

12th Annual Conference on Risk Governance **University of Siegen**

- KEY NOTE SPEECH -

“Dealing with a World of Risk, Uncertainty, and the Unknown”

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Background

A brief overview:

Financial economist, international banker, strategy scholar (UNC-Chapel Hill)

George Mason University, Johns Hopkins University, Copenhagen Business School

Research interests:

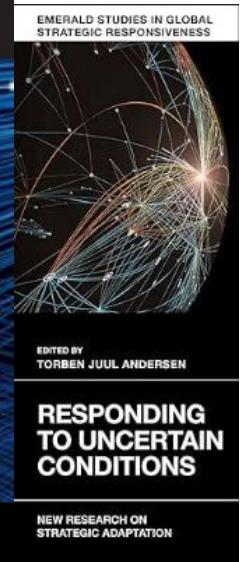
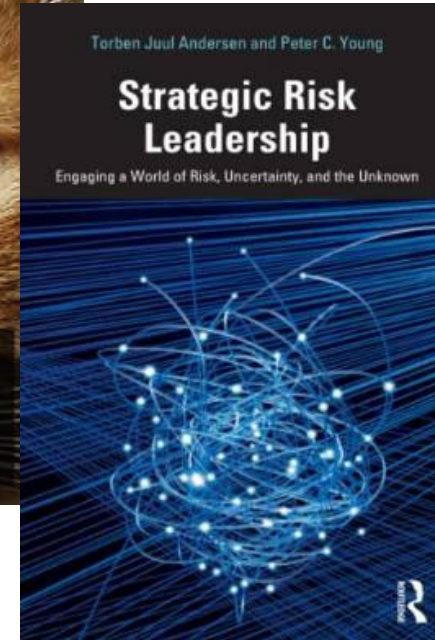
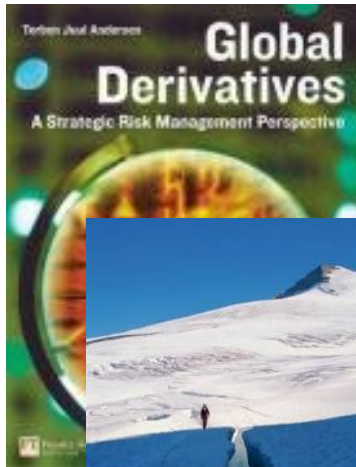
- Adaptive strategy-making processes
- Responding to uncertainty and the unknown
- Strategic risk leadership

Track Chair: *European Academy of Management (EURAM), Conferences, 2018-2023*

Conference Chair: *Collective Intelligence Conference, Copenhagen, June 2021*

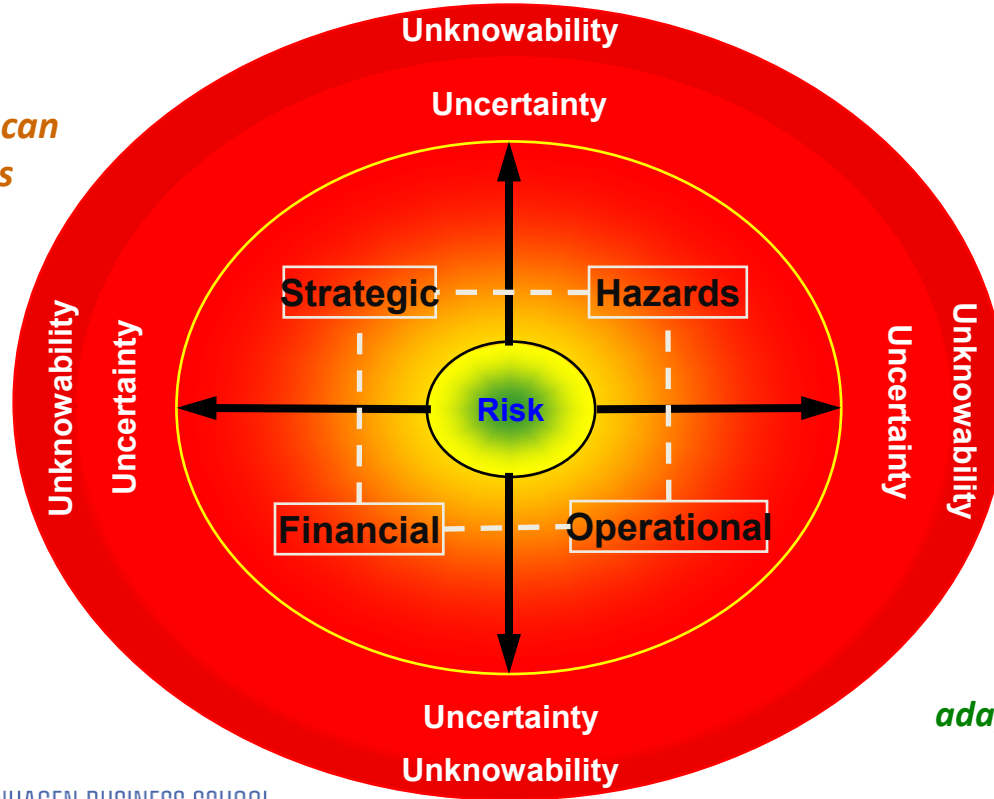
<https://conferenceacmci.wixsite.com/2021/organizers>

Some publications



A changing risk landscape?

To what extent can we identify risks in advance?



Do strategic objectives stay fixed, or are they adapted as we move?

Risk in strategy

The enterprise risk management (ERM) perspective:

Risk: the possibility that events will occur and affect the achievement of strategy and business objectives.

COSO's underlying philosophy is that "value is maximized when management sets strategy and objectives to strike an optimal balance between growth and return goals and related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives."

COSO: The Committee of Sponsoring Organizations of the Treadway Commission supported jointly by five US-based professional associations - American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), American Accounting Association (AAA), Institute of Internal Auditors (IIA), and Institute of Management Accountants (IMA).

The US Sarbanes-Oxley Act of 2002 extended executive responsibilities and the SEC requiring that all significant risk factors are disclosed in the 10-K/10-Q reports.

Comparable risk reporting requirements are imposed by EU Company Law to public companies operating within the EU.

"the 2008 banking crisis was caused not so much by technical failures as by failures in organizational culture and ethics"

Moore, Carter & Associates/Cranfield University (2010). *The RiskMinds 2009 Risk Managers Survey: The Causes and Implications of the 2008 Banking Crisis*.
<http://www.moorecarter.co.uk/RiskMinds%202009%20Risk%20Managers'%20Survey%20Report.19March2010.pdf>

Institutionalization of ERM

“Banks should have an effective independent risk management function, under the direction of a chief risk officer (CRO), with sufficient stature, independence, resources and access to the board.”

BIS. (2010, 2015). *Guidelines: Corporate Governance Principles for Banks*. p.25

Article 41.2, the 8th EU Company Law Directive (DIRECTIVE 2006/43/EC – Art. 41-2b), it requires that *“the audit committee shall, inter alia: monitor the effectiveness of the company’s internal control, internal audit where applicable, and risk management systems”*.

“FERMA/ECIIA ... supports the establishment of a centralized risk management function for coordinating and helping effect risk management across the organization ... best practice is to nominate a chief risk officer - smaller organizations may assign this responsibility to another senior executive.”

FERMA/ECIIA. (2011). *Guidance on the 8th EU Company Law Directive - article 41*, p.8

“COSO published guidance on risk assessments and on risk appetite (2012), which provides more specific guidance on certain issues. In 2009, the International Organisation for Standardisation issued its standard for implementation of risk management principles, ISO 31000, which has de facto become the world standard.”

OECD. (2014). *Risk Management and Corporate Governance*. p. 15-16

Implies a particular risk management, risk leadership, and risk governance approach!

Strategy-making processes

What are they?

Central reasoning: The importance senior management of the company ascribes to the various elements of rational analytical planning considerations.

Measured by four items: 1) establishing a corporate mission, 2) preparing long-term plans going 3-5 years forward, 3) setting annual goals for total sales, market share, operating efficiency, etc., and 4) evaluating the fulfilment of strategic performance goals.

7-point Likert scale (1 = totally disagree; 7 = totally agree).

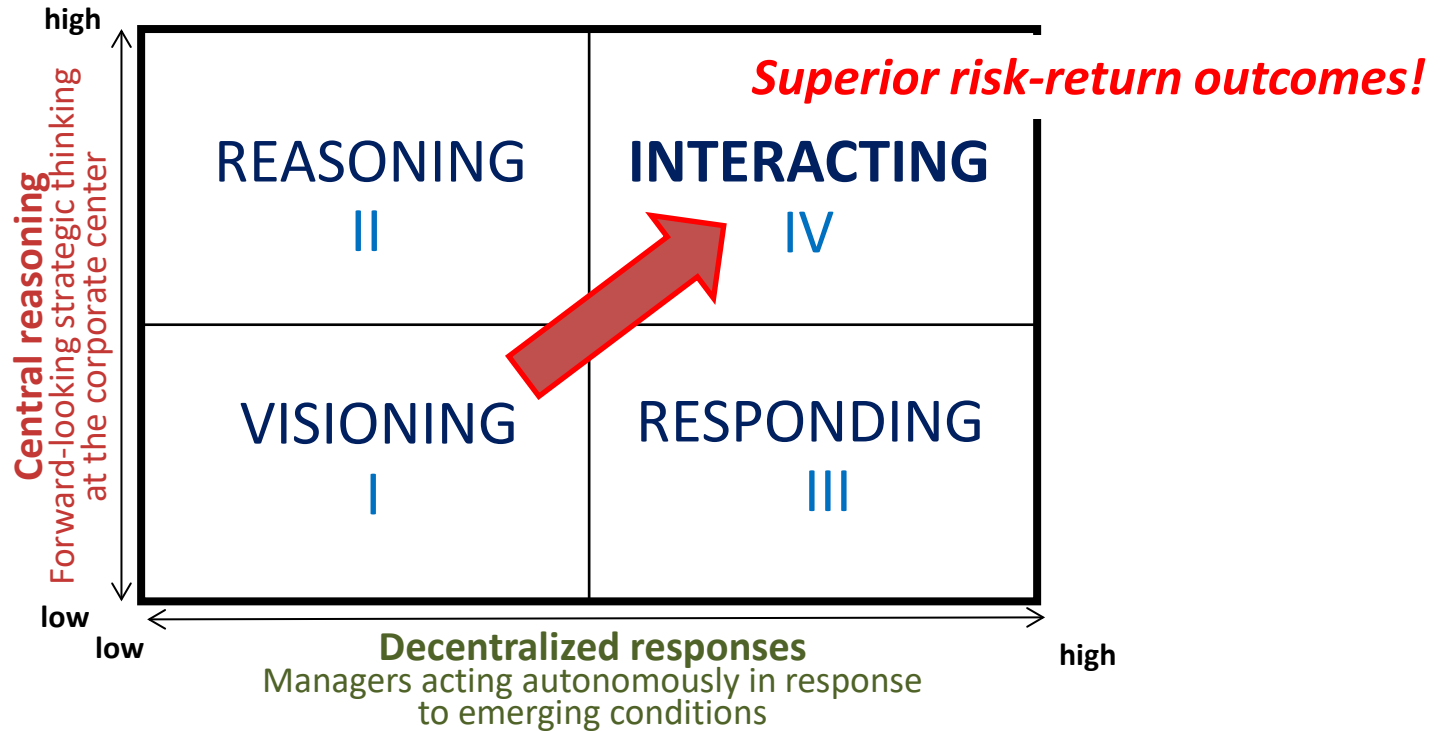
Decentralized responses: The extent to which middle managers in the organization are engaged in ongoing activities that can affect emerging strategic outcomes.

Measured by three items: 1) activities and initiatives aimed at increasing the market share, 2) sales efforts to enter new market segments, 3) new product developments.

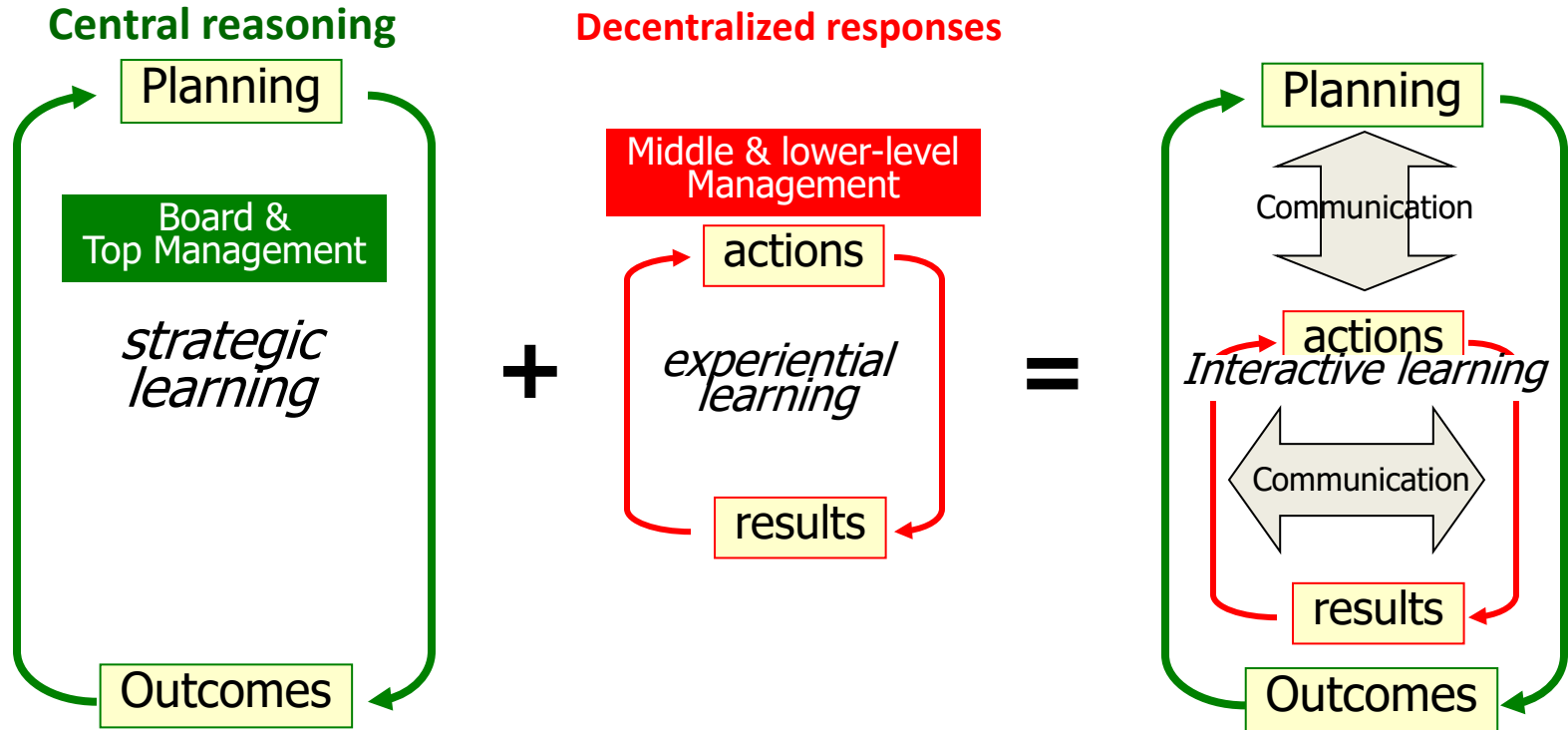
7-point Likert scale (1 = totally disagree; 7 = totally agree).

Interacting

What are their effects?

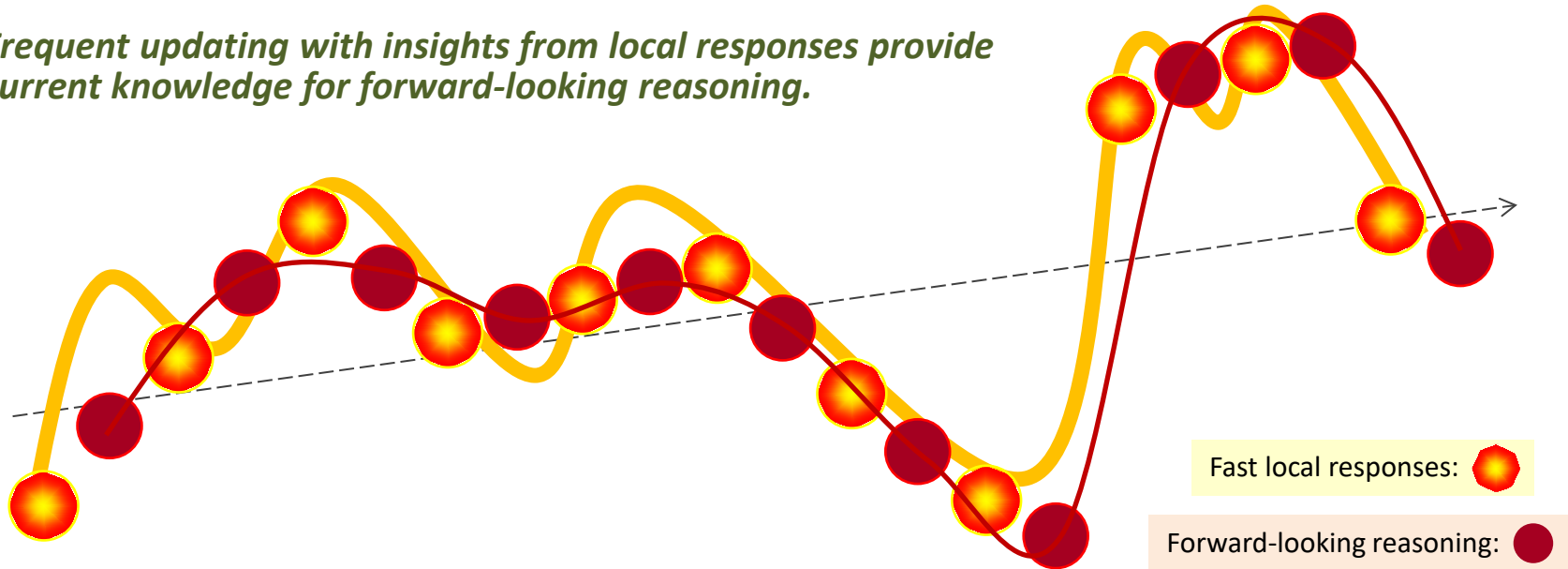


Complementary processes



Frequent updating

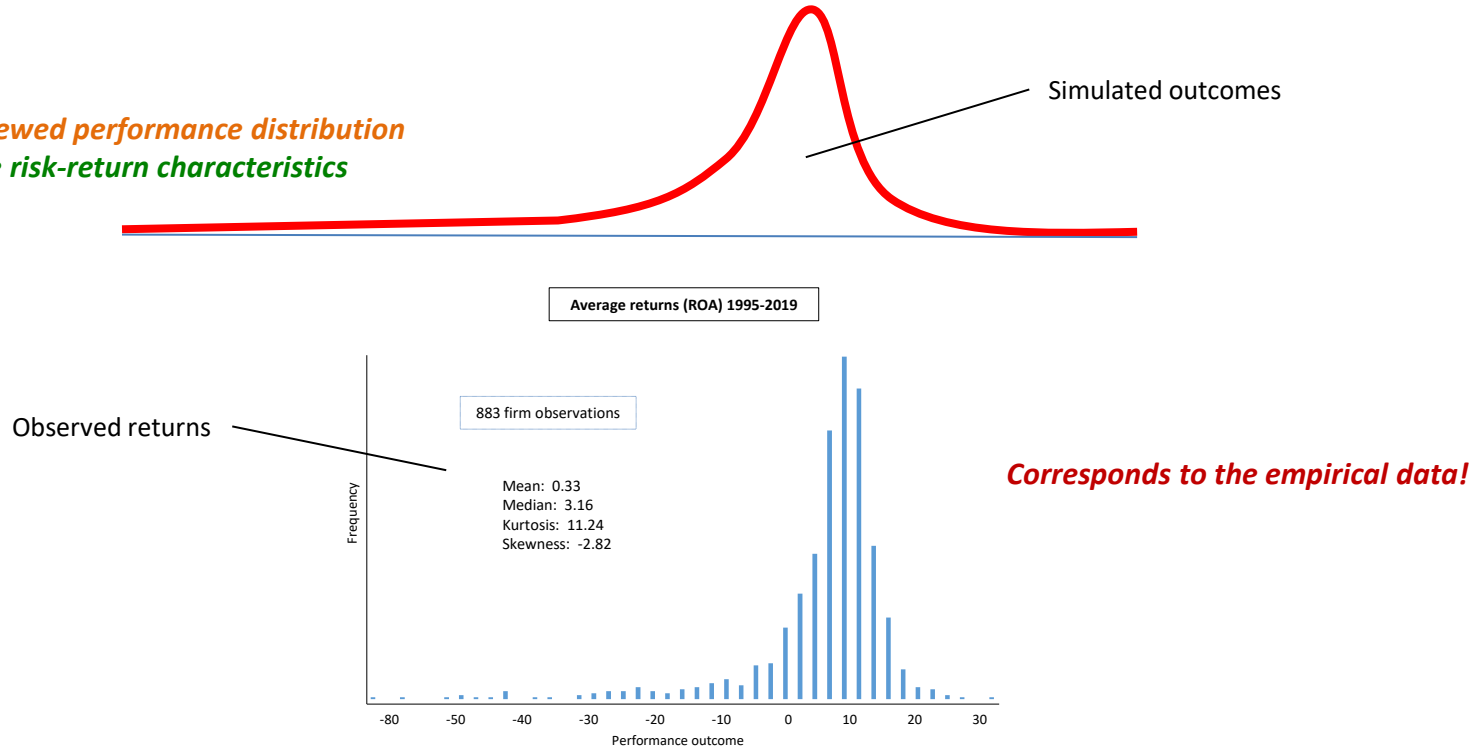
Frequent updating with insights from local responses provide current knowledge for forward-looking reasoning.



The model develops higher performance at lower performance risk for some firms!

Outcome effects

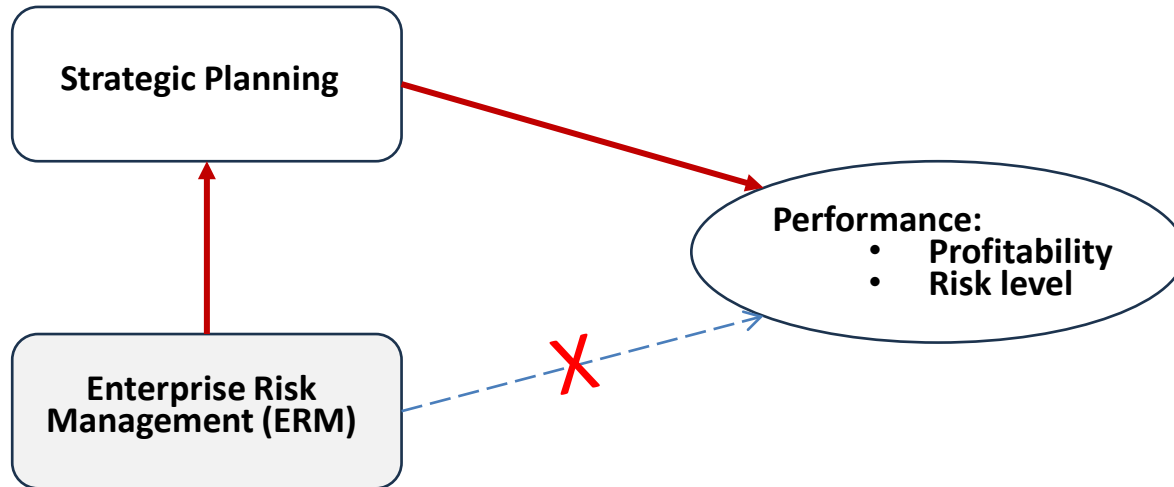
- *Left-skewed performance distribution*
- *Inverse risk-return characteristics*



ERM and strategic planning

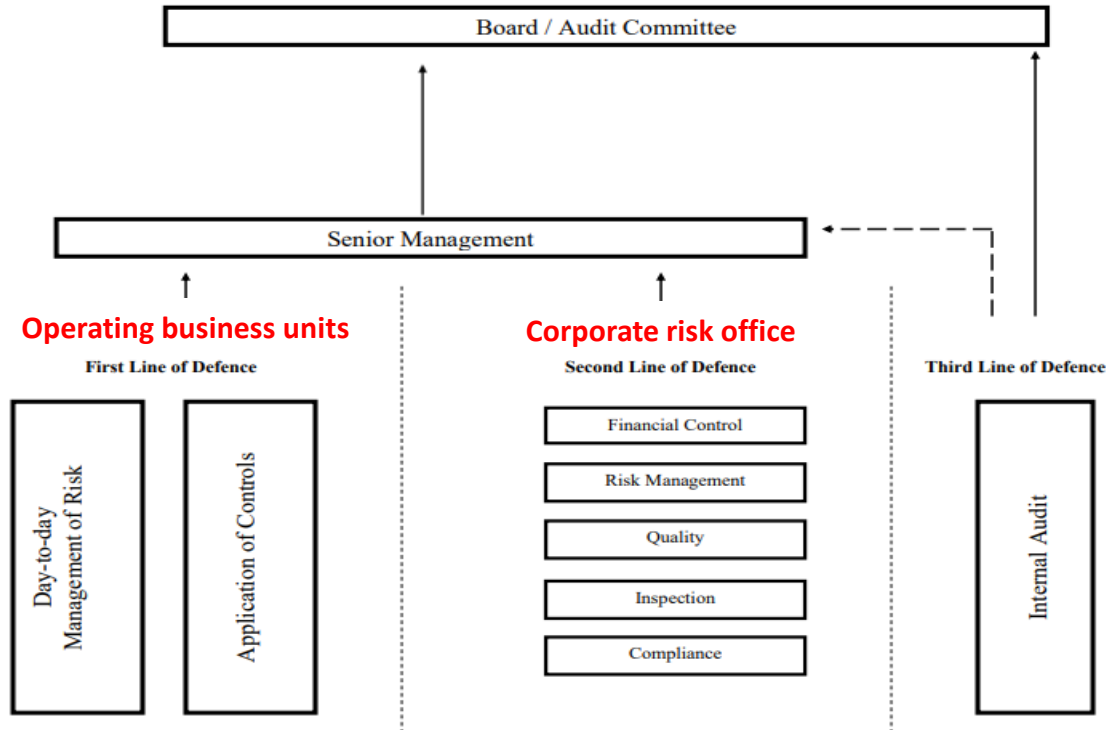
ERM: Adhering to risk management process described in COSO (2004) and ISO31000 (2009) .

Measured by six items: 1) a policy to handle strategic risks, 2) standard procedures to identify major risks and opportunities, 3) analysis of risks and opportunities to determine how they should be managed, 4) standard procedures to launch risk-reducing activities, 5) preparation of regular risk reports, and 6) standard procedures to monitor major risks and risk-reducing activities.



ERM extension

Three lines of defense



Risk governance

First and second line-of-defense measures:

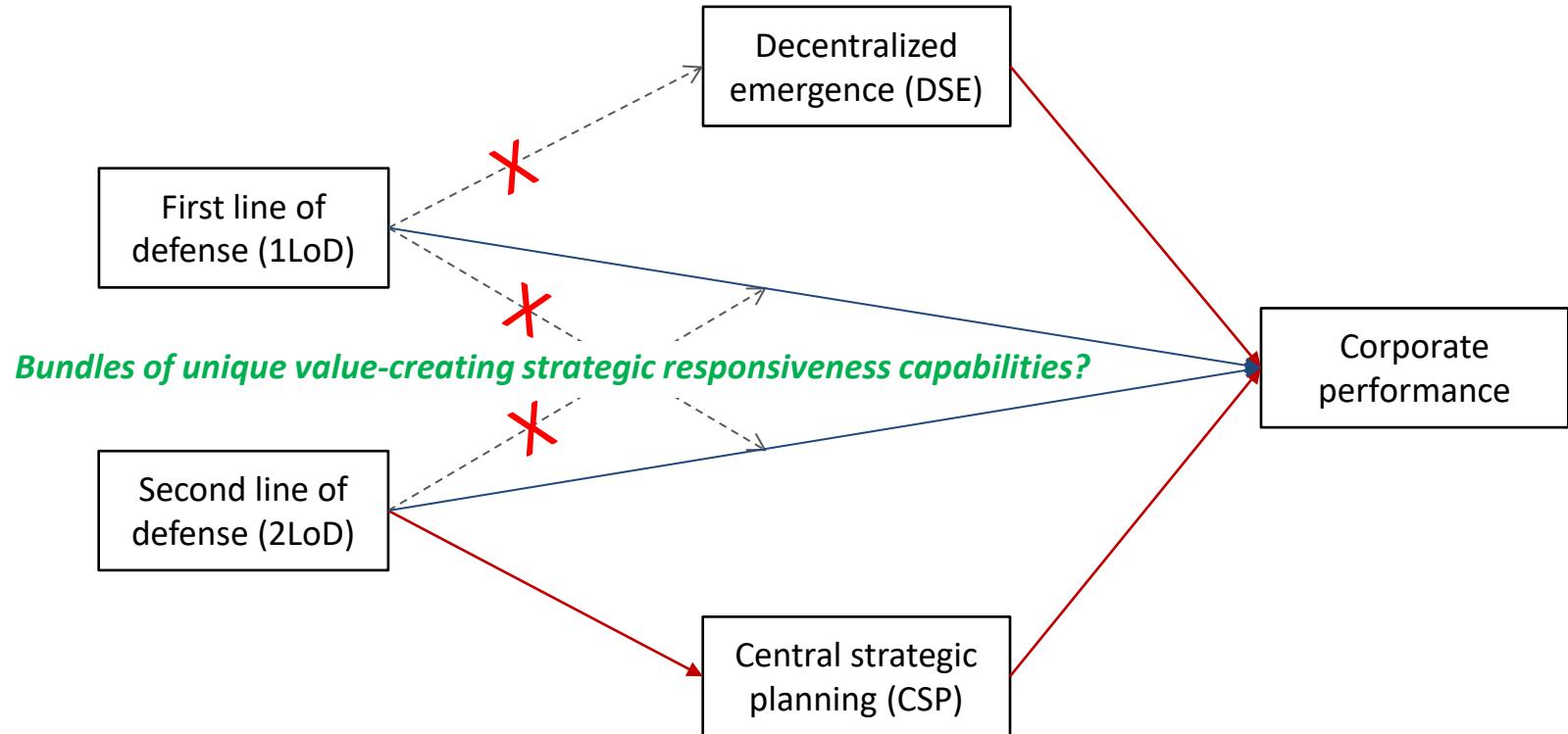
First line of defense: Risk control processes are carried out by the operating entities that conduct the daily business activities.

Measured by three items: 1) the identification of risks and opportunities is delegated to the business units, their managers and employees, 2) decisions on risk-reducing measures and exploitation of opportunities are delegated to the business units, 3) each business unit is responsible for identifying and assessing risks and opportunities.

Second line of defense: A centralized function conducting systematic holistic risk analysis for the organization to guide operating entities and report on corporate exposures to senior management.

Measured by three items: 1) a central risk management function dedicated to manage corporate risks, 2) a central risk management function that guides departments assessing major risks and opportunities, 3) a central risk management function that challenges the risk strategies of top management and the board.

ERM performance effects?



Strategic risk leadership

“the most critical risk issues today are large-scale exposures ... climate change, pandemics, migration, and political instability. ... organizations, governments, and society in general must find ways to collaborate because effective responses require more than application of traditional risk management for the organization itself.

They require a joint vision, cooperation, consensus building across involved parties, and sensible risk sharing arrangements ... arguably, these are actions of leadership.”

[Andersen & Young (2022), pp. 7-8]

“organizations able to operate as complex adaptive systems do so by enabling adaptive space ... a network structure not previously recognized ... and allows agents to interact in ways that generate emergence and new adaptive order for a system.”

“Adaptive space ... open information flows engage dynamics of complexity and network structures to enable emergence of novelty and innovation needed for adaptability.”

Uhl-Bien & Arena (2017). Complexity leadership: Enabling people and organizations, *Organization Dynamics*, 46(1). 9-20.

Needs a focus on “our values ... decision rules ... embedded beliefs ... accepted norms and behaviors ... they affect how we work together for common ends ... and imply a focus on the people that operate the organizations—and how to lead them.”

[Andersen & Young (2022), pp. 108-109]

Effective risk leadership

Characteristics of a responsive organization?

- ✓ *Top management listens to insights from the frontline?*
- ✓ *Applies analytical processes to assess ongoing developments?*
- ✓ *Combines central strategizing with decentralized responses?*
- ✓ *Forms a flexible operating structure with agile value chain?*
- ✓ *Adopts real options reasoning to exploit opportunities?*
- ✓ *Fosters a culture of open debate and collaboration?*

It calls for “enactive leadership ... foremost an executive recognition that a single individual, no matter how smart, intelligent, or powerful, cannot know everything and is unable to solely understand the complexity of contemporary business environments.”

[Andersen & Young (2022), pp. 135-163]

Grand challenges

Uncertainty and the unknown is becoming prevalent

- Increasingly complex structures and systems with more frequent and rapid changes
- More abrupt and extreme events, e.g., financial crisis, pandemic, military conflict, climate change
- Effects beyond individual firms affecting society at large ... with global impacts

Private and public institutions are slow to respond to these grand challenges

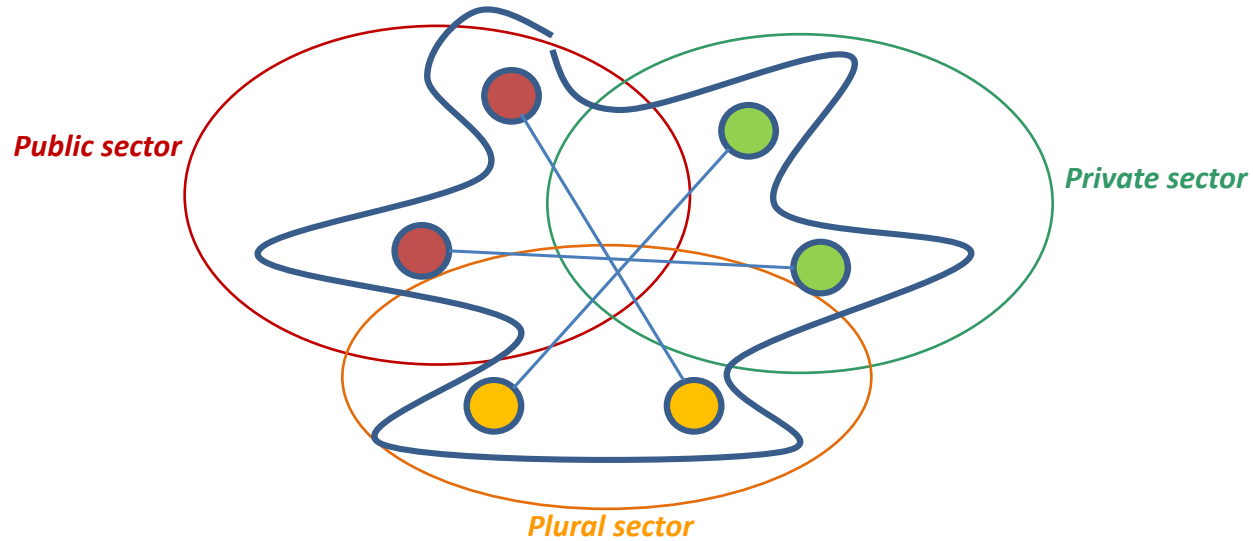
- **Business leaders must satisfy current demands for economic efficiency and performance ... it is hard to accept short-term losses for long-term gains**
- **Politicians must prevail to secure the next re-election ... it is hard to promote long-term goals if they do not have positive short-term effects**

The underlying challenges are systemic in nature and require collaborative solutions!

Systemic transformation

Collaborative coevolving responses across engaged public and private organizations.

Engage relevant stakeholders in exploratory innovative activities honing their collective intelligence!



Comments and questions?

