ERM Culture Alignment to Enhance Competitive Advantage

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2012 Enterprise Risk Management Symposium
April 18-20, 2012

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13 January 2012

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Abstract

The paper discusses the arguments supporting the need for risk culture to transition into ERM culture to be embedded across financial organizations. Creating and maintaining strong ERM culture is paramount to a lasting and meaningful ERM program. It is essential for organizations to understand what ERM culture is, how it gets established and in what way affects the process of ERM implementation. Often, the implications of financial enterprises not focusing on the significance of ERM culture manifested in severely compromised ability to generate sustainable value and market competitive advantage. This paper calls for rethinking the role of ERM culture in the context of managing risks.

Keywords: enterprise risk management (ERM), ERM implementation, ERM culture, competitive advantage, sustainable value, strategic alignment

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Section I Introduction

Shifting economic conditions, technological advances, emerging markets, geopolitical threats and changing regulatory environments have compelled organizations to turn to enterprise risk management (ERM).

ERM has evolved from risk management and is still perceived to need further development, particularly in regard to restructuring risk culture into ERM culture. As ERM matures, many organizations still need to distinguish between risk and ERM cultures and learn to embed the new approach in the organization.

The method can enable organizations to mitigate the impact of negative risks and identify opportunities for calculated risk taking. It has therefore sparked initial interest because of its value-generating potential. As organizations became more exposed to increased market volatility and unpredictability, continuous development of ERM has directly aligned it with its cultural element, which extends enterprisewide and is necessary for generating the high reliability and predictability in business results that enhance stakeholder confidence and build consistent value.

Consequently, ERM demonstrates a lasting value through sustainability and the competitive advantage it provides to the organization. Sustainability comes through the consistency of employees demonstrating the same behaviors and sharing the same corporate values in managing risk. Behaviors and shared values build an organizational ERM culture that enhances and maintains the positive impact of ERM.

The relatively new concept of ERM culture understanding it, confronting the challenges it brings and facilitating the cultural change to achieve acceptance across the organization has not yet been adequately researched and is the key topic of this paper.

Section II ERM Culture

The need for a strong ERM culture emerged from the shifting role of ERM—from being a specific type of risk management handled by a small department or specialized group to being a process of guiding the achievement of strategic objectives.

ERM is a recognized process that generates value. While ERM can protect organizations from the impact of negative risks, uncover opportunities for calculated risk taking and enhance the perception of stakeholders, it also can, when executed with consistency, create sustainable value. Consistency is essential for ensuring that ERM maintains its impact on the operations of the organization. Consistency occurs when the employees of the organization carry the same values and demonstrate the same behaviors that show reliable and predictable results. This consistency is the backbone of ERM culture. ERM culture, as a product of employees working together and sharing the same values and displaying the same behaviors, establishes the sustainability of an ERM program.

With the establishment of an ERM definition by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 2004, ERM became recognized as a process “applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” ERM surfaced as a course of continuous efforts that required the collaboration of departments, teams and functions across the entire organization. Through the recent involvement of departments, teams and functions not traditionally associated with risk management practices, new perspectives have come into the process of ERM and, with such integration of human capital, organizational cultures regarding the treatment of ERM emerged.

The COSO (2004) definition mentions human interactions that would influence the impact of ERM in organizations.

- ERM is “effected by an entity’s board of directors, management and other personnel.” This specifies the role of stakeholders across the organization making decisions and taking action on ERM. Opinions, perspectives, organizational politics and other human factors would influence the success of ERM. By this definition, ERM cannot be put into a “silo” but it must be influenced by multiple groups of stakeholders as it is used not only to protect the organization from loss but to preserve and enhance shareholder value (Branson 2010).
- ERM is “applied in strategy setting.” This specifies that ERM can be used as part of a procedure in enabling the organization to achieve its objectives and gain an advantage over competitors. This involves an agreement among stakeholders to make ERM a part of the strategy and to take action in using it as a means to enhance the customer perspective of the organization, market share and stakeholder confidence.

The prevalence of decision making and perspective sharing in driving ERM reveals the presence of underlying human forces influencing the management of risk. While the COSO definition of ERM opened the discussion for ERM to be integrated into organizational strategic plans in the years immediately following the issuance of this definition, a necessity remained to address the human forces that impacted the day-to-day operations which make strategy execution a reality. The day-to-day operations of strategy execution involve decisions and actions taken at all levels of the organization. Business decisions and actions regarding risk are shaped by a system of values and behaviors present throughout an organization. These values and behaviors can be demonstrated by individuals or groups within the organization (IIF 2009). Farrell and Hoon (2010) emphasize culture as being the product of shared values and behaviors. Culture is a value, in the context of ERM, that has an impact on business decisions (Brooks 2010) and determines the way in which the organization identifies, understands, discusses and acts on the risks it faces and the risks it takes (IIF 2009). ERM culture affects the decisions of management and employees whether or not they are consciously weighing benefits and costs (Farrell and Hoon 2009).

Culture, as argued by Brooks (2010), is not an intangible concept but one that can be measured. The strength of risk culture can be determined by the level of consistency that decisions over risk have with policies and the desired risk profile of the organization (Brooks 2010). Within decision making, there is an active consideration of potential rewards and losses in taking and avoiding risks. This consideration enables the decision makers to choose decisions that will align the best with the policies and desired risk profile of the organization, which, ultimately, based on Brooks' assessment, contributes to risk culture strength.

There are elements, consistent with organizational policies and the desired risk profile, that signify a strong risk culture within an organization:

- Committed executive leadership and senior managers that model the ERM culture they wish to see in the organization (IIF 2009)
- Incentives that reward risk awareness among departments, teams and employees to establish enterprisewide thinking (Buehler, Freeman and Hulme 2008)
- Information sharing and communication among departments and teams
- Learning opportunities for employees

Just as strength within an ERM culture can be noticed, weaknesses within an ERM culture can also be identified. ERM culture shows a lack of strength when decisions run counter to the organizational policies and the desired risk profile (Brooks 2010). This signifies the absence of a type of consistency typically found in the behaviors and values that shape a culture. The consistency necessary for an ERM culture can be undermined by competing interests. Brooks (2010) gives the following example of how considerations of risk get removed by other interests of stakeholders.

> It may occur at the top of an organization if an acquisition is being considered, and considerations of risk fall victim to the ego of the participants. They may be put aside because the participants in the transaction have "fallen in love with the deal," and cannot bear the thought of backing out of the transaction given the work that has been put into it and the potential benefits of the transaction. ... Rewards may also incent this type of behavior. These may be tangible rewards—bonuses and salary increases—or they may be intangible because the participants in successful transactions are those recognized in the organization, given higher profiles and promotions.

This example demonstrates how competing interests can ruin the consistency needed for developing the strength of a risk culture. Participants in the transaction focused on the benefits and the overall attractiveness of the deal instead of considering how the transaction would enhance or erode the risk portfolio the organization wishes to have.

However, organizations that do not possess an ERM culture fail to reap the benefits of a functional ERM program. Because ERM culture is a product of shared values and behaviors, it is based on establishing predictability and high reliability in executing processes for managing risks. When there is no ERM culture, business units are not working together in managing risks and achieving strategic objectives; they are working in silos. Low reliability and a lack of consistency in the execution of risk management processes are the result of business units practicing ERM in silos. They also signify the absence of quality in an ERM program and result in processes for managing risks to be repeated, which translates into additional costs in staff time and dedicated resources. When reliability and consistency are at low levels, a mixed message is communicated to staff on how the organization values ERM. This can negatively impact the perception of employees and diminish the support necessary for a global execution of ERM throughout the organization.

To identify its own ERM culture and determine its strength, an organization has to ask some introspective questions about how it values ERM.

- What are the shared values, beliefs and behaviors related to ERM in the organization?
- How are the organization’s policies regarding risk management considered in decision making?
- How is the organization’s risk tolerance or risk portfolio considered in decision making?
- How are employees rewarded for demonstrating organizational risk awareness?
- How are the board of directors, executives and managers engaged in the risk management of the organization? Why does this level of engagement exist?
- How open is the information sharing and communication between departments and teams in the organization?
- How is the condition of the learning environment for employees to apply ERM to their day-to-day jobs?

The alignment and cooperation of stakeholders throughout the organization are needed for the execution of strategy and building a sustainable competitive advantage. When employees share the same values and display the same behaviors in managing risk, consistency in the execution of ERM and business results are ensured. Consistency minimizes the costs associated with ERM because it prevents processes from being redone and it gives stakeholders the assurance of how the organization approaches its risk portfolio.

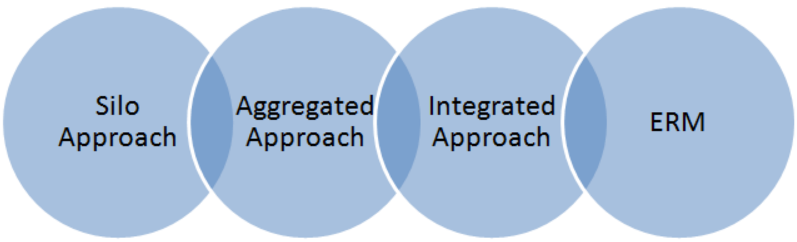
Section III Practical Examples and Literature Gaps

The concept of risk culture has been in the spotlight recently with the growing management realization that the financial collapses of many organizations originated from a flawed or nonexistent risk culture. Historically, most literature references on risk culture were made in connection to negative risk events, organizational failures and a spectrum of catastrophic occurrences (Aon 2010). The definition of risk culture had been formulated inadequately with key aspects remaining undetermined (Cooper 2011). A fragmented view on organizational culture and management's misperception of its complexity has undermined culture's role and importance in ERM implementation. Risk culture gaps can open organizations to vulnerability in the areas where key risks are being overlooked; leaving management exposed to unexpected future (loss) events. Organizations that foster self-reinforcing behaviors and build new mindsets create an intangible culture that can accelerate high business performance. Moreover, lack of solid risk culture can diminish an organization's ability to achieve business objectives, crippling business performance and weakening market competitiveness (Rossiter 2001).

Creating a strong ERM culture is a prerequisite for a sustainable and value-adding ERM. As a consequence, a lot of efforts were focused on conducting extensive surveys to analyze the flaws of existing risk management practices, corporate governance, management leadership and risk culture. Risk management culture was also the top priority at Deloitte's Directors Forum in 2011. Culture was identified as critical for building a risk intelligent organization where everyone takes responsibility for risk management and "minds the business" to protect and create value (Deloitte 2011).

While conveying an industry outlook onto risk culture, multiple surveys deliver a strong and uniform message to corporate management indicating significant culture deficiencies. The Enterprise Risk Management Survey (RMA 2006) highlighted that most organizations measure the effectiveness of ERM in the context of regulatory compliance with the expectation of enhancing shareholder value. The study highlighted the four most common ERM maturity stages, each influencing ERM culture distinctly (Figure 1). Risk culture formed within one of the distinctive risk management environments will have different dominating features and develop in a unique way.

Figure 1 Maturity of ERM Approaches



Source: Originated by the authors

Of the respondents, 48.4 percent respondents saw the ability to set a common risk culture, establish common risk language, and understand risk appetite as a potential benefit of ERM implementation benefits. When asked if “culture openly encourages the reporting of risks and losses,” 32 percent “agreed,” while only 16 percent “strongly agreed.” In conclusion, ERM was still in the initial stages of implementation and was considered by the surveyed a reasonably new concept. There has been significant progress to develop ERM further supported by management buy-in, but most risk management focus revolved around the Sarbanes–Oxley Act of 2002 (SOX) and was not a priority outside credit and audit groups. Silo risk approach visibly dominated as the main risk management approach and prevented organizations from developing a strong enterprise risk culture (RMA 2006).

In a 2010 KPMG international survey, 48 percent of respondents identified risk culture as a primary contributor to the financial crisis. Even though risk culture has become a fundamental component of ERM, many organizations show significant deficiencies in this area (Farrell and Hoon 2009). More than 58 percent of surveyed corporate board members and internal auditors admitted that most personnel had little or no understanding of how risk exposures should be assessed for likelihood and impact. This indicates the leadership may not adequately foster the culture of continuous enterprise risk development for the employees. Additionally, employees should fully comprehend how well-informed risk decisions are made and ensure risk behaviors are consistently permeated within the organization. Without a strong ERM approach, establishing an enterprise risk culture becomes unachievable and may adversely affect decision making.

Aon’s “Enterprise Risk Management: The Full Picture” survey (2007) investigates three core elements of ERM: strategy, resources and culture. Almost 65 percent of respondents believe embedding risk management culture is a key ERM component, and 45 percent claimed culture was considered throughout an ERM implementation process. Many organizations stated that culture is still often ignored and not seen as a corporate priority. Aon’s cultural model was used in the survey to categorize four cultural types across various enterprises (Figure 2). Organizations leaning toward “performance-driven” culture focus on results and exhibit effective and timely risk response. “Administration-driven” cultures feature inconsistency and bespoke risk methodology. Conversely, “development-driven” frameworks promote unique risk-thinking approaches, and “intimacy-driven” structures, a solid risk understanding and the idea of collective participation. Risk culture depends on what cultural model is adopted by an organization (Aon 2007).

Figure 2 Aon's cultural model (2007)

Performance
- Risk response
- Direct results accomplishments

Administration
- Consistency
- Accurate risk methodology

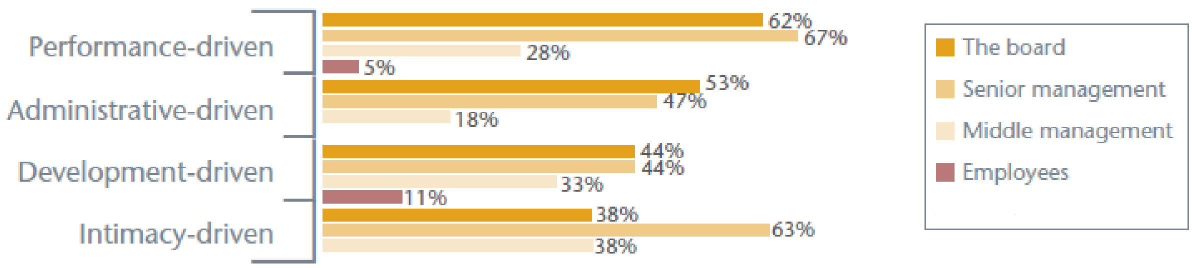
Development
- Out-of-the-box (risk) problem solving

Intimacy
- In-depth risk understanding
- Strong cooperation and participation enterprise-wide

Source: Originated by the authors

The 2007 Aon study also revealed that the risk management culture drives a better understanding of ERM and strategic objectives. For example, in performance-driven organizations and similarly in the intimacy-driven ones, board understanding of ERM objectives increases "significantly" by 62 percent while senior management understanding increases by 67 percent. This can be compared to the development-driven cultural profile where board and senior management support for ERM objectives has gone up only 44 percent (Figure 3). Surprisingly, the understanding of ERM objectives by employees has not increased significantly across all cultural types, which implicates there is still little enterprisewide involvement of personnel in the ERM implementation. The lack of employee engagement in ERM will most likely impede organizational ability to develop a comprehensive and effective ERM culture. Key findings of Aon's 2007 research show that only one in 10 organizations confirmed that ERM is embedded in the business process. One in four enterprises admitted that ERM had an impact on the enterprise's strategic planning process. Moreover, performance-driven cultures that are results-driven were most effective in implementing ERM and, therefore' establishing a strong baseline to develop a robust ERM culture.

Figure 3 Understanding of and support for ERM objectives



Source: Aon (2007)

More than 50 percent of the surveyed agreed that specific techniques were used to create a strong culture across the organizations. More than 70 percent of respondents in enterprises with a clearly defined ERM function favored policies and reviews endorsed by senior management and risk monitoring as efficient tools to create solid risk management culture. Almost 50 percent of respondents found stakeholder involvement useful and only 18 percent considered risk training programs effective. Accordingly, in organizations without the dedicated ERM function, only 46 percent of the surveyed deemed risk policies fostered by management meaningful enough. Almost 25 percent of the surveyed agreed that stakeholder engagement was relevant for culture development, and 11 percent saw risk programs in a favorable light (Aon 2007). The survey results emphasize that the importance of ERM culture is strongly associated with how organizations adopt ERM; organizations that developed resilient ERM have, therefore, an advantage in creating effective ERM culture. As a consequence, employees in organizations with established ERM show more trust and understanding of management's efforts to ingrain ERM culture into organizational structure.

Embedding ERM culture within a unique organizational structure may result in significantly different long-term results (Figure 4). More than 50 percent of employees in the performance-driven culture stated that key benefits were an enhanced shareholder value and meeting corporate objectives. For 40 percent of respondents in the administration-driven culture, creating a risk culture was a priority. In development-driven organizations, the focus is primarily on reducing the element of risk surprise and "fire-fighting" (nearly 70 percent of personnel). Enhanced shareholder value and reputation and minimized cost of risk were considered nearly equally important (close to 60 percent of all personnel). Key risk priorities in enterprises with intimacy-driven frameworks were identified as creating a risk culture and reducing a cost of risk. Disparity between ERM benefits resulting from a strong culture appear to be broad depending on the cultural risk framework implemented across an organization but can be utilized with equal effectiveness.

Figure 4 ERM Benefits by Cultural Type

% saying "very" or "fairly successful"	Performance-driven	Administrative-driven	Development-driven	Intimacy-driven
Enhance shareholder value	55%	29%	56%	25%
Engender risk culture	45%	41%	55%	50%
Meet corporate objectives	52%	24%	44%	25%
Enhance stakeholder reputation	42%	29%	56%	38%
Reduce fire-fighting	38%	24%	67%	25%
Facilitate change	40%	24%	33%	38%
Reduce cost of risk	30%	29%	56%	50%
Become established tool	42%	18%	11%	38%
Enhance customer service	40%	24%	22%	13%

Source: Aon (2007)

Another Aon survey, "Global ERM" (2010), performed in a highly uncertain economy during the third quarter of 2009, further demonstrates that regardless of some successful global ERM implementations and their effect on organizational ERM culture and stakeholders, there is still a great need for more development of both ERM and ERM culture (Aon 2010).

ERM culture as a critical ERM dimension can be perceived as a way employees feel about the organization; employees' attitudes toward risk will affect how an organization is managed. Integrated risk management, proposed by PWC (2009), presents some of the important features of an effective risk management culture (Figure 5) and addresses key insecurities of a change in risk management.

Figure 5 Effective risk culture and potential shortcomings

ERM Culture Alignment to Enhance Competitive Advantage

Source: Originated by the authors

The approach highlights key features of the effective risk management: 1) Leadership and Strategy, 2) Accountability and Reinforcement, 3) People and Communication, and 4) Risk Management and Infrastructure. Leadership promotes and integrates high ethical standards and ensures clear enterprisewide communication of business objectives. The accountability component warrants individual risk responsibility. The people and communication quadrant encompasses the need for growth of all employees and for the organizations to demonstrate the ability to share knowledge and promote continuous development. Lastly, the risk management quadrant depicts organizational capability in assessing, measuring and mitigating major risk exposures concentration. Those core attributes supported by set behaviors, specific knowledge and skills, and by appropriate infrastructure build on an integrated risk management framework and become a foundation for a corporate culture. Potential benefits of integrated risk management are enhanced risk awareness and a better understanding of what business and risk objectives are.

Followed by examples of cultural risk approaches practiced across the industries, this paper presents specific case studies on ERM culture illustrating key challenges and recommendations for further development relevant to this research (Table 1).

Table 1 ERM culture case studies

Organisation	Challenges	What was done? Results	Further Improvements and Recommendations
AZ Electronic Materials	➢ Reporting and process requirements ignited skepticism ➢ Focus on data collection instead of action dispersed management's attention ➢ Challenging Introduction (and integration) of risk culture to globally diverse business units ➢ Difficulties with cultural change and transitioning into the new risk approach ➢ Potential long-term benefits difficult to recognize and comprehend by employees	➢ Reprioritizing the importance of ERM and risk culture to protect the organization's mission and achieve better customer satisfaction ➢ Embedding ERM culture throughout the enterprise globally ➢ Initial Risk Assessment sessions received management support and adequate action responses **Results** ➢ Better understanding of corporate objectives and business continuity, customer needs and potential threats and opportunities to the business ➢ Improved quality controls ➢ Perception of strong competitive market image, stronger customer loyalty ➢ Better internal and external communication over potential business interruptions	➢ Focus on practical translation of risk analysis into risk action items (key threats and opportunities for the business) ➢ Continued integration of risk culture amid global environment, and achieve enterprisewide cultural uniformity ➢ Ensure logical understanding of both ERM and risk culture as extension of planning strategies ➢ Define explicit alignment of risk culture, competitive advantage and long-term suitability
Global Investment Bank	➢ New unit had a good ability to challenge each other's actions and ideas but a lack of cooperation and cohesion became main management concern ➢ Working toward reducing the visible disconnect in communication and daily operations between risk and business groups ➢ Minimizing the demographic divide between senior and junior employees, which hinders complete group integration	➢ Risk culture was re-assessed within sales and trading units recently integrated as a new unit ➢ Management aims to ensure a comprehensive integration of newly formed group though creating strong and consistent risk culture **Results** ➢ The existing risk culture needs to be rethought due to the gaps identified as a result of the internal survey ➢ Employees were unclear what the bank's risk tolerance meant ➢ The change of group's structure triggered unexpected behaviors and risk decisions	➢ Senior management should re-align the leadership team and encourage risk behaviors as a part of a robust risk culture ➢ Communicating risk tolerance enterprisewide should be changed; everyone in an organization should be able to understand and express clearly what risk tolerance is ➢ Increase transparency in making risk decisions and business involvement in setting risk appetite ➢ Rethink internal controls and processes to ensure effective approval mechanisms ➢ Reassess what value can be generated through risk culture
Global Professional Services	➢ Potential over-extending of junior staff was identified as an emerging concern ➢ Junior employees felt that senior colleagues did not appreciate "upward challenges" that in effect inflicted inhibition and lack of confidence to undertake challenges ➢ Employees expressed lack of clear guidelines and communication in terms of risk tolerance vs. appetite	➢ Current risk culture was assessed ➢ Management raised no specific cultural concerns to investigate but was keen on learning what can be improved ➢ Risk culture was considered "healthy" **Results** ➢ The study analysis revealed the risk culture can be considered "robust" especially regarding employees response to change and their caring about the quality of their work and the impact on the organization	➢ Senior and junior employees should work together to overcome disconnect and lack of integration ➢ Senior and more experienced staff should provide guidance to junior personnel to reinforce trust across the organization ➢ Comprehensive risk training for all employees (knowledge sharing, cross training) to clear away risk inconsistencies ➢ Restructured (more effective) annual planning process that incorporates key risks organization may face ➢ Re-align risk appetite and strategic business objectives
Financial Services	➢ Communication not consistent or the most effective enterprisewide ➢ Level of risk ownership and commitment was lacking and appeared to be disintegrated; employees felt like the risk ownership is primarily an element of risk management, not the business ➢ Lack of alignment between risk and business management magnified the view of risk as an inconvenience rather than a value-adding opportunity ➢ Lack of focus on adequate risk-adjusted incentives and compensation schemes discouraged effective managing risks, and diminishes risk morale in relation to positive recognition	➢ The state of existing risk culture was examined as a critical element of an effective risk management ➢ Internal risk survey was designed to gauge employees' attitudes toward the current risk management approach ➢ A baseline for development of risk culture was established on the survey analysis ➢ Bespoke workshops and discussions were organized within various stakeholders groups **Results** ➢ Employees value integrity and appreciate the organization appears to have a competitive advantage in the market driven by cultural change ➢ Risk change management has been perceived as well designed and implemented and communication was found effective bottom-up and top-down	➢ Effectively change management to engage with the new culture ➢ Robust information flow leading to informed business decisions ➢ Aligning compensation and risk-based performance to encourage effective risk management

Source: Originated by the authors

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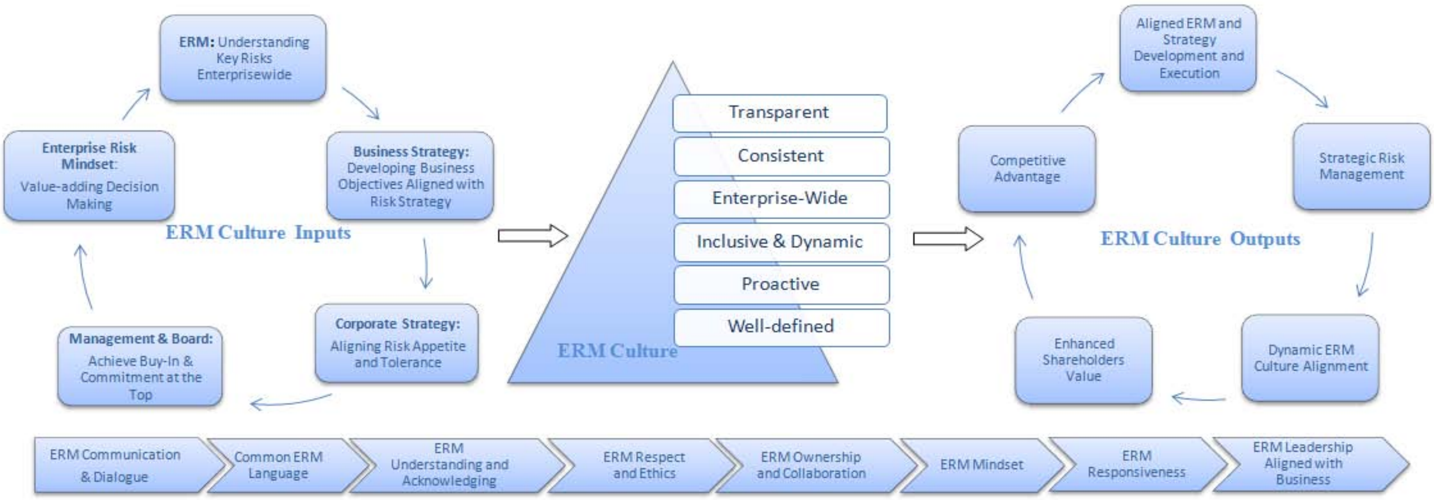
Analysis of the four case studies revealed competing views of ERM culture and what organizations did to achieve the end results, where they fell short and what future developmental recommendations might be. The surveys investigated in this paper formed a baseline for a new approach, ERM culture alignment (Figure 6), which addresses the shortcomings identified in the reviewed approaches.

Figure 6 ERM culture alignment



Source: Originated by the authors

The alignment approach consists of three key elements: ERM inputs that shape ERM culture attributes, ERM culture as a core of risk management structure and ERM outputs that influence the business results. ERM culture inputs focus on the elements critical to form an effective cultural ERM alignment. In all aspects, for business and corporate strategies to fold into an alignment with ERM strategy, enterprise risk awareness becomes essential. Among many organizations, main challenges for corporate leadership remain the same: to gain tacit understanding of what enterprisewide risk awareness means in business reality and how to align it with the business and corporate risk objectives. Corporate leaders often fail to focus on establishing a consistent and inclusive behavioral model that can reinforce intangible risk and business rules. Management attitudes should exemplify the ERM standards in the organization.

ERM culture alignment is introduced briefly in this paper as the authors continue to development the approach. It will be presented in more detail in a separate paper.

Section IV Driving an Effective ERM Culture

As demonstrated in previous sections of this paper, ERM culture is influenced by several factors. One of the most important factors is the involvement of leadership and employees at all levels in adopting, accepting and promoting ERM and ERM culture. While direct leadership engagement has immediate impact on corporate and business strategies, it also effectively leads to setting a clear organizational direction. While leveraging leadership involvement, enterprise risk management and strategy development should be aligned, thus becoming “two sides of the same coin.” ERM needs to be embedded in enterprisewide processes, policies and procedures, and implemented across all organization’s divisions, including strategic business units (SBUs). Consequently, ERM culture requires a synergy within the unique organizational culture.

A good example of an effective ERM approach and its focus on risk culture is found at Caterpillar Inc. The manufacturing firm adopted a unique ERM approach to the organizational structure, calling it business risk management (BRM), by setting the key objective: to identify, track and mitigate anything that would prevent the enterprise from achieving its long-term strategic objectives (Driscoll et al. 2011). To promote the BRM culture, Caterpillar developed a code of conduct statement called “Our Values in Action.” The code implies that they “see risk as something to be managed and as a potential opportunity” (Driscoll et al. 2011).

Other factors critical to developing an ERM culture include aligning ERM with corporate and business strategies and management buy-in. As senior management develops a strategic vision of the organization, the roadmap for corporate and business objectives is being established in parallel. Subsequently, business and risk objectives are defined in alignment with the warranted support from the management. Achieving management’s commitment to develop ERM and ERM culture is crucial throughout the entire process. An enterprise wide alignment of risk and strategies creates a foundation for effective ERM culture (Althonayan et al. 2011). The holistic alignment approach, developed as a result of earlier research, addresses the importance of linking ERM with the corporate and business strategies enterprise wide (ibid.). ERM as a core element of the holistic alignment approach links each business unit with the risk management enterprise wide and emphasizes the importance of a strong ERM culture as a prerequisite (ibid.).

According to Althonayan et al. (2011), “Comprehensive alignment of all three interconnected dimensions: ERM, corporate and business strategies aims to steer risk management initiatives and strategies in the same direction, therefore inspires improving organization’s ability to meet the strategic objectives. It aligns and prioritises key risks and strategies across the enterprise bringing organizational balance into the strategic equilibrium.”

Based on the conclusion of Aon’s 2007 research in Section III, organizational sustainability and creating a competitive advantage have been perceived as a significant step forward in organizational development by building a stronger and more dynamic risk culture. The result is a risk management culture that drives a better understanding of corporate and business objectives, robust talent management, enhanced cultural behaviors and adding shareholders value. Consequently, the presence of a robust ERM culture inspires collaborative efforts to achieve minimized total cost of risk, improved organizational performance and emerging growth opportunities. According to Aon's 2007 research, the full value of risk culture is not realized until it is completely integrated with ERM. Because ERM has been designed to support the business and ensure its long-term sustainability, management and all employees should be truly involved in the risk management process.

As indicated earlier, 93 percent of organizations with advanced ERM are successful in achieving corporate objectives and agree that aligning ERM and ERM culture helps enhance organizational value. Strong ERM culture is also a prerequisite for sustainable ERM; the ERM cultural alignment approach presented in Section III can be the source for sustainable competitive advantage.

Another research study, performed by IRM (2010), looked at risk culture from a different perspective and based its risk survey on four key themes: tone at the top, governance, competency and decision making. The study analyzed respondents' perceptions of current risk culture. On the basis of respondents' opinions, it was clear risk was not fully embedded into the organizational culture, and it was still often managed in isolation. Most of the risk aspects associated directly with risk leadership, level of risk transparency, making risk decisions and rewarding appropriate risk taking were rated by a surveyed 2 out of 4. Risk resources scored the highest rating of 2.6 out of 4 and, and risk competency the lowest: 1.9 out of 4. Key conclusions from the study indicate that the four discussed aspects of risk culture are intermittently correlated. The survey also revealed that embedding risk management in organizational culture remains a significant challenge, especially for organizations where risk management is developed in isolation to the business (i.e., there is no ERM culture established). Lastly, only a few organizations can honestly admit they have developed structured strategies that focus on creating a risk culture.

Research shows that to accomplish an alignment of ERM and risk culture, a well-defined vision and ERM planning become essential (Aon 2007). Senior management buy-in, a commitment to create a fitting internal environment and an appointment of resources has also been identified as critical in building risk culture. Finally, cross communication between lines of businesses, awareness of business objectives, risk-performance indicators and the integration of ERM into business planning were highly recommended. In organizations where ERM has been embedded into the internal structure, 85 percent of respondents confirmed the culture was "entirely" or "significantly" respected, compared to 39 percent of respondents in organizations where ERM is merely being established. This further confirms there is a strong interdependency between ERM development and a process of creating strong risk culture (Aon 2007).

Another significant factor contributing to the process of shaping ERM culture is ERM mindset and enterprise wide communication. Results-driven organizations view information flow and communication as key principles for creating strong governance and culture. Enterprise wide risk communication and a dialogue between management and employees can create understanding of key risk concentrations (in terms of risk appetite and tolerance) and strengthen the relationships between groups often working in isolation. Employees need to feel encouraged to logically debate and challenge risk-based business decision processes they participate in. An effective method for communicating and responding to risk issues within ERM culture alignment is to identify who the stakeholders are, gain their commitment and awareness, develop a robust communication strategy within “safe channels” and ensure continuous feedback. Finally, developing success metrics to measure the process effectiveness becomes crucial. Therefore, robust risk cultures promote leadership strategies for downward and upward communication.

Employees should see risk management as a strategic “partner” to the business and feel motivation for a proactive collaboration. Allocating the right resources to the right functions with the appropriate level of authority can significantly impact risk culture. One possibility is to realign the organizational structure and transition personnel from risk management into the business. Another is to require business staff consult directly with the risk management function. Moreover, common risk language creates an ERM mindset and permeates the atmosphere of no intimidation or fear to “talk business or risk” with the management. Management’s commitment to creating a sustainable organizational culture should support developing unique cultural characteristics that can result in significant impact on business reputation and value.

Section V Conclusions

As the role of risk management has gone through significant changes over the years, the restructuring of risk culture into an ERM culture has become an area of an increased focus. ERM culture affects the decisions of management and employees whether or not they are consciously weighing organizational benefits versus the costs. ERM culture reflects a lack of strength when decisions run counter to the organizational policies and risk profile.

The surveys conducted in recent years further demonstrate that flaws in or the lack of risk culture were primary contributors to the financial crisis. Even though risk culture has become a fundamental component of ERM, many organizations reflect significant deficiencies in this area. Risk culture gaps can expose organizations to vulnerability in the areas where key risks are being overlooked or to unexpected future risk events that can negatively impact business performance. The studies also confirmed that embedding risk management within the organizational culture remains a significant challenge, especially for organizations where risk management is developed in isolation to the business. Therefore, organizations need to rethink the current risk cultures and focus management efforts on developing a strong and dynamic ERM culture. As a prerequisite for a sustainable and value-adding ERM, ERM culture allows realizing its full value and capitalizes it enterprise wide. Enterprises with no ERM culture ingrained in the organizational structure fail to accomplish the full potential of ERM benefits. When there is no ERM culture, business units are not working together in managing risks and achieving strategic objectives but they are working in silos. Moreover, lack of solid risk culture can also diminish an organization's ability to achieve business objectives, crippling business performance and weakening market competitiveness.

ERM culture should be well-defined, transparent and maintain a level of consistency for all employees. It should be dynamic and proactive to unexpected changes and generate uniform risk response. Organizations that can understand and adapt all components of the ERM culture alignment proposed in this paper can execute corporate and business objectives aligned with risk strategy and gain competitive intelligence through an effective ERM culture. ERM culture alignment enforces integrating processes of formulating and executing core strategies with ERM implementation planning. It can inspire management to create effective cultural alignment that fosters integrity and empowerment and can become a key to generating enhanced shareholder value, meeting regulatory compliance and ensuring competitive sustainability.

In conclusion, there is still a great need for more development of both ERM and ERM culture and few organizations can honestly acknowledge adopting a comprehensive ERM culture.

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