How aligning risk functions can pay dividends

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As the risk function has grown in size and scope, the challenge for managers is to direct resources to where it is most needed.

No-one can predict the future with total accuracy. But if there is one thing most observers agree on, it is that the next ten years will see a significant rebalancing in the relationship between the established economies of the West and those economies we currently class as emerging markets.

And the economic environment in which this will play out is also uncertain. Clearly, while the global economic recovery has taken hold in some regions, serious dangers remain. Fiscal tightening and de-leveraging by western households may stall the incipient growth. Meanwhile the threat of bank failures and sovereign default may have temporarily slipped down the news agenda, but they remain real.

The Eurozone will remain, at least for the short term, to be the focus of attention. Politics aside, instability and uncertainty within the zone will bring with it a significant financial risk, principally focused on currency movements. For corporates, the fluctuations in currency prices will present one of the most immediate threats in the coming years.

Naturally currency movements will pitch the world's economies further into a competition, and clearly corporates in all regions will need to be aware of the dangers of trade disputes and the rise of protectionism. In that context, sectors outside banking and finance – automotive and pharmaceutical, for example - will be vulnerable to shocks. In short, while many of the risks are clear, others are less so.

In that context, asking anyone engaged at the functional level of risk management, from treasurer to internal audit manager, whether they feel their organization's risk management functions are fit for purpose, the chances are they will say yes. After all, since 2000, in the corporate space there has been a huge increase in the sums invested in the functions that fall under the banner of governance, risk and compliance (GRC).

That has been mirrored by the influx of talented individuals into risk management roles, lured by the promise of making a real difference to the survival and success of major businesses.

However, ask that same question of the "C-Suite" and you might get a different answer. While those working in GRC may perceive their function as delivering on value, cost and focus, evidence suggests those outside don't share that view. Indeed, it is this gap that is driving some of the transformational reforms currently happening in this area.

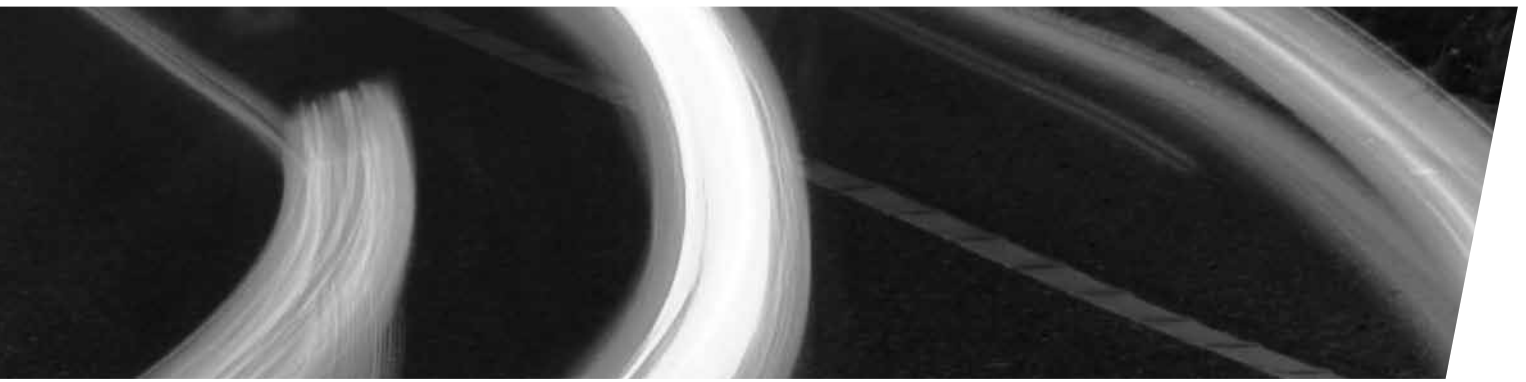
A recent Forbes survey revealed that while an overwhelming majority of senior executives believe strong risk management has a positive impact on their long-term earnings performance, only 44% of companies believe internal audit helps their organization achieve its business objectives. Therein lies the one of the key gaps in effectiveness.

The recent developments in the world economy have put greater focus on the response of corporate risk management. While we've seen the continued growth of a 'risk-industrial complex', in some cases this has led to organizations losing sight of what GRC is for; and, worse, having a GRC function that is poorly focused, overly bureaucratic and prone to duplication. Clearly that is dangerous and expensive.

Many organizations now have multiple risk management functions, some under different names, focused on different parts of the business, and following divergent agendas. As a result, in some cases, the response to the recent crises failed to meet the expectations of some senior executives.

Why did this happen? To many observers, it came about largely in response to the corporate crises that arrived in a flurry in the years following 2000. Enron, Worldcom, Parmalat – these were all in some way characterised as failures in governance and risk management. The effects of those crises were compounded by the regulation introduced to avoid them happening again.

Sarbanes Oxley heads that list, and there's no doubt that SOX led many corporates to greatly increase investment in GRC. That was followed by a tide of further national regulators adding to the risk management statute book with rules of their own. Investors and institutions demanded corporates demonstrate clearly that enough time and resource was devoted to GRC.



To illustrate the scale of the issue, some reports suggest that financial institutions alone spent up to US$100 billion globally on mitigating risk in 2010; others indicate that in the US companies alone, companies have invested up to US$30 billion over the same period.

These figures reflect a trend of senior managers becoming too reliant on GRC as a safeguard against failure. And not only that, managers are increasingly concerned by the way they were perceived by external stakeholders - regulators, investors, analysts, academics and journalists and so on – which has led to an arms race of GRC spending. Indeed, responses to an EY questionnaire placed 'global governance failure' second only to another liquidity shock as the most pressing risk they face.

But while spending has increased, have corporate organizations really upped their 'risk quotient'? Are they creating synergies across the various risk functions, are they taking cost out of the business by streamlining GRC, and are they aligning the disparate risk management functions along a coherent and focused programme?

Some are. It is certainly true that some companies were quicker to recognize that their GRC functions were becoming bloated and ineffective. Take the example of a major global healthcare business located in Europe, for instance. In 2009 it set a target of aligning all its GRC functions in order to reduce cost, increase the function's effectiveness and achieve synergies. This was in response to the business's growth in terms of size and complexity.

In practice, that takes various forms: there is greater integrated GRC planning, with the heads of audit and compliance meeting bi-weekly to align ongoing activities; there are cross functional initiatives (e. g. development of a compliance self-assessment tool or contract risk assessments); and greater information sharing. Overlaid on this cooperation, material risks are mapped against the coverage of the various assurance functions (e.g., IA, SHE, external audit, quality) to detect blind spots and avoid duplication.

So far, the effort has yielded some immediate benefits. Aligning and integrating the various GRC functions resulted in timely actions being taken with greater understanding of their impact. Running joint projects not only achieved synergies but also enhanced job satisfaction within the GRC ranks. And the mapping of assurance across the functions against risk ensured complete coverage.

Value can be generated when outside investors perceive a company's risk management policies to be properly aligned, hence driving up the value of their investment (and it can have a significant impact on a business's credit rating since S&P started grading companies on risk management; cost savings are achieved when functions are integrated and complexity reduced, avoiding duplication and mission creep; and compliance follows from these efforts – the more integrated risk functions are, the less likely a catastrophic risk is to occur.

For other major corporates, the challenge remains one of 'doing more with less': aligning the business's objectives with the resources available. That means achieving the most possible coverage as well as maintaining and improving the quality and efficiency of the audit services provided

There's no question that the 'risk revolution' is setting the bar higher for internal auditors and risk professionals. The focus for many is now shifting to a more proactive, 'front-foot' approach where internal audit can pioneer preventative frameworks to avoid risk. That will inevitably involve the risk function working across the business.

This can't happen in isolation, and so in order to maintain quality of management across the business, competencies must be improved. One head of audit at a global pharmaceutical firm is staunch in his belief that the more independent and proactive the risk function becomes, the better it must be. And that optimal performance relies on strong challenge from within and outside the function itself – risk professionals must not be afraid to engage with the rest of the organization.

Ultimately the momentum within most large corporates is towards greater integration of risk functions. In parallel to that, internal auditors now have an opportunity to truly demonstrate value by acting as consultants to the rest of the business. Indeed a large healthcare business now puts its risk functions under the title of Risk Advisory, reflecting the changed nature of the role it performs: working across the organization to develop proactive risk management techniques and thinking into everyday operations.

Achieving optimum performance will require patience and perseverance, but it is clear that risk professionals are ready to rise to the challenge.

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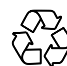

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