreas/BusinessIndustryAndGovernment/Resources/ERM/DownloadableDocuments/Enterprise%20Risk%20v3.pdf

The Cost of Failure

An example of an ultimate risk taker is Paul Allen, cofounder of Microsoft. Allen is amongst the richest people in the world. He was featured in the May 3, 2004, *Business Week* article "The $12 Billion Education of Paul Allen." Allen has lost $12 billion of his net worth while developing as a manager and an entrepreneur. Twelve billion dollars! He invested money in different ideas and enterprises for many years and lost money on each one. He took (and still does take) tremendous risks with his money.

Think about these questions:

- How many companies can afford to lose $12 billion to learn how to take risks?
- How many companies can afford to lose $1m to learn how to take risks?
- How much can you afford to lose when your next opportunity fails to materialise?
- Can you afford to undertake an expensive education on how to take safe risks?

That is the rationale for this book's theme: conditioning yourself and those around you to regularly ask, "Are we able to pay the cost for that particular risk?"

Managing everyday risk in business and life boils down to asking yourself, "What is the cost I cannot afford?"

You should ask yourself this question before you do something that you define as risky.

Summary of Risk Management– Watching for the Potholes

Murphy's Law of Business Mishaps

Anything that can go wrong in a business setting will take place when you are out of the office or on vacation. The longer you are away the bigger the problem.

Risks are like a pothole in the road of life. They are not easy to spot when travelling at the speed of business. When you hit one and feel your car shake you wish you had seen it sooner, so that you could have avoided that awful frame-jarring sensation to your car and body.

A risk is also like the mule Justin described. You can hope for the best—a peaceful ride—while simultaneously planning for the worst—rejection or a kick to the head.

This is proper risk management in a nutshell: a systematic and holistic way for your organisation to view and define risk taking, so that you understand the costs you can and cannot afford well in advance. Then when you hit a pothole or encounter the capricious Mr Murphy, you will know how to handle the situation, so that what you put at risk is not so costly to you or your organisation.

"One of life's joys is crashing into the unknown. One of life's miseries is when the unknown crashes into you." Ron Rael

Your Action Plan

Step One
Complete the "You and Risk Management" pop quiz. How do you currently define risk management? Think about why you define it that way. How is your definition affected by the chances you take?

Step Two
Make a list of costs that you cannot afford. This could be harm to your family, damage to your reputation or loss of your job. Think about why these are important to you, other than their financial value.

Step Three
How do you plan on using the information you take away from this book? In other words what problems or issues do you hope this information will address?