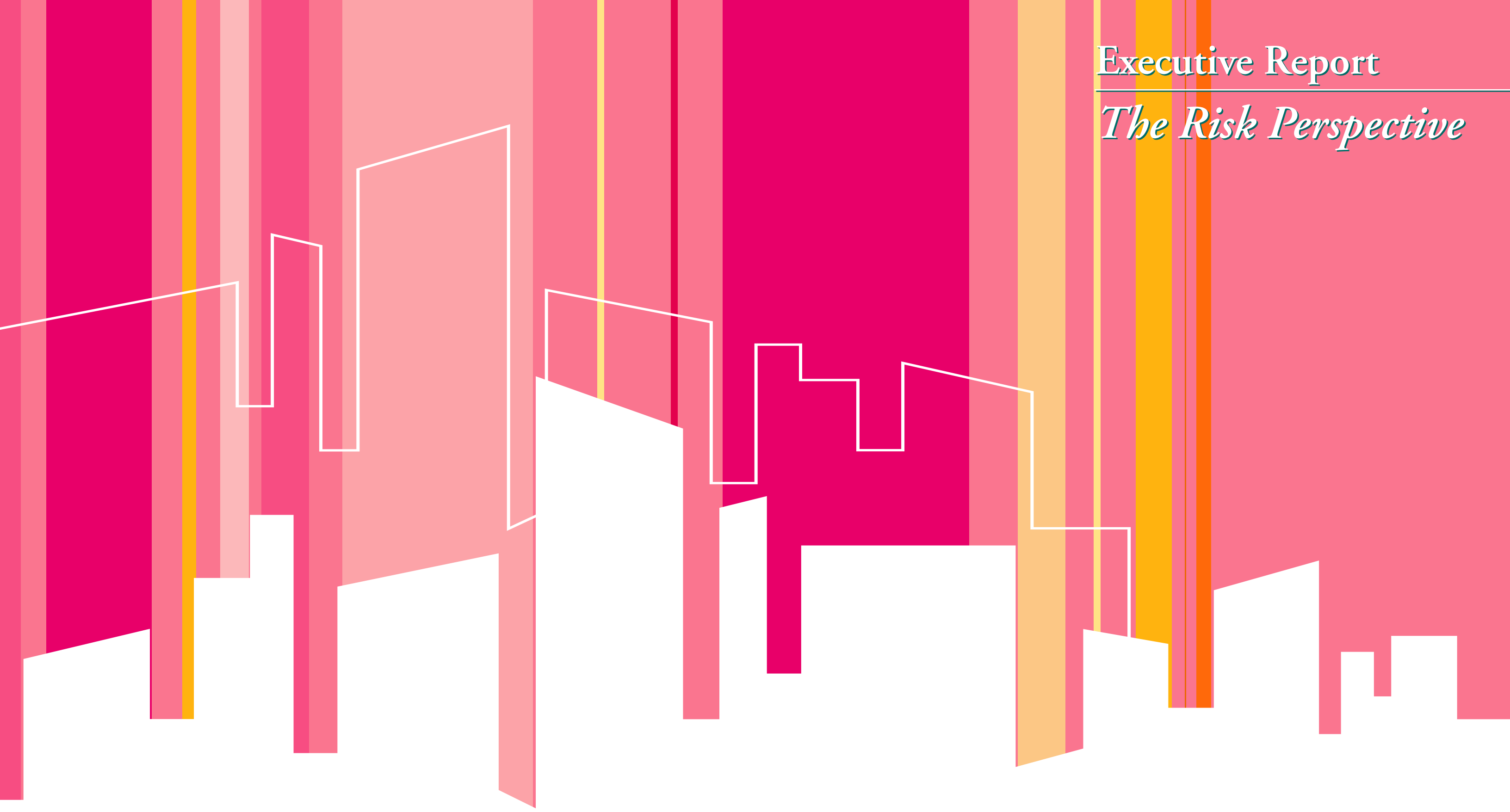

WHY A MATURE ERM EFFORT IS WORTH THE INVESTMENT

A report on the "The Valuation Implications of Enterprise Risk Management Maturity," a wholly independent and peer-reviewed research project conducted by Mark Farrell of Queens University Management School and Dr. Ronan Gallagher of Edinburgh Business School, published in The Journal of Risk and Insurance*, using data from the RIMS Risk Maturity Model.*

For a more in-depth look at the study, see "Testing Value Creation through ERM Maturity," a paper authored by Mark Farrell and Ronan Gallagher, published by RIMS.

One of the biggest challenges in implementing an enterprise risk management (ERM) program is articulating the value that it brings. Anecdotal evidence of the business value of ERM is abundant, but organizations of all types and their management teams, committees and regulators have been looking for value measurements verified by independent research.

While it is clear that ERM has gained much traction over the last decade, questions remain as to whether it is truly creating and providing value for the enterprise (weighed against the significant investment involved) and, if so, where should executives focus their attention and resources in order to realize and optimize the value from their ERM efforts. To address this question, Mark Farrell and Ronan Gallagher utilized RIMS Risk Maturity Model data collected over five years. The complete results of the statistical evidence for the value connection of mature enterprise risk management practices in organizations can be found in the article, "The Valuation Implications of Enterprise Risk Management Maturity," published by *The Journal of Risk and Insurance.*

According to Farrell and Gallagher, "This independent research project provides strong evidence for the value connection of mature enterprise risk management practices in organizations. Although the study necessarily focused on publicly traded companies, the value proposition of enterprise risk management applies to nonprofits and the public sector as well."

Organizations exhibiting mature risk management practices realize a valuation premium of 25%

The study found that there was "clear and significant statistical correlation between mature enterprise risk management practices and a firm's value." Organizations exhibiting mature risk management practices—as assessed with the RIMS Risk Maturity Model—realize a valuation premium of 25%.

Mature ERM organizations are ones that possess clear processes and ownership of risk with assessment, reporting and feedback on critical risk metrics being a central part of the firm's management right up through the chain of management to the executive and board levels.

Based on their findings, the authors report that, "Firms that have successfully integrated the ERM process into both their strategic activities and everyday practices display superior ability in uncovering risk dependencies and relationships across the entire enterprise and as a consequence enhanced [firm] value when undertaking the ERM maturity journey."

This study highlights several key findings of importance to executives. Chief among these is that maturation of ERM is associated with a significant valuation premium. When a company's ERM practices lack discipline and more specifically lack enterprise wide coordination, silo-based risk activities are dominant. Firms with more sophisticated and mature ERM programs have established routines throughout the enterprise with engagement from the top of the firm advancing risk-based decision-making at every level. The study reveals that this coordinated and consistent approach is highly value additive.

Although the study necessarily focused on publicly traded companies, the value proposition of enterprise risk management applies to nonprofits and the public sector as well.

IMPORTANCE OF THE MATURITY ATTRIBUTES FOR VALUE CREATION

The RIMS Risk Maturity Model for Enterprise Risk Management (RIMS RMM) deconstructs a firm's overall ERM maturity into seven key attributes (Figure 1). A key aspect of the RIMS RMM is that it examines ERM via a multi-faceted approach. Participants assess their organizations' ERM activities on a five-level maturity scale from "Ad hoc" to "Leadership." The responses are scored against 25 risk management competency drivers and their underlying 68 key readiness indicators. Participants score their organizations on three dimensions: 1) effectiveness of ERM activities; 2) degree of proactivity; and 3) pervasiveness throughout the organization. The 68 key readiness indicators roll up to 25 competency drivers to produce the overall risk index score, as well as separate scores in the seven core attributes.

Figure 1. Attributes from the RIMS Risk Maturity Model

ERM-based approach	Executive support within the corporate culture.
ERM process management	Integration into business processes to support the reduction of uncertainty and promote exploitation of opportunities.
Risk appetite management	Accountability within leadership and policy to guide decision-making regarding risk-reward tradeoffs.
Root cause discipline	Linking outcomes with their sources to minimize or prevent impact of adverse outcomes and maximize value extraction from opportunities.
Uncovering risks	Analyzing and documenting risks and opportunities to uncover dependencies, including emerging and dynamic risks.
Performance management	Executing vision, mission and strategy utilizing risk metrics as an integral element in strategy and planning activities.
Business resiliency and sustainability	Integration into operational planning and execution for ability to recover quickly from setbacks and to maintain something of value.

The study examined the value additivity of maturation of specific aspects of the ERM practices (Figure 2). Those attributes with the highest valuation impact: performance management (25%) and ERM process management (23%). Both attributes are process focused and communication centered.

Upon breaking down the maturity score into its core characteristics, the researchers found that the most important aspects of ERM from a valuation perspective relate to embedding discipline throughout the organization. For ERM to be effectual and add value, the study highlights the need for a strong risk management culture—through senior management and employee deployment and utilization of ERM—to aid in meeting the strategic objectives set by the executives of the firm.

The researchers conclude, "Here the lessons for businesses are that ERM processes must be scalable, repeatable and embedded throughout the organization with a hierarchy of risk-related responsibility. Furthermore, the quality of this process is monitored and improved by having a clear feedback mechanism throughout the firm hierarchy. Clear goals in relation to risk management and timely and sufficient reporting of performance against said goals are hallmarks of superior ERM and a value-additive proposition."

According to the study's authors, "Adoption of a sophisticated ERM-based approach requires top-down support for ERM activities that cascade down throughout the organization. The goals for a sophisticated ERM process are driven by a long-term focus and engagement with risk management practice and these goals are achieved by a risk culture that takes ownership of risk. The ERM sophisticated firm is disciplined in identifying risks and threats and monitoring those on an ongoing basis. Risk-conscious organizations study episodes of risk management failure inside and outside their organizations such that lessons can be learned and strengths and weaknesses in the risk management framework identified."

They go on to say, "Furthermore, the ability of the firm to identify risk events in a forward-looking manner is value additive. The sophisticated ERM process pays close attention to key risk indicators leveraging employee expertise, databases and other electronic files to uncover dependencies and correlations of risk across the enterprise. Risk indicators are continually reviewed and the various business units conduct analysis on the likelihood and impact of a risk event based on these indicators."

Figure 2. ERM Value by Constituent Attributes

RIMS RMM Attribute	Individual Value Contribution
Performance Management	23%
ERM Process Management	20%
Adoption of ERM Based Approach	17%
Root Cause Discipline	16%
Uncovering Risks	15%
Risk Appetite Management	<1%
Business Resilience and Sustainability	<1%

In their concluding comments, they note that, "Firms undertaking ERM maturity do not necessarily take these steps in isolation but rather they find significant correlation between the attributes themselves. The results support the assertion that the ERM maturity is multifaceted and that there are valuation synergies from maturation of various aspects of ERM practice. As such, the valuation impact of the composite ERM sophistication measure is larger than that of any of the individual component attributes that make up the composite score."

ATTRIBUTES ARE HIGHLY CORRELATED

Each of the individual ERM attributes is highly correlated with the others (with correlations generally in the range of 70% to 80%). This highlights the point that ERM maturation is not a matter of piecemeal improvements to one or two individual attributes at particular points in time. Rather, ERM maturity depends on evolving practices in concert with all of the seven attributes over time.

For example, more effective root cause discipline and ERM process management require top-level engagement from the firm's management. Superior ERM performance management relies on qualified individuals to uncover risks systematically, to take ownership of risks and report variations within the management hierarchy. As such, the holistic nature of ERM presents valuation synergies where the marginal valuation impact of the composite outweighs the impact of any of the individual attributes.

Although the risk appetite and business resiliency attributes do not demonstrate significant correlation to value in and of themselves, the high level of inter-correlation of these two attributes with the others do appear to contribute to the higher composite value.

Risk appetite management is most highly correlated with root cause discipline and performance attributes. The practice of risk appetite management, particularly in integration and resulting actions, is still in a nascent stage. This is driven partially by confusion surrounding definitions and uncertainty in how to apply risk appetite management in strategic and operational settings. It is not enough to merely have risk appetite statements; how the expressions of risk appetite are used as boundaries to inform decisions and monitor exceptions drives better performance. As the discipline of risk appetite management becomes more ingrained in business practices, this attribute possibly may become more identifiably correlated with value.

The business resilience and sustainability attribute deals with preparedness and adaptability to changing business conditions. This attribute is most highly correlated with the ability to identify and anticipate emerging and dynamic risks (uncovering risks attribute). It is not enough to identify future risks; the response and understanding the potential relevance and importance of the risks to the strategy, as well as strategy execution, enables an organization to be more adaptable. As scenarios may or may not come to pass, the contribution becomes more difficult to measure as an individual value contributor.

While this study (like all studies) had limitations, the study provides significant statistical evidence that supports the value that mature enterprise risk management practice can deliver. The positive correlations, while not "proving" the hypothesis in an academic sense, are strong nevertheless, and merit future studies to corroborate the results.

Firms that have successfully integrated the ERM process into both their strategic activities and everyday practices display superior ability in uncovering risk dependencies and relationships across the entire enterprise and as a consequence enhanced [firm] value when undertaking the ERM maturity journey.

KEY FINDINGS

- Evidence that mature practices across the five levels of ERM capability in seven distinct attributes—as defined and measured by the RIMS Risk Maturity Model—was worth a 25% firm value premium.
- The degree to which the organization is able to execute on vision and strategy alongside their risk management activities with ERM being viewed as an integral element in strategy and planning activities is highly significant and value additive.
- The level to which ERM is being integrated into everyday practices is a repeatable and scalable risk management process, allowing an effective embedding of risk culture throughout the organization, is also shown to be highly significant and value additive.
- Twenty-five key action items used to obtain higher levels of ERM capability separately and collectively account for the valuation gain.
- Organizations that are successfully integrating the ERM process into both their strategic activities and everyday practices display superior ability in uncovering risk dependencies and correlations across the entire enterprise and as a consequence enhanced value when undertaking the ERM maturity journey.

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About RIMS the risk management society™

As the preeminent organization dedicated to advancing the practice of risk management, RIMS, *the* Risk Management Society™, is a global not-for-profit organization representing more than 3,500 industrial, service, nonprofit, charitable and government entities throughout the world. Founded in 1950, RIMS brings networking, professional development and education opportunities to its membership of more than 11,000 risk management professionals located in more than 60 countries. For more information on RIMS, visit www.RIMS.org.

About LogicManager™

LogicManager is a leading developer of ERM solutions and creator of its own innovative risk maturity model. LogicManager, based in Boston, donated its intellectual property, expertise and services for the development of the RIMS Risk Maturity Model for Enterprise Risk Management. For more information about LogicManager, visit www.logicmanager.com.

About the RIMS Risk Maturity Model

RIMS Risk Maturity Model for Enterprise Risk Management™ (RIMS RMM), developed in 2005 by risk professionals, RIMS and LogicManager, is a free assessment tool for risk professionals and executives to develop and improve sustainable enterprise risk management programs. This online resource allows organizations to score their risk programs on a five-level scale, and receive an immediate downloadable report, which provides information not only on current maturity levels, but also offers ideas on what it may take to achieve a higher level of maturity in each of seven attributes. The RIMS Risk Maturity Model provides an actionable internal guide that corporations of all sizes, industries and geographies can use to improve their enterprise risk management maturity from whatever level they are at today. For more information about the RIMS RMM and to take the assessment, visit www.rims.org/resources/ERM/Pages/RiskMaturityModel.aspx.