

ERM and beyond

Martin Metcalf of **Strategic Thought Group** explains that, in tough financial times, shared business intelligence has become hard currency and software an agent for change. Leading edge companies and government agencies are, he says, recognising that knowledge shared through software really is power.

I've argued in earlier editions of *Excellence in Leadership* that the future of risk is about risk and reward – about business performance and innovation with resilience. I also suggested that the purpose of enterprise risk management (ERM) is to increase the chances of beating the earnings forecast.

In today's complex world, knowledge shared is power. Transparency matters, because it translates into greater certainty. ERM can deliver this transparency by creating a "true picture" of risk and reward throughout the entire organisation. Yet, just as ERM is becoming a mainstream boardroom topic, our experience, working with many of the world's most advanced companies, is that ERM theory and practice must be extended further still.

ERM in theory and practice

The ERM idea is not new – it emerged more than ten years ago. It has been rightly seen as an answer to the pressing strategic challenges of the age – albeit through carefully prioritised stepping-stones, tailored to specific, unique, corporate objectives.

Yet now, amid extreme credit conditions, there are new challenges. Delivering sustainable liquidity is one. ERM and risk transparency techniques can improve cashflow by reducing insurance costs; safely taking out duplicated contingency provisions; or by risk transfer between partners and customers on major projects.

There are two problems with conventional views of ERM. First, business models have fundamentally changed since it was first conceived. Second, until recently, methods for identifying exposures and opportunities and acting on them have not kept pace.

The business model problem is that organisations are working in entirely new ways. The expression "enterprise" is outdated because it is too inward looking. Businesses are not islands. The reality is that all organisations are part of complex networks

that are the source of resilience, optimisation and efficiency, but also the root of stress and systemic risk. Even before the recent financial markets crash, several studies illustrated that more than 60% of risks associated with lost value through earnings shortfalls were directly linked to the 'external' world – the world outside the organisation's boundaries. The crash has shown vividly that the vulnerability of these networks has been underestimated. Supplier networks, hit by credit squeezes and failures in routine trade finance, are proving to be particularly exposed.

'Shared knowledge gives the power to reduce uncertainty and in turn minimise cashflow volatility.'

In this new environment, information, trust-based knowledge sharing and communication around organisational boundaries are more critical than ever. Risks must be identified, made explicit and actions taken against them by engaging stakeholders in new ways.

This is what leading edge thinking around risk is about: it is no longer focused solely on internally focused enterprise risk, but also on what we now call networked ERM.

Networked solutions

The second, associated problem is that, to many, ERM and the more controls-oriented governance risk and compliance (GRC) have remained theories, ideas that have seen limited application in practice.

The reason is that, until relatively recently, the software applications to deliver the necessary framework and tools for intelligence gathering, information-sharing, codification and analysis, have lacked the combination of



ease of use and sophistication necessary to gain widespread acceptance.

All this has changed. Powerful software makes networked ERM possible. Results can be delivered quickly. Without the right software, no amount of expensive and time-consuming business process design, or disconnected organisational change, can deliver the networked ERM vision.

Software is the cultural change agent. Leading edge companies and government agencies are recognising that, in a complex world, knowledge shared through software really is power. Perhaps, above all, shared knowledge gives the power to reduce uncertainty and so in turn future cashflow volatility.

In an age of extreme change, networked ERM software can capture risk and reward information not in terms of conventional introspective and hierarchical structures, or linear supply chains, but in terms of complex supply and demand ecosystems.

In this sense, networked ERM is about acting on shared business intelligence. The prize – now within our grasp – is better, more predictable earnings performance. Software can enable transparency and intelligence sharing to balance risk, reward, and, in the reign of the cash kings, the liquidity management required for growth in a volatile world. ■

Further information

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