

Ignore **strategic risk** at your peril

Companies that disregard strategic risk are gambling with their long-term survival, says Gillian Lees, Governance Specialist at CIMA. She explains how the CIMA Strategic Scorecard™ can help boards efficiently manage strategic risk.

If organisations wish to ensure their long-term survival, not to mention success, they need to understand and manage strategic risk. And although many organisations have made considerable progress in addressing operational and financial risks in recent years, few have tackled strategic risks.

Evidence suggests that strategic risks have a much greater impact on shareholder value than operational or financial risks – sometimes resulting in the complete destruction of the organisation. Not only this, but the increasing pace of

change, coupled with globalisation, means that strategic risks are becoming a serious challenge for all organisations. In 'Countering the biggest risk of all', published in the *Harvard Business Review* in April 2005, Adrian Slywotzky and John Drzik point out that over the last 20 years the number of stocks receiving a high-quality rating by Standard & Poor's has fallen dramatically. They also show that between 1993 and 2003 more than one third of Fortune 1,000 companies lost at least 60% of their value in a single year. However, organisations, and in particular, their boards, can now address strategic

risks by using the CIMA Strategic Scorecard. This is a tool that CIMA has developed to help boards from organisations of all sizes and across all sectors to engage in strategy effectively rather than getting bogged down in detail and/or compliance issues.

Tackling complex risk

In general, a strategic risk can be defined as any occurrence that would prevent the organisation from achieving its goals. It can be difficult to identify such risks, as they can come from any direction at any time (see Table 1, right). It can be difficult



to categorise these risks because they tend to be multifaceted, resulting from a combination of circumstances and events.

Difficult as it can be to identify strategic risks, this is actually the easiest part of the process. It is tempting to believe that once such risks have been identified, assessed and listed on the risk register, the job is done. But in fact, it is only the start.

The real challenge is for boards to discuss strategic risk as an integral part of their overall discussions on strategy on an ongoing basis. So, for example, no major initiative, such as a merger or acquisition, could be pursued without proper consideration of the strategic risks arising from such a proposal.

Strategic boards lead the way

A strategically minded board that engages effectively with management can make a significant contribution to long-term success. The challenge for management is to leverage the combined skills and experience of the board in an effective and efficient way.

However, this is easier said than done. Boards can struggle to make effective contributions to strategic development due to:

- **Lack of time and crowded agendas.** In recent years, boards have been obliged to devote considerable time and effort to compliance issues. Not surprisingly, some commentators have argued that the pendulum has swung too far and the importance of strategy and entrepreneurial leadership needs to be reasserted. Moreover, boards typically include a significant proportion of non-executive directors whose involvement is part time, making it difficult for them to obtain a deep enough understanding of the business to make a meaningful contribution.
- **Greater complexity of business combined with information overload.** This makes the job of the director even more challenging. Information that is poorly presented or presented in different formats at each meeting is difficult for board members to digest properly.
- **Lack of robust processes at board level for dealing with strategy.** This is in contrast to other issues for which the board is responsible, such as audit and remuneration where there are dedicated committees established to handle those particular issues.

If boards are to deal with strategic risks as an integral part of strategy, then a useful

first step is to ensure that there is a robust board process in place. One possible tool is the CIMA Strategic Scorecard.

A structured approach

The CIMA Strategic Scorecard is designed to help boards contribute to and oversee strategy effectively. Flexibility is provided by the fact that the scorecard is an overarching strategic framework within which a wide

milestones in relation to the chosen strategic plans to be implemented in the coming period and then tracking performance against these

- highlighting the strategic risks facing the board and moving these into manageable opportunities or mitigation plans.

The scorecard ensures that strategy is discussed at board level on a regular basis

Strategic risk categories	Examples
Industry shifts	The deregulation of airlines, combined with the availability of the internet, has affected the viability of tour operators and travel agents.
Technological changes	The shift towards digital photography and music downloading has impacted the business models of music and camera companies.
Customer changes	The polarisation of the clothing market between designer clothing (driven by celebrity culture) and discount brands has left the middle market exposed.
Project failures	<ul style="list-style-type: none"> • M&A • Failed product or service launches; for example, the Marks & Spencer home furnishings store in Gateshead
Competitors	Witness Tesco's relentless march into non-food lines, such as mobile phones, books and CDs.
Loss of reputation	The recent controversy over premium-rate phone competitions harmed one of the BBC's most cherished brands – the children's programme <i>Blue Peter</i> .

Table 1. Risk can come from unexpected developments, negatively affecting strategy.

'It is tempting to believe that once risks have been identified, assessed and listed on the risk register, the job is done. But in fact, it is only the start.'

range of strategic tools and techniques can be used. The framework can also be adapted to meet an organisation's particular needs.

The scorecard pinpoints the key aspects of strategy so that the board can focus on what really matters and ask constructive and challenging questions. It is unique in bringing all this information together into an integrated whole. This means:

- summarising key aspects of the strategic position to ensure that the board is aware of changing economic and other factors
- identifying the major strategic options that could have a material impact on the strategic direction of the organisation and helping the board to determine which should be implemented
- charting the significant steps or

and provides assurance of the organisation's strategic position and progress. It also helps the board deal with strategic choice, transformational change and their associated risks. In short, the board is able to engage in the strategic process in a meaningful way. As one board member who has been involved in a trial of the scorecard told us: 'We have discussed more strategy than we ever have before at a board meetings and we have made more decisions.'

While the scorecard was designed as a tool for board-level use, management can also benefit from using it. In particular, the discipline of preparing and updating the scorecard helps management focus on the key strategic issues. In addition, it helps the management team discuss and refine its proposals on strategy before presenting it to

the board. In other words, it acts as a useful prompt to iron out all the glitches.

Because the quality of the information presented to the board is improved, the level and quality of the discussion on strategy is enhanced. The scorecard improves relations between the board and management, which can lead to better governance and performance. For example, one executive director says: 'We have had a great discussion with the board and I feel that they are totally supportive of our strategy. This process has brought us closer together.' Put simply, engaging the board at a number of levels leads to better discussion and makes risks easier to handle. (See box, right, for an overview of the scorecard's four dimensions.)

The scorecard in practice

When presented to the board, the scorecard is set out in the form of four tables, with relevant headings for each dimension. These can be modified to suit the individual organisation and prompt management to describe the activity in question, including when the last information was put to the board and when new information will be presented in future.

The board then determines which issues and activities are to be included. This enables it to ask challenging questions and decide whether action needs to be taken and/or whether it needs to explore a specific issue in more depth – perhaps by referring to the supporting analysis that management will have used to undertake the detailed strategic planning and management. So in effect, each dimension is supported by a variety of tools and techniques, and organisations can pick and choose what works best for them.

An additional item is a simple summary of all the issues covered in each dimension. This may sound basic, but it provides a snapshot of all the major issues and challenges facing the organisation, which is very useful to incoming non-executive directors who need to understand the business very quickly (see Table 2, right).

The full scorecard would be presented to the board on a quarterly or biannual basis, although specific components may be reviewed more frequently. For example, a particular strategic option may be considered at a number of meetings until specific actions are agreed. The guiding principle is that strategy needs to be included on the board agenda at a frequency and level that will keep pace with change and support delivery.

The four dimensions of the scorecard

1. Strategic position

This dimension focuses on the information required to assess the organisation's current and future position. It covers externally focused information, such as economic, political and regulatory developments, market share and internal issues, such as competencies and resources. The board would review the information and consider its implications.

2. Strategic options

The focus now shifts towards decision-making. Strategic options can be defined as those with the greatest potential for creating or destroying stakeholder value. Typically, there would be no more than four or five under consideration at any one time. The board would discuss a range of options and decide which should be developed into formal business plans.

3. Strategic implementation

At this point, the emphasis is on identifying milestones and monitoring strategy implementation. Decisions may be required if things are not proceeding as planned. It is important that the board does not get too immersed in the details. The board can really add value by generating strategic options and understanding strategic risks. It is important that all the work undertaken here supports the successful delivery of the strategy, as the best analysis and ideas will count for nothing if the strategy is not well executed.

4. Strategic risks

This dimension underpins the others by focusing specifically on the strategic risks that pose the greatest threat to the organisation's strategy. Other issues that need to be tackled here include determining the organisation's risk appetite and implementing effective risk management polices and processes.

Strategic position	Strategic options
List all the key issues, such as: <ul style="list-style-type: none"> • competitor activity • legislative developments • core competencies. 	List all the options, including: <ul style="list-style-type: none"> • divestment of major business • outsourcing major processes • development of major new service offering • development of alternative delivery channel.
Strategic implementation	Strategic risks
List all key actions: <ul style="list-style-type: none"> • introduction of new product • integration of recent acquisition • major reorganisation of business units. 	List all major process issues and strategic risks: <ul style="list-style-type: none"> • risk appetite • risk management capabilities • risk management policies • strategic risks.

Table 2. The CIMA Strategic Scorecard™ highlights the key strategic issues.

The strategic risk dimension in detail

The CIMA Strategic Scorecard provides a useful framework for integrating strategic risk into the overall context of strategy, ensuring that strategy is dealt with effectively.

There are three key components to strategic risk management.

- **Risk appetite.** This covers an organisation's propensity to take risk. Every organisation has a risk appetite, regardless of whether it is aware of it or not. Determining the risk appetite is a key strategic task, as it provides an overall context for the strategy.

- **Strategic risks and opportunities.** This includes the nature of the risks and opportunities facing the organisation, the likelihood of their occurrence and potential for exploitation, and the organisation's ability to manage risks. To a large extent, these need to be considered in respect of each of the other three dimensions, but the strategic risk dimension provides a useful check and balance to ensure that this is actually happening.
- **Process issues.** This includes risk monitoring processes, risk identification and prioritisation, how risks are actually managed within the organisation, training

issues, stress testing and whether any risks are currently materialising.

The strategic risk dimension could be regarded as encompassing or driving the other three dimensions, for example:

- a major motor company has considered repositioning the strategic risk dimension so that it is the first to be considered in the sequence
- an alternative approach, suggested by a major media company, is to view the strategic risks dimension as the 'strategy for risk' and add what it has termed the 'risk wrapper' to the entire scorecard with suggested interventions for each of the dimensions. This makes for a powerful and integrated strategic risk management tool.

What really matters is that the board spends adequate time on all three components of strategic risk and that risk management is fully embedded in the overall strategy. Best practice is intelligent risk taking combined with formalised risk management.

In terms of preparing the strategic risks table of the CIMA Strategic Scorecard, management has to decide which process issues need to be included. Risk appetite should certainly be included, but it may also be useful to include management capabilities, policies and methodologies. The strategic risks themselves also need to be covered; although many will have been identified in each of the other three dimensions, the board will need assurance that this has indeed been done and that these risks are being managed effectively.

There may be other general risks that do not relate to specific strategies, but would still affect the organisation's ability to achieve its strategy. These can be picked up here as well and perhaps delegated to operational management, reserving the strategic considerations for the board as part of the scorecard process.

At this point, the board has the opportunity to review the structure and content of this part of the scorecard. As part of its discussion, it could consider the following.

- Have we determined the risk appetite?
- Are there any gaps in risk management capabilities and how do we close them?
- Have all the risks been identified in relation to the actual (strategic implementation) and potential strategy (strategic position/options)? Are the

CIMA Strategic Scorecard: just another initiative?

CIMA's experience shows that the process of pulling together and using a scorecard is not unduly onerous when it ties in with an organisation's existing planning schedules. More often than not, the process consists of gathering information that already exists. This helps identify gaps in knowledge and analysis, as it shows all the key strategic information. Once the scorecard is up and running, boards quickly start to see benefits in terms of better use of their time, and it is easy to keep the scorecard updated.



- proposed risk responses appropriate?
- Have any of the identified risks materialised? What is actually being done and is this response effective?
- What is the organisation's risk management framework? Is it fit for purpose?

Basically, the scorecard facilitates board discussion by providing a simple framework. In this way, strategic risk can be embedded in the overall discussion on strategy and becomes a regular feature of the board agenda.

Current developments

Since boards need to take sufficient time to deal with strategic risk and best practice is intelligent risk taking with formalised risk management, a vital question is how the scorecard can support the integration of strategic risk into overall strategic development.

CIMA is undertaking trials with a number of organisations and gathering insights from others that have adopted scorecard principles. The results will be published at a later date.

It is essential for boards to take an active role in strategy development and strategic risk mitigation to safeguard the survival and success of their companies. Focusing on such issues in a structured manner is also an efficient way for boards and management to

gain an overview of their total strategic plans and work together towards implementation. No company can afford to ignore the risks that could obstruct its long-term goals. ■

This article is based on CIMA's recent executive report, *The CIMA Strategic Scorecard™ – boards engaging in strategy*, which can be downloaded from www.cimaglobal.com/strategicscorecard. A separate executive summary is also available.

Gillian Lees

Gillian Lees MA is a Governance Specialist within the Technical Department of CIMA. She has been working on corporate governance issues for nearly ten years and has been a key player in the CIMA/IFAC Enterprise Governance project.



She co-wrote *Corporate Governance – history, practice and future*, which was published by CIMA in 2000, and has contributed to various publications, including *Financial Management*, *Corporate Governance International* and the *Financial Times*. She has a background in the City, having worked for NatWest Bank and the Bank of England.