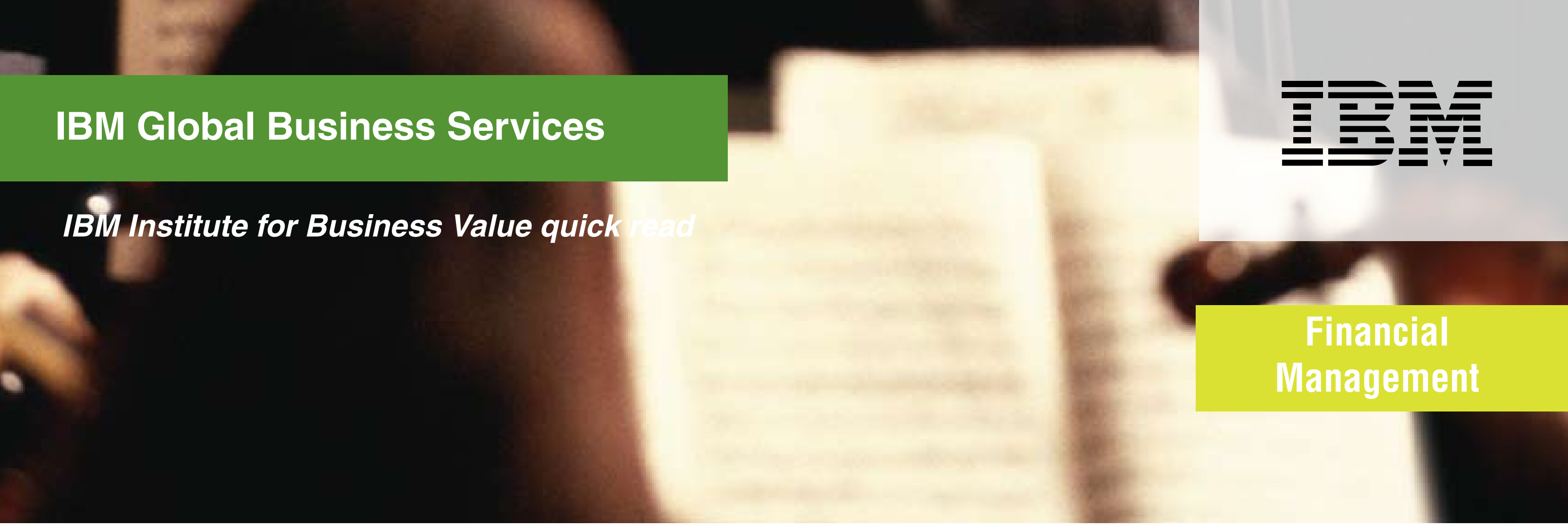


Orchestrating risk-adjusted performance management

Identify and address risk events better and faster

There's no denying the prevalence of new opportunities and risks in today's global environment. Yet, most enterprises are failing to put risk into the context of overall performance. By treating risk and performance management (sometimes referred to as corporate, enterprise or business performance management) as separate disciplines, they miss opportunities to limit surprises and/or capitalize on the upside of risk. CFOs are well-positioned to encourage a more holistic and cross-silo view of risk. Integrating risk into planning, budgeting, reporting and forecasting can lead to better decisions through risk-adjusted plans and budgets.

In the IBM CFO Study 2008 of over 1,200 CFOs and senior Finance professionals, two out of three (62 percent) enterprises with revenues over US$5 billion encountered material risk events in the last three years.[1] Of those, nearly half (42 percent) admitted to not being well prepared for it.

Risk comes in many flavors besides financial. The IBM CFO Study 2008 found that 87 percent of risk types were non-financial in nature, that is, *strategic, operational, geopolitical, environmental / health and legal / compliance risks.* Of the risk event types, the most frequently mentioned were s*trategic risks* involving decisions about markets, customers, products, M&A activity and other top-line business decisions. *Geopolitical* and *environmental / health* risks were the next most prevalent.

However, for publicly traded companies, it seems all risks come home to roost in the stock price. Therefore, virtually all risks ultimately have a financial impact. Astoundingly, most organizations don't plan for risk.

While most enterprises are not in the business to manage risks but instead to drive performance, does effective risk management correlate with better enterprise performance? In a word, yes. The IBM CFO Study 2008 found that increased effectiveness at supporting / managing / mitigating enterprise risk characterizes financial outperformers.[2]

CFOs are uniquely positioned to determine and guide the overall enterprise risk profile – largely due to the CFO's influential role both at the strategic and tactical levels, expertise in the organization's operations, support of data and measurement programs, and ultimate accountability to shareholders (and regulators).

The CFO as maestro

Successful enterprises are starting to take a broader view of risks and to orchestrate change by leveraging performance management tools to manage risk. The IBM CFO Study 2008 findings suggest two types of CFO actions to help businesses understand the trade-offs among revenue, profit and risk:

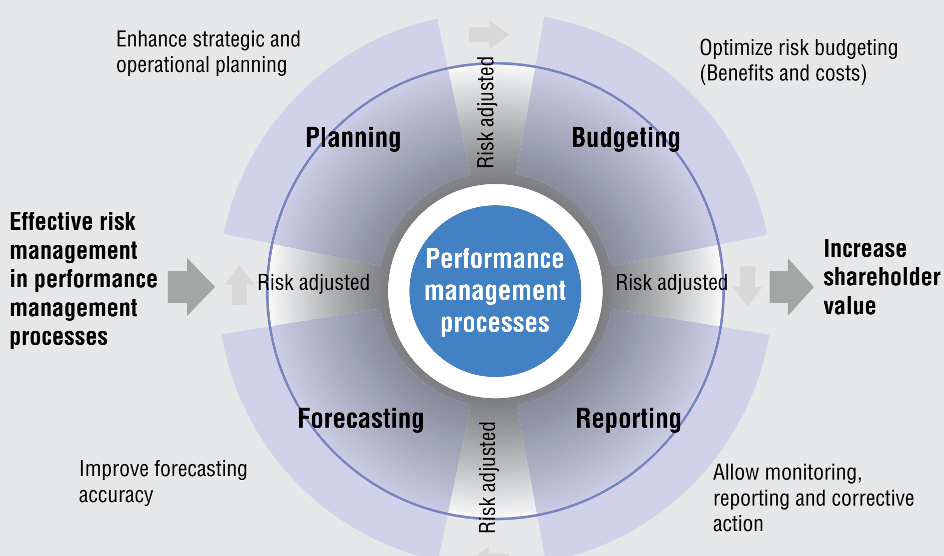
- *Develop a more holistic view of risk*. Facing a wide range of risks requires enterprises to broaden their risk apertures and focus on those risks with the greatest potential impact and occurrence. Enterprises will need to identify and properly define the most important risks, and assess internal and external risks across silos.
- *Integrate risk into planning, budgeting, reporting, and forecasting.* Factoring risk into four main areas of performance management positions the enterprise to better limit surprises and capitalize on upside opportunities. Governance and the management system should include: assessing a set of risks, implementing

risk management plans from prior risk assessments and monitoring the effectiveness of risk management plans already implemented.

CFOs can exploit their knowledge of planning, budgeting and forecasting to help set the risk management strategy. Key risk indicators (KRIs) can be presented alongside key performance indicators (KPIs) to monitor their material impact on value drivers. Therefore, factoring risk into the four main areas of performance management presents an opportunity (see Figure 1).

The risks enterprises face have the possibility to destroy or create value, and the successful mitigation of risk often defines who survives and who leads in the marketplace. We see a few recurring themes: risk is often defined too narrowly, managed too informally and too much is left to chance.

FIGURE 1.
Integrating risk into performance management processes of planning, budgeting, reporting and forecasting.



Source: IBM Institute for Business Value.

Enterprises seeking to place risk in context with performance have a lot to gain. Those that do so quickly and successfully should find themselves better able to navigate today's challenges and recover quickly from the inevitable events they will face.

To request a full version of this paper, e-mail us at iibv@us.ibm.com

Authors

Stephen Rogers, Leader of Financial Management practice, IBM Institute for Business Value.

Spencer Lin, Associate Partner in Financial Management, IBM Global Business Services.

Robert Torok, Executive Consultant, IBM Global Business Services.

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2 In the IBM CFO Study 2008, the term *outperformer* refers to the study participant that scored at least one-half standard deviation above the mean for the selected financial metric. Therefore, the term outperformers refers to the study participants that are in the top 50 percent based on this competitive comparison, whereas underperformers are those that fall in the bottom 50 percent. The IBM CFO Study 2008 looked at a subset of the sample, where publicly reported financial information was available. By taking a five-year view, the IBM CFO Study 2008 was able to identify which companies outperformed and underperformed the average compound annual growth rate (CAGR) for revenue and stock price appreciation across the sample. For this subset, stock price growth rates were normalized by analyzing the difference between the company stock price and the relevant industry index.

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