

# Weathering The Perfect Storm

## *Organisational Resilience Through Enterprise Risk Management*

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### The Spotlight On Risk

Risk is pervasive. It always has been. Yet only in recent times has the concept of risk management taken centre stage and given due recognition.

The *raison d'être* of any risk management system is to improve the survivability of the entity that implements it. The ultimate test of a resilient organisation is one that stands up to a “perfect storm”, brought about by a rare combination of a number of negative and unpredictable factors.

All of us manage risk, albeit to varying degrees. In fact, many organisations today have developed and implemented their own risk management systems and processes to deal with uncertainties facing their strategies and objectives.

Despite the apparent safeguards, we see that major events such as the Fukushima

nuclear disaster or the Eurozone debt crisis still occurring. It is in this context that we have to recognise that problems like these were not due to the absence of risk management systems, but rather their ineffectiveness in dealing with the circumstances.

An integrated, enterprise-wide approach towards managing risks has gained a lot of traction in recent years as the panacea for success in the increasingly volatile and uncertain business environment. While it is heartening that a growing number of organisations have acknowledged this heightened focus on managing risks, simply jumping on the Enterprise

Risk Management (ERM) bandwagon without properly thinking it through is a risk in itself.

### Reshaping The Paradigm

Most organisations look for a standard model that they can adopt for their ERM framework. The truth is that there is no one-size-fits-all model, by virtue of the fact that every organisation is different. In designing the ERM framework, one should also take into account certain “softer” aspects of the organisation, such as culture.

We also have to accept that it is impossible to fully eliminate risk, and in fact it is unhealthy to even try. The correct approach is to determine and achieve the right balance of mitigating the downside of risks to an acceptable level whilst still exploiting opportunities. That means we need to be exposed to

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risk regardless, without being reckless in so doing.

The risk-resilient organisation is one that has successfully embedded an awareness of risk within its DNA, such that risk management becomes second-nature in everything they do.

Think of it as this: activities such as brushing our teeth or locking our doors before going out are examples of embedded processes to managing risk in our everyday lives. We do not think twice about doing so, and even adapt these practices when and where necessary.

Extend the above concept to running an organisation, and you basically have the principles of effective risk management.

## Tackling Cognitive Biases

One of the key challenges in implementing an effective ERM programme is overcoming existing cognitive biases. Nassim Nicholas Taleb's "black swans" are made in reference to the fact that Europeans once assumed that all swans were white – until explorers in Australia discovered black ones.

Organisations often get lulled into complacency thinking that the risk management systems they have in place work, and will continue to do so ad infinitum. We have to be mindful that as the business landscape evolves, so too do the risks.

The other area where cognitive biases tend to be present is in strategy.

More often than not, risk analysis is relegated to the sideline when it comes to business decisions. Gut-feel usually drives decision-making without due consideration of risks. Given that the 2008 PwC State of the Internal Audit Profession Study highlighted that nearly 60% of the time, strategic or business factors are behind rapid declines in shareholder value<sup>1</sup>, shouldn't risk management instead be an integral part of an organisation's strategy-making process?

## Systems-Thinking

ERM introduces the concept of what engineers refer to as "systems-thinking" into the management of risks. Systems-thinking is the process of understanding how things influence one another within a whole. It focuses on cyclical rather than linear cause and effect.

System-thinking approaches problem-solving by considering problems from the perspective of an overall system and its inter-relationships. In the context of risk management, this means that risk is considered from the perspective

of the entire organisation, rather than individual departments.

Moving away from the "silo" mentality is essential because departments within an organisation are naturally linked like a system; an activity in one part of the system could potentially affect other parts. By adopting a framework that focuses on risk at an enterprise level, we can improve the quality and resilience of solutions developed to mitigate the risks faced by the organisation as a whole.

## The Push For Risk Governance

The recent events that led to global financial crisis and economic downturn have driven many countries to relook at their corporate governance codes, with the aim of instilling a stronger culture around risk management in corporate entities.

Singapore likewise, has also moved in the same direction. In February 2010, the Corporate Governance Council was set up to review Singapore's Code of Corporate Governance. A key recommendation made by the Council in the recent consultation paper<sup>ii</sup> issued by the Monetary Authority of Singapore called for greater emphasis on risk governance by the board.

Should the above-mentioned change be approved, Singapore will have taken a significant step towards introducing better risk management practices in its corporate scene.

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## ERM In Singapore

A state of ERM survey<sup>iii</sup> conducted in 2010 by the Singapore Institute of Directors (SID) revealed that 54% of companies listed in the Singapore Exchange did not have a formal ERM framework. Of these, 32% had no intention of implementing one.

One of the possible explanations for this is that ERM is often perceived as a “good to have”, instead of a “must have”. It is seen as an initiative that consumes considerable resource and has nothing to show for it (except when things go wrong). The irony of this is that the nature business essentially revolves around risk-taking.

There is a Chinese saying: “麻雀虽小五脏俱全” which translated says that “the sparrow may be small, but it still has five organs complete”. Put in the context of ERM, it means that regardless of the size of the organisation, there should be a framework of risk management as an integral part of doing business.

Evidently, there is a need for a mindset change towards ERM. We need to champion the adoption of ERM as a necessity; something that is able to enhance performance and more importantly, strengthen organisational resilience in the long term.

## Maintaining The Brakes

The economist Joseph Alois Schumpeter once said that “motorcars travel faster

than they otherwise would because they are provided with brakes.”

Building on his analogy, we also need to ensure that these brakes are constantly maintained. After all, ERM programmes are as good as they are relevant. In fact, poorly-maintained braking systems pose a greater risk than having no brakes at all as the driver will be under impression that his brakes work fine.

We often see a mismatch of resource allocation to Enterprise Risk Management, particularly amongst organisations that embarked on their ERM journey a while back. More often than not, organisations such as these tend to perceive establishing the ERM function as a one-off initiative, thus seeing little need to allocate resources into maintaining it.

Organisations need to ensure that their ERM frameworks, processes and structures are kept up-to-date with the current developments. There is little value in creating a risk register if the

information in it is irrelevant and no one sees any use in it.

Just as importantly, there also needs to be linkage between risk management and performance to inculcate the desired behaviours. After all, we know for a fact that what gets measured gets done.

## Taking On The Perfect Storm

The UK Walker Report in 2009 highlights that “Boards must look at future risks not just current risks”.

For effective risk management, organisations need to be adaptable and agile, especially when encountering new emerging risks (often referred to as the “unknown unknowns”). They need to be on a lookout for potential developments that can significantly affect their business models or worse still, have the potential put them out of business.

The perfect storm almost always manifests itself when we least expect it, with its consequence going beyond what we anticipate. We need to be constantly on our toes, scanning the horizon, keeping abreast with latest developments, all in the name of Enterprise Risk Management. The price of organisational resilience is vigilance.

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### Endnotes:

(i) PwC state of the Internal Audit Profession Study, 2008

(ii) Consultation paper; Proposed Revisions to the Code of Corporate Governance, Monetary Authority of Singapore, June 2011

(iii) Singapore Board of Directors Survey 2010, SID SGX et al