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## What's New?

ERM, Risk Intelligence and Your Nonprofit



**Audio Dial-In Information:**  
U.S. & Canada: 866.740.1260  
Access Code: 7853891

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## Agenda

- Relationship between uncertainty and risk
- History and evolution of risk management
- Risk management challenges
- Risk management imperatives

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## Uncertainty and Risk

- **Uncertainty** – “the overwhelming condition in which we live our lives, as individuals and organizations”
- **Risk** – a sub-set of uncertainty where we try to measure probabilities based on our knowledge, experience and even wishful thinking

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## Continuum of Uncertainty

Clear trends

Unknown but knowable

Residual uncertainty

Source: "Strategy Under Uncertainty,"  
Managing Uncertainty,  
Harvard Business Review

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## Residual Uncertainty

- Clear-enough future
- Alternative futures
- A range of futures
- True ambiguity

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## Risk Happens... or does it?

- "Events" and "situations" described by risk happen or don't happen... these events matter.
- We manage human behavior in the face of uncertainty and its subset, "risk."

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## History of Risk Management\*

- **Risk Management in Antiquity**
  - *Uncertainty* – instinctive drive to guard against the “risk of existence” – pursuit of food and shelter.
  - *Classical Period* – reliance on written language; attribution of the course of events to myth, superstition and divine beings. In 585 BC the philosopher Thales predicted an eclipse of the sun.
    - “A Brief History of Risk Management,” by H. Felix Kloman – featured as Chapter 2 of *Enterprise Risk Management*, John Wiley & Sons, Inc.

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## Renaissance and Enlightenment

- Two developments fueled the discipline of risk management:
  - People begin to believe they are “free agents”
  - Growing fascination with numbers
    - Interpretation of data, calculation of probabilities

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- “The Risk Management Revolution,” *Fortune* magazine - 1976
  - Coordination of “formerly unconnected” risk management functions
  - Board must accept responsibility for policy and oversight

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## “Against the Gods: The Remarkable Story of Risk”

by Peter Bernstein

- Recognition that examining the past could provide insight into the future
- Shift from “helplessness” to “choice,” from “fate” to probability-based forecasts of the future

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## The “Essence” of Risk Management

- “...maximizing the areas where we have some control over the outcome while minimizing the areas where we have absolutely no control over the outcome and the linkage between effect and cause is hidden from us.”
  - Peter Bernstein, *Against the Gods*

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## Risk Management

- “...Any decision relating to risk involves two distinct yet inseparable elements: the objective facts and a subjective view about the desirability of what is to be gained, or lost, by the decision. Both objective measurement and subjective degrees of belief are essential; neither is sufficient by itself.”
  - Peter Bernstein, *Against the Gods*

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## Risk Management as an "idea"

- "...a logical, consistent, and disciplined approach to the future's uncertainties will allow us to live more prudently and productively, avoiding unnecessary waste of resources." - H. Felix Kloman
- Beyond "faith and luck"

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## Let's Talk Terminology

- **Enterprise Risk Management** is: "...a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives."  
 > Source: *Committee of Sponsoring Organizations of the Treadway Commission, www.coso.org.*
- **Strategic Risk Management** is: "using an organization's resources and activities to counter potential losses and seize potential gains."  
 > Source: *Ready...or Not: A Risk Management Guide for Nonprofit Executives*

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## Terminology

- **Risk Intelligence** refers to: "an individual's or an organization's ability to weigh risks effectively."  
 > Source: *Risk Intelligence*, by David Apgar
- **"Risk intelligence** generates awareness of risk at all levels within an integrated framework to obtain the best intelligence available under the circumstance. The goal is to achieve decision superiority and competitive success."  
 > Source: *Surviving and Thriving in Uncertainty*, by Frederick Funston and Stephen Wagner

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## Risk Intelligence

- "...is that experience—any and all experience, past and future, that can help us solve problems requiring an understanding of the risk"
- "...about making choices bearing the risks that our natural run of experience can really penetrate."
- "...consists of whatever collective experience can help determine the evolving drivers of a risk."

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## David Apgar's "Myths" about Risk

- All risks are random
- There's no pattern to how risks evolve

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## More Terminology

- **Black Swan** – "An event or occurrence that deviates beyond what is normally expected of a situation and that would be extremely difficult to predict." "Black swan events are typically random and unexpected."  
 > Source: investopedia.com, but popularized by Nassim Nicholas Taleb in his book, *The Black Swan*

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## One More Term

- **Risk Communication** - "Risk communication is a complex cross disciplinary academic field. Problems for risk communicators involve how to reach the intended audience, to make the risk comprehensible and relatable to other risks, how to pay appropriate respect to the audience's values related to the risk, how to predict the audience's response to the communication, etc. A main goal of risk communication is to improve collective and individual decision-making."  
 > Source: wikipedia.com

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## Enterprise Risk Management

- "a natural evolution of the process of risk management"
- Risk viewed and addressed *between* and *above* the nonprofit's silos



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## ERM Principles for Nonprofits

- Keep "mission" at the forefront
- Acknowledge the environment and other factors beyond the organization's control
- Commit to identify several visions of the "future"
- Learn from our history, including mistakes and successes

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## Path to ERM for Nonprofits

1. Stop thinking of risk and risk management narrowly, e.g. yellow cones, waivers, the insurance renewal process, and protecting known assets.
2. Elevate the discussion of risk (what if?!) to the board table.
3. Look for ways to increase the staff team's comfort with risk vocabulary.
4. Recognize the unique aspects of your nonprofit: skills, awareness, culture, and perspective.
5. Engage an interdisciplinary team to champion risk management.

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Adapted from: *Risk Intelligence*, by David Apgar

## Risk Intelligence Principles for Nonprofits

- **Manage “risk selection”**
  - “Risk is the possibility of a loss or reversal—or gain or advance—different from what we expect from a decision or activity.”
- **Learn about risk:**
  - Formulate possible solutions to problems posed by risk; and
  - Tap experience that shows which solutions may be right, which ones are wrong, or whether we need more options
- Tap diverse perspectives: what do your stakeholders see?

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## Path to Risk Intelligence for Nonprofits

- Consider mission-critical interdependencies
- Explore ways to increase your vigilance with respect to threats and opportunities
- Focus on risk-awareness as a path to better decisions and coping with uncertainty under changing circumstances
- Recognize that you may need more information... set about getting what you need to understand the risks you face

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## Risk Intelligence Principles

- Funston and Wagner note “ten essential risk intelligence skills,” including:
  - Challenging assumptions (the “white swans”)
  - Taking enough of the right risks
  - Anticipating causes of failure

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## Risk Management Challenges

- Calibration
- Directional focus
- Sustainability
- Transparency

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## Risk Management Challenges

- **Calibration**
  - Fine tuning risk awareness, risk assessment and risk treatment
  - Division of labor: board and staff
  - Balance between compliance/reporting and strategy
  - Balancing risk taking with risk aversion
    - What big risks could we take to advance our mission?

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## Risk Management Challenges

- **Directional Focus**

Past and present

The future

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- “Predicting the future is about creating and presenting one view of how the future will unfold.”
- “**Anticipating and preparing for the future** is about looking at multiple views of how the future might unfold.”
  - Randy Park, *The Prediction Trap*

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## Commit to identifying several visions of the future

Our actual path...

Future Thinking Traps - “the trap of extrapolation”

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## "Alternate Futures"

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## Risk Management Challenges

- **Sustainability**
  - Too often risk management is viewed as time-bound activity
  - Institutionalizing skills, processes and tools is paramount
  - Organizations with long-standing silos encounter the most resistance

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## Risk Management Challenges

- **Transparency**
  - Drumbeat will only get louder

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## “Ethos of Transparency”

- The degree to which an organization:
  - Provides public access to information,
  - Accepts responsibility for its actions, and
  - Makes decisions more openly.

Source: Ball, C. (2009) What is Transparency? *Public Integrity*, 11(2), 293-307

- Practical steps?
  - Operating as if the policies and policy-making process of the organization were on display
  - Erring on the side of open, versus closed deliberations

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## Risk Management and Strategy

- **Strategy setting exercise:** what is the risk of not pursuing these goals? What is the risk of performance NOT matching strategy?
- Considering risk during strategy planning “creates an ability to seize risk opportunities”
  - For example: ERM may reveal areas where organization is being too risk averse, or ineffectively responding to similar risks that exist in more than one silo

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- **Strategic thinking (not just strategic planning) is key**
  - Board hones the organization’s direction by engaging in strategic thinking
  - For example:
    - To what degree is the organization’s fate or circumstances determined by environmental/subsector issues or trends?

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- **VUCA:** Volatility, Uncertainty, Complexity, Ambiguity
  - Anticipating issues that shape the environment in which the organization will operate in the future;
  - Appreciating the consequences of issues and action and interdependence of variables;
  - Preparing for alternative realities and leveraging key opportunities
- **“Beyond Strategic Planning”**

Source: wikipedia.com and Johansen, Bob (2007). *Get There Early: Sensing the Future to Compete in the Present*. San Francisco, CA: Berrett-Koehler Publishers, Inc. p. 68.

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### Risk and Time

- “Risk and time are opposite sides of the same coin, for if there were no tomorrow there would be no risk. Time transforms risk, and the nature of risk is shaped by the time horizon: the future is the playing field.”

➤ Peter Bernstein, *Against the Gods*, John Wiley & Sons, New York 1996

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### ERM Imperatives

- Keep “mission” at the forefront
- Acknowledge the environment and other factors beyond the organization’s control
- Commit to identify several visions of the “future”
- Learn from mistakes and loss

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## Final Thoughts

- The mark of a great leader is having the *courage to ask tough questions*, not boasting that you have all the answers.
- For example:
  - What events or trends happening around us impact our ability to deliver our mission?
  - What are the risks associated with our key strategies?
  - Are we “on deck”?

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## Thank you

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## Next Month's First Wednesday Webinar

- The Seven Deadly Sins of “Borrowed” Risk Management Policies
- Wednesday, **February 2, 2011** – 2 pm Eastern



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