

Managing Risk in Extraordinary Times

Strategy for High Performance

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"Companies are recognizing that a risk management program integrated across the enterprise – and embedded in the culture so that all understand it – is not just a protective tool but even a competitive edge in an uncertain world."

What keeps an executive awake at night? Probably the same nagging concern that worries most of us when we toss and turn at 3 a.m. Uncertainty. At any hour, what we don't know seems to loom more ominously than what we do.

For every business executive, the current economic turmoil offers plenty of cause for insomnia. Uncertainties abound. And inside each uncertainty is a risk. Something is at stake. For the C-suite executive of a trading organization, it could be fear of losses on counterparty credit risk. For a transportation company, it might be fuel prices—up in the stratosphere one month only to tumble dramatically the next. And you've hedged at the top of the market. How do you explain that to shareholders? Or, you're a utility executive. What impact will possible new green initiatives have on your company's bottom line?

Can we conjure up a crystal-ball view of the future and eliminate risk? Not a chance. But we can definitely manage it—and limit the surprises.

Rigorous enterprise-wide risk management does exactly that. Anything short of it can heighten the potential for calamitous consequences in the organization—as we've seen from the cascading fall of financial institutions and other household-name companies across the globe. Risk issues, left unaddressed, can weaken the foundation of the organization—even deliver a fatal blow.

But risk management, incorporated into the strategy of the business, can deliver just the opposite. It can actually increase the value of the company—improving cash flow while reducing earnings volatility and the cost of capital. Modern risk management does that by:

- **Providing a clear view of company-wide risk.** This integrated view of risk-adjusted performance by business units or regions enables better capital allocation.
- **Upgrading operational efficiency.** Through analysis of potential capital investments, risk management offers a better understanding of the risk/return equation in every decision.
- **Improving relations with ratings and regulatory agencies.** Rigorous risk management provides a broader framework for viewing metrics that come under scrutiny.

Risk management, it turns out, can improve bottom lines as well as company reputations. (See Figure 1)

How today's risk management delivers value

A modern risk-management program does what risk management has always done—it systematically identifies, measures, monitors, quantifies and reports risk. But enterprise-wide risk management today does far more. It provides the business with a new type of performance and compliance information that can be used to make strategic and operational decisions. It gives management the information and comprehensive risk overview needed to direct capital to the most productive uses in the business. It improves product and asset portfolio management. And through its rigorous policies and procedures, risk management is the basis of the confidence investors place in the stability and resilience of the company. All are value builders.

None of this is a quick-and-easy win. Putting a patch on the problem won't

suffice. And in order to work, a risk management program needs to appraise all types of risk.

In addition to these complexities, risk management is not an area that finance executives feel they handle particularly well. In Accenture's latest research—"The Changing Role of the Finance Organization in a Multi-Polar World," which identified the characteristics of high performance in the finance industry—just over one in 10 respondents say they are satisfied with their risk-management performance. Only 8 percent have a centralized, fully integrated risk management capability across the enterprise. But—in a key finding—companies that qualify as "finance masters" (that is, they have mastered the right capabilities and have best practices in place) are twice as likely to have implemented advanced and integrated risk-management processes and technologies over the last two years. These leaders use integrated,

enterprise-wide risk management to enhance shareholder value.

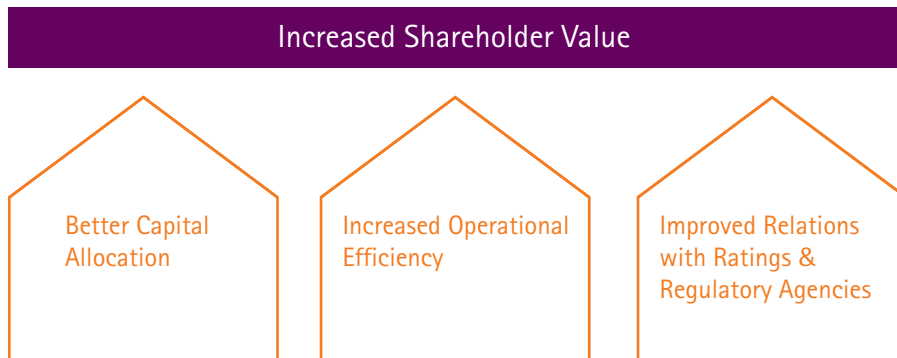
In the past, risk-management practices have often been a response to a flare-up in the company or to regulatory requirements. The perils of our time challenge the adequacy of that approach. Companies are recognizing that a risk-management program integrated across the enterprise—and embedded in the culture so that all understand it—is not just a protective tool but even a competitive edge in an uncertain world.

Clearly, for risk management, its time has come.

The link with strategy: risk management's strength

Much of the strength of modern risk management comes from its link to the strategy of the company. Bonded with strategy, risk management addresses one of the pitfalls of many troubled companies: the inability to value

Figure 1. Creating Value through Risk Management



assets and initiatives on a risk-adjusted basis. The recent meltdown in the subprime mortgage market demonstrates the potentially catastrophic consequences of this improper risk valuation. Incorporated into strategy, risk management gives the entire organization an appreciation of what risk is, how to value it and with what cultural mindset to approach the day's work.

Risk management and strategy come together in three core areas, making possible this elevated level of risk insight and control:

Formulating strategy

Here the mission of the strategy is established. Roles and objectives are defined within the organization. Strategy formulation has a people component, which outlines the corporation's risk culture, a process component, which defines the rules and regulations that will be used to manage the company's exposure to risks, and a technology component

that captures, measures, monitors and reports the risk.

Managing strategic risk

For every company, certain risks are inherent in the strategy of the business. For example, airlines worry about fuel prices; utilities, about wholesale power prices. Risk management uses tools and insights to identify and evaluate strategic risks and their possible impact longer term. Those risks could include technological changes, new competitors or long-term market price risks. While some short-term price risks can be hedged in liquid markets, longer-term strategic risks need a higher order of risk management.

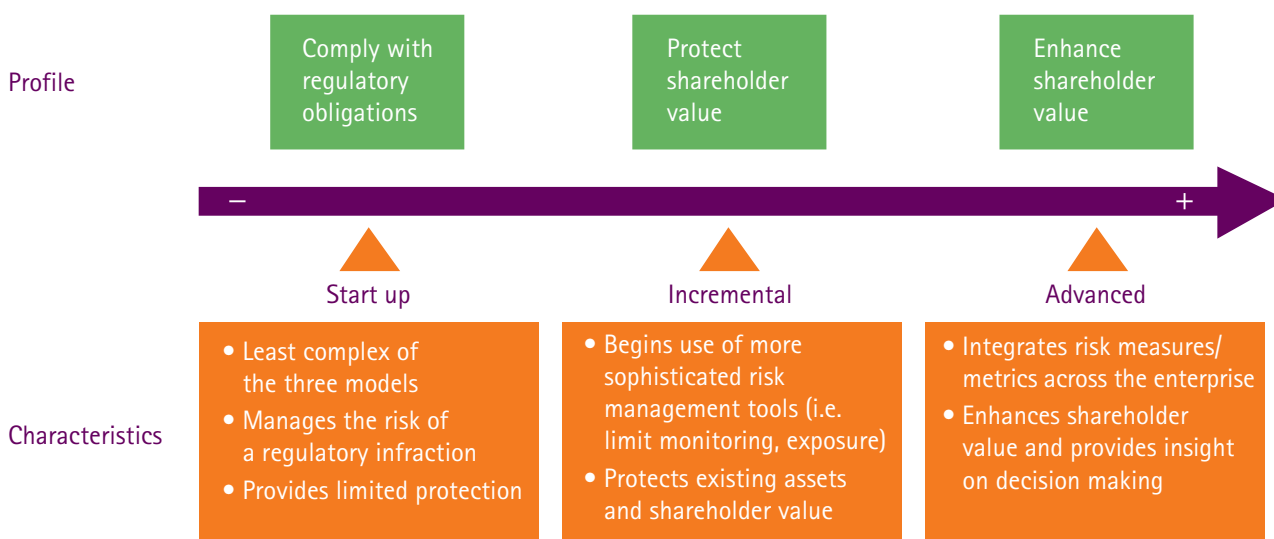
Evolving business strategy

Beyond measuring and protecting existing strategy, risk management uses tools and metrics to evaluate different strategic options. Possible new directions are assessed for their risk exposure, using a controlled risk/return model. This gives companies

faced with change one more tool they can use to evaluate the future direction of the business. It guides them in considering potentially profitable new opportunities

Strategic risk management provides a structure to address risk-related questions no matter where in the organization they occur—from C-suite executives and the risk committee on down to the employees who carry out day-to-day operations. Questions such as, what is the level of risk here and how much risk are we willing to take? Companies that embrace enterprise-wide risk management and link it to strategy understand the risk-reward equation in every decision. It is as basic—and critical—as that. In this way, risk management goes beyond mitigation, compliance and control. It links risk and profitability objectives so that management can make better strategic capital decisions and increase shareholder returns—and ultimately achieve high performance.

Figure 2. Risk Model Maturity Spectrum



What level of risk maturity? Three choices.

Get the culture right, get the strategy right, add the right processes and technology—and the outcome will be a risk-management capability that offers a competitive edge others may not have. But first it takes some looking in the mirror to find out what kind of company this is when it comes to risk management.

The choices are on a continuum. No one model is obviously superior for every company. After all, not all companies face the same kinds of risks. The most advantageous choice depends on what the company wants its risk-management capability to accomplish.

Figure 2 shows how the risk-maturity level of the organization advances as it moves along the spectrum—from complying with regulations to enhancing the value of the enterprise.

In the compliance-driven model, the risk-management capability may only include a few key areas, such as the trading and treasury groups. Advancing along the continuum, the model gives a high-level view of the company's overall risk profile, allowing management to incorporate this into decision making.

Risk management for compliance

In this model, the risk-management agenda is set by regulatory requirements. There are insufficient processes, roles and responsibilities to actively manage known risks. Technology is limited. The result keeps the organization compliant, but makes it vulnerable to unforeseen risks and often lacks control over expected risks.

Risk management for value protection

Additional controls and processes come into play here. This level of risk maturity is characterized by many different siloed risk functions, each using its own metrics, rules and measures. But each focuses only on its own unit or region. There is no

aggregated view of the overall risk profile of the company. This model mitigates expected risks and protects the business to a limited degree from unforeseen risks.

Risk management for value enhancement

An independent risk committee is formed to monitor risks enterprise-wide. Official risk policy and tolerance levels are based on current information, not simply on historical figures. Standards are set up across the enterprise, covering all dimensions of the business. With this broad analysis, the enterprise is almost fully protected against unforeseen risks. The company gains a competitive advantage because it has the ability to take on more controlled risk.

In choosing where to stand on the risk-management spectrum, a company is deciding what kind of risk-management culture it wants to embrace. Does it want to simply comply with regulations? Or does it want to be visionary and adjust risk management for the evolved company it will become as the business grows.

Choosing the appropriate risk-maturity model positions the company to address its risk management needs effectively. How? By a five-step framework that leads to an optimal risk management strategy.

Establishing a risk strategy

What kind of risk-management program does an organization need? Assessing that calls for a sequence of logical steps. The result is a strategy that embeds the company's risk-management objectives into the bones of the organization. At the same time it structures the implementation of that strategy into everyday operations.

The five steps to a risk management strategy:

1) Establish strategic guidelines

What does the company want this risk management program to do? Finding out means interviewing high-impact stakeholders, such as the board of

directors, the C-suite, project sponsors and relevant executives. What do they expect of the risk program? The role of the risk-management team is also determined at this point. Will it function as advisor to senior management, actively providing recommendations to the risk committee? Will it be a controller, ensuring compliance? Or will the team be a manager supporting business units and helping to perform risk analysis on their activities? It could be all three.

2) Determine model directions


This step is about defining the risk appetite of the organization. How much is the organization comfortable risking? To answer that, the company must assess the full array of risks—market, credit, operational and strategic—and decide how each is going to be measured. What kinds of metrics and parameters will be used? How far does the company want to take that analysis? The parameters help the business determine current risk levels and how much risk they are willing to take on.

3) Choose the model

Now the work gets more granular. Targets for each risk parameter are set. How much value does the company want to have at risk on any given day? To track against these targets, key performance indicators are used to pinpoint the kind of risk being taken and whether it is within the company's risk comfort zone.

4) Perform gap analysis

If a company already has an existing risk function, risk management compares this program to the new risk strategy and maps out the differences. It takes this "to-be" world of the future risk program and analyzes what has to be done to get the company to that point. What are we missing? The gaps may be in governance, framework, methodology, people or tools. All types of risk are included in the analysis.



“Enterprise-wide risk management provides the business with a new type of performance and compliance information that can be used to make strategic and operational decisions.”

5) Design a strategic road map

This step begins the transition into implementation. It outlines the actions needed to turn the strategy into reality in the organization, which requires high-level discussions on integrating strategy into daily operations. The result is a road map with initiatives for each functional area of the organization to put the new program in place.

Risk management: the right investment for the times

As abstract as risk-management strategy can sound, it relates urgently to events on the ground. No one knows that better than today's corporations. There is nothing abstract about financially endangered enterprises collapsing in near-domino fashion, with reverberating consequences across the globe. Risk management comes to prominence on the corporate agenda because so much depends on it now.

The good news is that there are effective ways to identify, measure, monitor and report risk and make sure no limits are being breached. Risk management can be driven by compliance—or it can be visionary and manage risks in ever more integrated ways. Choosing the latter approach, a company can use risk management to create higher value in the business.

Always, effective risk management derives from the culture of the organization. With that culture understood, the chosen level of risk tolerance can be implemented company-wide. This can be a company where people know the limits. It can be a company that is venturesome, but it may choose to be incrementally so—assessing measurable results along the way. Processes and technology give a company's risk management a competitive edge. But at a fundamental level, getting the right risk culture to penetrate throughout

the organization is one of the most valuable investments a company can make.

Accenture can help businesses on their journey to high performance through risk management. We can be with you anywhere on the continuum of risk management models. We can offer a team of people with deep global and industry experience—people who are pragmatic in their approach. People who can provide insight and guidance on how to put strategy and risk management together for a company—and make it work. We know how to help you use risk management for all it's worth—and move you closer to becoming that high-performance business you want to be.

If you'd like to find out how we can help do that in your company, please contact us.

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Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. With more than 186,000 people serving clients in over 120 countries, the company generated net revenues of US\$23.39 billion for the fiscal year ended Aug. 31, 2008. Its home page is www.accenture.com.

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