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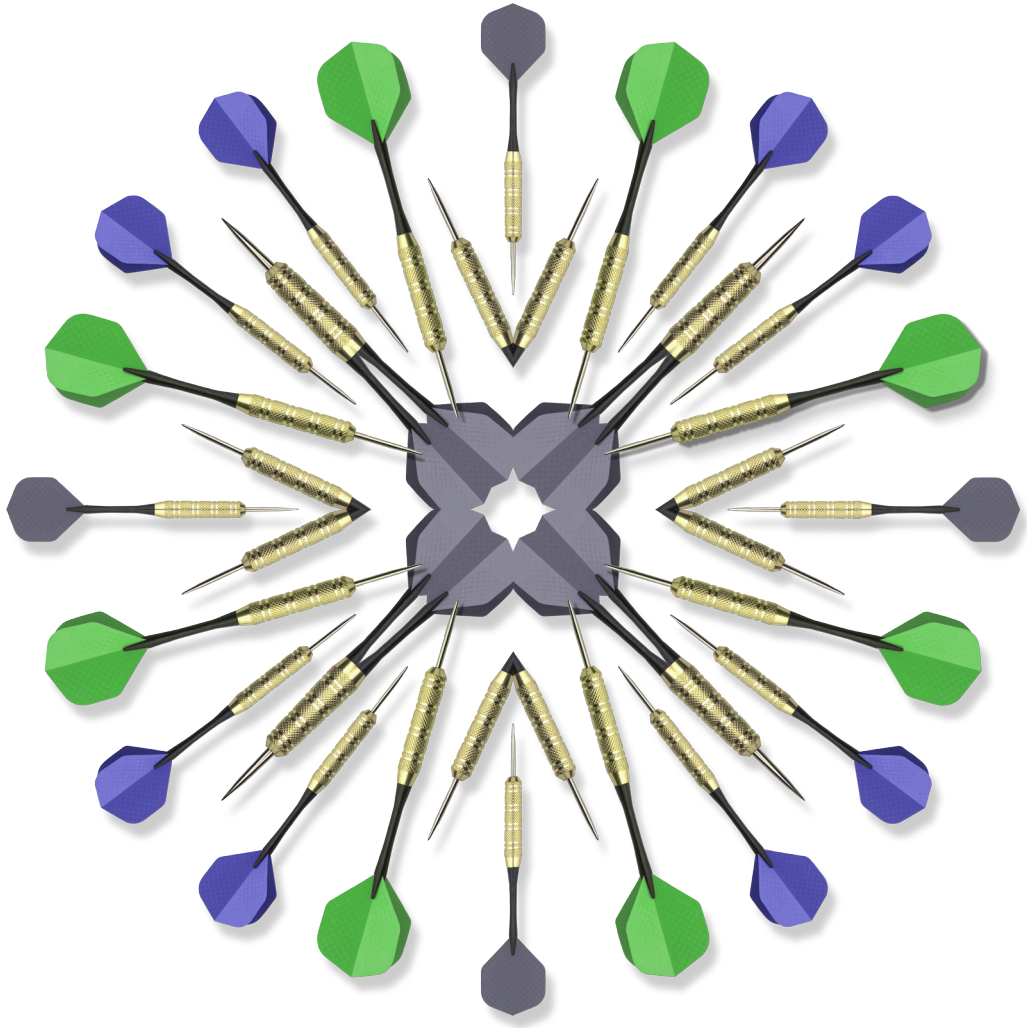

Taking aim at value

Avoid overconfidence and look again at risk

Strategic and Reputation Risk

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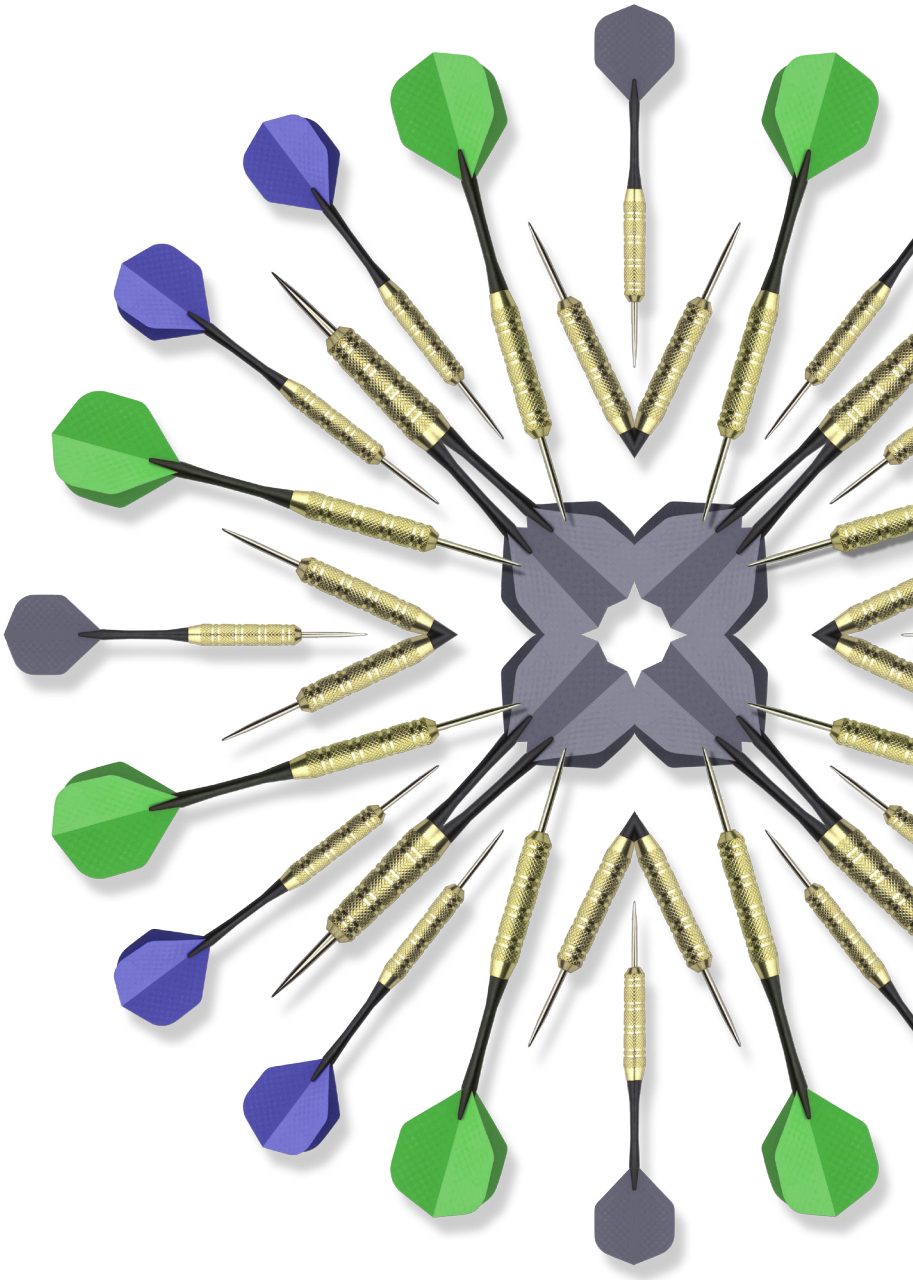

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Foreword

Are senior stakeholders placing too much confidence in their organization's risk management prowess?

We recently surveyed board members and the C-suite to find out. Wanting to better understand their organization's capabilities in balancing risk and reward, we asked how capably these organizations were integrating risk management within their pursuit of value creation and how effective their efforts were at detecting, preparing for, and responding to threats. By excluding chief risk officers (CROs) from our study, we were able to get a more objective, external view of not only risk strategy but also of the risk management function itself.

What we found is an abundance of confidence that, quite frankly, should be taken as a warning: too many senior stakeholders are likely overstating their risk awareness and capabilities. Nearly nine in 10 say that value creation should be a key focus within risk management, yet only one in five are taking the steps needed to implement the obvious improvements. Additionally, three out of five say their organizations are susceptible to the profound forces of innovation and disruption. So how can senior stakeholders feel so confident in their risk management?

Certainly, most companies have improved their risk management focus since the global economic downturn of 2008-09. But undoubtedly, much of risk management seems to be a heads-down, check-the-box exercise. Which is particularly curious when considering the disruptive forces at play today.

Worldwide, wholesale geopolitical and demographic change is rampant. Consumers are now borderless, mobile, highly-informed, socially connected, and interdependent. Many countries are in hot pursuit of sea change in trade, tax policy and rates, and regulatory activity, moves likely to spur shifts from other nations and regions. All of this is to say nothing of the relentless advances in technology, from robotics to artificial intelligence. Taken together, it is a world of unprecedented change, driving profound shifts in culture, commerce, business models, regulatory frameworks, and everything in between.

But the flipside to so much risk and uncertainty is the scale of its mirror opportunity. So, it is incumbent on risk professionals to step up and change the game. CROs need to migrate from a focus on operations or stewardship and become more of a catalyst and strategist. They need to take the lead in harnessing more proactive, predictive, big data-enabled solutions to their risk/reward equations. And in doing so, they must also find ways to work more closely with their boards, executive team peers, and business units.

Sam Balaji

Business leaders tend to be confident optimists by nature—and that can be a good thing. But the most effective leaders are also willing to challenge assumptions and hear alternative viewpoints. We believe companies can use risk management to not only protect value but to power performance.

So feel confident, by all means, but have a look at the research. Given the pace of change and these findings, we suggest a healthy dose of self-reflection accompanied by concrete action is in order.

Sam Balaji
Global Business Leader, Risk Advisory

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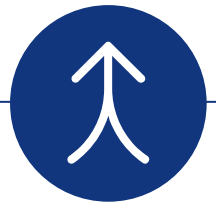
Introduction

CEOs and boards always have an eye on risk. But how do they perceive risk and what is their role in its effective oversight? Is risk management a means to avoid losses or a tool for creating value and optimizing outcomes? Is there a senior executive charged solely with managing risk, like a CRO? Which risks are companies actively managing and which are lower on the priority list? In general, what are leading companies doing to evolve their approach to risk?

To gain deeper insight into these and related questions, Forbes Insights, on behalf of Deloitte Touche Tohmatsu Limited, surveyed more than 300 senior stakeholders. All respondents are from the C-level or board—but exclude CROs. Responses are also evenly distributed across the Americas, European Middle East and Africa (EMEA), and Asia/Pacific regions.

Key industries surveyed include Consumer & Industrial Products, Life Sciences & Health Care, Financial Services, Manufacturing, Energy & Resources, as well as Technology, Media & Telecommunications. The survey sampled a range of companies from US$1 billion in revenue and up, including 23 percent over US$20 billion. We also interviewed three CEO/board level executives as well as a CRO to provide their own editorial and interpretation of the survey findings.

Some of our key observations from the research include:



Companies need to build closer alignment between value creation and risk

Nearly nine out of 10 recognize that risk management should focus on value creation—not mere risk avoidance. But fewer than one in five are taking sufficient action in this regard.

Companies need to do more to establish and optimize the role of the CRO

Nearly nine out of 10 of organizations say they have a full-time CRO or what they feel is its equivalent. But do they? Are they defining the role accurately? Are they promoting sufficient board interaction? Are they benefiting fully from this critical role? The research suggests otherwise.

Companies must forge responses to their most strategic risks and opportunities

Companies say they are focusing on a wide array of both newly emerging and longstanding strategic and tactical risks. But are these the right issues? Are they understating disruption, cybersecurity, or global political risks?

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Building closer alignment between value creation and risk

Nearly nine out of 10 organizations recognize that risk management should focus on value creation—not mere risk avoidance. But fewer than one in five are taking sufficient action in this regard.

Of those not already harnessing risk to drive returns:

49% Say they are taking steps to do so

20% See the benefit of value-driven focus, but have yet to take any steps

13% Believe the purpose of risk management is to prevent losses

Most—87 percent—recognize the importance of emphasizing risk management's role in value creation.

Nonetheless, only 18 percent cite value creation as a conscious goal of their risk management strategies.

Figure 1:
In which areas is your risk management delivering value?

	Currently	In near future
Improving customer loyalty	38% 1st	34% 1st
Increasing operational resilience	32% 2nd	21%
Identifying and exploiting new business opportunities	30% 3rd	25% 4th
Exploiting the power of new technologies	23% 4th	24% 5th
Improving cost-effectiveness	21% 5th	28% 2nd
Accelerating time to market	20%	18%
Ensuring the success of mergers	20%	26% 3rd
Optimizing return on capital	9%	7%
Improving stakeholder confidence	5%	11%

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Those whose risk management philosophies and programs focus on value creation cite a range of areas where their actions are delivering significant benefits. Respondents most frequently cited, both today and expected in the near future, customer loyalty. This is consistent with previous Deloitte research—a 2014 survey conducted by Forbes Insights—*Reputation@Risk*[1], which showed that 88 percent of companies were actively focusing on reputation risk. In addition, *Exploring Strategic Risk*[2], a 2013 survey, ranked customer capital (defined as loyalty, brand, and reputation) as core focuses for risk management.

Other key areas where risk management can drive value creation (see Figure 1) include increasing operational resilience, improving cost effectiveness, and identifying and exploiting new business opportunities. The realization, says Peter Harmer, Managing Director and CEO at IAG, is that business is "all about risk and reward—strategy and risk are two sides of the same coin." What this means in practical terms, says Harmer, "is that strategy discussions at our firm very quickly turn into conversations about risk."

Expressing wholesale agreement, Michael McCain, CEO of Maple Leaf Foods, believes that treating risk management as something separate from the core business is recipe for ruin. "When someone asks me, 'Do you do risk management?' my head just about explodes. I'm a 35 percent owner of this business, and risk and reward are all I ever think about, 24 hours a day seven days a week." The point, says McCain, "is that it is impossible to separate risk from value creation." Which means "it's my job as an owner operator—it's the job of any head of any business function—to understand everything that could go right as much as anything that could go wrong. That's what creates value."

Overconfidence?

Companies are highly confident regarding their core risk-focused decision making and integration with strategy. Key support for this view includes:

- 82 percent believe they are taking the right amount of risks.
- In terms of their ability to balance risk and reward, one in five companies (21 percent) believe they are well above average; two in five (39 percent) above average.
- 73 percent say their risk management programs support their ability to develop and execute business strategy to a high (60 percent) or very high degree (13 percent).
- 82 percent are either extremely confident (23 percent) or confident (59 percent) that their risk management activities are optimizing outcomes across the enterprise.
- In terms of confidence in understanding risks in the context of opportunities, 51 percent describe themselves as extremely confident (11 percent) or confident (40 percent).
- Three in five respondents (61 percent[a]) say their approach to risk management is either sophisticated (50 percent) or expert/highly sophisticated (12 percent).

[a] Figure is lower than the apparent sum due to rounding

But findings like these are surprising given that so many companies have already stated that they need to do more to engage and align risk management with strategy and value creation. Meanwhile, circumstances suggest an era of nearly unprecedented uncertainty: Brexit and upcoming elections in the European Union pose changes to its structure; a dramatic shift in direction in the US points to new policies in taxation, regulation, and trade; unrest in the Middle East and political, social, and military developments in Eastern Europe and Asia cast a pall on international relations; demographics and globalization are spawning enormous shifts in consumer demand and political policy. But even amid so much uncertainty, only 9 percent of survey respondents cite geopolitical risks as one of the top three forces exerting an impact on their business strategy.

Next, in spite of rapid evolution in digital platforms and processes, respondents tend to downplay the significance of technology and cybersecurity risks to their business strategies across a range of associated questions. That is, only relative minorities include such risks among their top three.

> "Treating risk management as something separate from the core business is recipe for ruin."
>
> **— Michael McCain**, CEO, Maple Leaf Foods

[1] *Reputation@Risk*, 2014 global survey on reputation risk, Deloitte/Forbes Insights, www.deloitte.com/reputationrisksurvey
[2] *Exploring Strategic Risk*, 300 executives around the world say their view of strategic risk is changing, 2013, Deloitte/Forbes Insights, www.deloitte.com/strategicrisksurvey

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> Business is all about risk and reward—strategy and risk are two sides of the same coin. Strategy discussions at our firm very quickly turn into conversations about risk.
>
> — **Peter Harmer**, Managing Director and CEO, IAG

Finally, only half of companies use sophisticated risk analytics (15 percent always; 36 percent usually) when making strategic business decisions. Key reasons for failing to do more with risk analytics include data teams who are already working to full capacity in other areas, and the organization's lack of skills needed to understand and analyze the data. The failure to incorporate such tools cast doubt on just how capably firms are assessing their risk profiles and optimizing their opportunities.

What is the right amount of risk?

One key area where companies might want to look more closely is their processes for determining whether they are taking the right amount of risk. Indeed, as Gerard Payen, CRO of Groupe Renault, explains, there simply is no perfect means for making such a determination.

"If risk management is considered to be a science, it's a very soft one," says Payen. "Whether you are taking the right levels of risk can only be appreciated in the long run. If, for the board of directors and other stakeholders, the firm's performance is in line with expectations over the long term, that is one indication that the risk choices are appropriate; that risk management is adequate." But beyond such general gauges, "there is no more accurate way of measuring," says Payen. "So if you want to sustain your performance, you need to be permanently conscious of the risks you are taking and make adjustments as needed."

In general, companies need to be more critical in terms of reviewing their risk assumptions and ongoing risk management operations. Indeed, at IAG, says Harmer, "We are taking a hard look at our risk management, and we're realizing we have some work to do."

As an insurance company, IAG looks at risk from two key perspectives to power its performance. First, "there's the volatility of other businesses or individuals that we assume, insurance liability, which requires very careful management," says Harmer. The other area is financial risk, which the firm breaks down into operational, regulatory, and technology risk. Risks in these core baskets "translate down to an operational level: How much risk will we assume within the pursuit of our business objectives?"

The firm focuses keenly on continuous improvement. In terms of dealing with insurance risk, counterparty risk within reinsurance programs and investment/financial risk—core focuses and competencies for the firm—Harmer is generally satisfied with performance with no new initiatives seeming necessary. In terms of regulatory risk, things are moving so fast today that here, the company sees "opportunities to improve the various listening posts throughout the organization so [they] can get and interpret information more quickly to help drive and improve management decisions."

Where IAG has the most work yet to be completed—but where improvement is fast arriving—is in terms of technology risk. In particular, Harmer says the firm has to become more agile in identifying emerging technologies presenting disruptive risks and opportunities. Here the work in areas ranging from cybersecurity to technology disruption is ongoing. In general, says Harmer, "If anyone tells you [they have these risks fully covered], I'd say they were delusional."

Establishing and optimizing the role of the Chief Risk Officer (CRO)

Nearly two-thirds say they have a full-time CRO—or what they feel is its equivalent. But are they defining the role accurately?

Surprisingly, 63 percent of senior stakeholders say the firms they represent have a full-time CRO—a figure the authors and reviewers of this research feel is significantly higher than what is actually observed in the marketplace. Certainly, it makes sense that the figure rises significantly among highly regulated industries such as Life Sciences & Health Care and Financial Services (both at 73 percent) while falling to 48 percent for Consumer & Industrial Products. But overall, the sense is that this figure may be inflated.

In addition, 24 percent of respondents say that while they do not have a CRO per se, this role is folded into the duties of another executive. But shouldn't this be a full-time role? Note that in 88 percent of these latter cases, the role is delegated to the CFO, an executive with an already extensive "to do" list (making CRO a part-time activity at best).

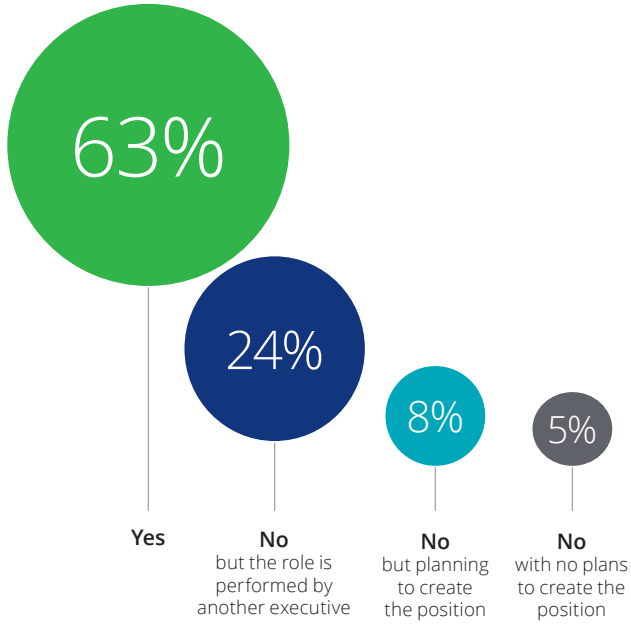
Eight percent of companies are meanwhile planning to create the CRO position, and five percent of businesses have no CRO or plans to create such a role.

At Groupe Renault, Payen points to the fact that the majority of companies listed on the Paris Stock Exchange have a CRO. "French legal and regulatory environments, in particular the Autorité des marchés financiers (AMF)[3], make it a strong recommendation—and to us it is a best practice."

Dean Yoost is a corporate governance thought leader, a board member of Pacific Life Insurance Company and MUFG Union Bank, as well as an advisory committee member of American Honda Finance Corporation. According to Yoost, "among medium to large banks, virtually all have a CRO." Shifting to insurance, CROs are not yet as common as in banking, "but the industry is moving there."

Nonetheless, continues Yoost, "the reality is, unless you dedicate senior resources to the activity, the management of risk just isn't going to develop the way that you probably intend for it to develop." He also cautions: "tick the box" regulatory requirements often come at the expense of stronger strategic risk management. As Yoost sees matters, "today's regulatory environment forces you to spend so much time on the regulatory expectations that strategy can

Figure 2:
Does your organization have a full-time CRO, or the equivalent?



[3] France's equivalent to the US Securities and Exchange Commission

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fall by the wayside." So what can happen, says Yoost, "is that you can tick all the right boxes but then still 'die in good health.'"

McCain of Maple Leaf Foods is quick to second such a concern. Having observed both the process-based approach in his work as a board executive and the approach of an owner/operator, "I am absolutely convinced that 'tick the box' does not deliver a better risk management result." Moreover, "there are times it delivers the wrong result, by focusing people on the process instead of what could really go wrong."

Leading, not assuming

Overall, it is important to recognize that the role of the CRO is to lead and assist with risk management—not assume risk. Risks are borne by the business units themselves with a risk management team behind them to help manage, mitigate, or transfer risks deemed undesirable or excessive. At IAG, for example, the CRO reports to the CEO and the risk subcommittee of the board, says Harmer. "We have a relatively small central staff, about 15, and they're primarily responsible for driving the conversations around risk appetite, risk tolerance; they design all the frameworks that support how we identify, manage, mitigate, and deal with residual risk throughout the enterprise."

The CRO's team also manages and reports on the effectiveness of controls. But the actual onus of business risk—of any residual risk not expressly delegated to risk management—resides within the business. As Harmer explains, "The individual CEOs of our business are accountable to me through the CRO for their performance in terms of managing, mitigating, and ultimately financing risk."

The IAG model is an example of an appropriate business and risk management interaction that is scalable to any size organization.

Which also resonates with Groupe Renault's Payen. "The CRO should be perceived by everyone—executive committee members, CEO, board members—as a business partner." The role of the CRO, he continues, "is to support the company and provide whatever help they can to secure business objectives of the company. This role is critical. It's far from a controlling role or an insurance type of role. It is about helping to achieve business objectives."

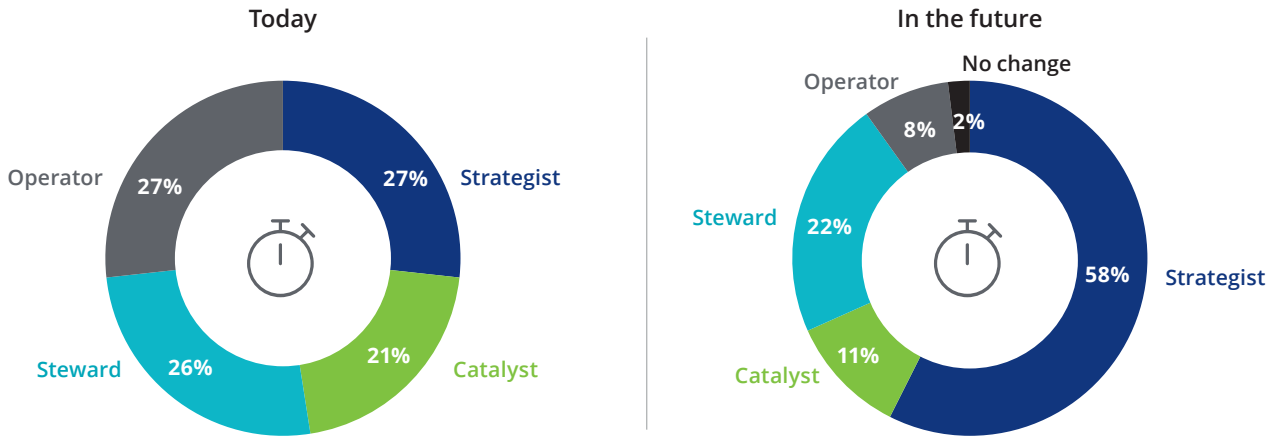
CROs must devote greater focus to strategy

One area where both our interviewees and our survey panelists agree: CROs need to devote more time to matters of business strategy. For more perspective, consider Deloitte's "four faces of the CRO" as described within this research:

- **Steward:** Protecting and challenging the organization through effective risk management; ensuring appropriate oversight and governance of risk-taking activities.
- **Operator:** Balancing structure, capabilities, talent, and technology within the risk management organization.
- **Strategist:** Participating in setting the strategic direction of the company and aligning risk management strategies accordingly.
- **Catalyst:** Engaging leadership across the organization in defining and executing strategic objectives in line with risk appetite.

Figure 3:

How do CROs spend their time today? Where should CROs spend more time in the future?*



*Figures do not add to 100% due to rounding.

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Today, survey responses indicated CROs divide their time relatively equally among these four roles. But in the survey results—entirely in accord with the view of the CRO as a business partner going forward—58 percent say their CROs need to spend significantly more time performing the strategist role.

Indeed, the most critical priorities for the CRO are strategic in nature. Respondents say CROs should be:

Leveraging risk management to inform stakeholder decision making

Evaluating/implementing new risk management methodologies (such as analytics, big data analysis)

Providing input for periodically reassessing risks within business strategy and planning

All of these are activities best-described by the strategist role.

In a closely related set of findings, a key goal for risk management over the past three years—and going forward over the next 18 months—is to improve reporting of risk to senior stakeholders and the board by leveraging data analytics, visualization techniques, and trend analysis. Senior stakeholders will also be doing more to shift the emphasis of risk strategy toward value creation/taking the right risks, and explicitly aligning risk appetite with overall business strategies.

The CRO should hold a C-suite position

Over two-thirds of companies say their CRO—or its equivalent—reports to the CEO; only one in 10 say this executive CRO reports to the board.

Note that to maximize effectiveness of risk oversight, the CRO would need to hold a C-suite position with accountability to the CEO. So the two-thirds figure already points to a shortcoming in practice; the figure should be nearer to 100 percent.

An accompanying finding—companies give relatively low grades to their CROs in terms of the quality of interaction with the board—provides additional evidence that this relationship needs to be strengthened.

As a board member for a range of companies, Yoost has a handful of insights relating to the appropriate relationships between a board and its CRO. Speaking first to board members, "it's important to make sure that at any point in time, you are well enough informed to be able to articulate the most important risks that the organization is facing."

Beyond staying current, "your role is to be the one in the room that asks the most thoughtful questions; the ones perhaps [management] hasn't thought about," says Yoost. But in addition, board members should also be seeking independent views on risk. "Getting information from management only is a weakness," he explains. "External viewpoints from investment bankers, stock analysts, or even law firms for certain topics are essential."

> "The reality is, unless you dedicate senior resources to the activity, the management of risk just isn't going to develop the way that you probably intend for it to develop."
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> — **Dean Yoost**, Board Member, Pacific Life Insurance Company and MUFG Union Bank; Advisory Committee Member, American Honda Finance Corporation

As for CROs, they should welcome a closer relationship with their board. As Yoost explains, the better the understanding between the two bodies regarding risk, the better the quality of risk-focused decision making. Companies can be more confident with their go-forward strategies knowing the risks are well understood in advance.

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Overall, it is clear from the interviews and other sources that as the role expands and evolves, current or would-be CROs need a skillset that goes well beyond traditional risk management.

As Payen explains, "It is important that the CRO has a broad background, one that includes experience in the business as well as an understanding of risk." But in addition, says Payen, "you also need to be a good listener, have sound critical thinking, and the ability to persuade."

What is a CRO?

Is it credible to say that nearly two-thirds of companies have a full-time CRO? In truth, this figure is significantly higher than what tends to be observed in the marketplace, with several interviewees being surprised by the figure. Is it telling that nearly one out of four, 24 percent, believe the role is being performed by another executive—especially when 88 percent of these dole CRO duties onto an already busy CFO?

These findings raise the question: Are companies overstating their risk management capabilities and not recognizing the full requirements for a CRO?

To be clear, a CRO:

- Is a C-suite executive—a peer to the CFO, CMO, CIO, and others.
- Is the steward of the company's risk management program, evaluating and reporting on risks to the company's business strategy and to its execution.
- Takes responsibility for promoting risk awareness throughout the organization.
- Ultimately takes responsibility for risk management strategy and its overall alignment with value creation.

Note:

- A risk-focused executive reporting to a CFO or other C-suite executive is *not* a CRO.
- Absent deep interaction with business units, key functions, C-suite peers, and the board, the executive is *not* a CRO.
- It is imperative that boards take part in clarifying this role and even selecting the right person to perform it.

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Addressing strategic risks and opportunities

Companies say they are focusing on a wide array of both newly emerging and longstanding strategic and tactical risks. But are these the right issues? Are they understating disruption or perhaps technology/cybersecurity risks?

Where are the risks?

Sustainability/corporate social responsibility (CSR), barely visible in a prior Deloitte 2013 survey: *Exploring Strategic Risk*[4], is now the most frequently cited risk to business strategies (34 percent). In second position are the risks of innovation/disruption (33 percent), and a more distant third place, legislative/regulatory trends ties with mergers and acquisitions (22 percent).

Figure 4:

Where does risk have the greatest impact on your business strategy? Please select your top three risk factors today and what you expect in three years' time.

	Today	In three years
Sustainability/CSR	34% 1st	29% 2nd
Innovation/disruption	33% 2nd	28% 3rd
Legislative/regulatory	22% 3rd	20%
Mergers and acquisitions (M&A)	22% 3rd	21%
Consumer demographics	20%	21%
Strategic alliances	21%	34% 1st
Intellectual property	18%	14%
Pricing/margins	17%	15%

	Today	In three years
Consumer/market concentration	17%	19%
Talent	17%	22%
Cybersecurity	17%	11%
Suppliers/vendors	16%	18%
Competitor actions	13%	10%
Business model change	14%	19%
Geopolitical	9%	8%
Brand reputation	7%	7%

[4] *Exploring Strategic Risk*, 300 executives around the world say their view of strategic risk is changing, 2013, Deloitte/Forbes Insights, www.deloitte.com/strategicrisksurvey

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A closer look

Sustainability, CSR, and even environmental, social, and corporate governance (ESG) are so highly ranked today thanks to their increasingly visible impacts—both potential and actual—to the traditional bottom line. Unquestionably, a growing number of consumers are making more choices based on a company's practices across social, environmental, and other sustainability-related issues. Closely related is the increase in socially conscious investing.

Not surprisingly, groups like the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD), chaired by Michael Bloomberg, are driving for heightened disclosure. Quoted on the organization's website, Bloomberg says greater transparency "makes markets more efficient, and economies more stable and resilient."

Similar initiatives from groups such as the Sustainability Accounting Standards Board (SASB) and the World Federation of Exchanges (WFE) only add to the momentum toward greater disclosure. So much added focus on such issues, the survey reveals, is absolutely capturing the attention of senior stakeholders.

Thinking about the next three years, strategic alliances/counterparty relationships surges into first place as the most frequently cited risk to business strategy (34 percent). In Deloitte's 2017 Extended Enterprise Risk Management report[5], 74 percent of respondents say they have faced at least one third-party related incident in the past three years. Sustainability/CSR fall slightly into second position, with innovation/disruption moving into third.

Regarding the third area of focus, a related question shows that nearly three out of five companies (58 percent) say their production/services/business models are prone to either innovation or disruption. This 58 percent figure increases to 67 percent for energy and resources firms (exposed to regulatory activism and shifting consumer preferences), but falls to 43 percent for the largest companies in the survey (seemingly more secure in their market positions).

But instead of expressing angst, respondents instead show confidence in the ability of their risk management processes to harness the forces of innovation/disruption. For example:

believe their risk management function does an effective job providing input/leadership on adjusting business strategies.

say their risk management teams actively assist operating managers with risk mapping of disruptive factors.

say they are evaluating disruptive factors to assist the corporate development function to better identify M&A/business development opportunities.

say their risk management teams are actively assisting executive management and strategic planning with scenario analysis of disruptive factors.

What this indicates is that companies feel their risk management teams are competent in three key steps essential to managing strategic risk:

Discovery

Developing and deploying "risk sensing" mechanisms enabling the company to identify key indicators that can provide early warnings of shifts in the environment.

Preparation

Developing scenarios presenting potential alternate futures and their implications for markets, business models, supply chains and so on.

Response

Developing response plans corresponding to the alternate futures—ready for implementation the moment early warning indicators begin flashing.

But despite relative confidence, areas where respondents believe improvement may be needed include helping to evaluate and facilitate innovation (58 percent) and monitoring the business environment for potential disruptors (45 percent). In addition, only about one-third of organizations (36 percent) say they use all available means to identify/assess all threats/opportunities—meaning that nearly two-thirds fail to do so.

[5] *Overcoming the threats and uncertainty, Extended enterprise risk management global survey report 2017,* https://www2.deloitte.com/global/en/pages/risk/articles/eerm-survey-report.html

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Disruption as opportunity

Yoost has strong views on disruption—and what companies need to do in response. "Companies tend to ignore disruption until it's too late," he explains. "Boards should be allocating time to think about out-of-the-box thinking, but most don't, often because they have limited time to begin with [amid] so much statutory risk reporting." At some point, maintains Yoost, "someone [in the home video business] should have been raising questions about the [wisdom] of building so many [physical] stores."

Going forward, "I believe it's the role of the CRO to develop clearer insight into the forces of disruption," continues Yoost. "Disruption and innovation are strategic risks, and the CRO has to take the lead on developing a viewpoint."

Peter Harmer at IAG says, "Disruption may be a risk, but it is also a wonderful opportunity. It means customer needs are not being met, so that's an opportunity." Which means the company is currently moving rapidly to assess and address rampant disruption across its business lines. Renault's Payen agrees wholeheartedly, saying a key force of disruption for his company was the fast-moving shift to electric vehicles. But instead of resisting, "we saw this as a game changer, turning a risk into an opportunity, and are now close to having sold half a million electric vehicles."

Look first at IAG Customer Labs, a group designed to speed the development of software that can improve both customer-facing and back-office processes and software. "We've shifted from the old ways to lean and agile processes. We test and learn, starting with the customer and working our way backwards. There are checkpoints throughout the process so we don't have to wait until the end to see if it's working, and this makes us much more responsive to opportunities around technology."

The company also runs a venture fund with a capitalization of some AUD$75 million along with a business incubator. "Here we're focusing on how emerging technologies and business models—like the sharing economy—will affect our customers and their homes and cars and their driving." Plus, Harmer continues, "we're looking at things like collision avoidance, autonomous braking, and the ways connected homes will create data points or sources that might enable us to create a dashboard of risk that customers can look at on their tablet or mobile phone." Such investments will likely deliver returns all on their own. But as Harmer explains, "the real value is that this brings learning into the organization."

The forces of disruption are also descending on food producers. As Maple Leaf's McCain explains, "We think about change at a strategic level all the time." For example, growing numbers are concerned about meat consumption or point to agriculture as a contributor to climate change. "But in the longer term, there may be disruptive technologies such as test tube cultured meat proteins and 3D-printed food," says McCain.

Overall, says McCain, "it's my, and my management's job, to be entrepreneurial and always thinking: Where is the ball going to land? You've got to have a view of what could go right or wrong not just today, but 10, 20 years out." A key step—shifting risk into opportunity—becomes: "One of our key strategies today is to diversify into vegetable proteins."

Finally, adds McCain, "no amount of risk management strategy and planning can precisely match what's coming around the corner." So the best risk management "is the culture of the organization." Here, says McCain, "it's vital to surround yourself with amazingly smart, driven, and capable people." Whether it's managing next quarter's financial reporting or long-term disruption, "you build organizational resilience through people and culture and capacity to withstand whatever comes around the corner."

> "Disruption may be a risk, but it is also a wonderful opportunity. It means customer needs are not being met, so that's an opportunity."
>
> — **Peter Harmer**, Managing Director and CEO, IAG

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> We are working within the ecosystem; collaborating on cybersecurity and related issues, but at all times, looking for opportunities to turn risk into reward.

— **Gerard Payen**, CRO/VP, Risk Management, Groupe Renault

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Other risks may be just as critical

Fewer numbers of respondents rank risks such as cyber/technology (17 percent), geopolitical (9 percent), and brand reputation (7 percent) as critical to their business strategies (although in a separate question, 70 percent of companies say their risk management function is closely tied to their brand/reputation risk).

But it is vital to recognize that respondents were asked to name the top three risks having an impact on their business strategy. This means that any of the risks that made the rankings are a top three most critical risk for a significant number of companies. Put another way, the statistics say, for example, that today, one out of five companies view strategic alliances (21 percent), changing consumer demographics (20 percent), or challenges to intellectual property (18 percent) as a top three risk.

Meanwhile, a given risk could certainly still be important to an organization but not quite percolate to top three status. Or alternatively, this could mean that cyber, geopolitical, and brand reputation risks are important, but companies feel their processes and strategies for risk mitigation are proving effective (and hence these risks are no longer having a major impact on strategy).

A focus on cybersecurity

A key driver of innovation/disruption, one of the top-cited risks, both now and in the next three years, is the speed at which companies are adopting digital business models. Hand in hand with greater use of data and technology comes heightened exposure to phishing, hacking, ransomware, and a host of other related risks.

Cybersecurity is indeed a risk being taken seriously by Groupe Renault. Amid advances in robotics, sensors, artificial intelligence, the Internet of Things (IoT), and mobile applications, the automotive business is moving high tech. Cars and trucks themselves are becoming decidedly more tech-infused and "connected." Such a shift, says Payen, necessarily introduces the various networked devices on any vehicle to heightened exposure to hacking.

But by no means is this an issue for automakers alone. "Cybersecurity in automotive must be managed from a global, holistic, ecosystem perspective," says Payen. Car makers, technology manufacturers, service providers, service aggregators (e.g., ride-sharing companies), as well as customers and regulators must all play key roles in defending against cyberattacks. Concerns include not just safety but also data privacy.

Key fears include not only hackers, but also the potential for excessive cybersecurity regulation that could stall growth in the ecosystem.

For Groupe Renault's part, "we are working within the ecosystem; collaborating on cybersecurity and related issues, but at all times, looking for opportunities to turn risk into reward."

At IAG, CEO Harmer says his firm takes cybersecurity risk "very seriously." Managing vast amounts of customer data as well as its own models, financial data, and intellectual property, "our response to cyber risk is maturing rapidly—we're only a seven today but we're improving."

But worth noting, says Harmer, is that cyber risk is something that needs to be dealt with operationally—and not exclusively through a risk mitigation tool such as insurance. "You need to prevent, detect, and defend—the emphasis has to be on perimeter security and having a plan ready if something happens so you can respond as quickly as possible." Certainly, insurance can soften the blow. "But if your strategy is to sit back and wait for the claim to be processed, you're going to be out of business."

How companies can "miss" disruptive risks/opportunities

Companies are often blindsided by disruptive forces. Some of the key causes include:

- Groupthink: The hive mentality preventing individuals from expressing alternative viewpoints.
- Reactive governance: Board agendas favoring breadth over depth.
- Poor communication: Silos, divisions, and turf wars.
- Bureaucracy and centralization: Well-intended but sometimes ineffective efforts to control uncertainty with processes and hierarchies.
- Busyness: Endless days of meetings, conference calls, and emails that prevent looking past the present and into the future.

Instead, companies need to be able to actively:

- Confront biases that might create inappropriate strategic assumptions.
- Scan the marketplace ruthlessly for innovative/disruptive trends.
- Accelerate adjustment to new business strategies/models/paradigms.
- Repeat these activities and make them a core part of risk management activities.

It is the duty of the CRO to evaluate and help the business overcome the above causes of myopic risk management but also to enable the forces that can spot trends, risks, and opportunities.

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Forging a response

Where this leads is to the realization that risk management is no longer regarded by companies merely as a means of preserving value and preventing harm. As firms become more proficient in managing risk, increasing numbers of senior stakeholders see that it can be used to create as well as protect value.

Companies today express confidence in their risk management capabilities. But while nearly nine in 10 say they believe risk management should focus on value creation, only one in five are taking active steps to do so. Moreover, evidence suggests that the numbers of companies with a real CRO—the executive whose role it is to instill optimum value creation amid risk protection—may be overstated.

The view going forward has got to be that every opportunity has its risks—but it is because opportunities present risk that their pursuit creates value. Becoming more capable in identifying and managing risk creates competitive advantage.

Those who are most skilled at accepting, balancing, and managing risk become the most capable in value creation. Success does not come to the risk-averse, but to the risk-aware; to those who measure risks capably and accept, reject, transfer, or mitigate risks consciously.

The most effective organizations are transforming their risk management functions from bolt-on activities focused on value protection to ones that permeate organizational efforts to create value. The purpose is to enable everyone in the organization to become responsible, accountable, and capable of addressing risk in a manner that not only ticks the right boxes, but—more significantly—enables the organization's business objectives and strategic goals.[6] Entire organizations need the ability to look ahead, identify risks and opportunities, then define alternate futures and plans for how to respond.

[6] *Strategic risk: A cornerstone of risk transformation*, https://www2.deloitte.com/global/en/pages/risk/articles/implementing-risk-transformation-in-organizations.html

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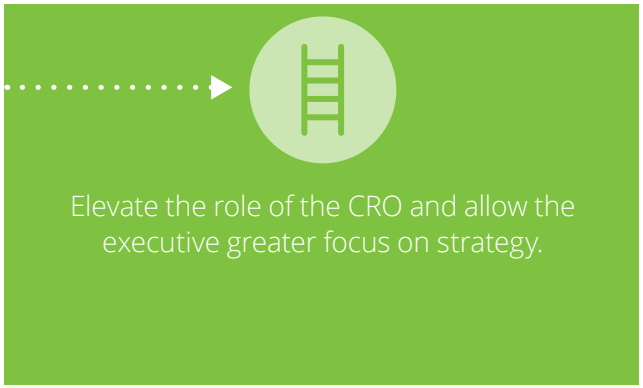
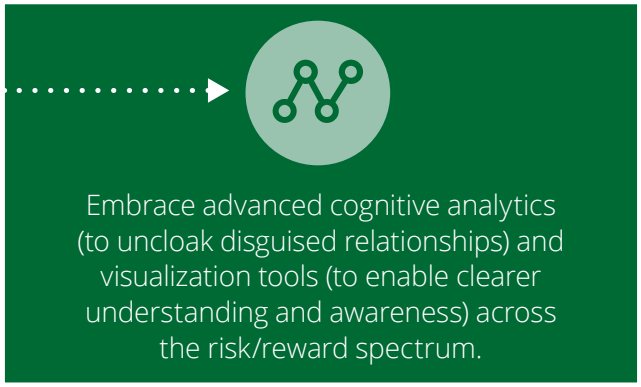
Key steps include:





Overall, companies need to take a step back to take a more critical, analytical, and objective view of their risk management strategies and practices. In such a volatile and uncertain era, companies cannot afford overconfidence.

So, we ask again: Is your company doing all it can to optimize its mix of risk and reward? Are you emphasizing the status quo, or challenging key assumptions? Are you certain your company is using risk acumen and risk awareness to improve performance against its full set of opportunities? And regarding any of the above, how do you know?

It's okay to be less than perfect; but don't fall victim to either overconfidence or using "well enough" as justification not to pursue balanced risk management programs.

Talk to us

We look forward to hearing from you and learning what you think about the ideas presented in this study. Please contact us at strategicrisk@deloitte.com.

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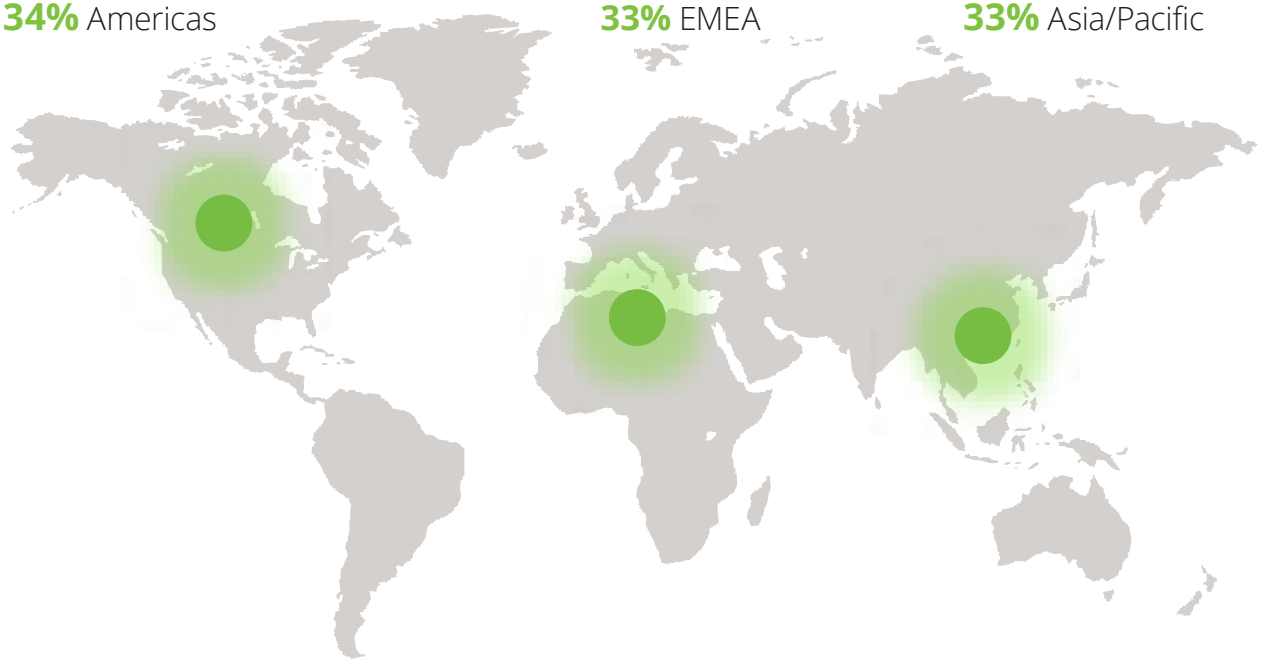
Methodology

The data in this report is derived from a survey of more than 300 senior stakeholders conducted by Forbes Insights, on behalf of Deloitte Touche Tohmatsu Limited, in November and December 2016. All respondents were from the C-level or board, not including CROs or other risk management professionals, and responses were evenly distributed across the Americas (34 percent), EMEA (33 percent), and Asia/Pacific (33 percent) regions. Key industries included Financial Services (18 percent), Consumer & Industrial Products (17 percent), Life Sciences & Health Care (17 percent), Manufacturing (17 percent), Technology, Media & Telecommunications (17 percent), and Energy & Resources (15 percent).

The survey sampled a range of companies from US$1 billion in revenue and up, including 23 percent over US$20 billion.

34% Americas **33%** EMEA **33%** Asia/Pacific



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