

# What Is Strategic Risk Management?

Organizations know they must manage strategic risk to create and protect value. Here are some guiding principles that might help.

**W**hat is strategic risk management (SRM)? Is it the same as or different from enterprise risk management (ERM)? What kinds of events or risks are strategic risks? Boards of directors and management teams have been asking these questions a lot lately.

One of the lessons many organizations learned from the global financial crisis is that they need to clearly link strategy and risk management and be able to identify and manage risk in a highly uncertain environment. Another is that they must focus risk management on *creating* value as well as *protecting* value. In this article, we present a working definition of and guiding principles for SRM that management teams and directors can use to help link ERM with strategy and strategy execution and to focus risk management on creating and protecting value. This insight is based on some of the latest developments in strategic risk management from the work we're doing with management teams and boards, research in the Strategic Risk Management Lab at DePaul University, and through

collaborative research with the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and other universities and professional organizations.

## The Relationship between SRM and ERM

In 2004, COSO issued its *Enterprise Risk Management—Integrated Framework* with this definition of ERM (see [www.coso.org](http://www.coso.org)):

*Enterprise risk management is a process, effected by an 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, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.*

That definition describes a broad set of processes that apply across the enterprise and involve everyone from the board of directors on down. (Note that ERM is directly related to “strategy setting.”)

The *Integrated Framework* provides the key principles and components of enterprise risk management and is grounded in the concept of ERM focusing on the achievement of an entity's objectives. The Framework groups entity

objectives into four categories: strategic, operations, reporting, and compliance. A particular objective may overlap certain categories, but the four categories allow an organization to focus on these separate objectives for purposes of ERM.

COSO defines *strategic* objectives as “high-level goals, aligned with and supporting its mission.” These strategic objectives are the core of an organization's strategy. Both internal and external events and scenarios that can inhibit an organization's ability to achieve its strategic objectives are *strategic risks*, which are the focus of strategic risk management. Accordingly, SRM is a critical part of an organization's overall ERM process. It isn't separate from ERM but is a critical element of it—and one that has been becoming more important.

## The Advent of Strategic Risk Management

Today, directors and executives are seeing increased expectations from shareholders, regulators, rating agencies, and other stakeholders that they understand and are managing the organization's risk and risk management processes—including strategic risks—and that there is transparency in the risk management process. It appears



that this reemergence of risk management, when coupled with the catastrophic losses incurred by some organizations, has fueled the current emphasis on “strategic risk management.”

Strategic risk management is focused on the most consequential and significant risks to shareholder value—clearly an area deserving the time and attention of executive management and the board of directors. Attributes for strategic risk management contained in the 2008 announcement by Standard & Poor’s include: “Management’s view of the most consequential risk the firm faces, their likelihood, and potential effect; the frequency and nature of updating the identification of these top risks; the influence of risk sensitivity on liability management and financial decisions; and the role of risk management in strategic decision making.” (See “Enterprise Risk Management: Standard & Poor’s to Apply Enterprise Risk Analysis to Corporate Ratings,” May 7, 2008, [www2.standardandpoors.com/spf/pdf/events/CRTconERM5908.pdf](http://www2.standardandpoors.com/spf/pdf/events/CRTconERM5908.pdf).)

A recent study from the Economist Intelligence Unit concluded: “Strategic risk management remains an immature activity in many companies.” (See “Fall Guys: Risk Management in the Front Line,” *The Economist Intelligence Unit Limited*, 2010, [www.businessresearch.eiu.com/fall-guys.html](http://www.businessresearch.eiu.com/fall-guys.html).) The study also found that “There is limited appetite for investment in the risk function. Despite rising to greater prominence in many companies, risk management has not generally attracted significant financial investment over the past year. Less than one-half of compa-

## To Learn More

- Mark S. Beasley and Mark L. Frigo, “Strategic Risk Management: Creating and Protecting Value,” *Strategic Finance*, May 2008.
- Mark L. Frigo and Richard J. Anderson, *Strategic Risk Management: A Primer for Directors and Management Teams*, Strategy and Execution, 2010.
- Mark L. Frigo, “Strategic Risk Management: The New Core Competency,” *Balanced Scorecard Report*, January-February 2009.
- Mark L. Frigo and Richard J. Anderson, “Strategic Risk Assessment: A First Step for Improving Risk Management and Governance,” *Strategic Finance*, December 2009.
- Mark L. Frigo and Richard J. Anderson, *Embracing Enterprise Risk Management: Practical Approaches for Getting Started*, COSO, 2011.
- Mark L. Frigo and Richard J. Anderson, *Strategic Risk Management: The New Core Competency*, Strategy and Execution (forthcoming, 2011).

nies have invested in risk processes, while less than one-quarter have allocated funds to headcount or training of managers in the central risk function. Ongoing cost constraints and company-wide budget freezes are undoubtedly helping to curtail investment, but care must be taken not to compromise the effectiveness of overall risk management.” This situation presents a serious dilemma where risk management remains immature and resource constraints present a barrier to further development.

## What Is Strategic Risk Management?

Organizations can adapt the following definition of strategic risk management to further develop their ERM capabilities and processes (see Mark Frigo and Richard Anderson, *Strategic Risk Management: A Primer for Directors and Management Teams*):

*Strategic Risk Management is a process for identifying, assessing and managing risks and uncertainties, affected by internal and external events or scenarios, that could inhibit an organization’s ability to achieve its strategy and strategic objectives with the ultimate goal of creating and protecting shareholder and stakeholder value. It is a primary*

*component and necessary foundation of Enterprise Risk Management.*

This definition, which also incorporates ERM, is based on six principles.

1. It’s a process for identifying, assessing, and managing both internal and external events and risks that could impede the achievement of strategy and strategic objectives.
2. The ultimate goal is creating and protecting shareholder and stakeholder value.
3. It’s a primary component and necessary foundation of the organization’s overall enterprise risk management process.
4. As a component of ERM, it is by definition effected by boards of directors, management, and others.
5. It requires a strategic view of risk and consideration of how external and internal events or scenarios will affect the ability of the organization to achieve its objectives.
6. It’s a continual process that should be embedded in strategy setting, strategy execution, and strategy management.

Organizations can adapt the definition and principles of SRM in developing their action plans for strengthening ERM and focusing it on strategic risks.

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## Strategic Management

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### Critical Steps for Strategic Risk Management

Strategic risk management increasingly is being viewed as a core competency at both the management and board levels. The exact steps that an organization should take will depend on the level of maturity of its overall ERM processes. For some organizations that have already started to implement ERM, the focus on strategic risks will be a refinement and evolution of their activities. For those just starting or just considering an ERM effort, an initiative focused on strategic risks may be a good starting point. Here's a working list of practices worth striving toward.

- ◆ Assess the maturity of the organization's ERM efforts relative to its strategic risks. Consider whether management and the board feel that they have a good understanding of the organization's strategic risks and the related risk management processes. Develop action plans to move to a high level of ERM maturity.

- ◆ Conduct a strategic risk assessment. Conduct a separate assessment to understand and prioritize the organization's strategic risks. Consider both internal and external risks and events.

- ◆ Review the process for strategy setting, including the identification of related risks. Review the organization's process for setting and updating its strategies and strategic objectives. Ensure that the process requires the identification and assessment of the risks embedded in the strategies.

- ◆ Review the processes to mea-

sure and monitor the organization's performance. Expand the processes to include the monitoring and reporting of key performance indicators (KPIs) related to strategic risks. Embed risk monitoring and reporting into the organization's core processes for budgeting, business performance monitoring, scorecards, and performance measurement systems.

- ◆ Develop an ongoing process to periodically update the assessment of strategic risks. Make the strategic risk assessment process an ongoing one with periodic updating and reporting. **SF**

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