Risk management

Taking risk management to the next level ...

Risk management at large corporates has evolved from a qualitative exercise and compliance effort into a quantitative discipline. Additionally, it has been better integrated into the daily management reality of businesses. Is this set up made to cope with future risk challenges? There might be some upgrades which should be considered ...

Risk management at large corporates has evolved significantly over the last few years. It has moved out of the insurance and compliance corner. It is supported by quantitative methodologies and supports key strategic decisions like portfolio management and day-to-day business decisions.

Risk management – what has been achieved?

By applying these practices, functional gaps between the risk management function, strategy/ corporate development and finance are being bridged. With the integration of a risk management perspective into the financial plan, performance can be measured and tracked in line with reporting cycles. A differentiation between business performance and external influences can be measured. Timely management action and intervention within and not at the end of the reporting period is possible. Hence, an issue and value based management approach can be followed more easily. But is this sufficient to cope with future risk management challenges?

Observations on risk management challenges ...

Two observations can be made when reviewing the characteristics of an evolving risk environment and talking to risk practitioners and senior management.

1. **Evolving risk environment** – 'Disruptive risk events with potentially high impact have been quite frequent ...': The recent history has produced risk events which have come as a surprise. Some of these have not been on the risk management agenda or have been underestimated.
    - **ECB monetary policy:** The change of monetary policy in the aftermath of the financial crisis has evolved from a risk to a reality impacting e.g. exchange rates, financing costs and availability of financing. Additional surprises have paved the way ... rather than moving back to normal, expansive monetary instruments have been introduced and are being discussed which have been off limits before.
    - **Infections:** Some years ago 'pandemic' was a new type of risk entering the risk inventory. The fear has become real that an infection might spread globally with large scale lethal impact. Since then, fears of spreading viruses have been on the agenda several times. Most recently there has been a debate about the Zika virus and the impact and threat it might have in the context of the 2016 Olympic games.
    - **Cyber:** This was considered to be a topic to be under control if a sound business continuity plan, IT set up and insurance coverage has been put in place. However, even intelligence agencies have been hacked. Most recently Apple´s operating system has been hacked enabling large scale access to user information and meta data, calls and messages. This has not considered to be a likely scenario given Apple´s focus on IT security. One might imagine the damage a similar event might cause especially in a digital world in which industrial and personal devices get increasingly connected. Maintaining resilience of commercial systems and public infrastructure is moving up on the priority list.
    - **Terrorism:** Terrorism has been a phenomenon which seemed to apply only to high risk global regions. Sadly, it has developed very quickly into a reality for modern societies with no recipe for an instant cure. Who would have thought this to be the case?
    - **Oil price:** Only in the recent months, the oil price has exhibited movements not expected previously. In the beginning of 2016, risk investors lined up large sums of capital behind the conventional wisdom for the oil price development in Q1/2016. They were proven wrong.

    This is just a selection of events and developments – more examples could be mentioned.

2. **Internal risk management capability set** – 'Quantitative capabilities need to complemented by qualitative assessment expertise ...': Historically, companies where challenged to get quantitative risk management capabilities on board. These days it is becoming more eminent that quantifications also have their limitations. Risk analysts and management might be blind sighted by an automatism how to look at risks.

But what needs to be done and how can these challenges be met?

Understanding risk and not only calculating it ...

Risks need to be genuinely understood. Only this allows to also package them into an appropriate quantitative framework and interpret how they evolve over time.

A risk culture needs to be established throughout the organisation. The intention is not to avoid risks but to take calculated risk for profit and to be prepared for higher impact events. Potential starting points are ...

- **@ risk management department level:** The necessity of complex and extensive quantification exercises should be reviewed. Quantification exercises might be balanced with (additional) qualitative risk assessment capabilities and capacities.
- **@ business management level**: Observations and impact assessments provided by risk management should be regular discussion topics at least in the context of planning cycles. In day-to-day management they need to influence management action and initiatives.

So, the next level of risk management evolution is not a substantial one but rather a corrective one. Organizational challenges and implementation hurdles should however not be underestimated.

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