

perspectives...

Presenting Thought Leaders' Points of View

Enterprise Risk Management Can Be a Strategic Opportunity
By Mark S. Beasley

About Perspectives

Perspectives offers points of view on critical and emerging issues in higher education, written by senior business officers and other leaders in the academy. In brief essays, these thought leaders go beyond theory to offer practical applications and potential solutions to issues faced by campus administrators. Published online by NACUBO and available free of charge, this occasional series offers an opportunity for robust dialogue about significant issues.

Project Contact

To learn more about *Perspectives* or for submission guidelines, email perspectives@nacubo.org



Declining resources, new delivery models for education, questions regarding the value of research, issues surrounding athletics, physical security threats, and slowing demand for college graduates represent only a few of the risks on the horizon for colleges and universities. Higher education is transforming rapidly, creating both opportunities and threats for academic institutions.

Faced with these new challenges, some institutions are reexamining how they identify, assess, and manage risks by embracing a more robust, top-down view of all types of risks. Business officers, who have an enterprisewide perspective, can provide leadership roles in strengthening the robustness of their institutions' risk oversight processes through enterprise risk management (ERM).

Why Is ERM Needed?

Over the past decade, the corporate community, nonprofits, and some institutions of higher learning have embraced ERM as a new way of identifying and managing risks. The explosion of the dot.com era, the recession of the early 2000s, the 9/11 terrorist attacks, the crash of Enron and WorldCom, among other events, threatened the performance of all types of organizations, including colleges and universities. In response, a number of constituencies began calling for new approaches to risk oversight.

New governance rules issued by the New York Stock Exchange in 2004, expanded SEC disclosure rules about the board's role in risk oversight, and heightened scrutiny of risk management processes by major credit rating agencies throughout the mid-2000s put extensive pressure on organizations, particularly publicly traded companies, to rethink their risk management practices. The financial crisis that emerged in 2008 revealed major risk-taking exposures that were being poorly managed in all kinds of entities. These events, among others, have motivated boards and senior executives to invest in new processes and infrastructures to better understand the key risks their organizations face. While initially targeted toward public companies, risk oversight expectations for boards and senior executives have quickly trickled down as emerging best practices for all types of organizations, including institutions of higher learning.

In 2004, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued its 2004 *Enterprise Risk Management-Integrated Framework*, which provides a principles-based framework that boards and management might use to strengthen their enterprise-level view of risks perceived to be most likely to influence the organization. COSO's framework defines ERM as "a process, effected by the 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, manage risks to be within its risk appetite to provide reasonable assurance regarding the achievement of entity objectives.

ERM is designed to be a process that provides a top-down, holistic view of those risks that are most likely to threaten the organization's ability to achieve its strategic objectives.

Is ERM Relevant for Institutions?

Some skeptics argue that ERM is a corporate issue. Others may dismiss ERM as a fad created by consulting firms interested in selling services, with little value-adding potential. A few may convince themselves that they are doing ERM-related thinking as part of their normal day-to-day management responsibilities. These skeptics fail to see risk oversight as an important strategic tool for their institutions and think of risk management as merely a compliance or loss-prevention activity.

Figure 1 Huge Management Challenge

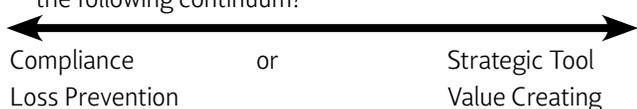


Source: ERM Initiative, Poole College of Management, North Carolina State University (www.zem.ncsu.edu)

Figure 1 illustrates examples of risk drivers for colleges and universities today, and this landscape is likely to alter drastically over the next decade. As you look at all of these risk drivers at an enterprise level, you begin to realize the huge challenge facing college and university leaders as they respond to this unfolding risk universe.

Now bring this home to your institution. As you look at each of these risk issues on the horizon, ask yourself these questions:

1. How would you score (on a scale of 1 to 10, with 1 being the weakest) your institution's capabilities in managing each of these example risks?
2. How would scores from other executives or the board of trustees at your institution compare to your assessment?
3. How easy would it be to articulate your institution's process for managing risks?
4. How is risk management viewed at your institution along the following continuum?



5. If asked to identify the top 10 most significant risks facing your institution over the next three to five years, what process would provide the basis for your answer?
6. If you were to ask other executives at your institution for their list of the top 10, to what extent would you find similarities and differences?

As you consider your responses to these questions, think about how your colleagues or the board might respond. It might be helpful to ask some of them for their perspectives to determine if they arrive at the same conclusions.

Using ERM as a Strategic Tool

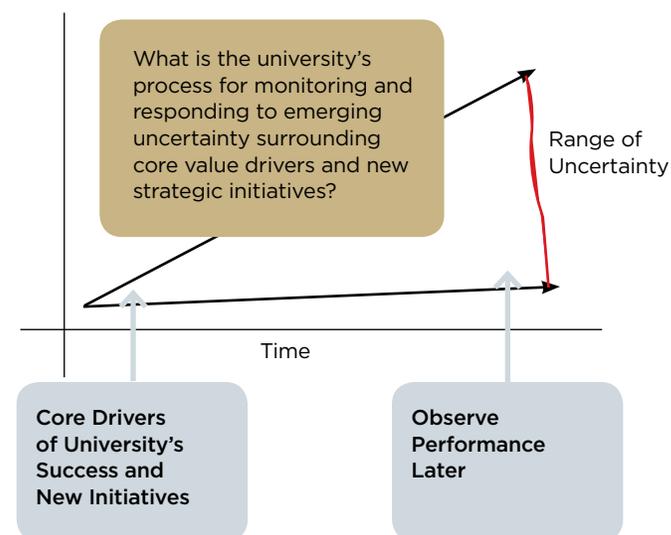
What prevents organizations from strengthening their approach to risk oversight? One barrier is the lack of understanding of the strategic relevance of ERM. They view risk management as a compliance activity—such as internal audit's review of compliance with policies or procedures—or a loss prevention technique—such as the purchase of property or casualty insurance. They fail to see ERM as a strategic tool.

Ironically, most business officers embrace the interconnectivity of risk and return. They realize that in order to advance in life, you must be willing to take risks. Despite understanding the fundamental reality that risk and return are connected in a hand-in-a-glove relationship, they fail to manage and monitor both sides of the risk/return equation, leading to an imbalance. Think about all the financial reporting systems, budgeting processes, annual evaluations, strategic plans and forecasts, and other systems used to measure and report performance.

Now think about the infrastructure for the risk side of the equation. Is risk management relegated to pockets at lower levels of the organization, which rarely see the light of executive management discussions? When this happens, university leaders miss the strategic connection of risk management and strategy execution.

Remember: ERM is all about the strategy. The reason to invest in more robust identification and management of risks is to increase the likelihood that your institution and its leaders will achieve the objectives you are working hard each day to accomplish. The more aware they are of risks on the horizon, the more likely your leaders will be in a position to navigate those risks to keep the university's strategies on track for success.

Figure 2 Strategic View of Risk Management



Take a look at the diagram in Figure 2. The blue box on the left reflects all the great activities that currently drive value, as well as new strategies to enhance the value of the university. The blue box to the right reflects the performance that will be observed in, say, three to five years. The diagram indicates that the world we live in today will look quite different tomorrow given unfolding uncertainties. As the world changes, risks could threaten the institution's performance. So, the real question to consider is in the center rectangular box: What is the process for monitoring and responding to emerging uncertainties surrounding your institution's core value drivers and new strategic initiatives?

So, how would you respond? For some institutions, the process is ad hoc and unstructured. Managers mostly use their gut instincts to identify and assess risks. More importantly, they



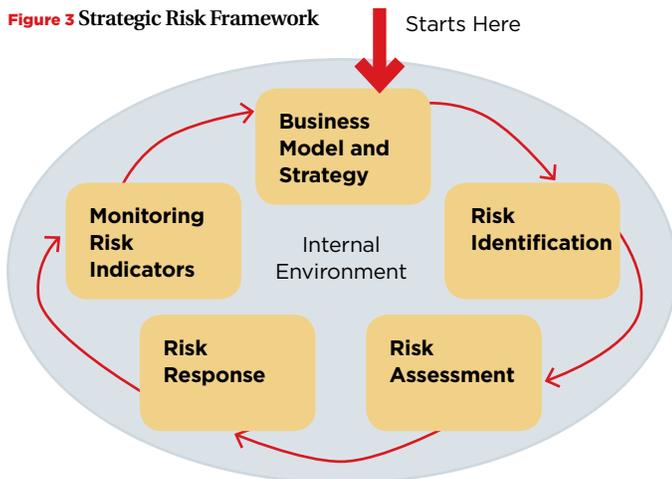
find that there is minimal structure and dialogue among senior executives and boards of directors to determine if the ad-hoc risk analysis is generating an accurate and complete picture of risks on the horizon or whether there is even consensus about the most important risks facing the institution.

Understand Your Success

Once they recognize the need to strengthen the enterprise-wide risk management processes, executives may wonder where to start. Some dive in by asking business unit leaders to describe risks and then they populate that information into some sort of risk inventory or risk universe. When they get to that point, they may become frustrated, wondering about the relevance of all this risk information and what to do next.

Before beginning any ERM effort, leaders must first understand what drives the institution's success today and what strategies are on the horizon that will protect and add value. The process we use when working with organizations is illustrated in Figure 3.

Figure 3 Strategic Risk Framework



Source: The Committee of Sponsoring Organizations of the Treadway Commission

Follow a Six-Step Process

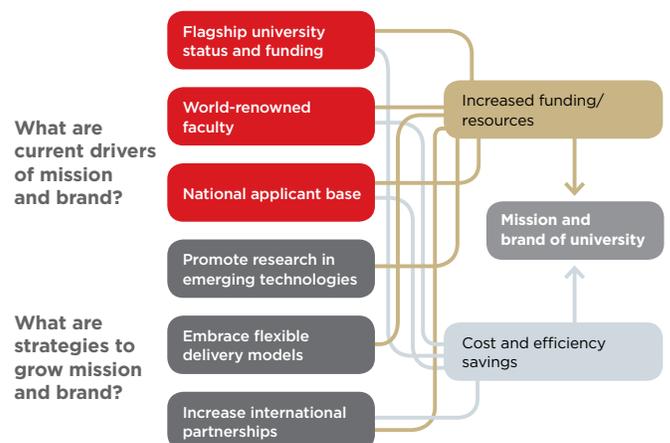
Once you know what is responsible for your institution's current success, you are ready to jump-start your institution's enterprise risk process by taking six steps:

1. **Understand the drivers of your institution's mission and value.** We begin any ERM effort by helping management articulate the current key business drivers and new strategic initiatives that are being implemented to drive enhancements to the value of the organization. We start with a comprehensive big-picture understanding of what makes the institution tick so

that we can center the identification and assessment of risks using a strategic lens.

Before starting down the risk identification and assessment process, we make sure managers have a rich strategic view of the enterprise so that they can focus on identifying and prioritizing those risks most critical to the institution's long-term strategic mission. The box on the far-right side of Figure 4 labeled "Mission and Brand of the University" reflects what most universities value and work to maintain and enhance each day. In essence, that box indicates what might be one of any institution's most important strategic goals: to protect and enhance the value of the institution's mission and brand. The goal of ERM is to then identify risks that might impair the achievement of that goal and others.

Figure 4 Identify Business Drivers and New Initiatives



Source: ERM Initiative, Poole College of Management, North Carolina State University (www.erm.ncsu.edu)

We encourage leaders to specifically identify the core drivers they consider the institution's "crown jewels," as illustrated by the three yellow boxes in Figure 4. The red boxes contain hypothetical examples of what might be current value drivers. In this example, the institution is a flagship university with extensive state funding, a world-renowned faculty, and a national student applicant base.

In addition to understanding the institution's crown jewels, leaders should be able to pinpoint specific initiatives contained in the current strategic plan that are being implemented over time to enhance the value of the institution. For example, the three dark grey boxes in Figure 4 contain hypothetical strategic initiatives that include efforts to promote research in emerging technologies, to embrace new flexible teaching delivery models, and to increase international partnerships.

Business officers can readily envision the big-picture view of the institution. As the leaders of the budgeting and finance function, they already understand the relationships between key activities and what drives value through the generation of funds and resources and how costs and efficiencies for the institution are achieved. Given the importance of starting with an understanding of this big-picture view of the institution, business officers are uniquely positioned to take on ERM leadership roles.

In the corporate world, ERM leadership commonly resides in finance and accounting functions, with CFOs and heads of the internal audit function frequently leading the efforts. Because of the relationships those executives have with the audit committee of the board of directors, responsibility for governing risk management processes is frequently assigned to the audit committee of a board.

To help your institution complete a risk and strategy perspective like that in Figure 4, you might try thinking about your core business drivers and new strategic initiatives along two primary themes:

What must go right for your institution to sustain the success of each of its core business drivers and new strategic initiatives? Questions that might help prompt answers include:

- a. What are the key inputs needed over time for the core driver or new initiative to retain its strategic value?
- b. What are the key processes and technologies that must be sustainable for that core driver or new strategic initiative to achieve and retain its value for the business?
- c. Who are the key suppliers, employees, customers, or regulators important to each core driver or new strategic initiative, and what must occur to ensure the contributions and expectations of these key players are sustainable?

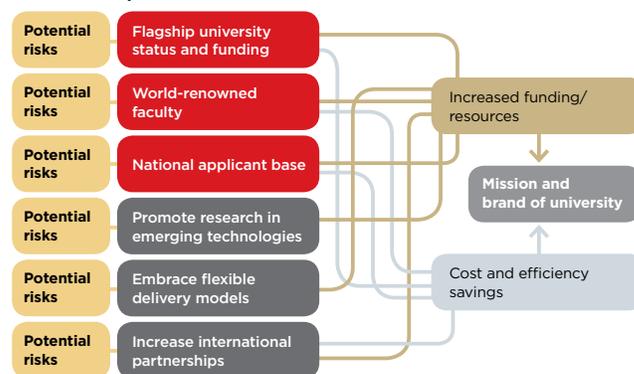
What assumptions are being made by management about the ability of the institution to obtain value from each current business driver and new strategic initiative over the long term?

- a. How are those assumptions developed?
- b. What ensures the assumptions are accurate and reliable?
- c. Who monitors those assumptions for changes?

Questions such as these and others can be addressed through management interviews, surveys, or workshops that prompt executives to develop a rich understanding of key value drivers. This strategic understanding provides the foundation to now begin identifying potential risks.

2. Think about risks to value drivers. Once you have a consensus understanding of the institution's core business drivers and its new strategic initiatives on the horizon, you are now positioned to approach the risk identification and assessment process using a strategic lens. ERM can help business officers pinpoint the most significant risks to the core business drivers and strategies of the institution. The purpose is to identify and prioritize those risks that are most critical to the ability to continue generating value from existing crown jewels or to achieve the value envisioned for each of the initiatives in the institution's strategic plan, as illustrated by Figure 5.

Figure 5 Identify Business Drivers and New Initiatives



Source: ERM Initiative, Poole College of Management, North Carolina State University (www.erm.ncsu.edu)

To help populate risks to the institution's business model and strategy, executives might be asked to think about answers to these questions for each of the crown jewels or new strategic initiatives:

What risks might emerge that could threaten critical elements of the institution's core business drivers and new strategic initiatives over the next two to three years?

- a. What might emerge that limits or eliminates access to key inputs that will be needed for the core driver or new initiative to retain its strategic value over the next several years?
- b. What might emerge that restricts, eliminates, or displaces the organization's ability to sustain key processes and technologies?



- c. What might influence the contributions and availability of key players, such as suppliers, employees, customers, and regulators, to this process?

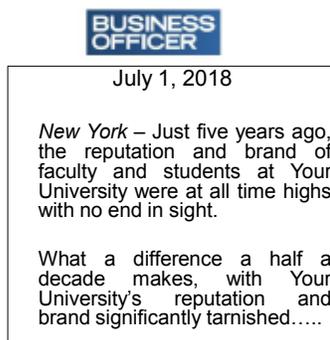
What might trigger changes in factors that support management's key assumptions about the ability to sustain its core business drivers and new strategic initiatives?

Leaders can use a number of techniques to encourage this kind of thinking, such as interviews with key executives, management workshops, or surveys. When NC State launched its ERM process in 2011, we chose to conduct one-on-one interviews of senior executives, deans, and those in critical leadership roles, such as athletics and security. Other organizations have used risk workshops in which executives are asked these kinds of questions, followed by discussion to fine tune understanding of each risk.

Whatever technique you select, you will want to engage executives in thinking about risks they see on the horizon that might impact the university's core business drivers or new strategic initiatives over time and then compile those responses to create a risk universe.

Some institutions have found conducting a pre-mortem analysis helpful. Using this technique, individuals think about a negative outcome that might be realized in the future so that management can then engage in prospective hindsight analysis about what might have occurred to cause that outcome. Take a look at Figure 6, which reflects a hypothetical news article in *Business Officer* five years from now that reports a negative outcome at your institution. The pre-mortem analysis would help executives begin to explore what might explain the occurrence of this negative event.

Figure 6 "Pre-Mortem" Analysis



Identify 3 of the most like causes for your college or university

3. Assess risk probabilities and impacts. When executives start thinking about risks they see on the horizon, they sometimes suddenly realize that the number of risks in their institution's universe can reach hundreds or thousands of potential events. Overwhelmed with too much risk detail, they lose sight of what to do next.

The board and senior executives can only practically manage 10 to 20 major risk areas or themes. So one of the objectives of the risk assessment process is to engage management in a process to prioritize risks into Tier 1 (top 10) and Tier 2 (top 11 to 20) lists of risks. To assess and prioritize risks, you can interview executives about specific risk probabilities and impacts. Another option is to sponsor risk workshops where executives use anonymous voting technologies to score specific risks along probability and impact dimensions. NC State used a survey approach in which executives responded anonymously to an online survey by scoring about 50 risks along a number of dimensions, including probability, impact, and preparedness for managing the risk.

The key to the success of any of these approaches is providing guidance to help executives think about probability and impact. Figure 7 shows the five-point scale provided to NC State executives to assess probability of each risk, and Figure 8 contains the five-point scale used to assess impact. Notice the scale for impact helps prompt management to think about a number of dimensions that a risk might have, such as how a risk might influence changes in funding, quality of students, faculty recruitment and retention, media attention, peer rankings, and endowment/development goals.

Figure 7 Likelihood Scale

Rare: Less than 5% chance of occurrence; very surprised if this were to happen.

Unlikely: 5%-25% chance of occurrence; surprised if this were to happen.

Occasional: 26%-49% chance of occurrence; approaching a toss-up.

Likely: 50%-74% chance of occurrence; surprised if this were not to happen.

Almost certain: 75% or greater chance of occurrence; very surprised if it did not happen.

FIGURE 8 Impact Ratings

- Potential impact over the next 2 years (Rating, Definition, Examples):
- 1. Negligible** – Examples: Virtually no change in funding; very little, if any, impact on quality of student applicant profile; very little, if any, impact on faculty recruitment and retention; no significant negative media attention or harm to reputation; peer ranking unchanged; and/or development fundraising goals still met.
 - 2. Minor** – Examples: 5-9% dip in funding; slight drop in student applicant quality; minor drop in recruitment and retention; a few negative media stories lasting 1-2 days in local media outlets; drop of 3-5 places in peer rankings; and/or 5% drop in development fundraising.
 - 3. Moderate** – Examples: 10-15% drop in funding; noted reduction in applicant quality; moderate drop in recruitment and retention; negative media stories in statewide media outlets; drop of 6-8 places in peer rankings; and/or 6-9% drop in development fundraising.
 - 4. Serious** – Examples: 15-19% drop in funding; 10% drop in applicants and drop in applicant quality; departure of key faculty and loss of corresponding grants; negative news stories lasting up to a week in statewide media outlets; drop of 9-11 places in peer ranking; and/or drop of 10-15% in development fundraising.
 - 5. Catastrophic** – Examples: 20% or more drop in funding; 15% or more drop in number of applicants; loss of AAU membership; accelerated departure of key faculty and loss of corresponding grants; breaking negative news stories carried by major state and/or national media outlets and for extended period of time; drop of 12 or more places in peer ranking; and/or drop of 16% or more in development fundraising.

Having the institution's key leadership team provide individual assessments of risks on the horizon from a probability and impact perspective ultimately leads to a consensus understanding of the institution's Tier 1 and Tier 2 risks. Going through this process helps management determine which risks are of greatest priority to manage.

4. Develop Responses to Key Risks. Most ERM frameworks outline four potential responses to potential risks:

Tolerate. Because some risks are worth taking, management accepts the risk as is.

Terminate. Certain risks are unacceptable so leaders stop or prohibit whatever activity or business process is triggering the potential for these risks.

Transfer. Sometimes risks can be shared with other entities through insurance, joint ventures, or outsourcing.

Treat. Leaders may decide to reduce the exposure to the institution by implementing new processes or controls.

Business officers are uniquely positioned to help manage the organization's responses to the most significant risks. For example, some responses require a reallocation of budget dollars from low-risk areas to high-risk areas. Business officers can provide perspective on how resources might best be used.

Similarly, because they track, consolidate, and report financial and operating information from business units across campus, business officers can observe duplications or other inefficiencies in efforts by various business units to manage the risks. They also may find cost savings by asking business units with similar risks to partner together in their responses at a consolidated level rather than individually managing similar risks at each business unit.

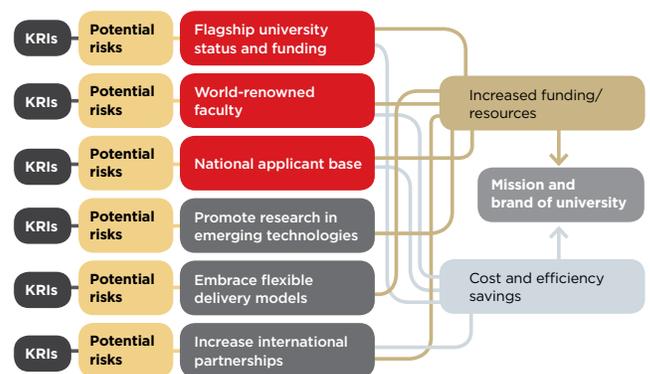
5. Monitor top risk exposures. The development of key risk indicators will help management keep an eye on each Tier 1 and Tier 2 risk conditions.

Business officers are very familiar with key performance indicators, which measure an institution's historical performance, often by the month, quarter, or year. By design, key performance indicators reveal a risk event after it has occurred, which leads to reactive versus proactive risk management.

Key risk indicators provide a forward-looking picture. In essence, they are designed to help management have a "peak around the corner" of risks that are beginning to emerge before they have an impact on the institution. While they can be based on internal information, often the most effective and relevant key risk indicators require analysis of data outside the institution.

For example, to address risk concerns about recruitment and retention of key faculty talent, a university may want to measure demographics about the number of individuals entering and exiting PhD programs across the U.S. or national forecasts of faculty retirements for research and teaching fields critical to the institution. Monitoring these kinds of trends helps position management to be in a proactive versus reactive posture for responding to risks, as illustrated by Figure 9.

Figure 9 KRIs to Monitor Emerging Risks



Source: ERM Initiative, Poole College of Management, North Carolina State University (www.erm.ncsu.edu)

Given their extensive experience in identifying, measuring, and reporting financial and operating performance data, business officers are uniquely qualified to identify and measure data that might serve as effective key risk indicators. And because they already assemble reports and dashboards of performance data for management and the board, business officers



can readily expand their reports and dashboards to include key risk indicators.

6. Assess the culture. Well-intended efforts to strengthen risk oversight occasionally fail, usually because executives fail to embrace the importance of effective risk management. They may believe other, more important priorities compete for their time and attention, they may not see the strategic value of ERM, or they may conclude that the institution just doesn't have the dollars, people, or software to do it.

Before investing time and energy leading an ERM process, business officers should honestly assess the culture and tone at the top. Without senior executive leadership and support, ERM cannot realize its potential.

At some institutions, the board of directors may be the impetus to strengthen risk oversight. It was inquiry from the chair of NC State's Audit, Finance, and Planning Committee of the Board of Trustees that prompted management at NC State to start its ERM process.

A Never-Ending Process

As they begin their ERM journey, business officers should not think of enterprise risk management as a project or software that needs to be installed by some set point in time. While activities surrounding the initial launch can be viewed as a project, business officers should consider ERM as a process that is ongoing and never-ending.

Why? Because risks constantly evolve and change, so managing with that in mind requires a continuous living process that helps executives navigate the risk landscape as it unfolds, ensuring that core value drivers and new strategic initiatives stay on track.

About the Author

Mark S. Beasley is the Deloitte Professor of Enterprise Risk Management and director of the ERM initiative in the Poole College of Management at North Carolina State University, Raleigh. To access more than 350 articles, thought papers, research, and other ERM implementation resources, visit the ERM Initiative's website www.erm.ncsu.edu. (Mark_Beasley@ncsu.edu)