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James Greenhill

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Aller au sommaire du numéro

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Major Dimensions of Risk Management Implementation

by James Greenhill

I. INTRODUCTION

A greater number of organizations are recognizing the advantages of developing and implementing organization/enterprise-wide risk management (ERM) with benefits beyond protection against adverse risk, including expanded opportunities due to better informed business decisions, more efficient use of resources, and improved strategic planning. This trend has been supported by programs and processes developed by independent bodies such as COSO's publication *Enterprise Risk Management – Integrated Framework*, and the Treasury Board of Canada's *Integrated Risk Management Framework – Implementation Guide*. Even with these advances and growth of supporting information, the practical implementation of an ERM program can be very complex and often only partially successful without careful planning. This paper outlines factors senior management must consider during implementation of a risk management framework and describes pitfalls to elude.

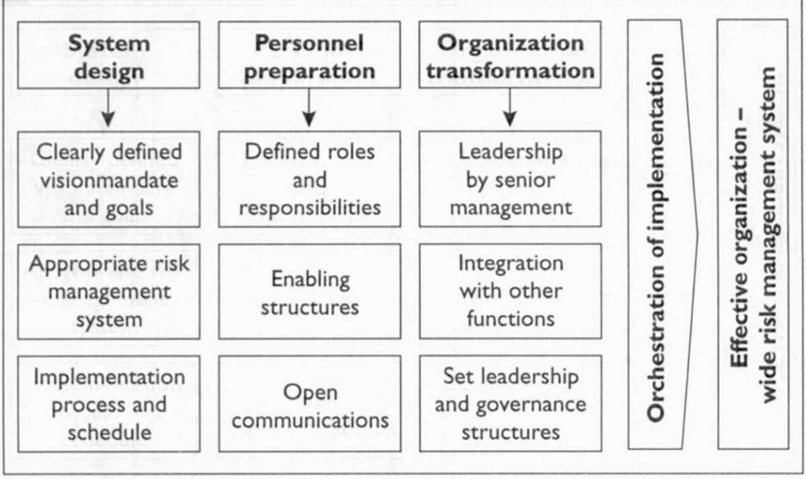
As the figure 1 indicates, there are three major dimensions to the changes required by a successful organization-wide risk management program: design of the risk management system, preparation of personnel, and transformation of the organization. Design of the system includes producing a precise definition of the mandate and goals of

The author:

James Greenhill is President of Risk Horizon, a consultant group that works with organizations in a decisive and rapid manner that derives immediate and long term benefits from the implementation of risk management processes.

risk management, an appropriate structure for accomplishing them, and a process for implementation. In preparing personnel to execute risk management, the key components are defining roles and responsibilities, ensuring that staff have the appropriate competencies, and allowing for an open exchange of information both upwards and downwards. Transforming the organization requires decisive leadership by senior management, as well as the integration of the risk management program into other functions, and the corresponding modification of the leadership and governance framework.

FIGURE 1
MAIN DIMENSIONS OF IMPLEMENTATION



2. SYSTEM DESIGN

The mandate and goals of the risk management program should harmonize with and support the overall mission of the organization. The key success factor is to not only carefully think through each aspect of the design, including expectations and benefits of the risk management program, but to also formulate the resulting decisions in a manner that can be clearly communicated to all members of the organization. Lack of such a vision and communication can lead to an inconsistent and chaotic implementation.

The design of the risk management structure should reflect the needs of the organization and not be driven by the availability of basic options, such as insurance, that may cover only part of a risk exposure. The figure 2 outlines the spectrum of risk manage-

FIGURE 2 – SPECTRUM OF RISK MANAGEMENT DEVELOPMENT

	Basic	Integrated	Comprehensive
Description	Risk managed in isolated silos. Management mostly reactive to risk issues.	Risk management coordinated on organization-wide basis. Key risks proactively managed	Risk portfolio managed on organization-wide 'real time' basis using complex systems and models
Often Present In	Start-up or small company	Medium to Large organizations	Organizations in heavily regulated industries
Highest Risk Management Responsibility Resides With	Department or function heads	Senior Management and Board Members	Senior Management and Board Members
Risk Identification	Each group has own unique way of identify risks. Risks may not even be called risks	Cross-functional; organization-wide assessment; Integrated into strategic planning process.	Continuous
Risk Analysis	Measurement of cost of past risk events	Determine potential frequency and severity of the organization's key risks	Constant monitoring of risk using complex mathematical models
Risk Strategy Design	Done independently at different loci in the organization	Developed on an organization wide basis	Continuously modified according to risk profile
Risk Management Strategy Execution	Done independently at different loci in the organization. Basic solutions implemented – e.g. insurance	Carried or on organization-wide basis using optimal combination of risk retention, transfer, avoidance, operational controls, and financing	Implemented on continuous basis.
Monitoring	Observation. Cost of risk measured after event occurs	Information captured and analyzed by organization allowing for proactive risk management	Measures enterprise value

ment development and gives examples of each component of a risk management system. While many organizations strive to achieve an 'advanced' or 'integrated' level of sophistication, they must ensure that the final result meets their particular needs.

There is often an assumption that large organizations benefit from the best risk management programs. This is not always the case, such as with the Federal Emergency Management Agency (FEMA) where management was not aware for three days about the flooding tragedy in New Orleans following hurricane Katrina in 2005 due to insufficient monitoring and communication capabilities. It is the organization that makes the best use of resources that operates the most beneficial risk management program.

The schedule of implementation has to be designed in clearly established stages and milestones. The pace should be realistic, but rapid enough to prevent a sense of complacency or topic fatigue. Best practice organizations often conduct a pilot project as a proof of concept before implementing the program on an organization-wide basis. The pilot project allows identification of necessary adaptations to the planned program with a minimum waste of resources, and generates enthusiasm for the concept. Feedback is also reviewed by senior management in order to improve the process for deploying risk management on an organization wide-basis.

3. PERSONNEL PREPARATION

There are four main categories of roles and responsibilities in the implementation process:

- Senior management who communicate the importance of the program to the organization and are ultimately responsible for risk management;
- Risk management champions who run the process once it is implemented;
- Line personnel who take on suitable local tasks to support the risk management process;
- Transition management team that acts as a catalyst for implementing the program, ensures that the components are suitably integrated, and then withdraws once it is in place.

The first three groups will continue to use the risk management system once implementation is complete. To ensure their capabilities to do this, the program should:

- Define the required competencies for each group;
- Provide enabling structures such as training, information and technical support programs, so that the groups can attain the required competencies;
- Demonstrate how risk management competence fits with individual career management.

Communications during the implementation should be organization-wide, done on a frequent basis, and be bottom-up as well as top-down, making use of both formal channels and the often more powerful informal communications that occurs with day to day interactions. Items to communicate include:

- Re-iteration of the vision of risk management;
- Progress on implementation;
- Early successes;
- Completion of milestones;
- Issues or problems during the change process that should be monitored and adjusted for in the implementation strategy;
- Beneficial experiences or practices that can be institutionalized through formal policies, systems and structures.

Communications helps build a supportive culture by:

- Driving out fear of failure that could distract the organization in achieving its mission;
- Mobilizing energy and commitment by encouraging personnel to help identify business problems and participate in developing their solutions;
- Reducing the sense of isolation that people may suffer during the implementation process.

4. ORGANIZATION TRANSFORMATION

Implementing a risk management program should not be seen as a one-off exercise in emergency preparedness, but rather a thorough review of operations and future strategic directions through the lens of risk identification and reduction that will become integrated with the business processes of the organization.

With any major initiative, decisive leadership by senior management is a key success factor. As they embody the tone and focus of the organization, it is crucial that the example set by management in formal and informal exchanges supports the risk management program. It is therefore critical for the senior management to understand and be able to clearly articulate the benefits of the risk management concept for the strategic and operational functions of the organization. Traditionally risk management has been seen as a supporting function, in much the same way human resources was once viewed. Just as organizations used the benefits of workforce management as a major strategic advantage at the end of the twentieth century, organizations which adopt risk management as a vital strategic business activity can reap an advantage in the twenty-first century.

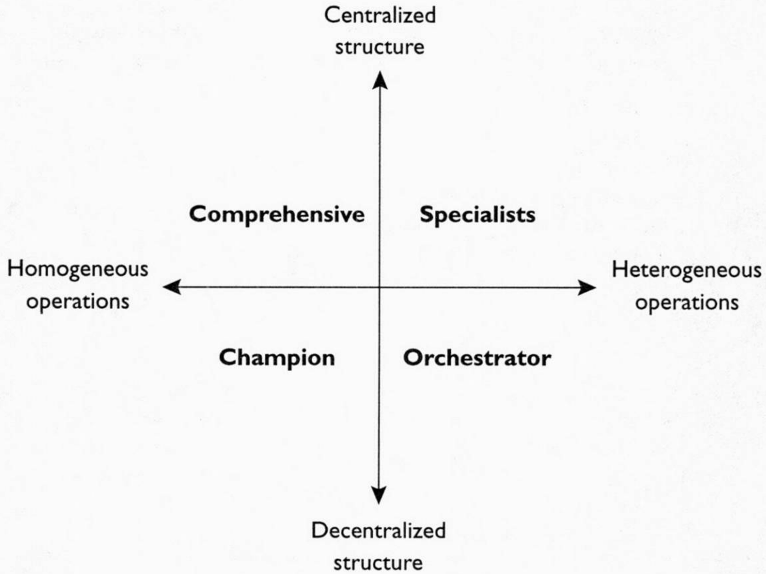
The shape of the risk management leadership and governance structure and how it coordinates with other functions depends on whether the organization operates in a centralized or decentralized manner, and whether operations are heterogeneous, with a wide variety of lines of business activities, or homogeneous, with little differentiation in lines of business or products. Further detail is provided in the figure 3. In addition, it is important to consider parallel functions, such as strategic planning and internal audit, in the implementation process as there is significant cross-functional impact with the on-going risk management process.

5. PITFALLS IN IMPLEMENTATION

As the figure 4 shows, there are a number of major potential impediments specific to each of the three dimensions of implementation. In designing the system, care must be taken to produce a very clear vision of the goals and mandate of the program. Without one, different members make their own interpretations resulting in a discordant and ineffective system. As well the system must be adapted to the organization's needs - a 'canned' solution usually does not meet all requirements and results in significant gaps in the risk management process.

In preparing personnel, plans and extra effort must be made for the resistance that some may have against the change. There are three

FIGURE 3 – RISK MANAGEMENT – STRUCTURE VS. TYPE OF OPERATIONS



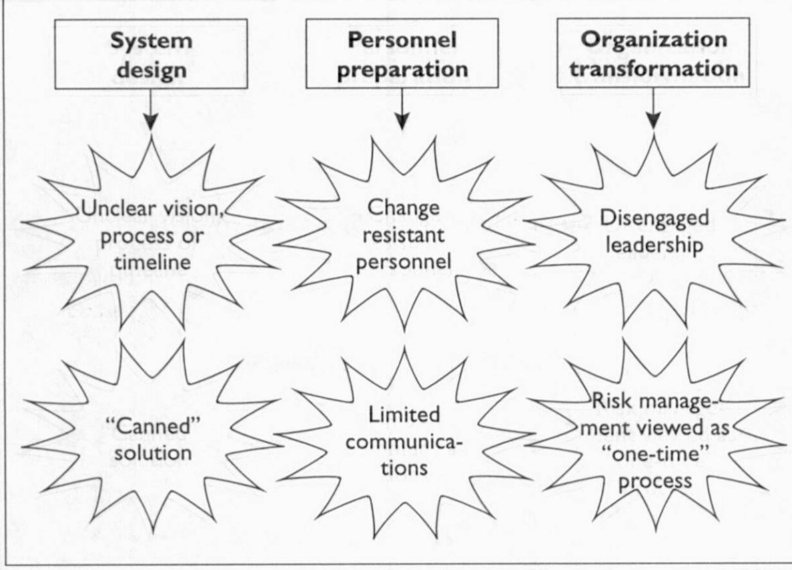
Comprehensive Function (Centralized-Homogeneous)
Operations that are centralized and homogeneous can allow for a single individual to have in-depth knowledge about the business and the nature of its risks. This person would be able to develop risk management processes, monitor their effects and enforce any deviations from standards.

Specialist Function (Centralized-Heterogeneous)
Operations which are centralized and heterogeneous would require specialists who understand the different portions of the organization's operations and how they relate to corporate level goals and objectives.

Champion Function (Decentralized-Heterogeneous)
Operations that are decentralized and heterogeneous means that the head of risk management would develop processes to protect the whole organization and would help adapt them to each operation.

Orchestrator (Decentralized-Homogeneous)
Operations that are decentralized and homogeneous imples that many functions and responsibilities are pushed down into subsidiary or business units. The head of risk management may then act more as a process catalyst, sharing best practices amongst business units and ensuring each one meets the organization's standards in risk management.

FIGURE 4
IMPEDIMENTS TO IMPLEMENTATION



main categories of change resistance that require different management strategies. Some personnel resist change passively because they are unsure of what they are supposed to do and are afraid of making a mistake. Defining roles and responsibilities as well as frequent supervision allows them to successfully engage in the process. The second type of change resistors are those who do not have or do not perceive themselves to have the competencies to accomplish their roles in the risk management program. Enabling structures such as training programs, information sessions and technical support usually effectively address their concerns. The last category of change resistors are those members who believe they are best served by preserving the status quo. Defining the benefits of risk management and indicating the cost of an unforeseen and unprotected risk event often helps move individuals out of their 'comfort zone' into accepting the implementation.

Communication and senior management attitude have already been identified as critical elements of a successful project implementation and their importance can not be over-emphasized. In addition once implementation is completed senior management must ensure that risk management is embedded in the culture of the organization and integrated as an on-going business process. With the effort required, many organizations feel rightly that completion of implementation is a time to 'declare victory'. However care should be taken to stress the fact that the risk management program is continuous, otherwise personnel may perceive that this is the end of the program and that they can return to "business as usual".

6. SUCCESSFUL IMPLEMENTATION

The successful implementation of a disciplined, systematic and comprehensive risk management process improves performance by allowing the organization to:

- Discover new opportunities by control and reduction of risk;
- Apply suitable amounts of risk control thus reducing waste of over-application or ineffectiveness of under-application of resources;
- Ensure continuity of operations. Few high performance organizations will tolerate the disruptions that a risk event could cause;
- Preserve assets. This is required either by externals stakeholders, such as financiers, or internal groups, such as senior management.

While larger organizations may have access to more resources, it is the wise organization that makes best use of resources for an optimal risk management program.

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