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Leadership in Risk Management

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ABOUT FERMA

The Federation of European Risk Management Associations (FERMA) brings together 22 national risk management associations in 20 European countries. FERMA has 4,500 individual members representing a wide range of business sectors, from major industrial and commercial companies to financial institutions and local government bodies. These members play a crucial role for their organizations with respect to the management and treatment of complex risks and insurance issues.

ABOUT PRIMO

The Public Risk Management Organisation (PRIMO) was established with the aim of advancing the knowledge about and use of risk management within the local governmental sector and the public sector at large in Europe. To achieve this purpose PRIMO Europe will provide a comprehensive Web library with risk management information, newsletters, education, and conferences.

PRIMO's long-term aim is to establish risk management as a natural and integral part of good public governance. It comprises a pan-European umbrella organization of independent PRIMO national chapters and other organizations within the public sector from sixteen European countries, covering 16,000 managers.

Leadership in Risk Management

Executive Summary

THE C-SUITE IS taking a stronger role in leading the risk management effort at major primarily European companies, underscoring the higher priority risk has assumed in the wake of several years of financial and economic turmoil. Congruently, companies are underscoring the need for strong board involvement to facilitate decision-making regarding strategic and enterprise-wide risks and to encourage acceptance of a culture of risk management further down in the organization. Companies are struggling, however, to create a wider role for the risk function as a participant in strategic planning and transformational initiatives. And European executives express concern about the robustness of their risk management processes and channels of communication.

Vast changes in how business is done, sparked by the technology revolution and globalization, are meanwhile raising concerns about company and brand risk. These and other challenges are prompting companies to devote more resources to defining their risk appetite and to tracking, measuring, and analyzing risk through such tools as “heat maps,” key risk indicator scorecards, scenario analysis, and loss forecasting. The challenge, however, some executives said, is still to make sure that risk is “owned” at appropriate levels of the organization and that risks are communicated efficiently, such that top management and the board can make timely, fact-based decisions about how to address them.

According to a recent Harvard Business Review Analytic Services survey of European companies, sponsored by Zurich, the Federation of European Risk Management Associations (FERMA), and the Public Risk Management Organisation (PRIMO):

- C-suite supervision of risk management is intensifying. The survey indicates that, at 35% of organizations, either a CRO or a risk manager has direct responsibility for risk management. At 27%, either the CEO or the CFO/treasurer has direct responsibility, while the board itself is responsible at 14%.
- The majority of companies have education and review processes in place that keep the board and the C-suite informed about their risk exposures. Key risks are communicated to the C-suite regularly at 70% of organizations.
- Only 17% of respondents described communication between the C-suite and the CRO as being comprehensive or nearly so. And 40% said their organization has not yet set up a broad-based, cross-functional risk committee—despite the crucial role the risk committee plays in making sure risk data are discussed thoroughly and passed on to the board.
- Companies aspire to forge closer links between risk management and strategic planning. Roughly half said their risk management process is closely or very closely aligned with their overall strategy and budget.
- Companies are making less progress at bringing the risk function’s resources to bear on transformative business projects such as mergers, however. Only 20% described the risk function as a tool for making more effective strategic decisions and investments.
- Companies have been slow to adopt risk-based incentives as part of compensation. Only 12% said they align risk management with executive pay.

SURVEY HIGHLIGHTS

48%

of companies said their chief risk officer plays a role in communicating an affirmative risk culture.

20%

of respondents’ organizations describe the risk function as a tool for making more effective strategic decisions and investments.

40%

of companies have yet to set up a broad-based cross-functional risk committee.

- Brand and reputation risk are also rising concerns, cited by nearly two-thirds of companies as an area requiring top management-level attention.
- Some executives and other experts single out lack of risk management talent as an important area of risk, particularly when the company is entering a new geographic or product market.
- Processes to define risk appetite are now in place at nearly half of companies. Systemic risk management tools and analytics that enable them to track and analyze risk, and can then inform risk committee discussions, are in more common use.

Introduction: Leadership at the Top Levels

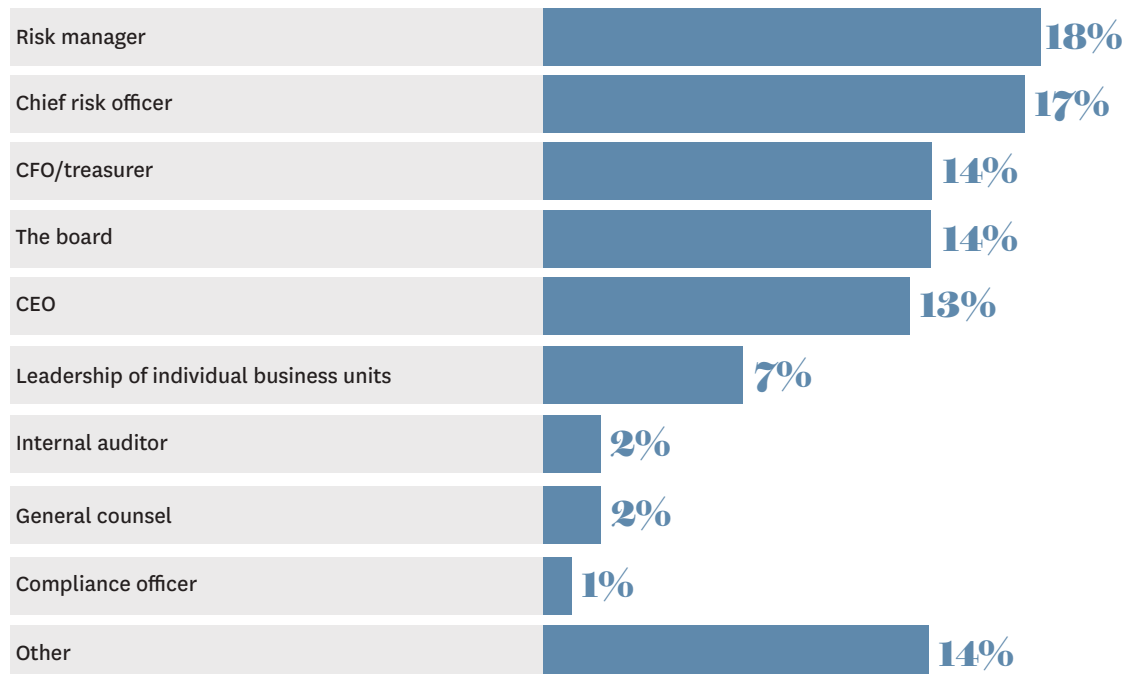
Buffeted by global competition, the shocks of the 2007-08 financial crash, and its recession-wracked aftermath, European companies are prioritizing risk management as never before. Increasingly, top management and the board are setting direction and taking tighter control of risk management, integrating with overall company strategy, and inculcating it deeper into the corporate culture. At the same time, they are intensifying their focus on such areas as reputation and IT risk and are acquiring new tools for forecasting and mitigating threats.

Reflecting this new prioritization of risk, executives at major companies and leading thinkers on risk management emphasize the board's and the C-suite's pivotal role in providing continued leadership and direction. "It's important that the C-suite be talking as much about risk management as it does about profit, growth, and customers because they are interdependent. The point is that you can't optimize profit if you do not manage—leverage or mitigate—exposures as appropriate," said Linda Conrad, Director of Strategic Business Risk at Zurich, at a May 2013 Harvard Business Review webinar.

Figure 1

Responsibility for Risk Management

QUESTION: WITHIN YOUR ORGANIZATION, WHO HAS DIRECT RESPONSIBILITY FOR RISK MANAGEMENT?



Total exceeds 100% due to rounding.

Three-quarters (75%) of respondents cited the risk function as a channel through which the C-suite gathers information, intelligence, and advice on risk.

A recent survey by Harvard Business Review Analytic Services found that direct supervision of risk management is becoming concentrated at the top levels of organizations—either with a chief risk officer (CRO) or in the C-suite or by the board itself. At 35% of organizations, either a CRO or a risk manager has direct responsibility for risk management. At 27% of organizations, either the CEO or the CFO/treasurer has direct responsibility, while the board itself is responsible at 14%. [Figure 1](#)

Conrad outlined a three-step process, emphasizing the role of top-level executives, that Zurich uses to advise on risk management:

- Securing an executive sponsor—possibly the CEO—together with “ongoing monitoring” by the board.
- Defining the scope of risk management and the organization’s risk appetite, prioritizing risks, and communicating these “down into the organization.”
- “Assessing and reassessing” the company’s risk profile, prioritizing the biggest risks, and identifying triggers that prompt measures to manage risks and assign accountability.

To make a structure like Zurich’s work, European companies are particularly emphasizing strong board engagement. “You need the support of the board. If you don’t have the support of the board, it will not work,” said Johan Willaert, Corporate Risk Manager at Agfa-Gevaert NV.

The majority of companies in the survey have education and review processes in place that keep the board and the C-suite regularly informed about their risk exposures. Key risks are communicated to the C-suite regularly at 70% of organizations. At more than half (59%) of organizations, the board reviews risk management policies and procedures annually, and at almost three out of four (72%), it reviews top risk exposures and treatment actions at least biannually. More than half (56%) of organizations have increased the resources they devote to risk-related education and training over the past three years, at least for the CRO level and higher.

Communication Makes Process Work

Making these processes work requires the risk function to serve as a conduit for information flowing between the board, the C-suite, and the rest of the organization. Almost half (48%) of survey respondents said the chief risk officer plays a role in communicating an affirmative “risk culture”—more even than the board (44%) or the C-suite (34%). Three-quarters (75%) of respondents cited the risk function as a channel through which the C-suite gathers information, intelligence, and advice on risk—more than any other.

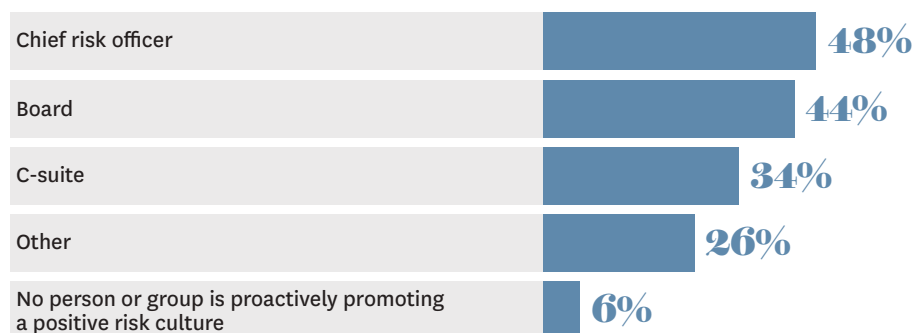
[Figure 2](#)

Process does not always translate into embedded knowledge and awareness, however. Only 17% of survey respondents described communication between the C-suite and the CRO as being comprehensive or nearly so. And 40% said their organization has not yet set up a broad-based, cross-functional risk committee. This, Willaert said, despite the crucial role that the risk committee—which must be independent and derive its authority from the board to be effective—plays a role in making sure all relevant levels of management discuss the company’s risk profile thoroughly and pass on information that enables the board to make fact-based decisions.

Figure 2

Involvement in Communicating an Affirmative Risk Culture

QUESTION: WITHIN YOUR ORGANIZATION, WHO IS INVOLVED IN DEVELOPING AND COMMUNICATING AN AFFIRMATIVE “RISK CULTURE”?



Sometimes the process itself breaks down. “As an academic, it often surprises me that, even today, board members and CEOs are not on the same page and are not having that conversation” about risk as an element of corporate strategy, said Paul Walker, Zurich Chair in Enterprise Risk Management at St. John’s University. Sometimes the information that board members receive is less than the unadorned truth.

“Last year, I was speaking on this subject,” he said, “and someone at a very large organization came up to me and said, ‘We clean it up before it gets to the board—we cleanse it, we sanitize it, we delete things.’”

The good news, Walker said, is that board members themselves are asking questions.

“Board members have said to me, ‘We’ve got to get better in doing that,’” said Walker. “Some of the complaints I get from boards are that they don’t get strategy risk information on a timely basis. So they can’t really help the executive team make the right decision, because they feel rushed in some of these situations. Or they see ERM leaders who talk about ERM, but they don’t seem to think broadly enough and they don’t do deep dives, and they don’t connect the dots. Or I’ve heard board members say to me, ‘You say you’re doing ERM, but from our perspective, it looks a lot like silo risk management.’ So they want organizations to try to connect the dots a little bit more, because there’s a lot of value in doing that.”

Giving Risk Management a Role in Strategic Planning

While many companies still need to get better at communicating about risk and reporting to the board, risk management is assuming a broader and more strategic role at some. Almost two-thirds of survey respondents (63%) said they are concerned or extremely concerned about strategic risks—the threat that some element of their business strategy may be creating new threats.

For some organizations, this translates into closer collaboration between the risk function and strategic planning. Just over half (52%) of respondents said their organization’s risk management process is closely or very closely aligned with its overall strategy and budget. More than one in four (27%) said that risk management should help the company leverage upside growth opportunities along with mitigating downside exposures. And 41% said the risk function has a seat during strategy setting, project launches, investment, and other business decisions, while 42% said it has a seat occasionally.

That still leaves the bulk of companies yet to be convinced that risk management has a place in strategic planning. “We are still not at that point, but we have progressed,” said Willaert. The CRO plays the pivotal role

in making the case, said Conrad: “You have to have a vocal CRO to let senior management know that there are tools and techniques used in traditional and enterprise risk management that can benefit the strategic decision-making process.”

Several survey respondents said that the risk function takes part regularly in strategy review meetings. Several also said that the risk manager or CRO is brought in whenever a major business investment is considered, including to perform an impact analysis or assessment. Yet only 20% described the risk function as a tool for making more effective strategic decisions and investments, and only 17% described it as a business tool to help drive profitability by facilitating achievement of objectives. [Figure 3](#)

To bring a more active role to the risk function, the CRO must dispel a common image as “a person who says no to ideas,” said Walker, and must demonstrate the value of the metrics and other tools at their disposal, often to skeptical officials. Walker cited a recent conversation with a chief strategy officer whose “biggest criticism of ERM was, ‘I need something that’s actionable. You tell me what the risk is, but how do I act upon that?’ So we’ve got to be ready for those difficult questions and have the solutions as well.”

Top-level support is crucial, Walker said. The CRO must have “some credibility and some respect and trust from the C-suite and from the board.” It’s also important “to really understand the business model and how the company creates value, makes money, or, if it’s a nonprofit, how it achieves its nonprofit objectives.” The CRO is often “not just someone who’s done ERM his or her whole life,” adds Conrad. “It’s someone who’s been in the business as well and who knows what’s required to be successful.”

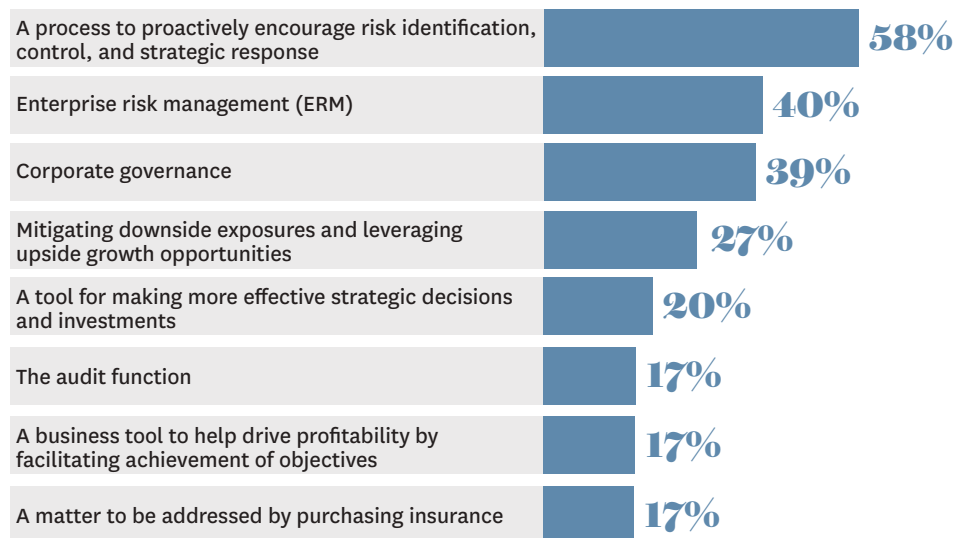
Creating a Risk Management Culture

Creating an internal culture that promotes risk management can be equally challenging. One gauge of progress, said Willaert, is whether successful risk management is regarded within the company merely as a nonnegative, or as “a positive thing, an added value.” Communication is key, he said, and needs to be encouraged in three directions: top-down, bottom-up, and from the audit committee to the board.

Figure 3

Corporate Culture’s View on Risk Management

QUESTION: WHICH OF THE FOLLOWING BEST DESCRIBES YOUR CORPORATE CULTURE’S VIEW ON RISK MANAGEMENT?



Only 12% of respondents said their organization aligns risk management with executive pay.

“The top-down part communicates the company’s goals and tools—how we will do it, why we do it—so that everybody knows not only that risk management is supported by the board but also that it is an added value for the group,” said Willaert. Bottom-up communication encourages business and functional leaders to “own” risk, understanding that if they raise an issue within their purview, their action will be seen “not as a reason to blame them but rather as an effort to improve and protect the balance sheet of the company.” The third circuit ensures that risks detected by the audit committee are brought to the board for discussion and possible action.

Communication and reporting standards emerged as a significant focus of concern in the survey. More than one-third of respondents expressed concern that proactive communication, potentially preventing or lessening the impact of a crisis, does not take place in a timely manner during daily operations. More than one in four (27%) expressed concern about the impact of both overrides and work-arounds to existing risk management policies and procedures and of a “good news culture” that prevents management from receiving and absorbing counterintuitive, non-consensus information or views on risk (29%).

If the process of communication, monitoring, and reporting of risk at every level is the “stick” of risk culture, the “carrot,” Conrad said, is incentives—“tying risk to hitting your targets for that year. There’s obviously a motivation for each person who likes to keep getting a paycheck or a bonus.” Organizations have been slow to adopt risk-based incentives as part of compensation. Only 12% of respondents said their organization aligns risk management with executive pay. Of those that do, some said their company had established compensation assessment periods sufficiently long to ensure that sustainable shareholder value is being created, while others said their organization adds clawback provisions to bonuses in case of underperformance.

Incentives work best when the organization can attract and retain staff with risk management capabilities. However, risk accountability is everyone’s responsibility, so it’s essential to provide risk training across business and functional areas, Conrad said. That hands a strong role to human resources.

“HR sometimes is one of the biggest risks,” said Walker. “One of the things I hear from boards, after we identify our risks—especially the big ones—is, ‘Do we have the talent in place to help manage that risk?’ If they are going into a new country or a new product, or competing in an area where they haven’t competed before, do they have the right executive-level talent to manage that risk? And that’s, I think, a critical question going forward.”

“We also have a lot of awareness activities that are driven by HR. One week will be business continuity management, or internal audit week. And so this awareness keeps risk front and foremost on people’s minds, whether through communication or learning development.” HR can also play a part in communicating and educating about risk. “Often,” said Conrad, “the learning development function is in HR. For example, at Zurich we make available different courses about risk on our intranet.”

Focusing on Reputation and IT Risk

“Risk to the corporate or brand reputation is likely to become a larger concern for companies—a concern that will have to be addressed directly by senior management,” Conrad said. “Trust in CEOs is at record

low levels,” she noted. “Pursuing an enterprise-wide risk management agenda is one way that top executives can counteract this image problem,” she argued—“being careful to lead risk management all the way down, from their level into the ranks of the company.”

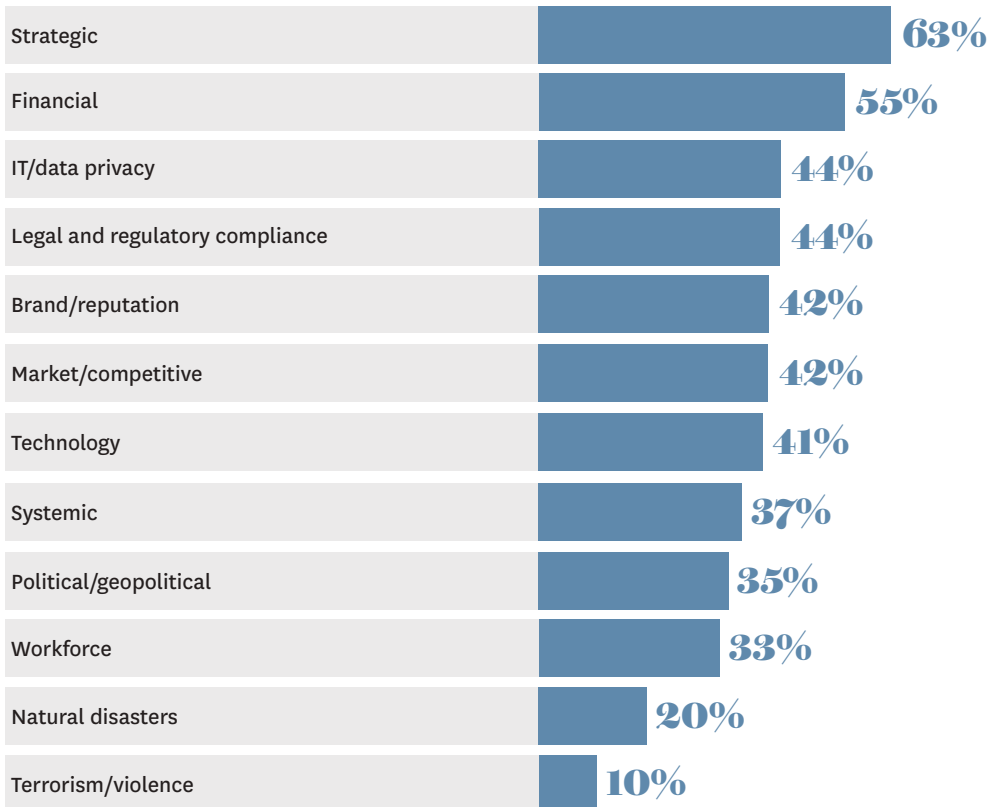
“Top management also needs to take a direct hand in controlling major enterprise exposure such as the closely related area of IT risk,” Conrad said. “Today, you know that every person in the organization has, potentially, a laptop or access to the Internet,” she noted. “So every employee needs to be made aware that he or she has a role to play in managing risk that could impact the company’s overall reputation. Obviously, this is exacerbated by media coverage and social media. Leadership has a role in driving that accountability and that understanding that each person has a role to play. Hopefully, that minimizes work-arounds by people avoiding risk management—because it’s seen as a positive contribution to the company’s profits.”

Indeed, survey responses suggest strongly that brand, reputation, and related risks are becoming more significant concerns. A full 42% of respondents cited brand/reputation risk as an area of concern, while slightly less than half (44%) mentioned IT/data privacy and technology (40%), underscoring organizations’ concerns about their exposure both to cyber risks and to potentially damaging communication on the Internet and social media. [Figure 4](#)

Figure 4

Level of Concern Over Areas of Risk

QUESTION: PLEASE RATE YOUR LEVEL OF CONCERN ABOUT EACH OF THE FOLLOWING AREAS OF RISK. Percentage indicating some level of concern by rating 7, 8, 9 or 10, where 10=extremely concerned



Forecasting and Mitigating Risk

“One of the advantages of creating a risk committee,” said Willaert, is that “it’s much easier to have extended discussions in respect to risk appetite, risk tolerance. Then you can come with a proposal to the board, and it’s much easier to make decisions on the basis of the complete facts.”

At nearly half (47%) of companies, the C-suite has developed a process for determining the organization’s risk appetite, and, of these, over half (59%) say this is clearly communicated to all levels of the organization.

Systemic risk management tools and analytics that enable companies to track and analyze risk and then inform risk committee discussions are becoming more commonplace. More than half (56%) of survey respondents said their organization has increased its use of analytics for risk management in the past three years. Among the tools most often cited are risk “heat maps” (41%), key risk indicator scorecards (36%), maps to identify risks inherent in the organization’s strategy (30%), scenario analysis and war-gaming (25%), loss forecasting (25%), and loss simulation (24%).

At Zurich, for example, a heat map is created each month, circulated to the business and functional owners of risk, and then reported up to senior management once a month and to the board once a quarter. But while “models should drive decision-making, they should not make up our minds for us,” Conrad cautioned, “so we use these tools to inform our decisions rather than to actually draw a line in the sand.”

Walker, too, warned against overreliance on data tools. “A common mistake I see is that people generate a risk map or a risk profile or a risk register, and then they go back and categorize certain things as strategic risks as opposed to financial or IT risks. That doesn’t really mean that you’ve identified strategic risk. Labeling some of the risk you’ve identified as strategic is not the same as doing serious strategic risk identification.”

What’s most important, said Conrad, is that appropriate metrics are set at the appropriate level of the organization: “KPIs are set depending on what objective we’re trying to meet. They may be set by the executive level if they’re longer term, or they may be set at the individual business or product level. Each group will have different types of KPIs, depending on what they’re measuring. This is where you start to dig a little bit deeper in assigning those key risk indicators that can drive your success or failure.”

ZURICH CASE STUDY

Over the past five years, Zurich’s operational risk capital efficiency has improved through a strengthening of its ERM process, which includes the introduction of an operational risk management framework. This framework provides Zurich with risk management tools to specifically identify, assess, manage, and quantify operational risks. Through this framework and the wider ERM process, Zurich increases its ability to achieve efficiency and effectiveness gains. This allows Zurich to better focus on optimizing company resources and in turn decide what opportunities to fund.

For example, one business unit experienced a reduction of 21.7% in operational risk-based capital consumption when Zurich moved from an asset-based approach to its current, risk-based approach for operational risk quantification. The business unit management then identified areas of high-risk exposure, performed a deeper assessment, and developed measures to mitigate the exposures. As a result, in the following year the unit experienced an additional reduction of 28.9% in operational risk capital consumption. The operational risk capital not consumed was then available to fund profitable growth for Zurich.

WHO PARTICIPATED IN THE SURVEY

All but three of the 217 respondents to the survey (98%) work for organizations based in Europe. Over half—53%—of respondents said they are involved in decision-making regarding risk management for their organization, while another 22% are responsible for making decisions regarding the entire range of risk management within their organization. Sixty percent of respondents are either CROs or risk managers—by far the largest category in the survey. Twelve percent are top corporate officials: board members, owners/partners, CEOs or other chief executives, CFOs, treasurers, and comptrollers. Seventy percent work for companies employing 1,000 or more people, and 34% work for companies employing more than 10,000 people.

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