LLOYD'S

TAKING RISK ON BOARD

HOW GLOBAL BUSINESS LEADERS VIEW RISK

In association with the Economist Intelligence Unit

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This briefing paper draws a number of conclusions, based on a programme of in-depth interviews with business leaders and industry analysts, and combined with extensive desk research, all carried out by the Economist Intelligence Unit.

The Economist Intelligence Unit is the world's foremost provider of country, industry and management analysis. Founded in 1946 when a director of intelligence was appointed to serve The Economist, the Economist Intelligence Unit is now a leading research and advisory firm with more than 40 offices worldwide. For nearly 60 years, the Economist Intelligence Unit has delivered vital business intelligence to influential decision-makers around the globe.

TAKING RISK ON BOARD

That business risks are proliferating in an increasingly competitive world is beyond dispute. Risks to business continuity and to intangible assets such as intellectual property and reputation are rising as the economy becomes ever more global.
At the same time, the post-Enron era has brought heightened focus on the role and responsibility of corporate boards and their members. So, just how high is risk management on the corporate agenda?
This paper explores the extent to which risk is now a board-level responsibility, what boards see as their risk-related priorities, and what they do and don't do to implement effective risk management strategies throughout their organisations.

EXECUTIVE SUMMARY

The good news is that boards are now taking risk more seriously. Less reassuring is that this is largely because of governance and regulatory factors rather than a recognition that overall business strategy would benefit from fully integrating risk management into board-level decision-making. Indeed, it is too often seen as a constraint – a diversion of resources and an obstacle to risk-taking – rather than as a way of driving shareholder value.

1 BOARDS ARE TAKING RISK MUCH MORE SERIOUSLY

This is with good reason: according to the survey results one in five companies suffered significant damage from a failure to manage risk adequately last year, and over half had at least one "near miss". That boards are spending more time looking at risk is therefore hardly surprising, but the scale of the increase is: the amount of time company boards spend on risk management has risen four-fold in just three years.

2 BOARDS ARE ONLY SLOWLY INCORPORATING THE FULL RANGE OF RISKS INTO DECISION-MAKING

Corporate scandals and the resulting tightening of regulation have caused roughly two thirds of the companies surveyed to reassess their risk management strategies, yet fewer than half of the companies surveyed have done so in response to the threat of terrorism, and only one in four as a result of growing climatic and natural hazard risks. Perhaps as a result, just 14% of board members are confident that their organisations' boards understand, and will respond correctly to, risks facing their foreign operations.

3 MORE NEEDS TO BE DONE TO EMBED RISK MANAGEMENT CULTURE

In just half of the companies surveyed risk management is centralised and overseen by the board; and a similar proportion have company-wide systems to identify and monitor risks. Furthermore, while over 60% of boards have regular dialogue with business units on risk issues, less than a quarter include a risk management element in staff job descriptions, and only a quarter set regular risk targets for managers.

4 BOARDS NEED BETTER TRAINING AND EDUCATION ON RISK MANAGEMENT

Surprisingly, less than a third of boards feel that technical risk management skills and qualifications are important or train their staff in these skills, and just 18% of board members have received training in how to implement risk management across their organisations. By contrast, almost half of board members surveyed have had training on corporate governance, suggesting that companies undervalue the benefits of specialist risk management expertise.

5 COMPANIES ARE YET TO REALISE THE FULL BENEFITS OF STRONG RISK MANAGEMENT

Greater board attention to risk management has brought notably improved internal controls and standards of governance in around half of the companies surveyed, but in only one in four of the companies surveyed have boards identified improved shareholder value or investment returns as benefits of stronger risk management, and only a third would consider it worthwhile investing in a risk management rating from a recognised agency.

6 THE INSURANCE INDUSTRY IS A PRIME SOURCE OF RISK MANAGEMENT EXPERTISE

Half the organisations surveyed believe that they should be receiving risk advice from insurers. While this is a strong vote of confidence in the insurance industry and its skills and knowledge, it also raises the question as to whether businesses are currently over-reliant on insurance and failing to consider the full range of risk management tools available.

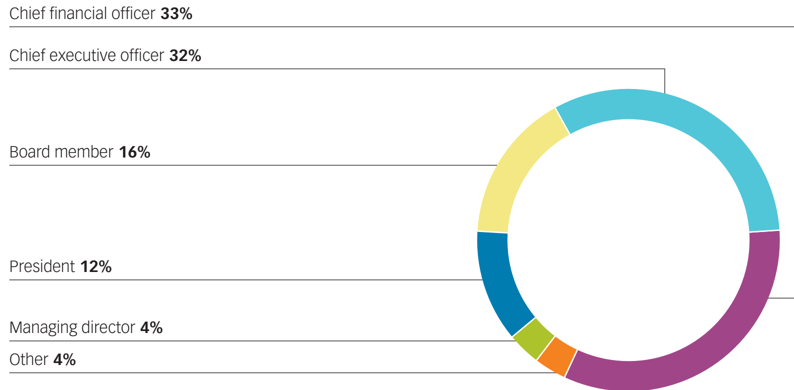
METHODOLOGY

The Economist Intelligence Unit carried out a detailed programme of research activity on which this report is based.

First, a wide-ranging survey was undertaken of 112 board members around the world, about their organisations' management of risk.

The Economist Intelligence Unit's survey targeted a very high level of seniority. A total of 112 board members participated, and almost two-thirds of these were either chief executive officers or chief financial officers. A further 12% were company presidents.

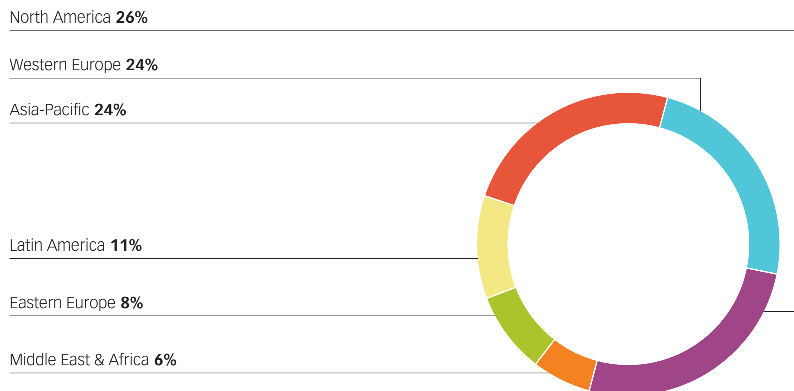
Which of the following titles best describes your job?



Source: Economist Intelligence Unit, 2005

A broad spectrum of industries was included: the biggest proportion – 23% of respondents – came from the financial services sector. Other well-represented sectors were professional services, healthcare and pharmaceuticals, construction and real estate, chemicals and manufacturing. Responses were drawn from across the world, but Western Europe and North America accounted for 50%.

Where is your company headquartered?



Source: Economist Intelligence Unit, 2005

To supplement the survey results, the Economist Intelligence Unit carried out a number of in-depth interviews with board members of companies operating across a range of sectors. The executives include:

Atle Farstad, Chief Risk Officer, Norkse Skog. **John Fraser,** Chief Risk Officer, Hydro One. **Mark Wilford,** Director of Risk, Rolls-Royce plc. **Kim Bundgaard,** Head of Finance and Corporate Governance, Novo Nordisk. **Julian James,** Director of Worldwide Markets, Lloyd's. **Ken Bertsch,** Senior Vice President and Director of Corporate Governance, Moody's Investors Services. **Andrew Taylor,** Group Risk Manager, First Choice Holidays. **Leonard Turk,** Legal Director and Company Secretary, MTR Corporation. **Tom Dowling,** Chief Risk Officer, Interpublic Group.

THE REWARDS OF RISK MANAGEMENT

As Sir John Bond, chairman of HSBC, once said: "It used to take years of dedicated bad management to destroy a company. Now it can be done almost overnight." It is not just the range of hazards – from fraud and financial upheaval to terrorism and failures in supply chains – that can threaten a company; it is the speed with which such risks can strike. As Andersen found to its cost when Enron went bust in 2002, risks from an overlooked quarter can engulf even the most established of organisations.

The failures in corporate governance that led to the collapse of Enron, WorldCom and others are proof of this, as are the tough new rules – not least America's Sarbanes-Oxley – that have since been introduced to tighten up corporate governance. In addition, in the UK, the FSA regulatory regime imposes considerable obligations on senior management to identify, assess and manage the risks involved in their business. Unsurprisingly, companies' boards have been the target of criticism. Should they have seen these problems coming? What more could they have done to avoid such lapses? Were they asleep on the job?

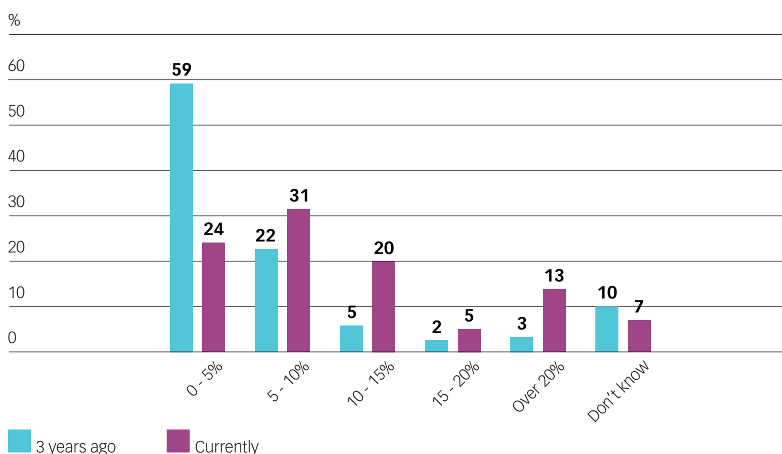
In the first report of its kind, this paper examines how the senior management of companies view risk, what they do to identify it, and what training they have had in risk management.

A BOARD ISSUE

"For some time now, anecdotal evidence has suggested that boards are taking risk more seriously," says Julian James, Director of Worldwide Markets at Lloyd's. This survey now provides the quantitative evidence to back that up: three years ago, just one in ten boards spent more than 10% of their time on formal risk management; this proportion has now risen to almost 40%. The number of boards spending more than 20% of their time on risk issues has increased even more dramatically – jumping from 3% to 13%.

EVIDENCE SUGGESTS THAT BOARDS ARE TAKING RISK MORE SERIOUSLY

How much of your board's time is devoted to formal risk management compared with three years ago?



Source: Economist Intelligence Unit, 2005

THREE YEARS AGO, JUST ONE IN TEN BOARDS SPENT MORE THAN 10% OF THEIR TIME ON FORMAL RISK MANAGEMENT

While they may not yet be incorporating the full range of risks into decision-making, there is also evidence that boards are assessing a wider range of threats. As well as risks posed by regulation, disruption to business continuity, and financial instability, firms are also more alive to threats that country-specific risks pose to their increasingly international operations. Mounting regulatory and governance risk emerge from the survey as the factors that have done most to convince boards of the need to reassess risk management. Perhaps worryingly, however, these factors come far ahead of terrorism or climatic factors, despite recent high profile catastrophes in these areas.

DIRECTORS KEENLY FEEL THE RISKS NOW JUST OF BEING ON BOARDS

Has your board reassessed risk management in light of any of the following?

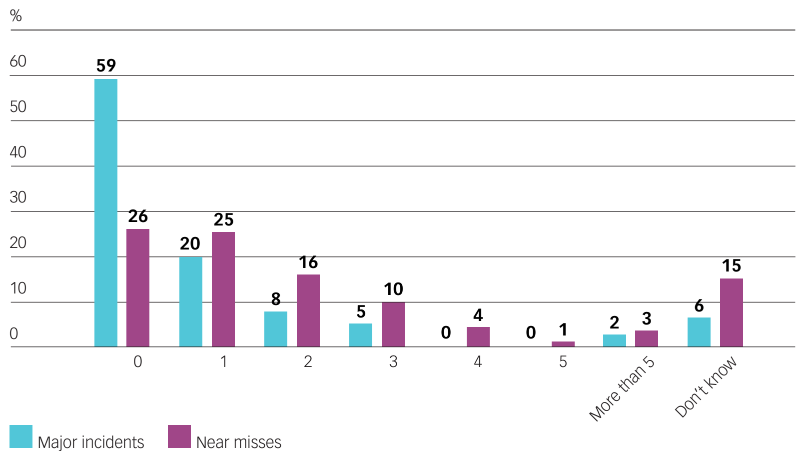
	Yes
Regulatory risk	71%
Governance risk	63%
Country risk	58%
Dominant individual risk	51%
Terrorism	43%
Political risk	34%
Natural hazard	28%
Product recalls	28%
Weather risk	26%

Source: Economist Intelligence Unit, 2005

ONE IN FIVE OF THE COMPANIES SURVEYED HAD SUFFERED SIGNIFICANT DAMAGE FROM A FAILURE TO MANAGE RISK

Overall, however, there is little doubt that the question of risk is climbing up the corporate agenda. According to Ken Bertsch, an analyst with Moody's Investors Services, a rating agency: "Directors keenly feel the risks now just of being on boards," thanks in part to Sarbanes-Oxley. Yet the fact that boards are more aware of risks than they were, say, three years ago does not mean that they agree on how best to identify and, where necessary, mitigate them. We found that during the past 12 months one in five of the companies surveyed had suffered significant damage from a failure to manage risk and over half (56%) had experienced at least one near miss. As many as 10% of respondents reported three near misses during the past year alone. And these are only the ones that companies will admit to.

In the past 12 months, how many times has your organisation suffered significant damage due to a failure of risk management? How many near misses have occurred during the same time period?



Source: Economist Intelligence Unit, 2005

Just over 50% of organisations manage risk in a centralised way across the entire firm, overseen by the board as part of their overall business strategy; a similar proportion have company-wide systems to identify and monitor risks. CEOs and boards between them are also taking charge of risk in a way that they haven't in the past. More than 54% of those questioned in the survey said that CEOs were primarily responsible for risk management in their organisation; and no fewer than 44% of respondents said that their board of directors, including non-executives, filled a similar role.

THE ADOPTION OF RISK MANAGEMENT STANDARDS IS NOT AS THOROUGH AS IT NEEDS TO BE

Which of the following best describes how your organisation manages risk?

	All industries	Turnover up to $1bn	Turnover £1bn-$10bn	Turnover in excess of $10bn
Centralised and firm-wide risk management that is overseen by the board as part of overall business strategy	52%	54%	54%	60%
Decentralised risk management with formal co-ordination	28%	23%	23%	30%
Decentralised risk management without formal co-ordination	17%	19%	19%	10%
Other/don't know	4%	4%	4%	0%

Source: Economist Intelligence Unit, 2005

FEWER THAN ONE THIRD PROVIDE RISK MANAGEMENT TRAINING

However, the adoption of risk management standards across companies is not as thorough as it needs to be. While nearly 60% of organisations have regular dialogue with managers of business units on risk management, only one-quarter set regular risk targets for managers, and fewer than one-third provide risk management training for managers and staff. According to Julian James at Lloyd's, this suggests a failure to 'embed' risk management within organisations, and is symptomatic of a culture where risk management is viewed as "someone else's job".

This is surprising given the lessons that should have been learnt from the scandals of the past few years. Under Sarbanes-Oxley, the directors of companies whose shares are listed in the US are not only required to set up independent audit committees to ensure that shareholders' rights are protected; senior executives also have to certify their companies' accounts. The penalties for lax or negligent governance, particularly if it leads to shareholders being defrauded, are severe. As Bertsch of Moody's notes: "The reputations of directors are on the line, not just that of their companies."

RISK GOES GLOBAL

The failure to view risk holistically stems in part from the speed with which many industries are becoming global. A total of 54% of respondents to the survey are very confident that their boards understand, and would respond appropriately to, the risks facing their domestic business. But, significantly, this falls to 14% when it comes to their foreign operations. Respondents from smaller companies are even more sceptical that their boards understand risks to their foreign operations.

How confident are you that your board understands, and responds appropriately to, the risk facing the following areas of your business?

	Very confident	Somewhat confident	Not confident	Don't know/not applicable
Domestic operations	54%	38%	4%	4%
Foreign operations	14%	50%	21%	15%
Sales	24%	61%	8%	7%
Marketing	20%	60%	8%	13%
Customer service	29%	49%	13%	9%
Production	29%	41%	10%	20%

Source: Economist Intelligence Unit, 2005

RISKS THAT, IN ISOLATION, MAY SEEM BENIGN CAN OCCUR TOGETHER WITH UNFORSEEN CONSEQUENCES

Often this is because companies' organisational structures fail to change with the times. Take, for example, Interpublic Group, a holding company that owns advertising agencies and companies involved in marketing services around the world.
In March 2005, the company admitted that it would need more time to report its results because of internal control issues. As a result, it was unable to meet the deadline for satisfying section 404 of the Sarbanes-Oxley Act.

However, 20 years ago, when Interpublic was expanding fast, the company's loose structure worked well. In future, according to Tom Dowling, the company's chief risk officer, Interpublic intends to concentrate risk management in the holding company. Not only will this enable the group's directors in New York to exert more control over certain functions (and thus certify to regulators that they have done so), it will also allow officers at group level to reduce costs by centralising functions and achieving economies of scale.

Interpublic is not alone. Many diverse groups with international operations can find themselves exposed on several fronts with little or no warning. Sometimes it is because of a combination of events. Two risks that, in isolation, may seem benign can present unforeseen dangers if they occur at the same time. For example, the international bank that is defending a case of unfair dismissal may find itself in even deeper water if, at the same time, its fund management division were suddenly to be accused by regulators of defrauding unit holders.

Or the car manufacturer that has been forced to recall thousands of its latest model because of a design fault would find its credibility tested if its CEO were discovered to have conspired to cover up the fault, so jeopardising the safety of its customers. As many firms have found to their cost, such gaffes have a habit not just of damaging their reputation and of undermining the integrity of the brand, but also, at a stroke, of wiping millions off their stock market value.

CHANGE HAS COME NOT JUST FROM CORPORATE SCANDALS BUT FROM A SUCCESSION OF DISASTERS

The impetus for change has come not just from the corporate scandals of the past few years but also from a succession of disasters, including the breakdown of America's savings and loans industry and the derivatives losses of the 1990s. These resulted, among others, in the Joint Australian/New Zealand Standard for Risk Management (which is widely used around the world), the recommendations of the Committee of the Sponsoring Organisations of the Treadway Commission (COSO) in America, as well as Britain's Cadbury and Turnbull Reports on corporate governance and controls.

53% OF RESPONDENTS CITED OTHER PRIORITIES AS AN OBSTACLE TO MAKING RISK MANAGEMENT AN INTEGRAL PART OF THEIR COMPANY'S BUSINESS STRATEGY

Such standards encourage companies to dovetail their efforts to identify risk with those aimed at raising transparency and standards of corporate governance. However, although there is evidence that boards themselves are beginning to understand the nature of risk, too many are still reluctant to take the steps needed to ensure that a greater awareness spreads throughout their organisations. Significantly, only 10% of respondents to our survey reported that it was extremely important to their boards to extend the principles of risk management into the wider business strategy. This compares with 45% who cited ensuring business continuity.

It is not just a failure to see the merits of risk management across an entire enterprise. There is also a fear of creating a culture of risk aversion that could impede the very business it seeks to protect. No fewer than 53% of respondents to the survey cited competition with other priorities as an obstacle to making risk management an integral part of their company's business strategy. And 45% said that a fear of creating a risk-averse or bureaucratic culture did the same. Julian James of Lloyd's believes that boards need to challenge these views, which ultimately "make it more difficult for the organisation to monitor and enforce risk management throughout its global operations".

What are the principal obstacles to making risk management integral with overall business strategy at your organisation?

	All industries
Competition with other priorities	53%
Fear of creating a risk-averse and bureaucratic culture	45%
A lack of cost-effective risk management tools	35%
Directors consider risk management a task for line management, not the board	25%
Poor awareness amoung staff inhibiting implementation	25%
The board does not understand or appreciate the principles and benefits of enterprise risk management	21%
Governance requirements (eg, Sarbanes-Oxley)	18%
Opposition from a key board member or group of members	10%
Other	4%

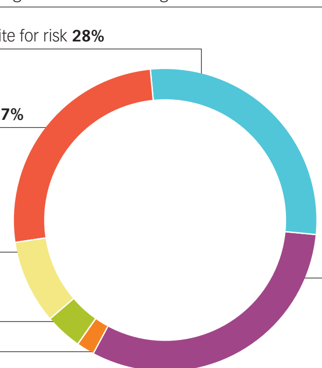
Source: Economist Intelligence Unit, 2005

DETERMINING RISK APPETITE

An important first step for any company is to decide on its appetite for risk: what level is appropriate for its business? This is something that the boards of companies in the financial services sector do best, probably because of the disciplines imposed by prudential regulation. Indeed, half of respondents in the sector agreed that this should be the primary responsibility of the board when managing risk, significantly more than among the respondents as a whole.

In your view, what is the board's primary responsibility regarding risk management?

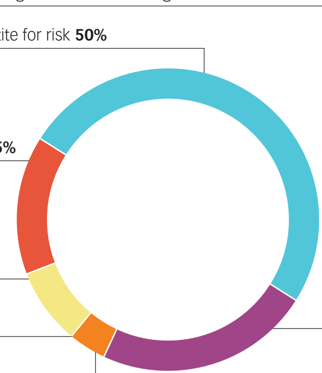
All industries



Source: Economist Intelligence Unit, 2005

AN IMPORTANT FIRST STEP FOR ANY COMPANY IS TO DECIDE ON ITS APPETITE FOR RISK

Financial services



Source: Economist Intelligence Unit, 2005

Banks and other financial services organisations have pioneered techniques to measure the likelihood of certain risks in a scientific manner and to weigh up the need and cost of mitigating them, measuring a firm's so-called 'value at risk'. This has become so successful that industrial firms are starting to use similar models.

The importance of value at risk to boards is twofold. First, it gives them valuable data that they can digest as often as they need, and, second, it provides a vital focus for debate between the board and a company's risk officer or risk committee. Take, for example, Norkse Skog, a Norwegian company and the world's second-largest producer of newsprint and paper. During the past few years Atle Farstad, the company's chief risk officer, has developed a system that measures a wide range of risks, including threats to the company's reputation.

RELATING RISK MANAGEMENT TO PROFITABILITY HELPS TO FOCUS MINDS

He divides risks into hard and soft ones and scores them accordingly. In all, Farstad takes into account about 80 variables, each of which could affect the profitability of the business. These are reviewed every six to 12 months, depending on their nature and severity. Only in this way, he says, can he and the board keep tabs on the risks that could affect the company's bottom line. "We attach probabilities to all types of risks, even soft ones. Why? Because they could all pop up on the balance sheet or the profit and loss account," he explains.

Relating risk management to the company's profitability in this way not only helps to focus the minds of the company's directors and senior officers on the hazards they face; it also ensures that the process of identifying and mitigating risks remains relevant to the company's day-to-day business. In this way, too, Farstad helps Norske Skog's board to maintain its control over the company's international operations (and so discharge its responsibilities to shareholders).

THE LINK BETWEEN CO-ORDINATED RISK MANAGEMENT AND HIGHER PROFITS HAS YET TO BE MADE BY MANY

Although such models are successfully employed by some, the connection between co-ordinated risk management and higher profits has apparently yet to be made by a majority of senior executives. When asked about the consequences of their board taking greater responsibility for risk management, only 25% of respondents to our survey pointed to improvements in shareholder value and even fewer (23%) to improved returns on investment. Hydro One, a utility in Ontario, is an exception. "When we want to spend money, we have to be able to justify it in terms of risk," comments John Fraser, the company's chief risk officer.

Which of the following have resulted from your board taking greater responsibility for risk management?

	All industries
Improved internal controls	50%
Improved standards of governance	45%
Improved business strategy	41%
Reduced compliance risks	40%
More robust corporate approach to risk-taking within the organisation	31%
Improved shareholder value	25%
Reduced cost of risk management	24%
Lower insurance costs	24%
Improved returns on investment	23%

Source: Economist Intelligence Unit, 2005

HIGH PERFORMANCE

BOARDS ATTACH MORE IMPORTANCE TO BUSINESS CONTINUITY AND COMPLIANCE THAN DELIVERING AN INTEGRATED RISK PICTURE

The previous figures are hardly surprising when you consider that only 31% of respondents said that the board's primary responsibility when it came to risk should be to manage it as part of a firm's day-to-day planning and decision-making – a proportion admittedly that jumps to 50% for companies with an annual turnover in excess of $10bn. Significantly, too, respondents attach more importance to such things as business continuity and complying with regulations than to delivering an integrated picture of risk across an enterprise, despite the fact that "a greater focus on the latter would undoubtedly help to reduce risks from the former," according to Julian James of Lloyd's.

In your view, what is the board's primary responsibility regarding risk management?

	All industries	Turnover up to $1bn	Turnover £1bn-$10bn	Turnover in excess of $10bn
To manage risk as an integral part of day-to-day board-level planning and decision-making	30%	28%	26%	50%
To be proactive in determining the organisation's level of appetite for risk	28%	28%	30%	20%
To spot emerging risks and develop strategies to prepare for them	27%	26%	33%	20%
To sanction or reject risk assessments conducted at lower levels of the organisation	9%	9%	7%	0%
To respond to risks as they arise	4%	5%	0%	0%
Other	3%	3%	4%	0%

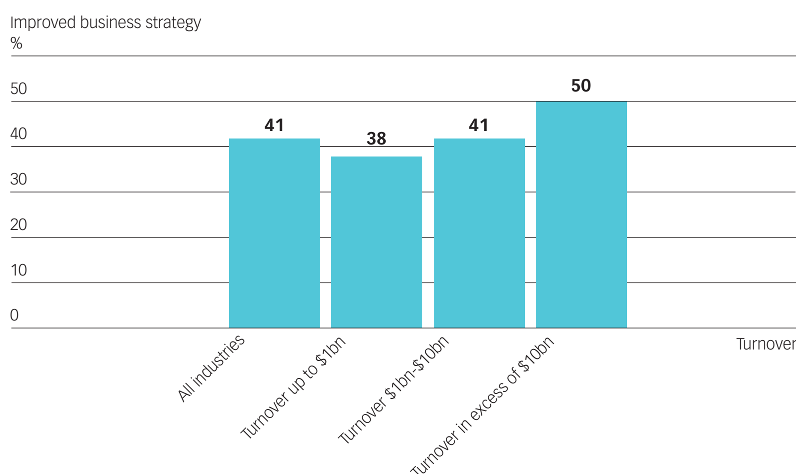
Source: Economist Intelligence Unit, 2005

FEW, ESPECIALLY SMALL COMPANY BOARDS, SEE A LINK BETWEEN RISK MANAGEMENT AND CORPORATE REPUTATION

Nor do boards, particularly those of smaller companies, see a clear link between risk management and corporate reputation. Fewer than one-third of respondents said that their company would invest in a risk management rating from a recognised agency, although this proportion jumps to more than one-half for firms with a turnover of more than $10bn a year. It suggests too that they do not see a link between risk management and cost of capital: although such ratings are unlikely on their own to lead to a reduction in a company's borrowing costs, they may well contribute to one.

The link between risk management and a successful business strategy also remains tenuous, according to a majority of the survey respondents. Only 40% of those questioned cited an improved business strategy as one of the things resulting from their board taking greater responsibility for risk management.

Which of the following have resulted from your board taking greater responsibility for risk management?



Source: Economist Intelligence Unit, 2005

FEWER THAN ONE IN THREE RESPONDENTS SAID THEIR COMPANY WOULD INVEST IN A RISK MANAGEMENT RATING FROM A RECOGNISED AGENCY

One company that is increasingly conscious of the relationship between risk management and performance is Rolls-Royce, a UK manufacturer of aero engines and other power units. "Most businessmen would regard managing risk as part of the day job. It is how you manage it while reaching your business objectives that is important," says Mark Wilford, the company's director of risk. Like other firms that have built up technical expertise over generations, Rolls-Royce prides itself on the way it manages projects to develop new technology. Risks are identified and assessed from the moment that an engineer sets down a new idea to the point when the completed engine is delivered to the customer. Careful planning is second nature to a company with Rolls-Royce's heritage.

The difference now is that the board is extending this expertise to all areas of its business. Each division is still responsible for identifying the risks it faces but the results are all assessed by Wilford and his team. And the process is as much bottom up, as it is imposed from the top down. "We need to know how our various risks break down, what the levers that drive them are, and what action we are taking to reduce the risk to an acceptable level. We need to have a feeling for our exposure across a range of risks," points out Wilford. The result: no major project is given the go-ahead unless the board deems the risks to be appropriate.

Rolls-Royce's board is fed information on risk in two main ways: through the company's audit committee, which is made up of non-executive directors and is responsible, among other things, for assessing the firm's internal controls and for identifying all forms of risk; and through the company's risk committee, which reports directly to the board of directors. Straddling the two is Wilford, who is a member of both committees. "My job is not to reduce the level of risk per se," he explains. "There is a level of risk that the company must take in order to make a return on its investment. Rather, my job is to make sure that the organisation is aware of the risks it is taking and that the board is advised on how to respond."

The same is true of Novo Nordisk, a Danish healthcare company and a world leader in the care of diabetes. During the past few years the company has developed a system that maps out the top ten risks facing it. Each quarter these are presented to the board, says Kim Bundgaard, the company's head of finance and corporate governance. Each risk is assessed for the probability that it will disrupt the company's ability to meet its objectives.

As a pharmaceuticals group, the company's board monitors risks not just to its pipeline of new drugs or treatments. It assesses whether it has enough capacity to meet demand, any new competition that might be emerging, as well as such things as foreign-exchange risks. A specialist team under Bundgaard, who has a direct line to the board, has the power to investigate any risk anywhere in the company that it considers material.

SKILLS IN DEMAND

As risks proliferate, it would be surprising if companies did not search for new ways of quantifying them. Industries learn from each other. Just as industrial firms are beginning to embrace the concept of value at risk pioneered by banks and financial services companies, so banks themselves are taking up what is known as the Monte Carlo simulation, long applied in engineering, to help quantify their own risks. The Monte Carlo simulation can combine thousands, sometimes millions, of scenarios, each weighted for its probability, into a single result. Since most banks make money from taking risks of one sort or another, an increasing number are beginning to use such techniques when calculating the numbers that point to their own value at risk.

RISK MODELS CAN BECOME 'BLACK BOXES' HIDING THE COMPLEX REALITY FROM BOARD MEMBERS WITH LIMITED TECHNICAL UNDERSTANDING OF RISK ISSUES

Is there a danger, however, that the increasing use of sophisticated models will divert the directors of companies from the real risks facing them? Didier Cosin, UBS professor of banking at IMD in Lausanne, thinks so. He warns: "Risk models can become 'black boxes' hiding the complex reality from board members with limited technical understanding of risk issues." Moody's has raised similar fears. Indeed, only 8% of respondents to our survey answered that technical risk management was an area in which the directors of their companies had received most training, despite 30% believing that such skills are necessary to manage risk effectively. Rather more (18%) reported that their boards had been trained in how to implement risk management across their organisation. However, by contrast, 47% said that their directors had received training on the finer points of corporate governance and their responsibilities to shareholders.

In which of the following areas have your board members received the most training?

	All industries	Turnover up to $1bn	Turnover £1bn-$10bn	Turnover in excess of $10bn
Corporate governance and board responsibilities.	47%	42%	57%	70%
Ensuring business continuity	34%	33%	33%	40%
Monitoring and identifying emergent risks	28%	25%	33%	30%
Extending risk principles into the wider business strategy	28%	26%	30%	30%
Implementing a risk management policy across the organisation	18%	15%	22%	20%
Developing alternative risk strategies	13%	13%	11%	20%
Communicating risk management policies to the workforce	12%	11%	11%	20%
Evaluating insurance coverage	11%	11%	11%	10%
Technical risk management skills (eg, risk measurement, risk modelling)	8%	7%	7%	20%

Source: Economist Intelligence Unit, 2005

RESPONDENTS VALUE INDEPENDENT SOURCES OF RISK ADVICE

CORPORATE BOARDS BELIEVE THAT THE INSURANCE INDUSTRY IS THE BEST SOURCE OF ADVICE ON RISK MANAGEMENT ISSUES

QUANTS NEED NOT APPLY

It is notoriously difficult to prove that introducing a structured system of risk management actually reduces the cost of capital. How a company deals with risk is only one of a number of issues – such as the strength of its balance sheet or, say, the durability of its strategy – that, until now, credit-rating agencies have taken into account when assigning a rating. In future, companies could find their risk management under much closer scrutiny.

One rating agency has already decided specifically to assess how companies manage the risks they face. Starting with the world's largest financial institutions and big international companies exposed to financial, commodity or energy risk, the agency has begun to test firms' appetite for risk and their capacity to control it.

Moody's analysts plan to probe whether, for example, a company's senior managers know how much they are prepared to lose from all sources of risk over a given period; whether they know where their biggest exposures are (in terms of both measured risk and plain uncertainty); and how these exposures break down.

The agency will examine, among other things, the rigour of the risk management process, whether or not senior managers are buying in to it, how appropriate the adopted framework is for the company's mix of businesses, and, importantly, how competent the managers are at interpreting the results.

Analysts are unlikely to be impressed by logarithms and metrics alone. "Given the uniqueness of events putting firms in peril, we emphasise the use of a variety of measures instead of excessive reliance on standardised models such as value at risk for market risk, for example," says the agency. Hint to directors of big companies: a black box alone is unlikely to win the day, particularly if too many of the firms' managers don't understand what it is telling them.

Indeed, suggesting a lack of confidence in their own ability to assess the risks they face, the survey respondents (especially smaller organisations) place considerable value on independent sources of risk advice. When asked whom their board turns to for advice on risk, 38% of respondents cited their insurers, only marginally fewer than the 40% that rely on internal risk management personnel. Strikingly, 29% of those questioned cited regulators as a main source of advice compared with just 26% who seek advice from specialised risk consultants (although this proportion does rise to 60% among companies with a turnover in excess of $10bn).

From where does your board currently receive advice on risk management and where do you think your board should receive advice on risk management from?

	Currently receive	Should receive
Internal risk management personnel	40%	48%
Insurers	38%	50%
Regulators	29%	35%
Trade associations	28%	37%
Risk consultants	26%	47%
Chief risk officer	22%	39%
Government	19%	34%
None	10%	0%
Other	12%	8%

Source: Economist Intelligence Unit, 2005

CARE NEEDS TO BE TAKEN NOT TO ADOPT RISK MANAGEMENT SYSTEMS THAT FAIL TO GROW WITH THE COMPANY

Corporate boards believe that the insurance industry is the best source of advice on risk management issues. While they currently rely most on internal expertise, 50% of the organisations surveyed believe that they should be receiving advice from insurers, and a further 47% from risk consultants such as brokers and other specialists. While this represents a vote of confidence in the insurance industry, it also suggests a potential lack of understanding about insurance's real scope. "It is only one of a range of risk management tools which boards should be using," according to Julian James of Lloyd's.

Whatever advice they take, boards should be careful not to adopt integrated systems of risk management that fail to grow with them. They must also be aware that no single model of risk management fits all industries, let alone all firms, and that they need to devise one that is flexible and well suited to their particular business.

CONCLUSION: STILL NOT SERIOUS ENOUGH ABOUT RISK?

Today's global business leaders know that the chances and potential cost of a risk management failure or 'near miss' in their organisation are too high, and they are devoting much more time to formal risk management now than they did three years ago, and are assessing a wider range of threats. Nevertheless, competition with other business priorities presents a real obstacle to embedding risk management throughout organisations.

The fact that boards are only slowly becoming conscious of the connection between good risk management, better financial performance and stronger corporate reputation suggests that they need to focus more closely on the wider benefits of fully integrating risk management into corporate decision-making, and on the tools available to facilitate this process. Until they begin to do so, risk management is likely to continue to be seen by senior management as a constraint on their business rather than as a source of competitiveness.

Since merchants first met to insure their ships at Edward Lloyd's coffee shop over 300 years ago, nearly every aspect of the way we do business has changed. But one constant is the bold confidence proclaimed by our motto, reflected in both our unique appetite for risk and our worldwide reputation for settling valid claims.

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