Harvard Business Review

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Risk Management in a Time of Global Uncertainty

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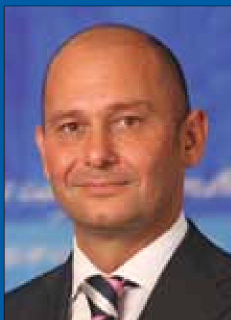

Thomas Hürlimann
Chief Executive Officer
Zurich Global Corporate

To say that the risks we face today are changing rapidly is an understatement. Even before the financial crisis, the pace and scope of globalization and the growing opportunities presented by emerging markets were redefining the strategies and aspirations of many multinational organizations. Inevitably, with these opportunities came an expanding continuum of risk. However, the broadly held belief that economic growth had nowhere to go but up may have made many of the risks seem somehow less severe when weighed against widening global opportunities. Then, in the fall of 2008, the dream of unhindered economic growth was brought literally to its knees by the most serious financial crisis in almost 80 years, and the word "uncertainty" began to loom much larger in the minds of corporate leaders around the globe.

Today, a measure of stability has returned, but significant volatility remains, complicating our ability to effectively manage global risk and sustaining an uncomfortable level of uncertainty. From sovereign debt to tsunamis, the universe of enterprise risk seems broader and more consequential than ever before, requiring new frameworks for strategic thinking. Those doing that thinking — ranging from C-suites, corporate boards, chief risk officers, and risk managers — have identified the need to take much broader, enterprise-wide views of complex risk interrelationships in order to effectively deal with new realities of risk.

For many, the journey toward true enterprise risk management has only begun, but at Zurich we believe it is a journey well worth taking to help ensure sustainable growth and profitability in an increasingly uncertain world. We are pleased to have sponsored this important Harvard Business Review Analytic Services research and we hope you will gain important insights from it that will help shape how your organization thinks about enterprise risk and global opportunities in the challenging years ahead.

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Focus on enterprise-wide risk management has grown, but most executives feel their companies still have a long way to go in building an effective, risk-aware culture.

Executive Summary

Already on the upswing in many industries, the focus on enterprise-wide risk management has entered a more intense phase across a broad range of global companies since the 2008 financial crisis and recession. In a survey by Harvard Business Review Analytic Services, over two-thirds of 1,419 business executives said risk management has become somewhat or significantly more important over the past three years.

Most executives still feel their companies have a long way to go, however, in building an effective, risk-aware culture. The Harvard Business Review Analytic Services study, which was sponsored by Zurich Financial Services Group, found that only 1 in 10 respondents said their executive management was "highly effective" at creating a "strong risk-aware culture." And only 40% of respondents considered their approach to enterprise risk management (ERM) to be "proactive," with an integrated process that involves the board and business and functional leaders at all levels of the organization.

Over the past decade, and increasingly since the financial crisis, companies in many industries are either instituting ERM processes for the first time or improving existing processes. Today, for example, 42% of companies with 10,000 or more employees report that they have a chief risk officer, compared with only 11% three years ago. Yet companies with best practices in ERM continue to be concentrated in a few sectors that have traditionally been strong in this area: financial services, health care, and energy.

By contrast, barely one-third of all respondents felt they were doing well at any of the six risk management capabilities they most often cited as critical to organizational performance:

- Linking risk information to strategic decision making (34%),
- Embedding a risk-aware culture at all levels (34%),
- Embedding risk management practices and responsibilities within strategy and operations (30%),
- Ensuring that all decisions remain within the organization's risk tolerance (28%),
- Driving risk mitigation activities (28%), and
- Proactively identifying current and emerging risks (28%).

Organizations with a CRO do more extensive advance planning than other companies in almost every major risk area.

The study, which also included follow-up interviews with executives at 13 companies around the world, nevertheless found broad agreement on the increased importance of ERM, the benefits it brings to companies with mature risk management processes, and the "lessons" that companies must absorb in order to establish best practices in ERM. These five lessons are as follows:

- Risk management needs to have a clear "owner" to be effective.
- Risk management and corporate goals must be integrated.
- Companies must manage risk proactively.
- Companies must look deeper and wider to determine what their most serious risks will be in the long run.
- Companies must break down silos and managerial bottlenecks.

Respondents overwhelmingly cited "tone at the top" — the degree of support from the board and the C-suite — as critical to establishing effective ERM. "You can't do anything without it," says the head of risk management and business assurance at a global mining company. In particular, executives stressed the need for clear upward reporting to non-executives on the audit or risk committees.

The presence of a CRO or other individual with overall responsibility for risk management — typically, either reporting directly to the CEO or else situated within the finance or strategic planning function — also emerged as a key indicator of success. The study found that organizations with a CRO do more extensive advance planning than other companies in almost every major risk area — notably, information security, new regulations, scarcity and/or cost of capital, and the prospect of another asset bubble developing.

Executives cited the forging of a close relationship between CEO and CRO as key to ERM success. Just as important, the CRO must maintain a close working relationship with line management, helping to instill a "risk culture" within the business units that enables the CRO and business leaders to identify, analyze, and manage risks as an ongoing activity rather than a periodic "review" process. Nearly three out of five companies report that they decentralize risk management responsibilities. This brings them closer to best practice, which calls for organizing ERM around three "lines of defense": Line Management; Risk Management (including Legal and Compliance); and Audit.

Two types of events — natural disasters and financial and economic crises — have risen to the top of companies' risk lists in the past three years, the study revealed. Sixty percent of companies responded that the possibility of a double-dip recession or continued slow economic recovery in their key markets has risen significantly. Both the economic downturn and natural disasters like the Japanese tsunami are prompting companies to stretch the definition of ERM to include their relationships with outside entities either upstream or downstream from their own operations. A U.S. manufacturer, for instance, now has a risk scorecard that enables it to gauge the risk inherent in acquisitions and joint venture agreements before they happen.

Strikingly, however, the other risks most often cited in the study are largely operational matters that underpin companies' ability to deliver their strategic goals and maintain a viable, competitive organization going forward. More than half of companies mentioned risk related to talent retention and acquisition as having risen significantly, one European manufacturer citing particularly the threat of losing a key project manager. Corporate and/or brand reputation has become a more significant concern at half of companies, while business planning and continuity and legal risks were mentioned by nearly half.

Companies also say they want their ERM processes to produce a better understanding of the way risks can build on each other to create more serious problems than might be expected individually. One European CRO calls these "sequential risks, where if Risk A happens, it is seen as inevitable that some element of Risk B will happen, although it's not certain."

For companies that are still early in implementing their ERM processes, however, it may be some time before this level of risk analysis is possible. While 58% of companies reported having changed their risk metrics since the recession, 62% said they continue to use metrics developed in-house, partly out of concern that their metrics continue to fit their corporate profile.

Companies outside the sectors that typically have best-practice ERM in place, but that are attempting to move in that direction, point to a further concern: obtaining buy-in from line management. The first concern at companies working to build a strong ERM process is to sell the program deep into their own organizations. The barriers "are almost always cultural, not technical," says the CRO at a Pacific region company. But convincing business unit leaders that ERM is relevant to their business can be difficult if the process threatens to overcomplicate their jobs, warns an executive with risk management responsibility at a U.S. manufacturer.

Balancing this concern is a more widespread consciousness of the benefits of ERM. Between one-third and one-half of respondents to the study cite five key business benefits:

- Increased risk mitigation,
- Better ability to identify and manage risks,
- Better strategic decision making,
- Improved governance, and
- Increased management accountability.

A successful ERM process breaks down barriers to communication and sharing of best practices across the organization, executives said in follow-up interviews. Risk management processes "have helped improve communication across the board," says a European airline executive. Particularly when ERM is joined to some degree with strategic planning, "there's a reduction of siloed thinking as more people talk across businesses," says a European group risk management head. Effective ERM processes can make a company more competitive not only by giving it more confidence in its decision making, but also in some cases, by augmenting the company's brand and reputation.

Some of the top benefits of ERM that respondents cited are not directly related to risk management. Instead, they see it as helping their companies to achieve better overall strategic performance — through:

- Improved strategic decision making (39%),
- Improved governance (34%), and
- Increased management accountability (31%).

These benefits are best achieved when ERM develops organically, executives agreed. However closely they monitor risk at the business level, ERM must be "owned" by the business leaders themselves. While outside consultants can be helpful in developing their ERM process and tools and in benchmarking, "risk management has to be run by people within the organization, with relationships and knowledge of how it works with and influences management," says the CRO at a U.K.-based multinational.

Risk Management in a Time of Global Uncertainty

FULL REPORT

TIME OF TURMOIL

As business leaders, along with the rest of the world, look back on the decade following the September 11, 2001 terrorist attacks, the picture that emerges is of a period of revolutionary change for risk management in the corporate sector. Acts of terror and natural disasters such as hurricanes and earthquakes have become part of the everyday vocabulary of enterprise risk. At the same time, largely unforeseen financial shocks, from the collapse of the dot-com economy to the bursting of the housing bubble and the slow recovery that followed, have forced business leaders to look for risk both more deeply within their own organizations and more widely in the competitive world within which they operate.

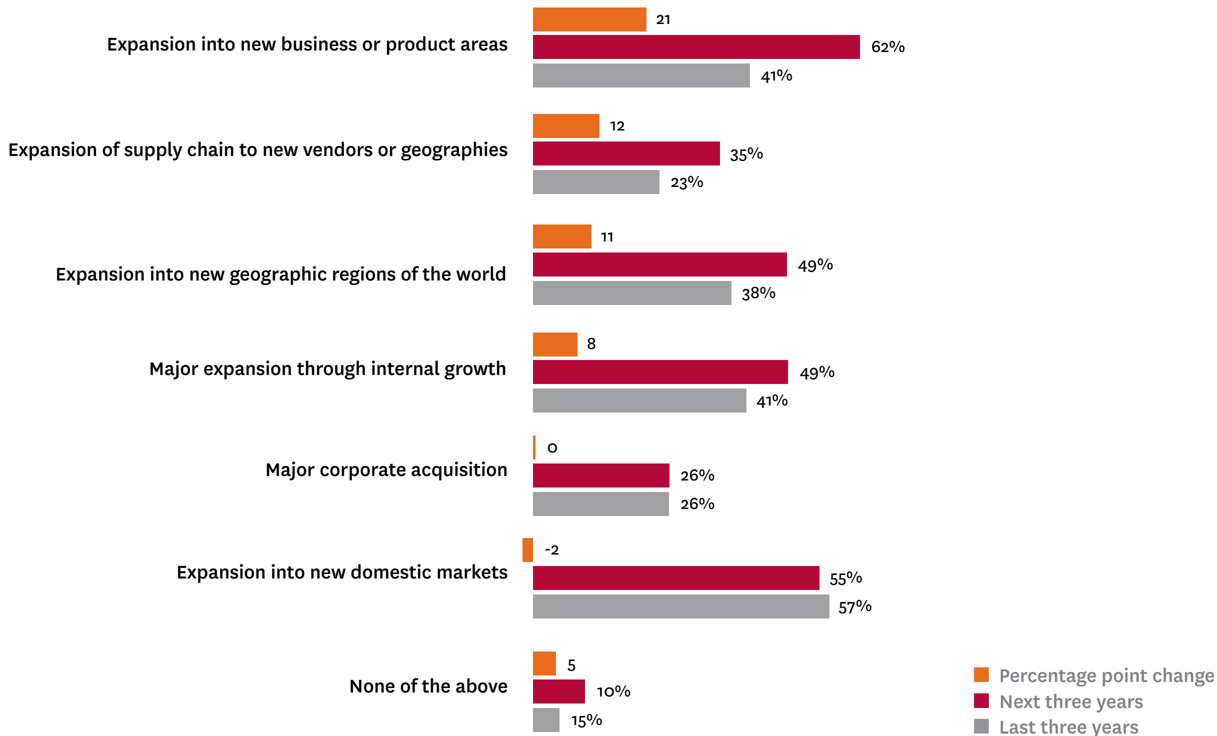
The process has accelerated greatly in the past three years, according to data compiled this past summer by Harvard Business Review Analytic Services. Over two-thirds of respondents to a survey of 1,419 executives from companies around the world said risk management had become either somewhat or significantly more important since the recession. This in spite of the fact that these companies have now largely shifted away from post-recession retrenchment. Only 11% said their strategic focus remains on cost-cutting and cost-containment, while 62% said they expect to expand into new business or product areas in the next three years. Figure 1

The Harvard Business Review Analytic Services study, sponsored by Zurich Financial Services Group, consisted of executives at the C-suite level, with a concentration on chief risk officers and others directly responsible for conducting the company's enterprise risk management processes. More than two-thirds were either decision-makers or were involved in making decisions regarding risk management.

Executives who participated in the survey and then gave in-depth follow-up interviews revealed that they are now closely tracking a wide assortment of newly emerging risks, including information security lapses,

Business initiatives, last three years, and next three years (ranked by growth rate) Figure 1

QUESTIONS: Which of the following initiatives has your organization undertaken in the last three years? Which of the following initiatives do you anticipate your organization will undertake in the next three years?



cyberterrorism, political instability radiating from events like the Arab Spring, and environmental and health hazards associated with nanotechnology development. The prospect of continuing market volatility and the slow rate of economic recovery in the industrialized countries top many companies' lists. Some, too, are turning their attention to monitoring aggregate or sequential risks: chain reactions that result from the confluence of two or more risk events.

These developments are prompting many businesses to focus on proactively managing risk, rather than simply mitigating it in a reactive way. Companies in highly regulated industries such as financial services, health care, and energy have traditionally been the earliest implementers of best practices in enterprise risk management, and this continues to be the case. Financial services companies remain twice as likely to employ a chief risk officer, for example — a factor revealed in this research as a key indicator that a company will perform well at all aspects of risk management.

But in the past decade, and increasingly over the last three years, companies in many other industries are either instituting ERM processes for the first time or else ramping up more rudimentary structures to

Maturity in risk management is when the company does its risk assessment at project kickoff, rather than at the end.

a higher standard. The head of group risk management at a global agribusiness company headquartered in Europe notes that organizations adopt ERM typically for one of three reasons: that it is a good idea, because new laws or regulations compel them to do so, or due to a "burning platform" — anything from a financial crisis to a physical disaster. Others have done so as the result of personal initiative from the board or the C-suite. In the aftermath, some have even come to see ERM as, potentially, a source of competitive advantage.

One European manufacturer, whose production facilities are all located in a small number of countries and that offers a narrow range of products, initiated an ERM program in 2007 in response to a run of bad earnings that had threatened its independence. At a U.S. industrial products company, the board created a formal ERM process in 2007, during the early days of the financial markets crisis, out of concern that rapid growth from acquisitions might expose it to unanticipated risks.

ERM practices at these companies are beginning to more closely resemble those of older adopters. In particular, more than half of companies surveyed now have a single, identifiable individual with enterprise-wide risk management responsibility — a key factor in driving success in this area. Over two-thirds said responsibility for risk management has changed in the past three years, while 25% of companies now have a chief risk officer, compared with just 9% three years ago. Among larger organizations with 10,000 or more employees, the proportion with a CRO has risen even faster, from 11% to 42%. Figure 2 Companies with a CRO were more likely than those in other categories to take a proactive approach to risk management, integrating processes across the organization and attempting to anticipate risks rather than reacting to events.

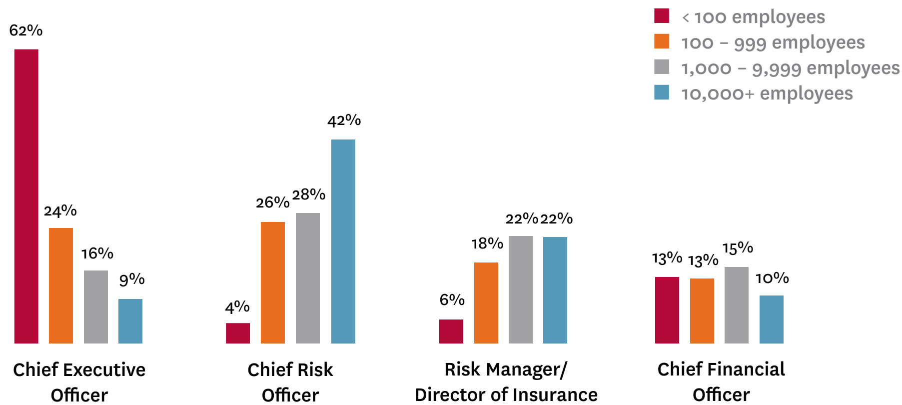
STILL A LONG WAY TO GO

"Maturity in risk management is when the company does its risk assessment when it's about to kick off a project, rather than doing it at the end," says the head of internal audit at a European infrastructure company that operates under a government-sanctioned monopoly. Most executives, however, still feel their companies have a long way to go in extending a proactive risk management culture deep into the organization. Almost 40% consider their companies to be proactive. But only one in 10 consider their executive management to be highly effective in creating a strong, risk-aware culture, and 35% feel their executive efforts are ineffective. Figure 3

Nearly two-thirds of executives still describe their company's risk culture as basic or reactive, with the proportion edging higher for the smallest enterprises — under 100 employees — and nonprofit organizations. And while 34% of survey respondents cited linking risk information to strategic decision making and embedding a risk-aware culture as two of the most important capabilities for successful risk management in their businesses, only 14% felt they were doing extremely well at the first and only 11% rated themselves highly at the second.

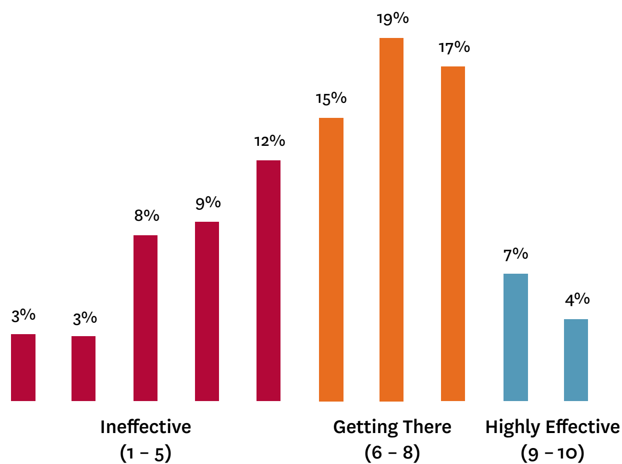
Day-to-day responsibility for risk management Figure 2

QUESTION: Which of the following job titles best describes the person with direct day-to-day responsibility for risk management in your organization? Base: All respondents with an identifiable person for managing risk.



Impact of executive management on creating a risk-aware culture Figure 3

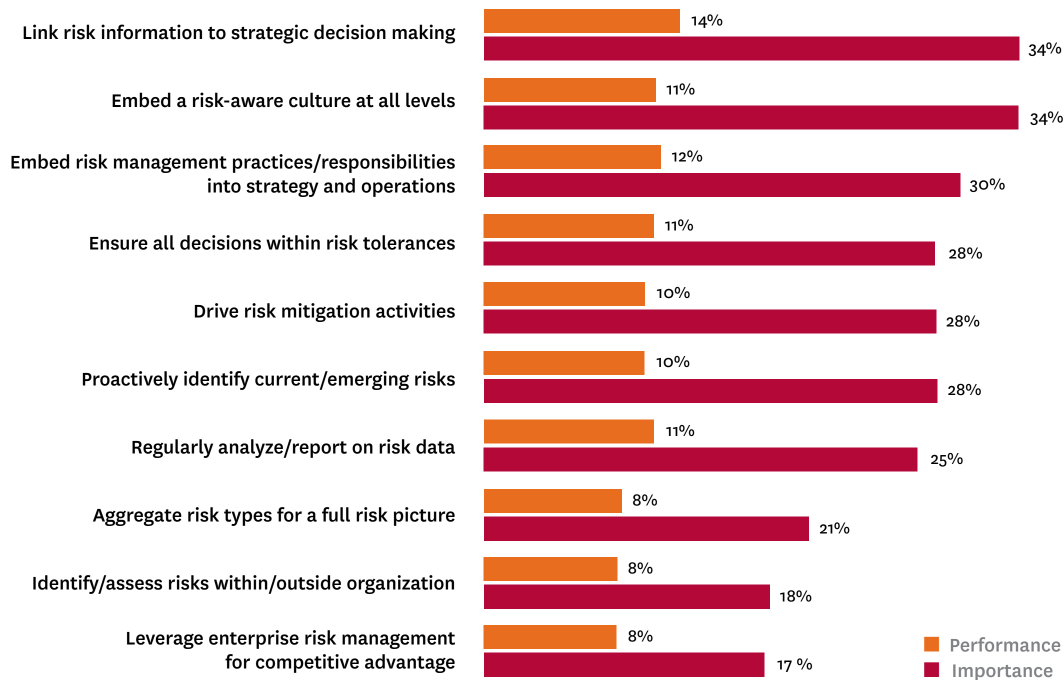
QUESTION: How effective is your organization's executive management in generating a strong risk-aware culture throughout the organization?



The gap between risk management activities: importance vs. performance Figure 4

Top box scores (9-10)

QUESTIONS: Please rate the importance of each of the following capabilities to the success of risk management activities in your organization. Please rate how well your organization is performing with regard to these same risk management capabilities.



This extends to all of the six risk management capabilities most often cited by survey respondents as critical to organizational performance:

- Linking risk information to strategic decision making (34%),
- Embedding a risk-aware culture at all levels (34%),
- Embedding risk management practices and responsibilities within strategy and operations (30%),
- Ensuring that all decisions remain within the organization's risk tolerance (28%),
- Driving risk mitigation activities (28%), and
- Proactively identifying current and emerging risks (28%).

In every case, the survey found a wide gap between the importance placed on these capabilities and executives' assessment of their companies' performance — even for organizations that have a CRO. Figure 4 Follow-up interviews reinforced the conclusion that most companies still have a long way to go to embed a truly successful risk management culture — a culture focused on driving sustainable and profitable growth rather than simply protecting against downside losses and operational risks.

"Tone at the top" — the degree of support from the board and the C-suite — was overwhelmingly cited as critical to creating a change in this direction. "You can't do anything without it," says the head of risk management and business assurance at a global mining company. "If you don't have the CEO behind you, it's very difficult to make inroads within the organization," adds the head of risk at a U.K. company. "It's a difficult topic to value in financial terms, since you're often trying to prove a negative — that your risks have not materialized."

Reality across the corporate world is still far from reflecting these concerns, however. At around half of companies, the board has increased its involvement in risk management — but the rest report no change. Only a quarter of executives rate their board's involvement as high, and 30% describe it as static or declining.

Companies that note high board commitment to ERM tend to follow a fairly distinct pattern. Most heavily represented in this group are those with a CRO or another individual directly in charge of risk management; larger companies with 10,000 or more employees; and companies in the financial sector. In follow-up interviews, executives who noted strong board involvement in ERM tend to be from companies that fall into these categories, although in several cases the company had instituted a formal ERM process only in the last three to five years. This indicates that much of the progress toward more mature, deeply embedded ERM is still bypassing smaller companies in industries that have not traditionally been strong in this area.

PREDICTORS OF SUCCESS

The presence of a CRO or other individual with overall responsibility for risk management is a key indicator of success at building an enterprise-wide risk management process. Besides taking a more proactive approach, the Harvard Business Review Analytic Services study found that organizations with a CRO did more extensive advance planning than other companies in almost every major risk area — notably, information security, new regulations, scarcity and/or cost of capital, and the prospect of another asset bubble developing. Figure 5

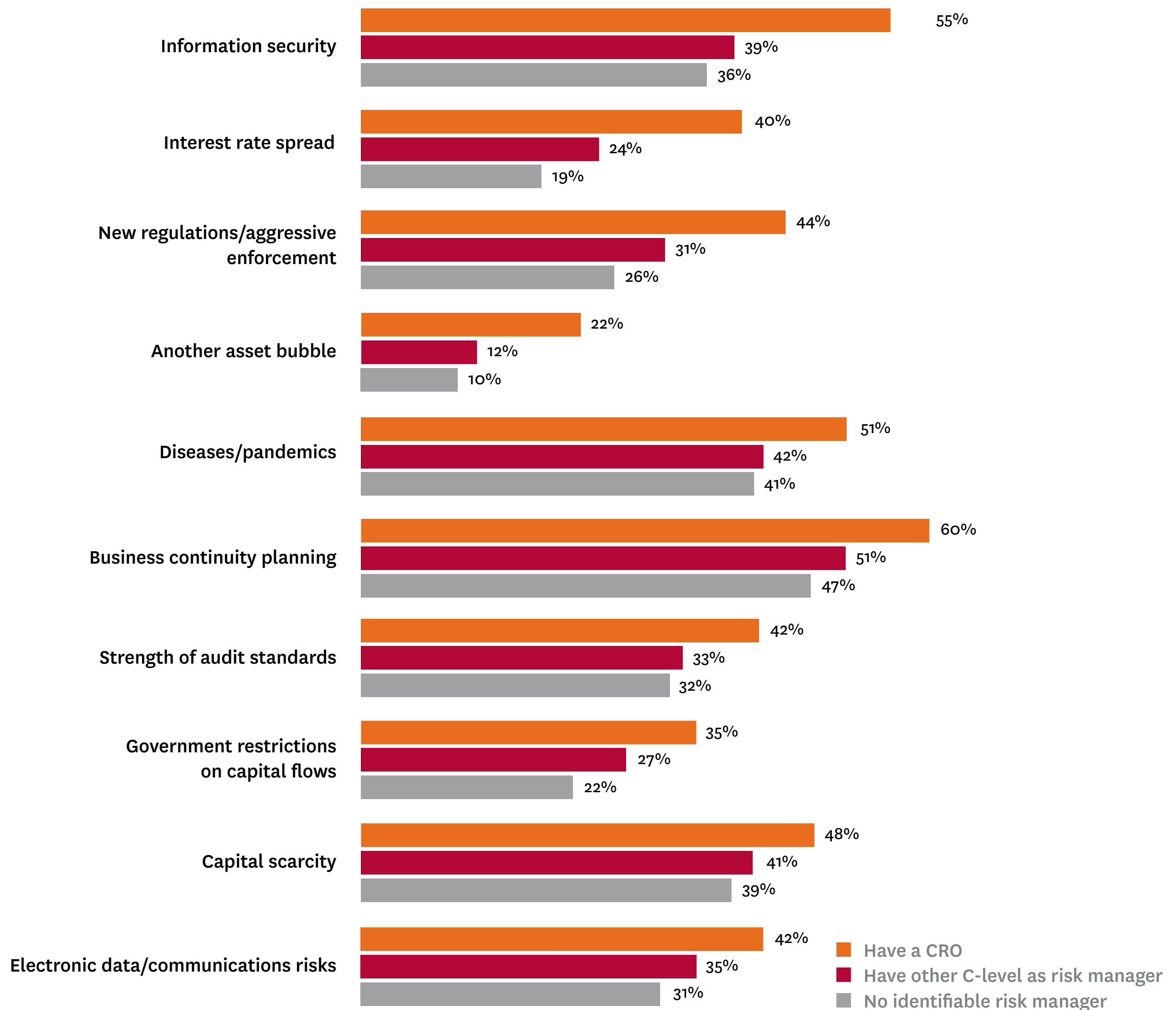
Not surprisingly, then, executives cite the forging of a close relationship between CEO and CRO as key to ERM success. At a large, independent European investment banking firm, the CRO reports directly to the CEO. The firm tightened its risk management processes in 2007-08, after the collapse of a proprietary trading portfolio followed by losses in its credit operations led to a temporary government takeover, notes an executive who is responsible for enterprise-level risk as well as head of crisis management.

Just as important, executives say, is for the CRO to maintain a close but separate relationship with line management. Risk managers should have a separately constructed compensation package that helps to maintain their independence and does not deter them from "blowing the whistle" when necessary. Additionally, executives stress the need for clear upward reporting to non-executives on the audit or risk committees.

One European manufacturer reports that it created more formal ERM processes in 2007, when a former high-ranking official at a major bank joined the company as CEO. An executive who had been with the company 25 years and was serving in the corporate controller's office was put in charge of risk management. Although he reports directly to the CFO, he says he was given "total freedom in time and

Top 10 risk planning gaps Figure 5

Data drawn from these questions, regarding which risks companies are mitigating against through drawn-up plans. Data presents differences between those with a CRO, other risk manager, and no risk manager.



resources." He also had vocal support from the new CEO, who blogged about the importance of the new risk management effort.

Despite the need for support at the top, however, executives repeatedly describe ERM as a collaborative process, emphasizing the need for business leaders — and not the CRO or the C-suite — to "own" the risks that touch their operations. Nearly three out of five companies report that they decentralize risk management responsibilities. This brings them closer to best practice, which calls for organizing ERM around three "lines of defense": Line Management; Risk Management (including Legal and Compliance); and Audit. One European national airline first hired a manager to run an enterprise-wide risk management program after

41% of companies say they are deepening and extending the ties between risk management and strategic planning.

the 2008 recession. However, "the most important improvement we've made has been the more active involvement of middle management in the process of identification and scoring of risks across the board," says a top finance official.

Several executives noted the influence of the 2004 report by COSO (the Committee of Sponsoring Organizations of the Treadway Commission), "Enterprise Risk Management — Integrated Framework." That report outlined a decentralized model in which everyone in the organization has some responsibility for risk management, and the enterprise-level risk officer supports and facilitates the process rather than controlling it.

Business leaders "are effectively the first line of defense, and they must understand and feel responsible for risk management," says the risk officer at a European investment bank. The job of the group-level head of risk management, then, is to instill that understanding by acting as a key intermediary, communicating regularly with business leaders and advising them on project-level risk control.

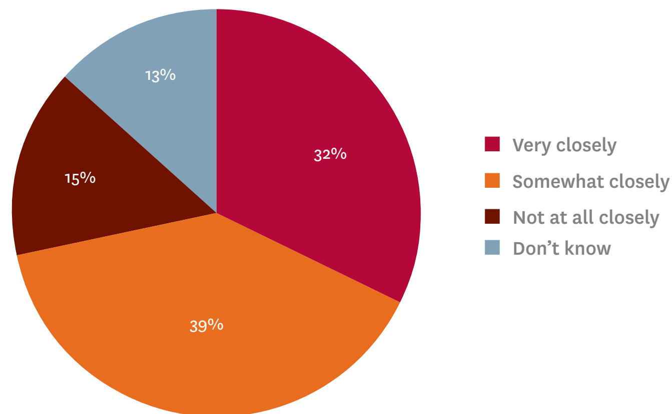
While acknowledging the importance of top management's support for effective ERM, the CRO at a global information technology services company based in India considers the relationship between risk management and the business units to be more important. "It's the ability of the risk manager to raise a red flag with the business leaders and to work with them to resolve problems in 60-70% of cases," he says. "Before a particular risk becomes critical at the enterprise level, I need to be able to roll up my sleeves and work with their team to alleviate the potential risk and manage the program to closure, and then cross-check it through an independent stress test. That inspires confidence with the business units."

Traditionally, at many companies, risk management has been regarded as the province of Internal Audit and Compliance. One of the first steps taken by companies attempting to create a more mature ERM process is to establish risk management as a separate function. The head of risk management at a global mining company recalls, "Risk management was a reporting exercise linked with the audit committee" before he was hired five years ago. "Instructions were sent to the mines and other business sites to rate their risks and send them up for consolidation. It was reporting, not management of risk, and not very accurate. I turned it into a facilitated discussion. We'll prepare a workshop that the relevant managers attend, and hold discussions with members of a relevant management team, draw out the risks, prioritize them according to a matrix, and discuss how to implement controls."

One global company based in Europe began creating a more integrated risk management process in 2006, after a former top banking executive became non-executive chairman. The head of group risk management, who joined at about the same time, describes ERM at the company today as a "center-of-excellence approach in which he and his small, lean staff collect, aggregate, and consolidate data" and prepare an annual report to the board, as well as topic-specific reports as requested. Beyond this, they meet regularly with business leaders — at the corporate center, in the localities, and over the phone — to review their practices, disseminate best practices among the business units, and ask questions that help to bring to light risks of which business leaders may be less aware.

Relationship between risk management and the audit function Figure 6

QUESTION: How closely does the individual in your organization most responsible for risk management work with the audit function?



The director of strategic risk management at a European manufacturer ascribes some of its success at developing a more proactive approach to risk management to the intimate knowledge he gained of the company's operations through his previous decades of experience there. His counterpart at a European-based multinational stresses the need for the enterprise-level risk officer and staff to travel and familiarize themselves with the on-the-ground operations of the business. Otherwise, "we could find ourselves constructing a reality [in the team's risk reports] that doesn't help at the end of the day."

At the same time, however, 41% of companies said they are also deepening and extending the ties between risk management and strategic planning. This is particularly true of companies that have been in growth mode. One U.S.-based industrial and automotive supplies company began strengthening its ERM process at the initiative of several board members concerned about the corporate governance scandals at Enron and elsewhere. The company, which has a lean corporate center but has grown rapidly through acquisitions, adopted a formal ERM process in 2007.

Rather than name a CRO, however, it placed the job of coordinating ERM with the vice president of corporate strategy — because, he says, "most of our risks are strategic." The company's decentralized structure argued against appointing a CRO, he adds, because otherwise, "risk management would have become a paperwork exercise and the organization would have rebelled against it."

Key risk concerns typically find their way into his strategic planning reports to the board. This in turn helps to make risk management concerns more visible and enlists the attention of the board and top management in encouraging business leaders to address them. "The best way to make the board aware is to present risk management analysis as part of your strategic planning presentation to the board," says the CEO of a U.S. agricultural lender.

While risk management reporting today is increasingly an independent operation, internal audit continues to play a role examining and evaluating the ERM process. Almost three-quarters of executives reported that the person responsible for risk management at their company works closely with the audit function. Figure 6

At one U.K. company, the process commences with an audit of the risk management function itself. This takes place in October and November, when the head of internal audit begins his annual planning cycle. He starts by asking for the risk registers that the head of risk management gathers from each business leader. "We don't challenge the businesses on whether they're identifying the right risks," he says, "but whether the process is designed and being carried out properly. We look at the quality of the staff, if action plans are in place, do they make sense, whether roles and responsibilities are properly assigned, and the quality of the content." Administratively, internal audit reports to the CFO, but as a U.K. company, by statute, it submits its risk management audit to the Audit-Risk Management Committee, which is composed of non-executive board members.

Companies with well-developed ERM practices frequently go a step further, implementing several improvements and often have internal audit base its audit plan around the risks identified in the ERM process. Figure 7 This ensures that the company follows a uniform approach to risk identification, rather than splitting it into separate, perhaps inconsistent exercises performed by multiple functions — for example, Audit, Compliance and Legal.

MANAGING RISK: MORE COMPANIES ESTABLISHING ERM PROCESSES

A point raised consistently in both the survey and follow-up interviews was the crucial role of the board. At

Risk management process improvements over last three years Figure 7

QUESTION: What has your company done to improve and extend its risk management processes in the past three years?

A good risk management group "should operate like a boutique firm, with everyone an expert in a particular area who can be asked to do deep-level work."

most companies, the board is either directly involved in the risk management process or else is highly supportive. At one, the chairman sits on the Compliance and Risk Management Committee; at another, a board member heads the executive-level Risk Management Committee; and at a third, the CEO is a member of the board-level Risk Committee and "hasn't missed a meeting yet," according to the company's risk management head. At a fourth, a European investment bank, the regulatory conditions under which it was re-launched as a private institution after a brief government takeover included more board-level attention to risk management. This echoes findings among companies that have been taken private by private equity investors, which often instill a greater focus on risk management as a way to improve ROE.

Some companies have outside directors with direct experience in the field. For example, at a U.S.-based metals manufacturer, the director of internal audit notes that the company adopted its ERM program four years ago at the instigation of the head of the audit committee, an outside director who had implemented a similar program at a large science and technology organization. The head of risk management at a U.K. company notes that in general, non-executive directors help to engage the board more closely with risk management, since the ERM process "helps them to get more insight into the company, which helps them to do their job" — that is, to ask the right questions about the risk-related information they receive.

Best practices in ERM extend to staffing and skill sets within the risk management function as well. Large companies that have large risk management offices look for a well-defined set of skills and backgrounds in hiring. The CRO at a global IT services company maintains a staff of 72, including 40 focused specifically on IT. He hires from within, looking for people with experience in every part of the company. He prefers to hire people who are already known to the business leadership team, "which helps to break down siloed walls." He also seeks out chartered accountants and individuals with "good contractual skills, framework development, and the ability to move beyond tactical facility to the enterprise level."

A good risk management group "should operate like a boutique firm," says the CRO, "with everyone an expert in a particular area who can be asked to do deep-level work." The company's strategic — as opposed to IT — risk management team is broken into three subgroups. One team addresses intellectual property-related issues, a center of excellence develops frameworks and analytics for projecting the effects of potential crises on the company's business, and a third focuses on regulatory compliance and stress testing.

Companies participating in the Harvard Business Review Analytic Services study that have only begun creating a formal ERM process over the past several years span a broad category of enterprises, from a privately held maker of a limited set of products to a government-sponsored monopoly to a diversified industrial supply company with global reach. But the processes they have built for identifying, aggregating, and mitigating or managing risks follow a similar pattern.

At one U.S. manufacturer, the annual risk management exercise, which was adopted four years ago, begins in September, when the executive with enterprise-level risk responsibility reviews a list of 105 risks with the company's business leaders. Each creates a list of top risks, which early in the following year goes to the Risk Committee. The committee pinpoints the 10 most significant risks; in some cases, it has been known to replace two or three of these with lower-scoring risks that members believe may be important anyway. At the same time, the committee identifies 10 top enterprise-wide risks from across the lists submitted by the business leaders. For each risk both on the enterprise and business unit level, it then creates a mitigation and management plan.

Another company relatively new to formalized ERM is a Pacific-region agricultural cooperative group that installed an enterprise-wide process in 2006, having suffered two big losses in the property market the year before. Its risk review takes place every year to 18 months, says the general manager of policy and risk. His office gathers lists of the top 15 risks from business leaders for review by the C-suite and the board.

At a U.K. company that established its ERM process more recently, risk assessment also begins with creation of a risk register through forums that the head of risk holds with business leaders. Out of these come 20 risks, of which the executive committee selects a half-dozen that will get action plans, says the head of internal audit. The committee then creates a "scoring matrix" that assesses the company's tolerance of each risk — say, of unplanned disruptions on multiple routes — based on its expected impact on the company and the probable frequency with which it could occur.

This process takes place annually, although the executive committee then reviews its action plans every two months. The frequent reviews are due to the fact that the process is still "very immature," the head of internal audit says. As it becomes better understood within the organization and the annual risk registers begin to create a common language of risk within the company, the reviews are expected to take place less frequently.

Confining ERM to a once-a-year review assessment is not considered best practice at companies with mature risk management processes. However, interviews reveal that many companies that have put processes in place more recently consider annual reviews to be an evolutionary stage toward an approach that embeds ERM more consistently in daily operations.

Some go a step further. One European manufacturer, "when appropriate," conducts back tests of its risk portfolio over specific periods of time, comparing the risks it prioritized with those that actually had an impact on the company, says the company's risk management head. It also systematically assesses its actual risk exposure against its appetite for specific risks.

This kind of ongoing evaluation is also useful in further heightening awareness of risk throughout the organization. At one small U.S. banking and securities firm, the IT manager notes that while the "target audience" for the results of its annual risk assessments "is management and above, the information is shared with all levels of the organization via middle managers and town hall-style quarterly meetings."

IDENTIFYING RISK: LOOKING DEEPER AND WIDER

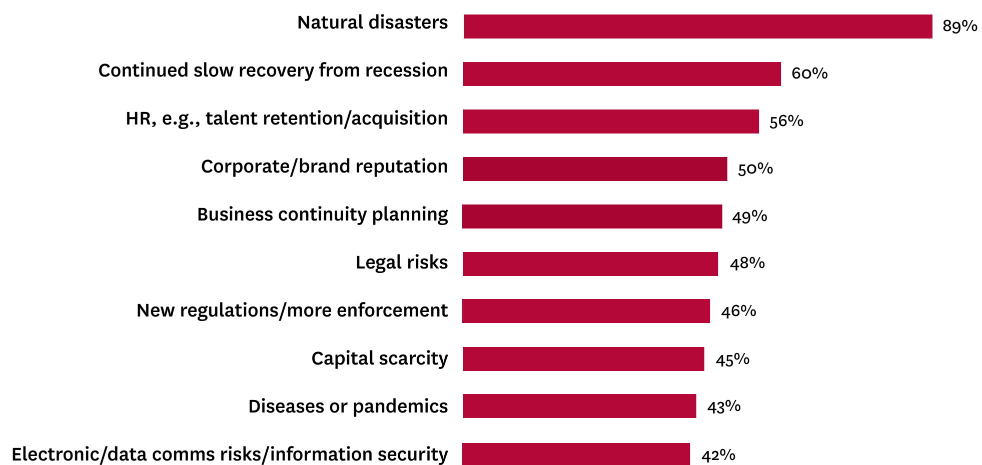
Two series of events — natural disasters and financial and economic crises — have risen to the top of companies' risk lists, the Harvard Business Review Analytic Services study shows. Figure 8 The disasters of the past three years have prompted them to ramp up their ERM processes and work harder at installing a risk management culture. Some companies have also made more basic changes designed to forestall similar occurrences or enable executives to respond to them more effectively. At the same time, however, the threat of unanticipated "black swan" events has encouraged many companies to broaden their search for potential risks. Interviews reveal that some are looking more closely at their outside relationships — with suppliers, customers, and joint venture partners. Some are also beginning to sharpen their analysis of aggregate or cascading effects, when two or more unrelated risks create a multiplier effect.

Globally, 89% of companies cited the risk of a natural disaster, such as an earthquake or hurricane, as having risen significantly in the past three years. The risk list at one Pacific-region company is topped by the loss of a major production site, a supply chain disruption, a lapse in security, and commodity price shocks, which could be caused by a natural disaster or, possibly, a further economic crisis. Business continuity became a more prominent issue last year at one U.S. manufacturer. "The economy is improving, but we have a lot of sole-source customers," says the head of corporate strategy. "When the tsunami hit in Japan, we had contingencies in place to deal with the disruptions. But we also have a concern about distressed suppliers during a downturn."

Companies remain very concerned about the risks that could be triggered by a double-dip recession or continued slow economic recovery in their key markets, with 60% responding that the possibility of the latter has risen significantly in the past three years. Although it suffered relatively little during the 2008

Top 10 risks that have risen the most in significance in the last three years Figure 8

QUESTION: Which areas of risk have risen most significantly in importance during the past three years?



downturn, management at a Pacific-region company continue to be concerned about currency volatility and has set up long-term credit arrangements to make sure it stabilizes its credit base. A U.S. manufacturer that does a great deal of business in Europe is also concerned that the continuing debt worries there could affect the company's floating rate debt and therefore its cost of capital. Market volatility beginning in 2008 has been a major spur for one European investment bank to improve its ERM process, says an executive with risk management responsibility, because "we must be able to instantly evaluate risks and see the total exposure of the group."

One European consumer products manufacturer actually benefited from the last recession, since in the U.S. and its other major markets, consumers shifted in favor of less expensive purchases. However, "a financial meltdown leading to another significant consumer spending decline may very well affect the organization as well," says the company's top risk management executive. "We are looking at relevant early warning metrics as well as preparing downside scenarios and action plans."

A striking finding of the Harvard Business Review Analytic Services study, however, is that beyond the "headline" risk events of natural disaster and economic slump, the other most-often-cited risks are largely operational matters that underpin the companies' ability to deliver on their strategic goals and maintain a viable, competitive organization going forward. More than half of companies mentioned risk related to talent retention and acquisition as having risen significantly, one European manufacturer citing particularly the threat of losing a key project manager. Corporate and/or brand reputation has become a more significant concern at half of companies, while business planning and continuity and legal risks were mentioned by nearly half. Figure 9

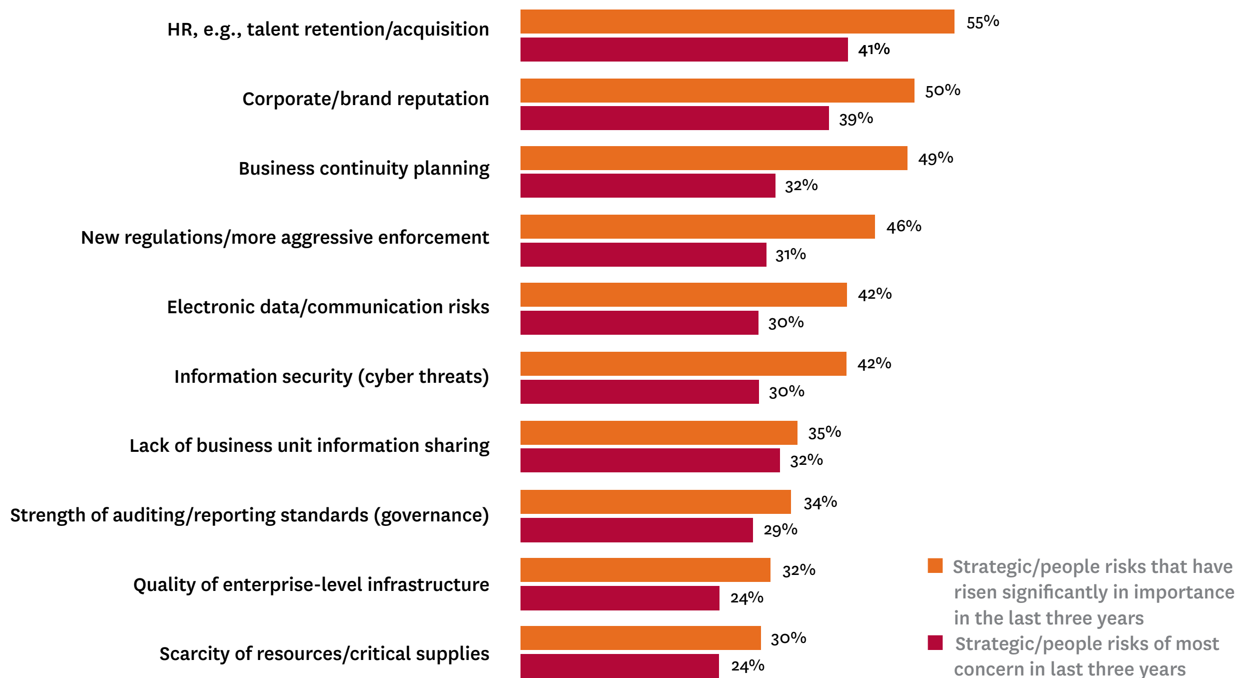
As a result, companies that have returned to growth mode are more conscious of the need to focus more on the operational aspects of risk management and at the same time address broader strategic risks. A large U.S. agricultural lender, at the time of the 2008 crash, had "the lowest capital level in our history," its CEO notes. "We had to take extraordinary measures to build back our capital." Top executives remain concerned that the firm is too concentrated in certain sectors and are considering strategies for diversification. Meanwhile, the lender worked with a consultant to design and implement a new ERM process coordinated by the vice president for operations and similar to the risk assessment required of public companies under Sarbanes-Oxley.

A similar combination of operational and strategic risk concerns surfaced at an IT services provider that built its business on sophisticated data systems and management. The company's 32-person risk management team is supplemented by a 40-person unit handling IT risk related to information security and that reports to the business leader rather than the CFO. Highest-priority issues also include contractual risks and intellectual property risk — both infringement of the company's own proprietary tools and methodologies and the possibility that it might unwittingly violate another organization's — but also operational issues such as project delivery risk.

A U.S. metals manufacturer that has seen its sales rise rapidly overseas, and is also back in growth mode, is more concerned about operational risks. While its manufacturing still takes place primarily in the U.S., it anticipates placing production facilities in some of its newer markets, including the BRIC countries — "where we'll have to accept more risk," says the director of internal audit. This in turn means that the

Most concerning strategic/people risks of the last three years Figure 9

QUESTIONS: Which areas of strategic/people risk have been of most concern to your organization over the past three years? Which areas of strategic/people risk have risen most significantly in importance during the past three years?



company "will have to get used to a more decentralized structure that pushes decision making authority further out into the field. Risk management is a big component of that."

Both the economic downturn and natural disasters like the tsunami in Japan are prompting companies to stretch the definition of ERM to include their relationships with outside entities. A U.S. manufacturer, for instance, now has a risk scorecard that enables it to gauge the risk inherent in acquisitions and joint venture agreements before they happen. At a European agribusiness company, the interviews conducted by the group risk management head and his staff as part of the annual risk reporting process now include some with executives "upstream" and "downstream" from the company itself.

A Pacific region agricultural cooperative now insists that joint ventures and any enterprise over which it lacks full control must adopt risk management policies consistent with its own. A partner at a large U.S.-based accountancy and consultancy firm describes how it has formalized this process: "Before entering into a client engagement, we complete a risk analysis using a spreadsheet program promulgated by the leadership. The program changes from time to time. The report must be provided to the partner in charge of our service line to ensure that risk thresholds are met. In the case of large, multimillion-dollar clients, more senior partners are involved."

Companies also express, although more tentatively, a desire to incorporate a better understanding of the way risks can build on each other to produce more serious problems than might be expected individually. One European CRO calls these "sequential risks, where if Risk A happens, it is seen as inevitable that some element of Risk B will happen." As an example, he draws a scenario in which his company suddenly encounters competition from another major player. "If that happens, we'll get demand for higher margin from our retailers, demand for higher quality from our customers, and the risk that we won't sell as many units — thus putting pressure on our cost base."

While this is the sort of scenario that any company that participates in a competitive market must be cognizant of, other, less predictable events can create sequential risks as well. For example, it has been reported that the Japanese earthquake and tsunami in early 2011 caused supply chain interruptions that then curtailed production in facilities across Asia.

How to incorporate potential chain reactions such as these into risk reporting and management? "We need to look beyond the obvious, at reducing the unknown unknowns," says the head of group risk management at a European multinational. That means driving a risk management culture deeper into the company, so that its annual risk reporting is informed by a close understanding of how the company operates. With that, he says, "we'll have a holistic, comprehensive view of the driving factors behind risk, allowing us to see the interlinkages between potential risks."

For companies that are still early in implementing their ERM processes, however, it may be some time before this level of risk analysis is possible. "We're not there yet," says a U.K. head of internal audit, because it takes several years of cycling through the risk reporting process before everyone who participates in it is clearly using the same terminology and speaking the same language about risk. "As we continue to build our risk registers, we'll see how risk aggregates up" from his company's 15 primary customers, "and we'll be better able to see risk in the company as a whole. However, other executives said that achieving best practice means going further and actually analyzing risk interlinkages.

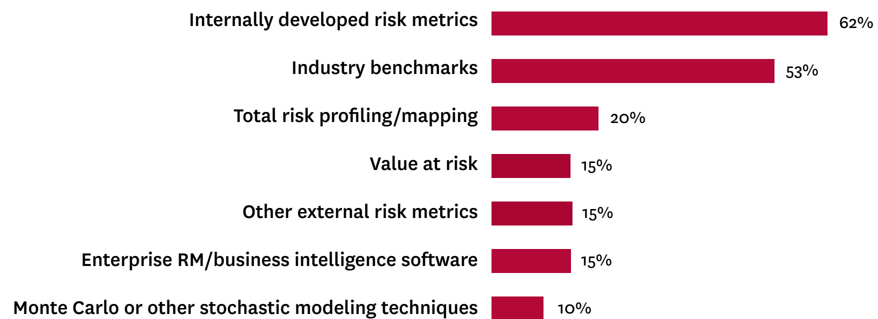
MEASURING RISK: KEEPING IT SIMPLE

Typically, one of the risk officer's primary duties is to create documents and templates that business leaders then use to make their risk reports. The language and structure of these forms is an important element in creating a broad and deep risk management culture, since it encourages the adoption of a common language and common definitions. This has been a matter of concern over the past three years, as 58% of companies report having changed their risk metrics during that period. Those most likely to have done so, however, were those that tended to have mature ERM processes in place already — financial services firms and large companies with more than 10,000 employees.

Except for financial services, companies in most industries still rely on internally developed and industry-specific documents, mapping tools, and metrics. Internally developed metrics are used by 62% of companies, the Harvard Business Review Analytic Services study found, while 53% use industry benchmarks to assess their risk management performance. Figure 10 Financial services companies were the most likely to use all other measurement tools covered in the study: total risk profiling and mapping, value at risk (VAR), ERM and business intelligence software, and Monte Carlo or other stochastic modeling tools.

Primary risk management measurement tools Figure 10

QUESTION: What are the primary tools your organization relies on to identify, assess, and/or quantify risk?



Some companies say standard risk profiling and stochastic modeling tools are more appropriate for businesses such as financial services, where success can be traced precisely to certain quantitative results. At one global mining company, "quantification of event risk — natural disasters, unexpected disruptions — is valuable," says the head of risk management. "But the risks we look at often — hiring people with the right skills in the right place, political and environmental risks — don't lend themselves to Monte Carlo simulation."

There are exceptions. One European multinational also uses a template that brings together internally developed and standardized metrics, including, "where it makes sense," Monte Carlo modeling. To get a better grasp of how risks in its businesses might play off each other, it built an "interconnectivity map" that took as its starting point the Correlation Matrix developed by the World Economic Forum's Global Risk Network. However, this process also allows for "tailor-made adjustments if there are specific, unique situations in a particular sector" of the company, says the head of group risk management.

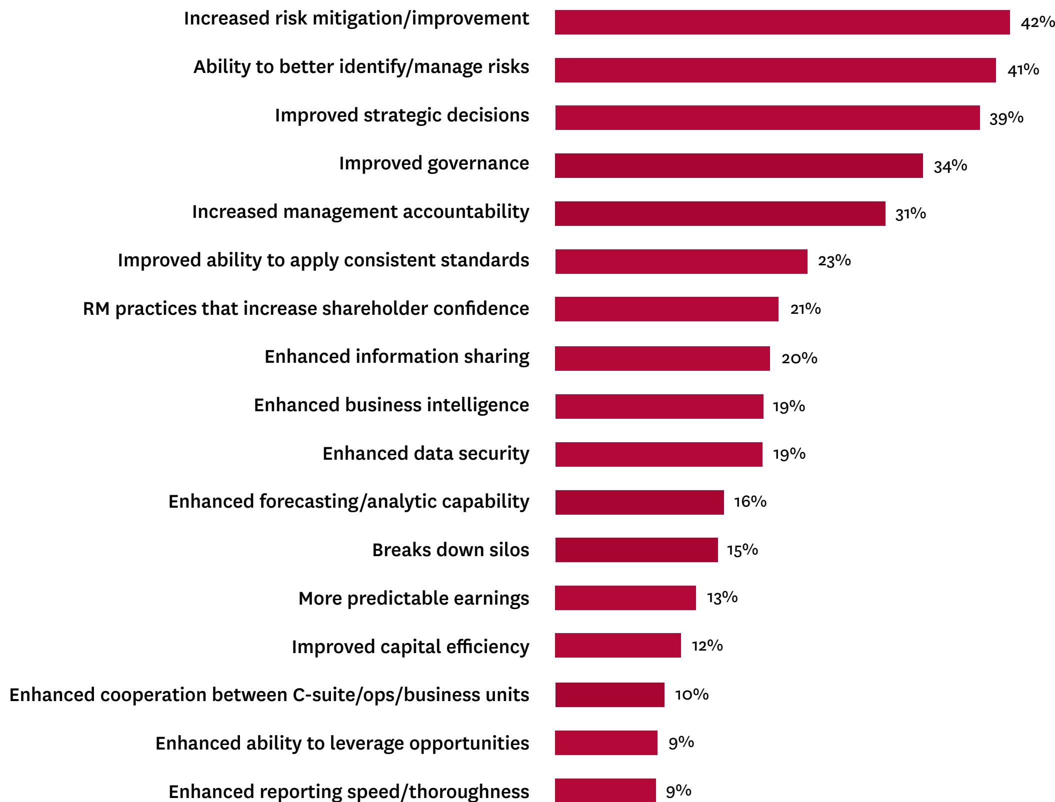
Degree of use of sophisticated modeling can depend as well on the background of the individuals involved in ERM. Says a European corporate risk officer, "most of our managers are numbers guys, and we introduced Monte Carlo modeling because one of our execs needed one number to say what our risk exposure is." Since then, the company has used Monte Carlo analysis to demonstrate the true volatility of its budget and performance forecasts, which in turn enables it to define a company-wide risk appetite. That gives management a "comfort level to take more aggressive investments."

Others stick almost entirely with internally developed metrics and other tools, however, out of concern that externally developed tools would not fit their profiles. This applies even to some financial services companies. "There's software out there we could purchase," says the CEO of a U.S. agricultural lender that uses an internally developed risk scorecard in Excel, "but we view our risks differently than a traditional bank. For example, we can diversify within agriculture, but we are still an agricultural bank."

Companies outside the sectors that typically have best-practice ERM in place, but that are attempting to move in that direction, point to a common concern: obtaining buy-in from the company's business leaders, such that they give their wholehearted support to the ERM process. That can be difficult if the process threatens to overcomplicate their jobs, warns an executive with risk management responsibility at a U.S.

Business benefits of enterprise risk management Figure 11

QUESTION: What have been the primary benefits to your organization of implementing enterprise risk management processes?



manufacturer. "We don't want to implement a logistical nightmare," he says. "We have way too many corporate initiatives already at the business unit level, these guys are trying to grow the business, and the best thing for risk management is to get more time for them to talk about the risks they face." Hence, progress toward greater use of sophisticated risk profiling and analytic tools has been slow.

REAPING THE BENEFITS

If companies are at widely different stages of development in the adoption of formal risk measurement tools and models, they agree generally about the benefits of implementing an ERM process, some of these relating directly to risk management and others helping to make the company itself more competitive. Between one-third and one-half of respondents to the Harvard Business Review Analytic Services study cite five key business benefits: Figure 11

- Increased risk mitigation,
- Better ability to identify and manage risks,

- Better strategic decision making,
- Improved governance, and
- Increased management accountability.

Effective ERM can bring competitive advantages as well. “Insurance companies lay a lot of importance on what we do,” says the CRO at a global IT services company, “and that seems to have had a positive impact on our premiums the last two years.” Having a well-regarded ERM program can also help a company’s case with potential clients. “We have a lot of Fortune 100 and Fortune 500 customers,” says the CRO. “Their own corporate governance practices place an emphasis on robust ERM by companies like us. They want confidence that things won’t blow up.”

Most useful from a risk management perspective, executives say a successful ERM process breaks down barriers to communication and sharing of best practices across the organization. Risk management processes “have helped improve communication across the board,” says a European airline executive. Particularly when ERM is joined to some degree with strategic planning, “there’s a reduction of siloed thinking as more people talk across businesses,” says a European group risk management head.

The result is “more aware decision making and better processes in areas such as M&A, because the company is taking known risks and it knows it’s taking them for the right reasons,” says a Pacific region corporate risk manager. Creating a standard language and processes around risk reporting also makes for “better governance,” he says. “People follow standards and guidelines rather than ignoring them and reinventing the wheel.” At a European investment bank, “when we’re adding businesses, [the ERM process] has made it much easier to make rational decisions, because we know how much risk-adjusted money we can make, and we understand the probable costs of that risk,” says an executive with risk management responsibility. Decision making can be faster as well. One European-based global mining company found that the information gathered in its risk reporting and evaluation process helped it to make speedier choices in such areas as health and safety standards, because the company’s risk appetite in these areas was already clear, says the group risk manager.

Better understanding of risk can lead to more fundamental changes in responsibilities within the company, once management and business leaders trace the source of the risk and understand their appetite for it. Interestingly, however, this does not always mean greater centralization. A U.S. agricultural lender, for instance, for a long time left underwriting and processing of loans in the hands of its 10 branch offices, each of which had its own procedures and criteria. Following the 2008 crash, the firm decided to centralize underwriting and processing at its corporate office, using a single standard and procedure. Decisions about whether to grant a loan, however, remained at the branch level. The result has been to lower operational costs while keeping risk-sensitive decisions in the hands best suited to make them.

A less centralized model makes sense especially in financial services, where many key employees are, effectively, licensed risk-takers, notes the CEO of a U.S.-based mining and metals trading firm. The firm was nearly bankrupted in 2009 when it found that one of its 10 branch offices was making unauthorized, speculative trades that led to big losses. Now, it has a small staff working under the CEO that monitors transactions and notifies each office of “red-flag events” such as when a commodity is approaching the price level at which a supplier must ship or a buyer must pay. The CEO also holds bimonthly videoconferences to discuss any recurring deficiencies.

The decision to take action, however, remains in the hands of the 30 decision-makers in their firm's branch offices. "If I take away risk management from the offices, they won't be as good buyers and sellers," says the CEO. "I want them to be independent, to make clear I trust their capabilities." He credits the new notification process with helping to boost his firm's revenues by 30% over the past year.

At the same time, a closer look at its outside relationships prompted the firm to eliminate many of its smaller buyers and vendors, a process that the CEO partly credits with boosting the firm's revenues last year. "When my decision-makers could see that they can sleep much better, and can do a lot more business with long-term businesses that understand pricing, they saw the value of doing this," he says.

Effective ERM processes can make a company more competitive not only by giving it more confidence in its decision making — making "aggressive investments" easier to agree upon, as the corporate risk management executive at one European company puts it — but in some cases, by augmenting the company's brand and reputation. "The process has helped us find opportunities," says an executive with risk management responsibility at a U.S. manufacturer. "We can turn around and sell our strong ERM as part of our business management and facilities management offerings."

CREATING A RISK CULTURE

The first concern at companies working to build a strong ERM process is to sell the program deep into their own organizations. The barriers "are almost always cultural, not technical," says the CRO at a Pacific region company. The procurement director at a medium-sized Asian firm that responded to the Harvard Business Review Analytic Services study complained of "insufficient awareness of risk and its management by most staff globally who are not involved in oversight and management functions." Forty-two percent of CROs said the main barrier to embedding risk management was too much emphasis on compliance rather than fundamental processes, while 41% cited lack of strong support by top management. Figure 12

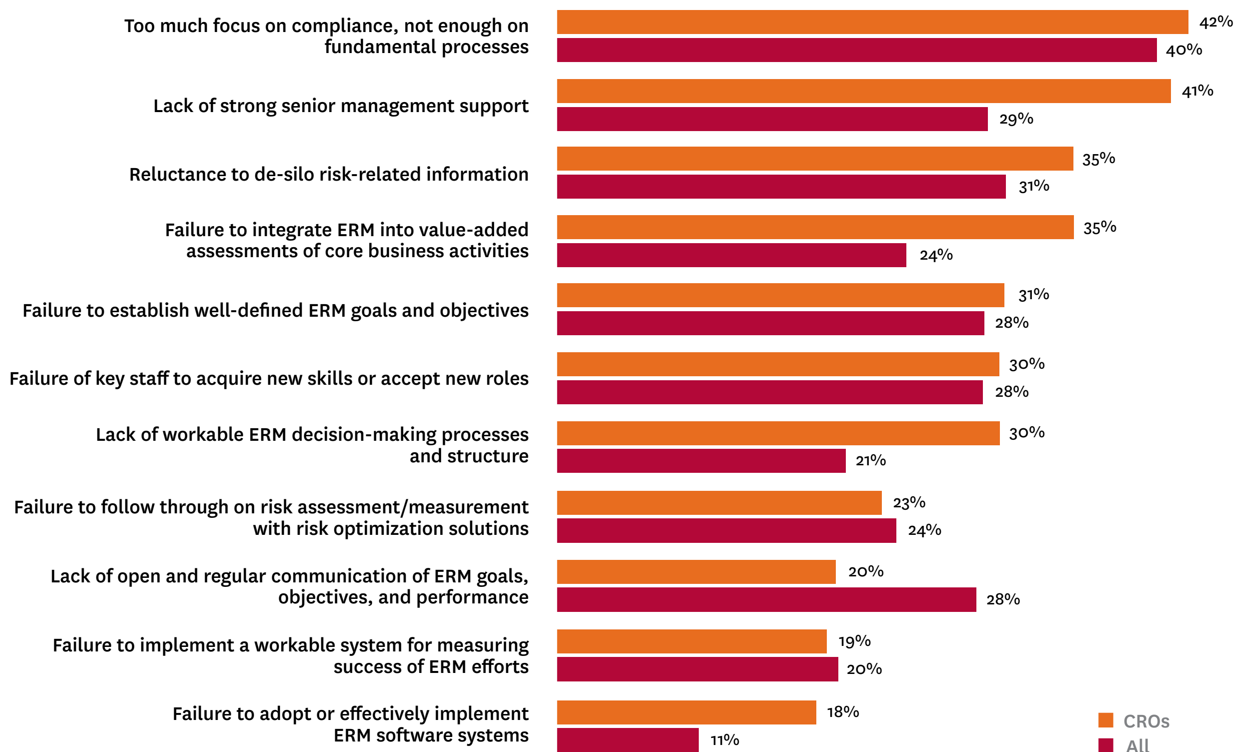
For some companies, a stumbling block that does not fall into the cultural category is when the rules are set to minimize competition. One European infrastructure company that operates as a state-sanctioned monopoly implemented a formal ERM process only very recently. The head of risk at this company notes that top management has been "difficult to convince" to get fully behind the effort, because "this organization doesn't have to do it. Regulatory and statutory rules require us to have this program, but otherwise we don't have to, because no one will be held accountable."

These difficulties become barriers to effective ERM, especially at companies that have initiated ERM processes only in recent years, because they undermine what several executives said is the most important task for a corporate risk officer: convincing business leaders that ERM is relevant to their business. This depends first on good interaction between the CRO or equivalent executive and each business leader. "Perhaps the most important factor in getting buy-in is to get a half-hour meeting — not an hour meeting," says a European corporate risk officer. "I prepare very diligently — I know what they're doing and what their challenges are, what risks they run, and the more exotic risks they may not be aware of.

"I want them to know that as part of corporate finance, my job is to make them shine. But if they don't want to do these things, then my fiduciary role comes in."

Primary barriers to embedding enterprise risk management Figure 12

QUESTION: What have been the primary barriers to more deeply embedding enterprise risk management across your organization?



At a European consumer manufacturer, ERM has strong support from top management. When this is not the case, and even in many cases, when it is, risk officers say it is very important to build the reporting process around documents and templates that standardize the language and reporting categories for risk management, but that encourage business leaders to think carefully about the range of risks to which they may be exposed. A European executive, who joined his company as its first group risk manager seven years ago, says he spent the first three to four years developing materials that drew out the needed information from a group of global business leaders who were accustomed to wide autonomy.

Initially, he used a detailed questionnaire, developed in collaboration with a consultant and using rigidly standardized terminology that received a “very poor response.” The company’s South American operations, for instance, tended to overemphasize small operational issues in their responses, while ignoring others with much bigger potential impact. The risk manager replaced the questionnaire with a simpler, two-page policy reporting template that asks business leaders to list their risk priorities, explain what they

Companies remain worried about the risks that could be triggered by a double-dip recession or continued slow economic recovery in their key markets.

did to address these, and what the outcome was. Giving them the freedom, in effect, to supply this information as they understand it has resulted in a more useful set of risk reports, he says.

While a risk officer's job is in part to be the company's chief internal champion of ERM, close monitoring is another important aspect. "That's probably the topmost issue for us," says the CEO of a U.S. mining and metals trading firm. After financial disasters in 2008-09, the firm created a new internal auditing system that gives the CFO access to every office's server. Every three months, the CFO conducts a review in which he highlights problems and raises questions about the activity in each of the firm's offices. "Honestly, because we have these things in place, every office has increased its value," says the CEO.

Monitoring is necessary in part, executives say, because in many settings, ERM processes go against the grain of what business leaders are accustomed to think are their primary goals. "The desire to make money, and make it fast, will always be a strong force that's inherent in the business" of investment banking, says a European financial services executive with risk management responsibility. "We need not only competitive people, but also people who have respect for regulation, and internal controls to make sure they're not exceeding their risk limits."

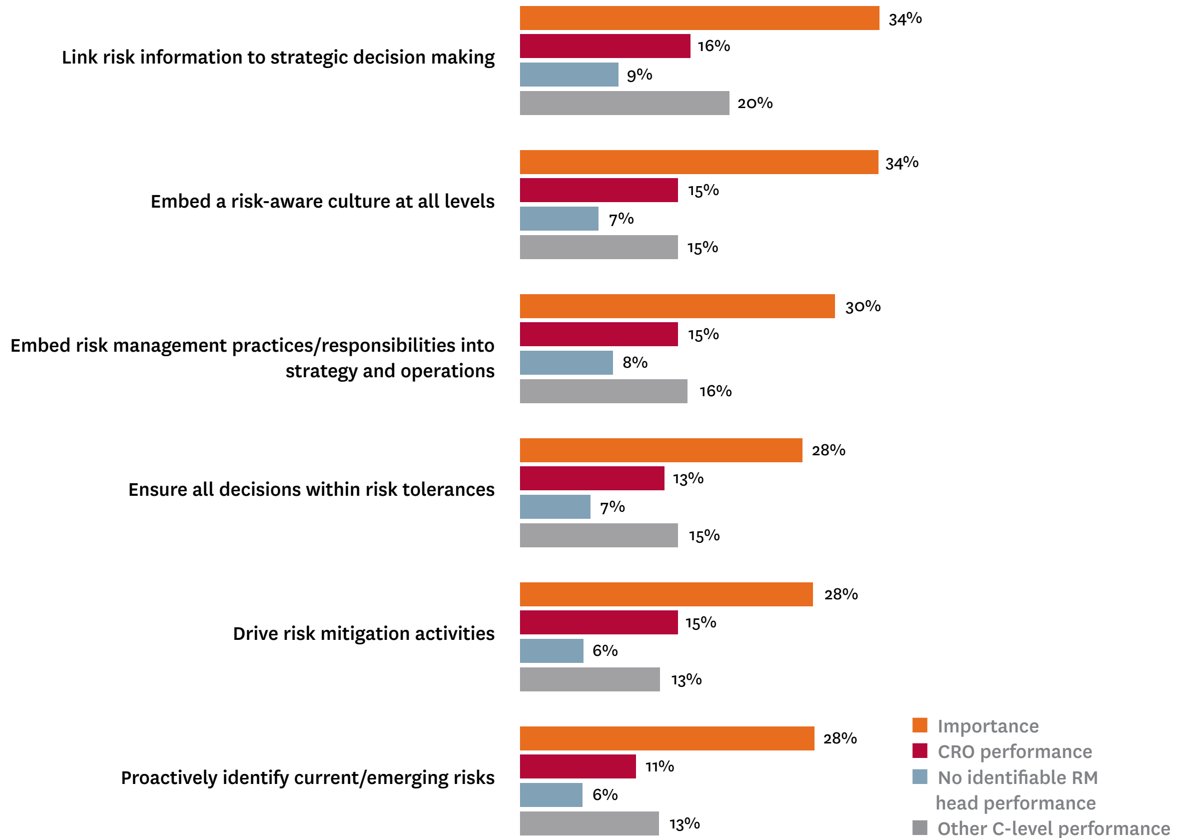
Something similar can be the case in manufacturing as well. Lean inventory practices, for instance, that help keep costs down "are great, but not for risk management," notes an executive at a U.S. manufacturer. "If a tsunami hits, that doesn't leave you with a lot of room to recover."

However closely they monitor risk at the business level, most executives still emphasize the need for these processes to be "owned" by the business leaders themselves. Several executives who participated in the Harvard Business Review Analytic Services study said their companies had used outside consultants to develop their ERM process and tools, to assess the program's effectiveness, and to benchmark it against other companies considered to have best-in-class risk management. But they cautioned against turning over aspects of the ERM process itself to the consultant, which would raise the prospect that once the outside advisor completed its work, the new process might collapse. The appearance as well as the reality must be that ERM is initiated and carried out by the risk officer, in close collaboration with the business leaders.

"Outside people can help to shape the program," says the CRO at a U.K.-based multinational, "but risk management has to be run by people within the organization, with relationships and knowledge of how it works with and influences management." That dovetails with the organic approach that executives said repeatedly was essential to creating a strong, deep risk management culture. Says the CRO at a Pacific-region company, "It's about getting business leaders to sit back and think about risks and including them in the process of developing the systems themselves. That way, we've created a risk-conscious set of behaviors at each level of the company." Figure 13

Top six risk management capabilities (top box scores, 9-10) Figure 13

QUESTIONS: Please rate the importance of each of the following capabilities to the success of risk management activities in your organization. Please rate how well your organization is performing with regard to these same risk management capabilities.



A truly successful risk management culture is focused on driving sustainable and profitable growth rather than simply protecting against downside losses and operational risks.

CONCLUSION

The past three years have seen more companies recognizing the importance of enterprise-wide risk management and, often for the first time, adopting practices to implement it. ERM has become a more important strategic consideration as well, enabling better informed and more confident decision making in such areas as acquisitions, geographic expansion, and new product development and launch. More companies, too, are moving to a higher level of maturity in their risk management processes, focusing more on proactively managing risk rather than reactively mitigating it. However, outside the industries where sophisticated ERM processes are the norm — financial services, health care, energy, large companies with 10,000 or more employees — most companies still have a long way to go in adopting best practices in risk management.

What constitutes best practices is becoming better defined, however, especially as many companies' processes were tested by the events of the past three years, which ranged widely from financial crises to natural disasters. Five distinct "lessons" emerge from the Harvard Business Review Analytic Services survey and follow-up interviews:

Risk management needs to have a clear "owner" to be effective. Having a single, identifiable individual charged with enterprise-wide risk management responsibility — preferably a CRO — is a key factor in driving success in this area. That individual should ensure that risk identification and management is a standardized process throughout the enterprise. To accomplish this, the CRO must have a close relationship with the CEO. Just as important, however, the CRO must work closely with line management to convince the business unit heads that ERM is relevant to their specific business and thus create an embedded risk management culture. Both sides of this relationship — with the C-suite and line management — should encompass continuing efforts to identify, analyze, and manage risk, rather than be confined to a periodic "review" process.

Risk management and corporate goals must be integrated. The Harvard Business Review Analytic Services survey identified a mismatch between the perceived importance of ERM and the actual state of the art within most companies. The majority of executives still give their companies low marks when it comes to embedding a risk-aware culture at all levels and linking risk information to strategic planning and

decision making. To get there, companies must ensure a high level of support for risk management, as well as active involvement in the process, from the board and the C-suite.

Companies must manage risk proactively. Too often, companies are identifying risks only after they have impacted the bottom line. To reverse this requires two changes in the way most companies conduct ERM. First, an active collaboration must be established between the CRO and the business units, such that the latter employ the CRO to analyze potential risks before new initiatives are adopted. Second, companies must move beyond relying on internally developed risk measurement procedures. They must begin using more sophisticated risk metrics that enable them to measure potential impacts on an ongoing basis — taking care not to create an overly complex process that could make collaboration with line management more difficult.

Companies must look deeper and wider to determine what their most serious risks will be in the long run. This means guarding against distorted perceptions created by recent events that had a powerful impact but nevertheless have a low probability of recurring in the long run. While natural disasters and financial crises have served to focus more attention on risk management, for example, many of the most frequently cited risks in the Harvard Business Review Analytic Services survey were operational in nature: talent acquisition and retention, corporate and/or brand reputation, and legal risks. Companies must become better able to anticipate sequential risks and the chain reactions they can precipitate. An important goal of ERM must be to identify and manage these risks before a crisis develops, rather than habitually responding to the causes of the last crisis.

Companies must break down silos and managerial bottlenecks. When the C-suite fails to focus on potentially serious risks, this often signals that the risk management process centers too much on compliance and not enough on fundamental processes, or that top management is not sufficiently engaged in ERM. Best practices in ERM include the CRO facilitating better communication between lines of business and with the C-suite, such that crucial information about new or growing risks is absorbed and acted upon quickly. Thus, ERM becomes a company-wide, collaborative process with three “lines of defense” — Line Management; Risk Management (including Legal and Compliance); and Audit.

While most executives still feel their companies have not attained the proactive approach to risk management that typifies best practices in ERM, there was little or no disagreement on the importance of doing so. In that sense, companies in a variety of industries stretching well beyond the sectors that traditionally practice ERM most strongly are now attempting to absorb at least some of these lessons.

METHODOLOGY AND PARTICIPANT PROFILE

Harvard Business Review Analytic Services completed research with 1,419 individuals who were drawn primarily from the list of *Harvard Business Review* magazine and email newsletter subscribers. In addition, in-depth interviews were conducted by telephone with a cross-section of executives. This research was conducted in June and July of 2011.

Participant Profile

Seniority
Thirty-two percent of respondents held executive-level management positions, 31% were senior managers, and 25% were middle managers. Six percent described themselves as CROs/risk managers.

Involvement in risk management
Over two-thirds (69%) of respondents were decision-makers or involved in RM decisions. Seven percent were not involved, and about one-quarter (24%) were influencers.

Key industry sectors
Seventeen percent of respondents were in banking/securities/financial services/real estate/insurance. Fifteen percent were from professional and business services firms, with 11% in manufacturing. Health care, education, and IT each were represented by 9% of respondents.

Functional area
Twenty-three percent of respondents were in general management roles. Fifteen percent were in support functions, with 13% working in production/operational areas. Twelve percent worked in finance departments.

Size of organization
Twenty-six percent of respondents were from organizations with more than 10,000 employees, while 24% were from organizations with 1,000-9,999 employees. Twenty-four percent were from organizations with 100-999 employees, and 26% were from organizations with less than 100 employees.

Region
Forty-one percent of responding organizations were based in North America, one-quarter in Europe (25%), a fifth in Asia (20%), 8% in the Middle East/Africa, and 6% in South/Central America.

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