Risk Enabled Performance Management
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Th. A. Stewart, ‘Managing Risk in the 21st Century’
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“More shareholder value has been destroyed as a result of strategic mismanagement and poor execution than in all of the financial reporting and compliance scandals combined”

Worrying About the Wrong Risks
Paul Kocourek and Jim Newfrock
The Corporate Board Magazine
Risk Enabled Performance Management

Risk Management and Performance Management have often been viewed as two separate management practices that to a large degree have been kept apart in management decision making. Even though more and more companies recognize the importance of systematically linking risk and reward, a gap between awareness and action still exists.

EY have experienced that more mature and integrated risk management systems result in higher revenues and EBITDA margins. In fact, EY studies have shown that companies that are leading at integrating performance and risk management experience substantial benefits in the market - companies in the top 20% of risk management maturity delivered three times the level of EBITDA than the bottom 20%. Moreover, 82% of institutional investors are willing to pay a premium for effective risk management.

This is the first of a series of articles that aims at providing insight into how the areas of risk- and performance management should be linked to improve the quality of management decision making thus increasing value creation. The purpose of this article is to provide an introduction to risk enabled performance management, moreover how companies should integrate risk- and performance management at all levels, turning ambition into action within the desired risk appetite.

Issues with traditional performance management and risk management setup

Traditionally Performance Management and Risk Management has been kept a part. Performance Management has focused primarily on questions like, where are we, where do we want to go and what do we need to do to get there? On the other hand Risk Management has been a more or less isolated add-on to operations, focusing primarily on compliance and control activities.

A narrow approach to performance- and risk management can pose challenges for an organization. It reduces the organizations ability to monitor and mitigate critical risks and it prevents key decision makers from leveraging risk information. In sum, preventing the business from identifying and exploiting the bigger, smarter risks in an increasingly volatile business environment. It is perfectly possible for a company to be fully compliant, but suffer from clearly inadequate risk management resulting in unexpected events that prevent the company from reaching its strategic goals and objectives. In fact, more shareholder value has been destroyed as a result of strategic mismanagement and poor execution than in all the financial reporting scandals combined1.

Risk enabled performance management - a new era

Due to the increasing velocity, variation and demand for visibility in the business world these days the requirements for successful performance management grow rapidly. It gets harder and harder to be able to make the right decisions at the right time, and the consequences of getting it wrong is increasing. A lot of the traditional risk related knowledge becomes more relevant at all levels of the organizations. The leaders of today need to be able to handle uncertainties and improvement at the same time. Risk exposure, what-if scenarios, uncertainty, best case/worst case forecast, earned value models, risk drivers and contingency plans etc. are now desired by management at all levels. Leaders cannot afford the traditional set up where risk is something handled independently by risk managers once a quarter - they need access to the insights, tools and models on a continuous basis. Thus, the need for Risk Enabled Performance Management (REPM) arises.

What does it take?

To succeed with REPM you need to change the role and objective of the risk function, -knowledge and -structures of your company. Risk and Performance Management have to become inherently integrated at all levels, and the risk experts need to become trusted business advisors for line managers. This often requires a change of management principals, mental models and governance set up. In addition, management processes at strategic, tactical and operational level need to get sufficient risk support in goal setting, planning, performing and evaluating efforts. New risk enabled management processes often results in changes to existing meeting structure and new requirements for management information related to progress and forecast on key value and risk drivers. In addition the process has to be supported with simple tools to measure risk exposure towards the companies’ risk appetite along with the effectiveness of their control activities. To succeed with REPM, larger corporates often have to evaluate technology enablement, either in form of integrating new GRC suite or expanding their current performance management system. Last, but not least, it takes management attention and continuous focus on change management, training and coaching.

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1A New Balanced Scorecard, measuring Performance and Risk, EYG AU0227, 2009, Ernst & Young
The change needed in the role of risk

1. Independent risk identification and assessment process designed to run in silo for each risk department
2. Designed to provide risk reporting to Leadership and the Board
3. Evaluation of current exposures based on historical perspectives
4. Focus on compliance and protecting the business

1. Integrated risk identification and assessment in the “rhythm of the business” through the use of appropriate tools
2. Designed to add value and provide fact based insights to management and stakeholders at all levels
3. Analyzing future looking business and risk drivers to create scenarios and reduce uncertainty
4. Balancing growth, optimization and protection of the business, monitoring upside potential as well as limiting downside risks
What does good look like?

Most organizations have a performance management system of some sort in place helping managers to make decisions. The quality of these systems depend on several factors and the degree of how risk and reward are linked is beyond doubt one of the most important ones.

To become a fully risk enabled organization you need to clearly define and articulate the risk boundaries and appetite, and integrate this into all strategic considerations such as major investment decisions and portfolio risk exposure levels. Moreover the ambition and tolerance levels for both risk and reward need to be communicated and implemented by the board and executive level, establishing a tone from the top, guiding decisions on all levels in the organization.

On a tactical and operational level, you need to turn strategic plans and initiatives into objectives, performance prognosis, plans and projects, backed up by fact based analysis of the most important risk and value drivers. Based on this, you gain more control of uncertainties and opportunities going forward, ultimately improving performance and reducing unwanted risks. To secure alignment between ongoing activities and strategic plans, operational performance feedback should always be incorporated with risk trend and -indicator analysis. These analyzes should be closely monitored and reviewed to assess relevance and impact. Standard review processes provides agility going forward and enable managers to continuously revise plans, scenarios and focus areas and escalate deviations if necessary.

Where are we heading?

Strategic focus 3-5 years  Strategy review

<table>
<thead>
<tr>
<th>Long term ambitions</th>
<th>Risk capacity and appetite</th>
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<td>Strategic value drivers</td>
<td>Strategic risks and the handling of these</td>
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<tr>
<td>Strategic prioritization, plans and initiatives</td>
<td>Distribution of risk appetite</td>
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What has to be done now?

Tactical focus 3-6 months Business review

<table>
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<tr>
<th>Tactical objectives, analysis and prognosis of performance</th>
<th>Risk tolerance, analysis of risk and uncertainty</th>
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<tr>
<td>Tactical prioritization, plan with initiatives and projects</td>
<td>Action and control plan</td>
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</table>

How do we do it?

Operational focus, Day/week/months, Regular operational meetings

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<th>Operational prioritizations and plans, continuous problem solving</th>
<th>Operational limits/reviews, mitigating actions</th>
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<tr>
<td>Improvement of performance</td>
<td>Reduction of risk and uncertainty</td>
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How can EY help?

Based on our experience we have developed a best practice set of approaches to establishing Risk Enabled Performance Management. All of these represent pieces that must be in place for an organization to be fully risk enabled. As the next articles in this series will focus more on these approaches we have only briefly described them below:

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<tr>
<th>EY’s 6 approaches:</th>
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<tbody>
<tr>
<td><strong>1</strong> Risk Enabled Corporate Management</td>
<td>Integrating risk in the rhythm of group management, improving alignment, cooperation, prioritization and execution across the different business areas</td>
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<tr>
<td><strong>2</strong> Risk Enabled Driver-based Management</td>
<td>Linking strategic objectives to outcome metrics, underlying drivers and risks</td>
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<tr>
<td><strong>3</strong> Risk Enabled Project and Portfolio Management</td>
<td>Improving our ability to prioritize and manage our project portfolio, reducing the amount of surprises and increasing the value added from our projects</td>
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<td><strong>4</strong> Risk Enabled IT governance</td>
<td>Governing IT to maximize business value within desired risk appetite</td>
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<td><strong>5</strong> Risk Enabled Sustainability</td>
<td>Ensuring that key sustainability aspects are managed</td>
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<tr>
<td><strong>6</strong> Risk Enabled Technology Enablement</td>
<td>Put in place the IT system that support risk enabled performance management</td>
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EY has experienced that it is often challenging to have a complete understanding of the current state and what area to address first. Therefore, in addition to the 6 approaches we have developed a rapid assessment approach, Rapid Assessment for Risk Enabled Performance Management, assessing the current state of risk and performance management.

Sum up of Key messages

Performance management and risk management are two sides of the same coin and should be treated as such. Splitting them into different and virtually separate management systems significantly reduces the effectiveness of these systems and may have dramatic consequences for the organization. To succeed with Risk Enabled Performance Management you need to change the role of the risk manager, from a compliance officer to a business partner. Only in this way you will be able to identify and take advantage of the bigger, smarter risks that will drive performance in an increasingly volatile business environment.

This article has mainly focused on introducing Risk Enabled Performance Management as a concept and explained why there is a need to think of performance management and risk management in an integrated way. In the following articles we will go more in depth describing how you can establish best practice risk enabled performance management. The next article will explain how your organization can improve the ability to prioritize and manage the project portfolio, reducing the amount of surprises and increasing the value added from these projects.

EY have helped several companies improving their risk enabled performance management. We have established a global network of SMEs. Based on our experience we have established a best practice approach to establish risk enabled performance management, integrated in our 6 products and the rapid assessment.

If you want to hear more about this subject, do not hesitate to contact:

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About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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