

Exploring the risk management mix: *A field-study perspective*

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Why study risk management?

*'Enterprise Risk Management is a process, effected by an entity's **board of directors**, management and other personnel , applied in **strategy setting** and across the enterprise, designed to **identify** potential events that may affect the entity, **and manage risks** to be within its risk appetite, to provide reasonable assurance regarding the **achievement of entity objectives.**'*

(COSO, 2003)



Gaps in the literature

- ERM is an elusive and under-specified management control
 - the fuzziness of ERM is a conceptual challenge
- We have little understanding of how enterprise risk management works in action
 - CROs are currently stamping out their territories
 - (Lam, 2000; Tillinghast – Towers Perrin, 2001; Oliver, Wyman & Company, 2002; PWC, 2005, 2007; Deloitte, 2007)
- Unexplored is how the risk control system is used by decision makers
 - Interactive vs. diagnostic use (Simons, 1990, 1991, 1994)?
 - Interactions with other control systems (e.g. accounting)?
- We do not yet understand the 'value added' by risk management
 - 'Organisational significance'?

Objectives of the paper

- **As a conceptual study:**
to synthesize the practices described by the normative literature
- **As a field study:**
to explore a new controller group ('risk managers'),
the forms and uses of ERM,
and the roles that risk managers have come to play in two organisations.

Concepts framing the study

➤ Assemblies of Practices

- Activity Management (Cooper and Kaplan, 1988, 1991, 1992; Gosselin, 1997)
- Balanced Scorecard (Kaplan and Norton, 1992, 1996, 2001; Speckbacher et al. 2003)

➤ The Risk Management Mix

➤ Contingent control studies

- e.g. Dent, 1987; Simons, 1990, 1991; Ahrens, 1996; Chapman, 1998

➤ Calculative cultures:

- Calculative idealism ('quantitative enthusiasts')
- Calculative pragmatism ('quantitative sceptics')

➤ External institutional pressures:

- Shareholder Value imperative
- Risk-based internal control imperative

Towards the 'Risk Management mix'

- Institutional background
- Driving ambition
- Techniques

	Risk Silo Management	Integrated Risk Management	Risk and Value Management	Holistic Risk Management
<i>Institutional background</i>	International regulation of bank capital adequacy	Rating agency expectations of bank capital adequacy	Rise of the shareholder value imperative	The rise of risk-based internal control (Anglo-Saxon and German corporate governance)
<i>Related theme in the literature</i>	Risk quantification (by risk type)	Risk aggregation (by business line)	Risk-based performance Measurement	The management of non-quantifiable risks
<i>Techniques (examples)</i>	<ul style="list-style-type: none"> • Market risk measures • Credit risk measures 	Economic Capital as the common denominator of risk	<ul style="list-style-type: none"> * Ratio approach (RAROC) * SVA (Economic Profit) 	<ul style="list-style-type: none"> * Scenario analysis * 'Special risk reviews'

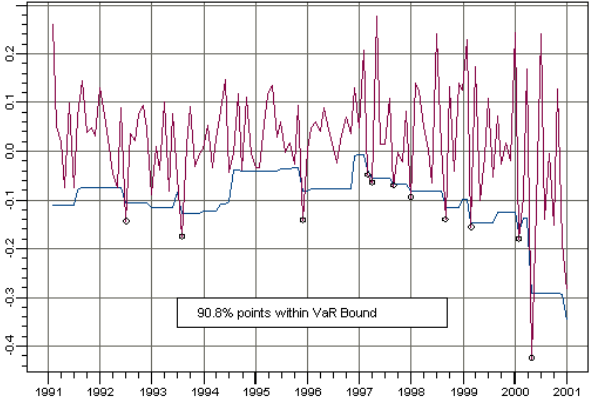
Research design – a matched pair



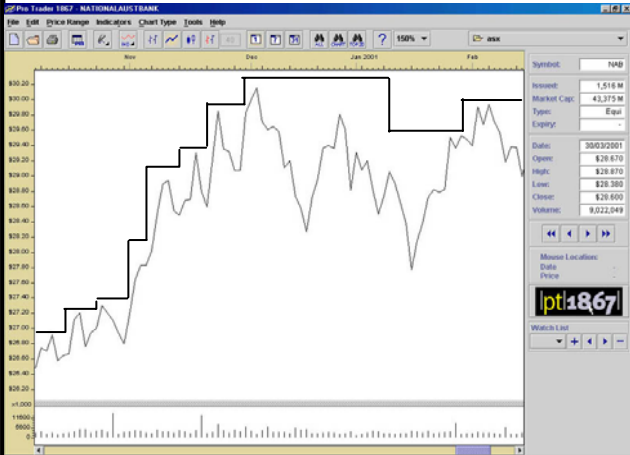
Patterns in the case data

	Fraser Bank			BWT		
	Risk controllers	Capital controllers	Senior risk officers	Risk controllers	Capital controllers	Senior risk officers
Risk Silo Management						
Integrated Risk Management						
Risk and Value Management						
Strategic Risk Management						

Calculative cultures

Artifact (illustrative)	Fraser Bank ('quantitative enthusiasts')	Calculative idealism
<p data-bbox="324 603 544 624">Value at Risk Backtesting</p> 	<p data-bbox="768 435 1503 560">"If you want to manage risk, you have to quantify it." (Risk Policy Director)</p> <hr/> <p data-bbox="768 730 1503 906">"First we made the management of market risk more professional, so it is much more structured and quantified. Then we made credit risk more quantified." (Risk Policy Director)</p>	<ul style="list-style-type: none"> <li data-bbox="1550 435 1928 515">• Managing by the numbers <li data-bbox="1550 547 1928 715">• Emphasis on the representational faithfulness of risk models <li data-bbox="1550 746 1928 786">• 'Trust in numbers' <li data-bbox="1550 818 1989 986">• Risk models to replace judgment in risk-return calculations
	<p data-bbox="768 1106 1406 1185">"Back in the 90s I think Fraser had a really good methodology. We can't afford any of the analysts or anyone else saying we have a bad methodology." (Assistant Director, Strategy)</p>	

Calculative cultures (cont'd.)

Artifact (illustrative)	BWT('quantitative skeptics')	Calculative pragmatism
	<p>"The big question is to what extent you actually understand the dynamics of the beast you are looking at." (CRO)</p>	<ul style="list-style-type: none"> • Less emphasis on the representational faithfulness of risk models • Risk models as trend indicators • Risk models to inform judgment, not replace it
	<p>"Here is something very interesting and important to me. The migration matrix. [...]"</p> <p>It doesn't say anything about the amount of risk. However, the trend is interesting.</p> <p>My function is to show the problems." (Head of Credit Risk Controlling)</p>	
	<p>"I have doubts whether you can actually define key risk indicators on operational risk. " (CRO)</p>	

Patterns in the case data (cont'd.)

	Fraser Bank			BWT		
	Risk controllers	Capital controllers	Senior risk officers	Risk controllers	Capital controllers	Senior risk officers
Risk Silo Management	☺			☺		
Integrated Risk Management		☺			☹	
Risk and Value Management		☺			☹	
Strategic Risk Management			☹			☺

☺ Espoused role = role 'in action'

☹ Espoused role ≠ role 'in action'

Two roads to strategic significance

ERM mix	Value-based (Fraser)	Holistic (BWT)
Span of risk control	Quantifiable risks (risk silos)	Both quantifiable and non-quantifiable risks
The strategic significance of risk management	Integrating risk management with planning and performance management	Influencing top-level decision making
The ultimate responsibility of the risk manager	Providing line management with tools to 'optimise' the risk-return trade-off	Attention directing and orchestrating stop-loss strategies
Top management's use of risk controls	Diagnostic use of Risk Silo Management & Integrated Risk Management	Diagnostic use of Risk Silo Management & Interactive use of Holistic Risk Management

Discussion (cont'd.)

ERM mix	Value-based (Fraser)	Holistic (BWT)
Corporate Governance Imperative	Shareholder value imperative (The CRO as a 'value advocate')	Risk-based internal control Imperative (The CRO as the 'devil's advocate')
Calculative culture	Calculative idealism	Calculative pragmatism
Realised strategy (1998-2004)	Follower (Steady, moderate growth)	Entrepreneurial firm (Strategic spurs and halts)

Directions for further research

- **A survey of a larger sample of risk organisations:**
 - Further exploration of the 'firm - ERM mix' congruence
 - An attitude survey of senior risk officers to explore calculative cultures
 - Further exploration of the functional differentiation for risk officers
- **Contribution to the 'managing by numbers' discourse:**
 - Applying 'calculative cultures' in other control settings
 - Does representational faithfulness matter?
- **Furthering a dynamic view of (risk) management controls**
 - Does Simons' process view apply on the interactive use of risk controls?
 - How do risk control interact with accounting and other controls?
- **Investigating the further development of ERM models:**
 - is there a divergence in the risk management world?
 - Or is it rather convergence – with different stages of the evolution?
- **ERM in accounting research and education**
 - Here to stay?