



The State of Risk Governance and How it Might Need to Evolve

10th Annual Conference on Risk Governance
October 27-28, 2022
University of Siegen

Mark Beasley

KPMG Professor and Director of ERM Initiative
North Carolina State University
Raleigh, North Carolina



MISSION

To be internationally recognized as a thought leader on ERM in strategy and governance.



NC STATE Poole College of Management
Enterprise Risk Management Initiative

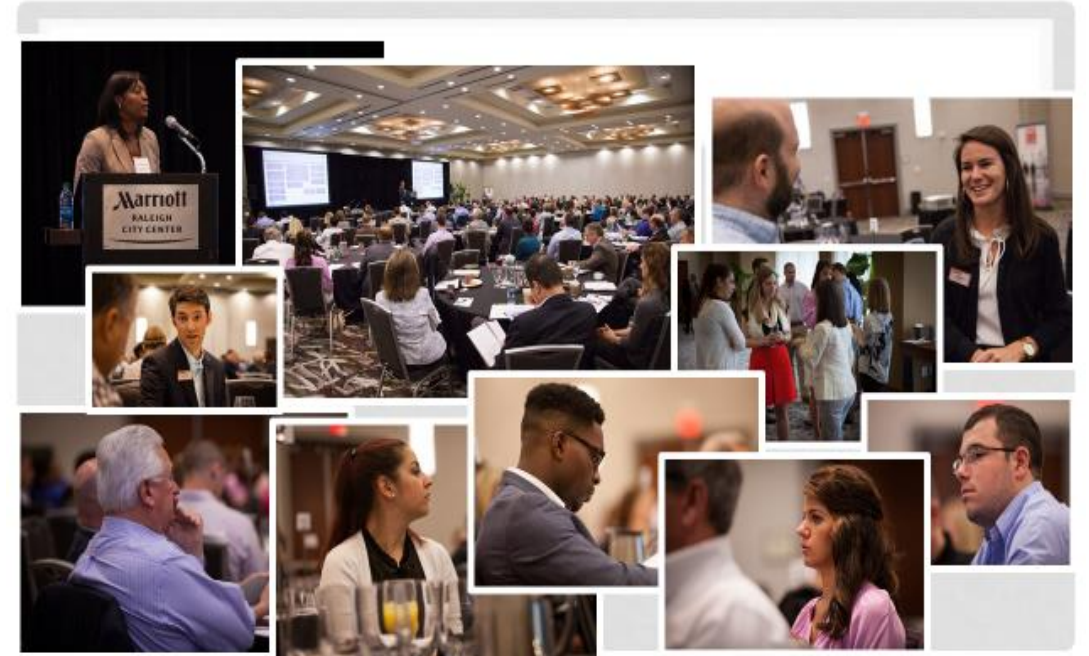
Helping leaders manage today's uncertainty for tomorrow's success.

Outreach to Executives



Executive Education

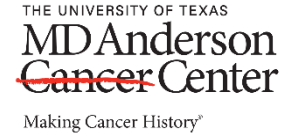
- ERM Fundamentals
- Evaluating Your ERM Program's Maturity
- ERM in Higher Education
- ERM in Non-Profits



Online ERM Resources

Over 600+ articles, case studies thought papers

ADVISORY BOARD





IMPACTFUL RESEARCH

Executive Perspectives on Top Risks

State of ERM Processes

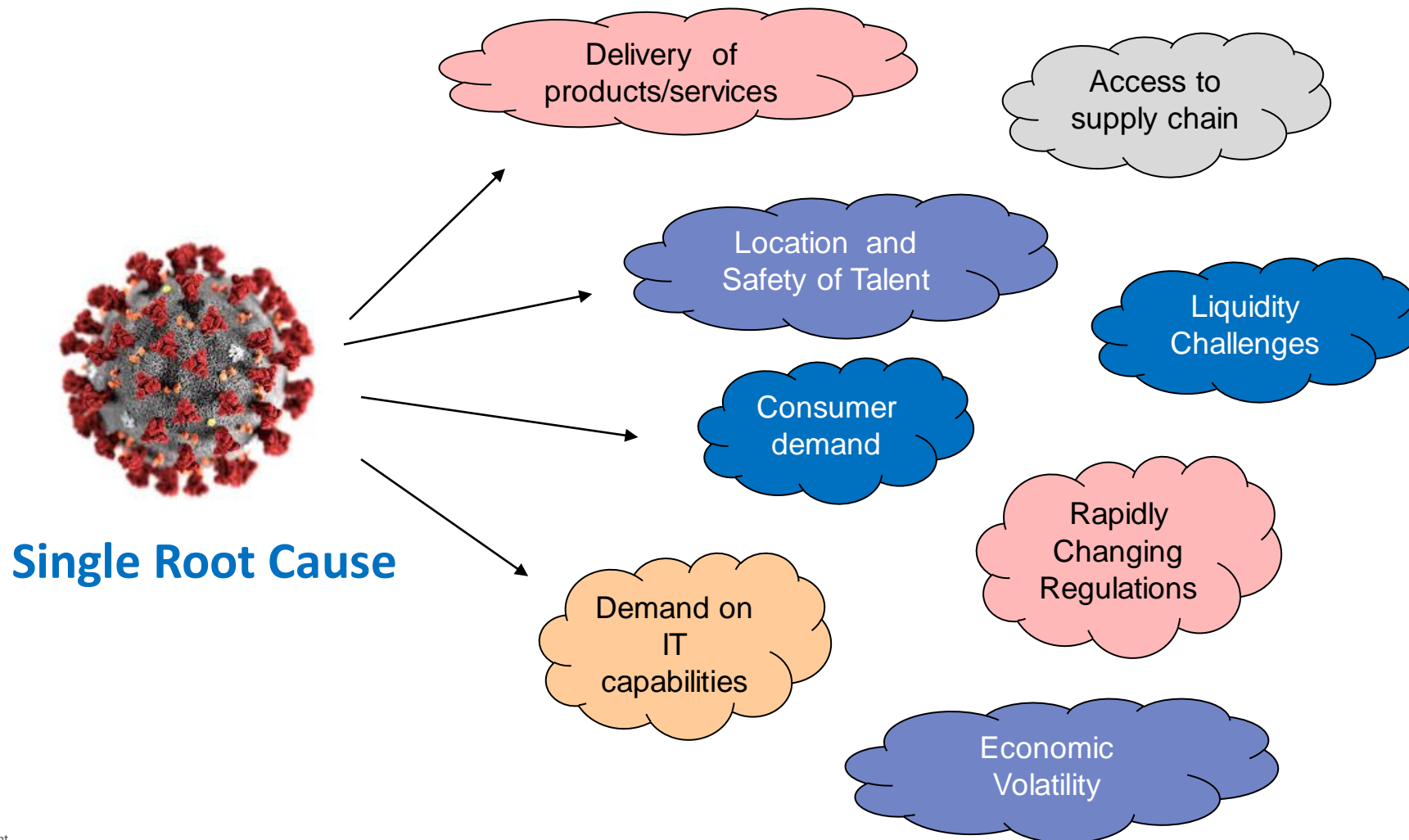
Global Perspectives on Risk Oversight



State of Risk Governance in 2022

The Good News:

COVID-19 Has Drawn Attention to Risk Management



And (unfortunately) there's more...



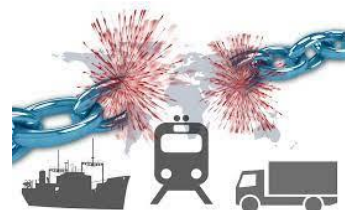
Cyber Threats



Social unrest



War in Ukraine



Disrupted supply chain



Nervous markets



Labor Frustrations



Political Shifts and Elections



Great resignation



Out of control wildfires

Are risk management approaches sufficient to address the ever-changing landscape?

All this Uncertainty...Creates Management Challenges

65% believe that the volume & complexity of risks increased significantly in past 5 years

69% for public companies



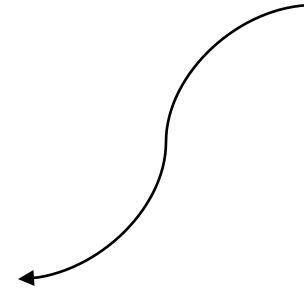
Similar in other parts of the world





53%

say organization **mostly** to **“extensively”** faced a significant operational surprise in past 5 years



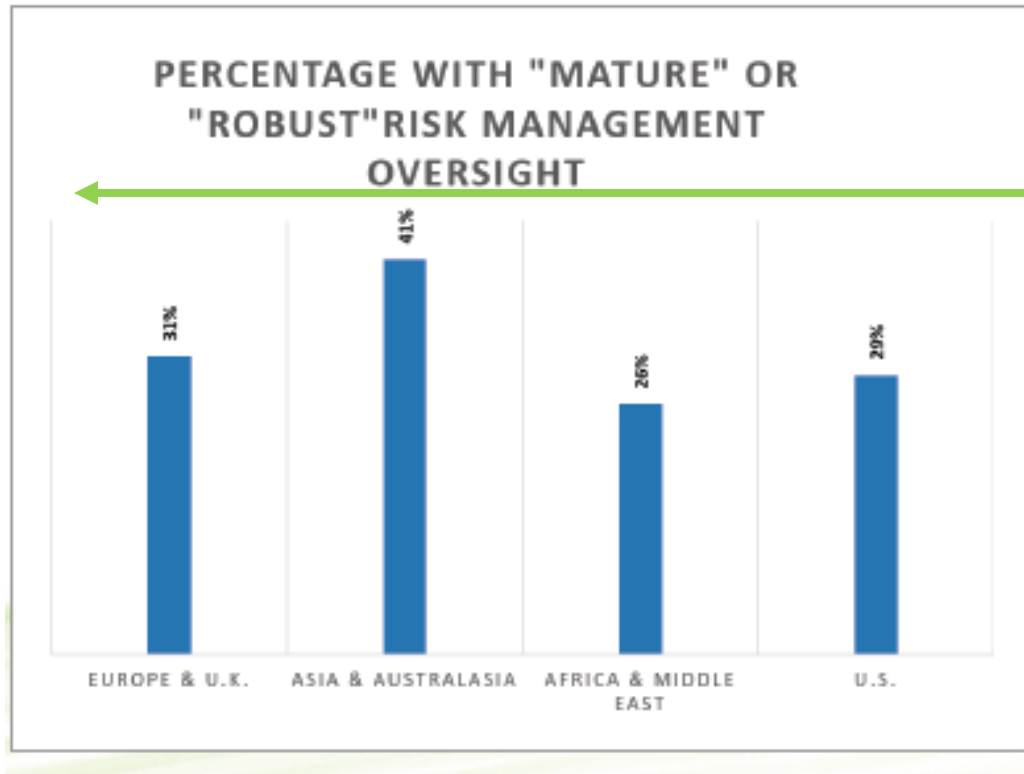
But 29%

describe their risk management process as **mature** or **robust**



A Disconnect?

It's an International Trend

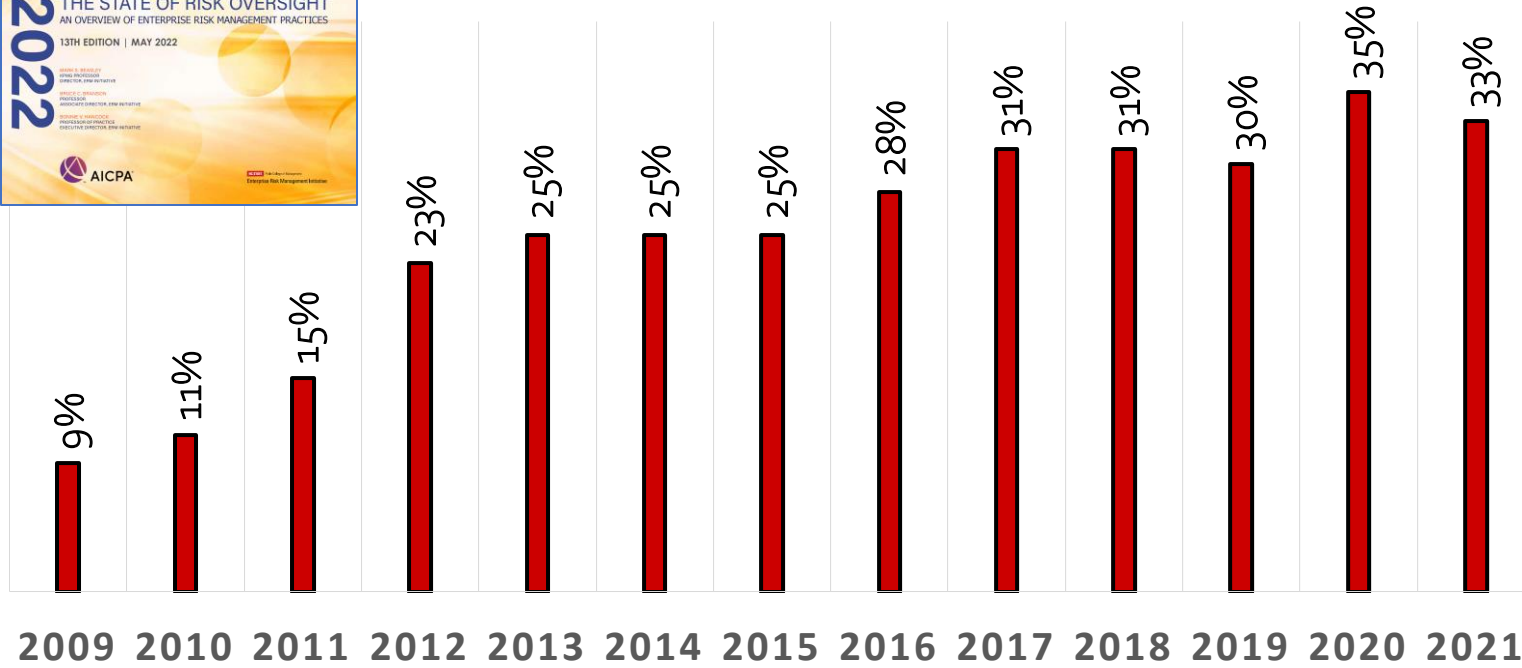


Well below
50%

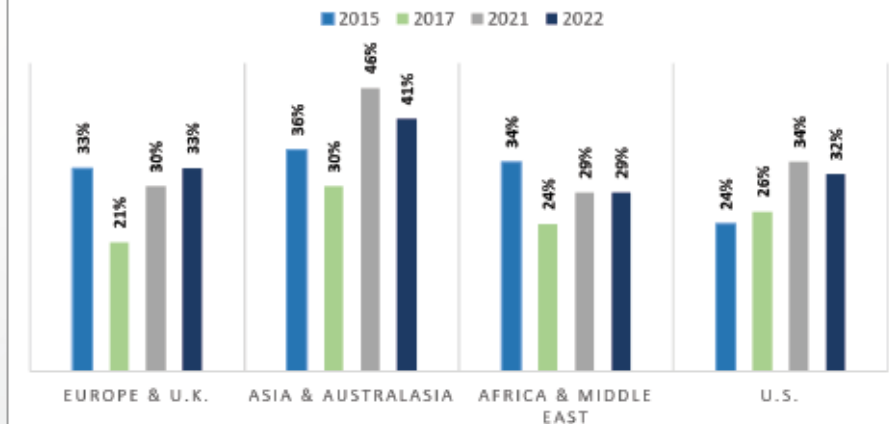


Steady, but Slow Progress

COMPLETE ERM IN PLACE: FULL SAMPLE

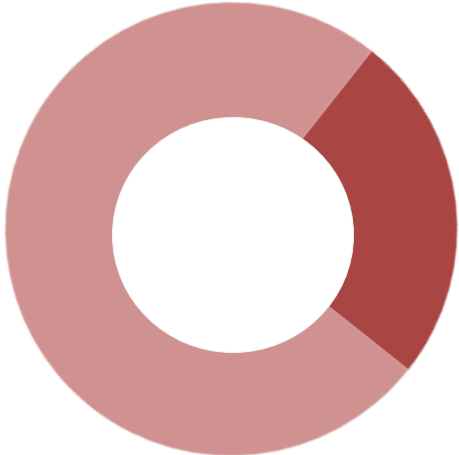


PERCENTAGE WITH "COMPLETE ERM PROCESSES IN PLACE"

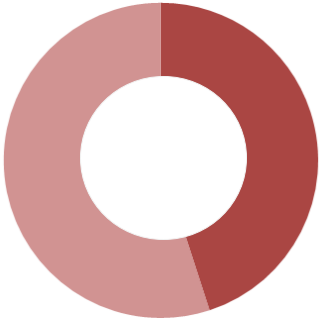


Consistent across the globe

More Advanced in Certain Sectors



65% Public Companies



60% Financial Services



56% Large Companies



23% Not-for-Profit



Risk Management
is not becoming easier

But it is becoming
More Critical!

Current Challenges...

Research Opportunities

Challenge #1

There is a Culture and Mindset Problem.

“We manage risks all the time”

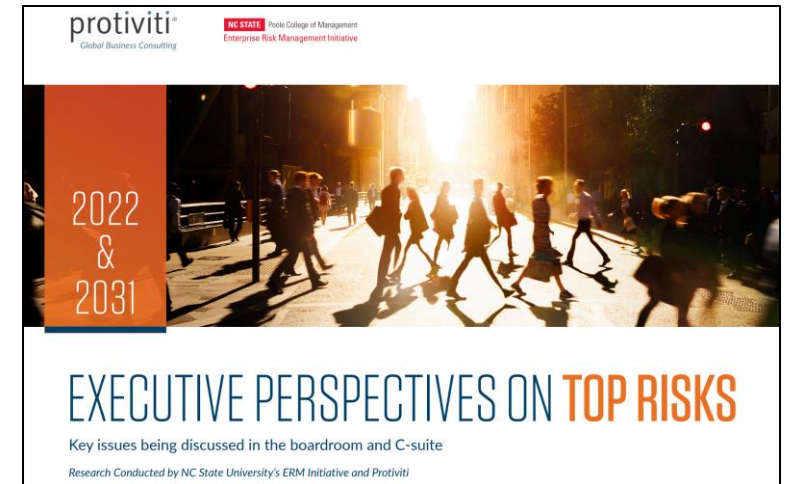


“Risk management is all about compliance”

“We don’t like naysayers”

“Risk Management...That’s the role of insurance or audit”

Top Risk Concern: Risk #11 – Organization’s Culture



Organization’s culture may not sufficiently encourage the timely identification and escalation of risk issues affecting achievement of strategic objectives

Interestingly – this was in top 10 risks pre-COVID

Common Barriers to Risk Management

Negative perceptions include the view that...

PERCENTAGE IDENTIFYING EACH AS A BARRIER TO ERM IMPLEMENTATION					
Percentage of respondents who describe each of the following as being a "barrier" or "significant barrier" to effective ERM	Full Sample	Largest Organizations (Revenues >\$1B)	Public Companies	Financial Services	Not-for-Profit Organizations
Competing priorities	44%	35%	36%	47%	50%
Insufficient resources	43%	41%	40%	43%	52%
Lack of perceived value	28%	31%	27%	25%	29%
Perception ERM adds bureaucracy	24%	25%	23%	21%	26%
Lack of board or senior executive ERM leadership	21%	18%	19%	16%	22%
Legal or regulatory barriers	6%	3%	4%	6%	6%



Perceived Barriers to Effective ERM	Percentages Reflecting "Barrier" or "Significant Barrier"			
	Europe & U.K.	Asia & Australasia	Africa & Middle East	U.S.
Competing priorities	36%	37%	37%	44%
Insufficient resources	45%	43%	50%	43%
ERM perceived as unneeded bureaucracy	24%	30%	21%	23%
Lack of perceived value	24%	39%	22%	27%

Ultimately leads to view that risk management isn't necessary

How Might Research Help Address?

- 1. Expand research related to organizational culture and risk management**
 - What entity and leader attributes lead to embrace of risk management?
 - How does organizational culture impact risk taking and risk management? Is there a separate “risk culture”?
- 2. Build upon psychology research to understand people (vs. entity) factors leading some to embrace ERM and others to reject**
 - Why do some C-Suites support and others lukewarm?
 - Risk governance involves a network of players – what are their roles?
 - What’s the influence of regulatory demands – “carrot” vs. “stick” approach?
- 3. Examine impacts of differences in country and social cultures and embrace of risk management**
 - How might risk management differ in China vs. Europe, vs. Middle East, vs. Latin America?
 - What is the impact of remote vs. in-person risk management dynamics?
- 4. Explore techniques to compensate for judgment and decision-making biases**
 - “Rush to solve,” “overconfidence,” “anchoring to known risks” lead management teams to under-invest in risk thinking – how overcome?
 - What is the psyche to merely “window dress” risk management?

Opportunities for Research

Challenge #2

Struggle to Integrate Strategy and Risk.



Unfortunately....

Many View Risk Management
as Loss Prevention &
Compliance Exercise

Few Think of Risk
Management as Strategic
Tool



This Reminds Us of What Truth?



Strategic Value

*Just
12%??*



Respondents stating that the risk management process "Mostly" or "Extensively" provides unique competitive advantage

Percentages Reflecting "Mostly" and "Extensively"

13% Europe & U.K.	34% Africa & Middle East
40% Asia & Australasia	11% United States (U.S.)

Unfortunately...



Percentage of entities whose process focus “mostly” to “extensively” on	Full Sample	Public Companies
IT Risks	68%	84%
Legal/Compliance Risks	61%	84%
Finance/Investing/Financial Reporting	56%	81%
Operational/Supply Chain/Process Risks	49%	76%
Reputation/Political Risks	49%	66%
Emerging Strategic/Market Risks	45%	67%



How Might Research Help Address?

- 1. Some studies document a value proposition (e.g., Tobin's Q, market reactions, etc.) but we know less about factors that enhance strategic value**
 - Characteristics of risk governance that add value
 - Organizational structures, board structures, leadership structures that lead to value-adding risk management
 - Lessons from strategy researchers
- 2. Identify how risk can be embedded into strategic planning, budgeting, & capital allocation**
 - Processes for making risk an explicit component of strategic planning
 - Understand how risk management can be elevated from lower-level bureaucracy to having a seat at the strategy table
- 3. Explore techniques to focus on the positive side of risk**
 - Over-emphasis on the "threat" side of risk
 - How use risk management to identify opportunities not taken or overly risk averse mindset
- 4. Develop thought leadership to help advance strategic connection**
 - What can be done to motivate CEOs to "pull" for risk information rather than risk managers having to "push" risk information upwards?

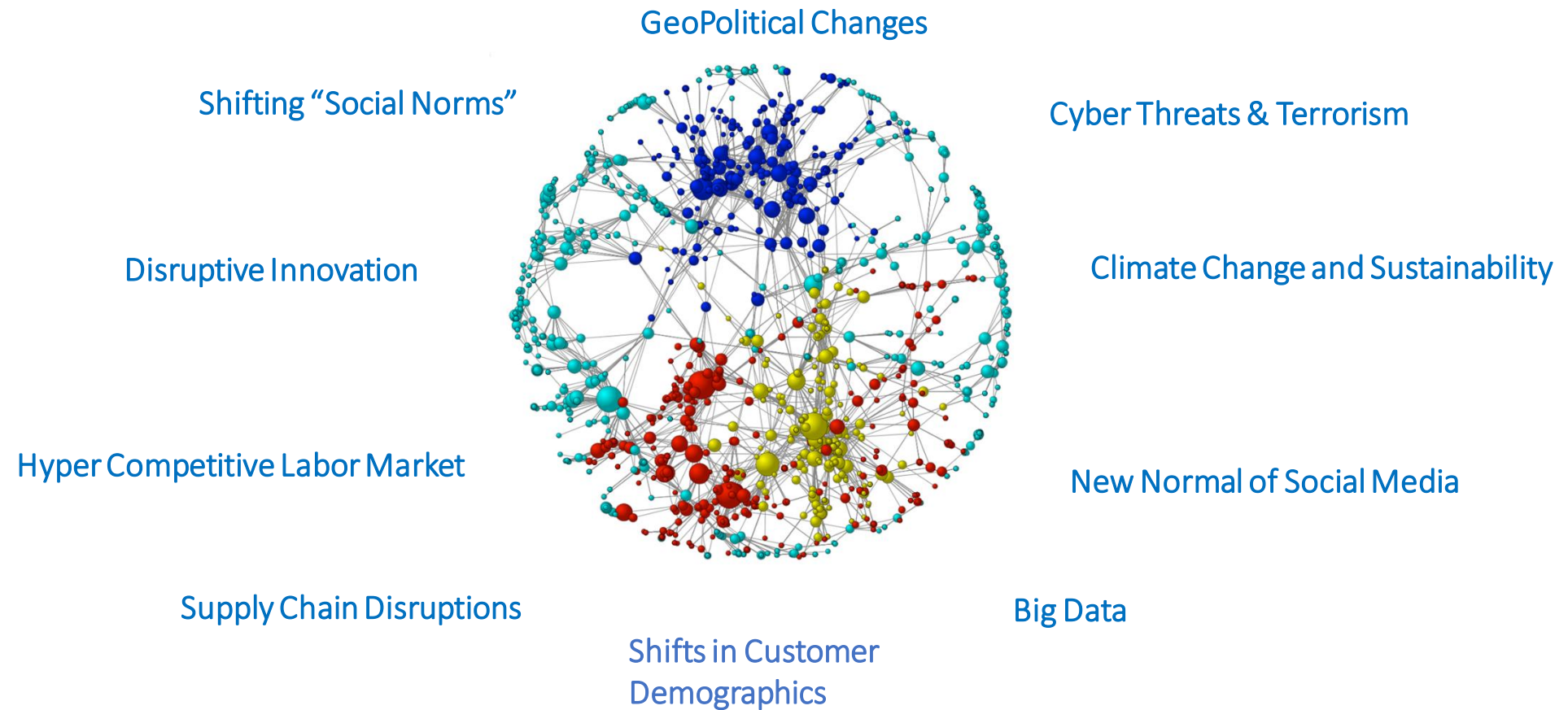
Opportunities for Research

Challenge #3

Risk Judgments Are Not Easy.



Organizations Operate in a World of Growing External Uncertainties



Each of these is complex... and complicated by their interconnectedness

Risk Managers are Human, Too

Blind Spots

Overlooking blindspots leads to risks

Normal human limitations

- Tend to focus on the “known”
- Lean more towards internal issues, ignoring external risks
- We get lost in the weeds, miss forest for the trees



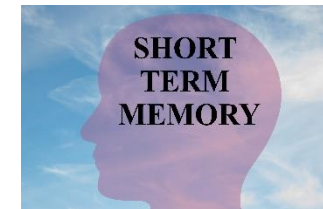
Overlook the “gray rhinos”?

- High probability, high impact events
- Things we ought to see that are coming



Humans Struggle with Assessing Probabilities

- Especially when there is no history or data
- Often ignore other factors – consequence
- Low probability treated as “zero probability”



Our memories are short

- Lots of risk management in March 2020, but not the same level of attention in 2022
- When performance is good, we overlook risk management

How Might Research Help Address?

- 1. Incorporate “Design Thinking” theories and concepts to open our views beyond what we can see**
 - How might research in “the arts” expand our thinking beyond “known risks”?
 - What techniques might lead to more critical thinking about risks?
- 2. Build upon statistics and actuarial science to strengthen our understanding of risk probabilities along with impact, velocity**
 - How might we enhance our approach to assessing risk probabilities, especially very low probability events?
 - How do we measure the interconnectedness of risks when some risks can only be assessed qualitatively?
- 3. Integrate judgment and decision making research**
 - How do leaders overcome “blindspots”?
 - How can groups/teams reconcile differences in views of risk probabilities?
 - What techniques help overcome overconfidence when performance is strong?
- 4. Conduct field studies to examine “how” risk assessment occurs – what works, what doesn’t**
 - What approaches to prioritize risks work most effectively?

Opportunities for Research

Challenge #4

The focus is on short-term, not long term horizons.



Most ERM time horizons are 1-5 years

Unfortunately...



55%

Extent organization's ERM process formally identifies, assesses and responds to emerging strategic, market, or industry risks is

“not at all”, “minimally” or “somewhat”

32% for public companies

44% for financial services

64% for non-profits

TOP RISKS FOR 2022

1. Pandemic-related government policies and regulation impact business performance
2. Succession challenges, ability to attract and retain top talent
3. Pandemic-related market conditions reduce customer demand
4. Adoption of digital technologies may require new skills or significant efforts to upskill/reskill existing employees
5. Economic conditions, including inflationary pressures, constrain growth opportunities
6. Increasing labor costs impact profitability targets
7. Resistance to change operations and the business model
8. Inability to utilize data analytics and "big data" to achieve market intelligence and increase productivity and efficiency
9. Cyber threats
10. Shifts in expectations about social issues and diversity, equity and inclusion (DEI) outpace organization's response

TOP RISKS FOR 2031

1. Adoption of digital technologies may require new skills or significant efforts to upskill/reskill existing employees
2. Succession challenges, ability to attract and retain top talent
3. Rapid speed of disruptive innovation may outpace our ability to compete
4. Substitute products or services may arise that affect our business model
5. Economic conditions, including inflationary pressures, constrain growth opportunities
6. Entrance of new competitors and other industry changes threaten market share
7. Impact of regulatory change and scrutiny on operational resilience, products, and services
8. Resistance to change operations and the business model
9. Hybrid work environment and changes in nature of work challenge ability to compete
10. Inability to utilize data analytics and "big data" to achieve market intelligence and increase productivity and efficiency



Risks seem different when looking a decade out



Rapidly escalating discussions of ERM and ESG

Particularly calls for more disclosures of climate risks.



How Might Research Help Address?

- 1. Integrate research on incentives to understand differences in short-term vs. long-term perspective**
 - How do compensation plans discourage long-term thinking?
 - What mechanism help capture risk management performance as part of reward incentives?
- 2. Incorporate research on the environment, particularly climate, to consider risk impacts on business models**
 - Which industries are most vulnerable?
 - What other risks will be triggered by ESG risks?
 - How are societal and political expectations leading to unexpected risks?
- 3. Leverage research in innovation and R&D to explore processes for looking out for emerging innovations**
 - How do we deal with “Fuzzy” hypotheticals?
 - What techniques help expand awareness of emerging or disruptive advancements?
- 4. Incorporate research from insurance**
 - How do we predict probabilities of outcomes 10-20-30 years out?
- 5. Partner with computer science to explore techniques for leveraging technologies**
 - How can technologies be used to develop robust dashboards of real-time indicators of emerging risks?
 - What are the strengths and limitations of text analyses for identifying emerging risks?

Opportunities for Research

And the list goes on

- *How do we identify and reach consensus on different appetites for risk taking when there are multiple individuals with different personal aversions to risk taking?*
- *How do we create a risk mindset across the entire organization? Are there particularly effective processes to accomplish this?*
- *With the “no one size fits all” approach to risk management, how can we determine if the risk management system is effective? What is the future of assurance on ERM processes?*
- *How does business education need to change to improve knowledge and skill for managing risks?*
- *What happens behind closed doors regarding board governance of risks?*
- *How do different forms of communications about risks (visualizations, reports, storyboards) impact understanding?*

There are many research opportunities in ERM



Contact

Mark S. Beasley

KPMG Professor of Accounting
Director of the ERM Initiative
ERM Initiative

NC State University

mark_beasley@ncsu.edu

(919) 515-6064

erm.ncsu.edu