



CONFERENCE

PRESENTS

**Ten things that keep risk managers
up at night**

Ten Things That Keep a Risk Manager Up At Night



Robert Patzelt, Q.C.
September 14, 2009
St. John's

In the great province of Newfoundland and Labrador



New World Order

What, Me Worry?



Risk Has Changed

- Heightened level of competition
- Rapid pace of change
- Destroying ability to predict
- Operational related impact
 - Technology, social, political, competition, etc.

Risk Is Broader

- Legal, political, regulatory
- Shareholder and stakeholder relations
- Management's responsibility including
 - Competition,
 - Health, safety & environment
 - Product development
 - Fraud
 - Reputation
 - And the age old financial aspects of running an organization

Business Has Changed

- Intangible assets are a major source of increased risk and complexity
- Intangible assets (Blair and Kochan 2000)
 - 17% of corporate value in 1979
 - 69% by end of 1998
- Cannot wait for the world to unfold
- Admiral Grace Murray – *“A ship in port is safe, but that’s not what ships are built for.”*

Evolution of Risk Management

- Historical risks
 - Property, liability, etc.
 - Departmental analysis
 - Management in silos
- Present day
 - Non-traditional risks
 - New causes of risk
 - Organizational wide involvement
 - Senior management and board involvement
 - Risk indicators

Evolution

- Late 1960s Royal Dutch Shell started to develop "scenarios"
- Helped them react more quickly to 1973 oil crisis (OPEC oil embargo)
- NOW
 - Strategic risk is any unintended event or conditions that ***significantly reduces your ability to implement the business strategy***

Risk Management is Evolving

- Individual hazards
- Focus on all risks
- Risk mitigation
- Risks with no owners
- Risk limits
- Hazard identification
- Risk is not my responsibility
- Enterprise wide view
- Focus on critical risks
- Risk optimization
- Defined responsibility
- Risk strategy
- Monitor & measure
- Everyone's responsibility

Just In Case You Don't Think The World Is Changing

- Introduction of the Euro – Iraq dumped the USD for Euro (USD devalued 50% from 2001) Euro up 90% since inception
- Collapse of dot-com bubble (wiped out \$5 trillion)
- Monthly avg. crude domestic oil from
 - June 08 - \$122.64
 - Dec 08 - \$ 32.94
 - June 09 - \$61.46
- Subprime mortgage market collapses (California – housing prices dropping \$3k per week)
- S&P Price Earnings Ratio 46 in 2000 vs. historical average of 15
- Mercer study of S&P 1500 companies – go from a \$60 billion surplus in 2007 to \$409 billion deficit by end of 2008

E&Y Study

“Risks that Matter”

- Sudden increases and decreases in shareholder value and the implications for CEO's
- 75% chance of a positive shareholder value shift $> 30\%$ in 5 year period
- 40% chance of negative shift
- No pattern for timing of events

E&Y Study cont'd

- 2/3 of +/- value shifts are strategic
- Not operational or financial and hence no engineering or financial instrument to hedge
- Drivers of negative shifts
 - Failure to adapt to changing business environment
 - Customer mismanagement
 - Poor investor relations

Not For Profit & NGO's

Things Are No Different For You

- Key trends
 - Expectation to provide more services
 - More regulation and self-regulation
 - Provision of information
 - Strategic alliances (M&A in my world)
 - Revenue issues (user pay, dues, non-dues, grants, etc.)

NFP and NGO cont'd

- Peer review study of key issues
 - 75% strategic planning challenges
 - 75% conflicting volunteer-staff/leadership challenges
 - 70% deficient member needs assessment (customer disconnect)
 - 75% insufficient crisis management plans

It Is Just Words

- The vernacular is different but it all comes down to
 - Planning
 - People
 - Operations and execution
 - Luck (or bad luck as it were)

Something To Think About

- Whether you act (or not) is as dependent on the probability that you are right but also on the consequences if you are wrong
- If you are comfortable, be concerned
- Anything can happen, we cannot know with certainty the future

A

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Part

2 of 6

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Welcome To The Top 10



Not in order – there is no order anymore!



Reputational Risk

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It takes 20 years to build a reputation and five minutes to ruin it.

If you think about that, you'll do things differently.

Warren Buffett

A good reputation is more valuable than money.

Publilius Syrus, 1st century, B.C.

Criteria of Reputations

- Ability to change
- Management quality
- Long-term focus
- Degree of innovation
- Ability to develop and keep key personnel
- Well-being of employees
- Profitability
- Legal compliance
- Asset usage
- Financial stability
- Investment value
- Customer loyalty & satisfaction
- Product/service quality
- Community & environmental friendliness
- Corporate citizenship

Events

- Martha Stewart
- Canadian Red Cross – tainted blood
- Exxon Valdez
- Tylenol
- Lead products – China
- Enron
- Texaco + racial discrimination
- Weapons of mass destruction

Trusted Brands 2009: Reader's Digest Canada

- Airline



- Packaged meats



Studies

- 2002 study of 800 CEOs – majority believe most important outcome of positive reputation is increase in sales
- 300 companies in Dow Jones Sustainability Index outperformed other global indexes from 2000 to 2003
- 500 largest US companies on *Business Week 1000* with defined commitment to ethical principles outperformed their peers

Research

- Kevin T. Jackson – author of *Building Reputational Capital*
 - “...annual loss of reputational capital to corporations from unscrupulous conduct exceeds the combined profits of the top 40 corporations in the United States.”
- 70% of consumers said that if price and quality are equal – will likely switch to a brand tied to a good cause.

Ask Yourself

- How good is your brand and reputation?
- What are you doing to build or protect it?



Environment and the Green Agenda

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Environmental Indexes

- Indexes now part of socio-economic research and policy planning
- Some key indexes
 - Environmental Sustainability Index (ESI)
 - Environmental Performance Index (EPI)
 - Wellbeing Index (Prescott-Allen)
 - Dashboard of Sustainability
 - Genuine Progress Indicator (GPI)

Indexes cont'd

- Dow Jones Sustainability Indexes
 - DJSI World
 - DJSI STOXX
- Living Planet Index/Ecological Footprint
- EarthTrends of the World Resources Institute

Environment Is On The Agenda

- Part of corporate social responsibility
- \$ spent on advertising, PR and promotion
- Real and moving away from exaggeration
- Credibility issue and avoiding
 - Green spin
 - Greenwash
 - Ecopornography

Coming to a Walmart Near You!



Walmart – Sustainable Product Index

- July 16, 2009 announces SPI
- 15 questions for suppliers
- 4 key areas
 - Energy and climate
 - Material efficiency (reduce waste and enhance quality)
 - Natural resources (high quality, responsibly resources materials)
 - People and community

The 15 Questions Energy and Climate

1. Have you measured your corporate greenhouse gas emissions?
2. Have you opted to report your greenhouse gas emissions to the Carbon Disclosure Project?
3. What is your total annual greenhouse gas emissions reported in the most recent year measured?
4. Have you set publicly available greenhouse gas reduction targets? If yes, what are those targets?

15 Questions cont'd

Material Efficiency

5. If measured, please report the total amount of solid waste generated from the facilities that produce your product(s) for Walmart for the most recent year measured.
6. Have you set publicly available solid waste reduction targets? If yes, what are those targets?
7. If measured, please report total water use from facilities that produce your product(s) for Walmart for the most recent year measured.
8. Have you set publicly available water use reduction targets? If yes, what are those targets?

15 Questions cont'd

Natural Resources

9. Have you established publicly available sustainable purchasing guidelines for your direct suppliers that addresses issues such as environmental compliance, employment practices and product/ingredient safety?
10. Have you obtained 3rd party certifications for any of the products that you sell to Walmart?

15 Questions cont'd

People and Community

11. Do you know the location of 100 percent of your facilities that produce your product(s)?
12. Before beginning a business relationship with a manufacturing facility, do you evaluate the quality of, and capacity for, production?
13. Do you have a process for managing social compliance at the manufacturing level?
14. Do you work with your supply base to resolve issues found during social compliance evaluations and also document specific corrections and improvements?
15. Do you invest in community development activities in the markets you source from and/or operate within?



"You are not here merely to make a living. You are here in order to enable the world to live more amply, with greater vision, with a finer spirit of hope and achievement. You are here to enrich the world, and you impoverish yourself if you forget the errand."

-- Woodrow Wilson, 28th President of United States



Supply Chain Risk

The World Is Flat and Connected

- *“When we try to pick out anything by itself, we find it hitched to everything else in the Universe”, John Muir, **My First Summer in the Sierra***
- Shorter production runs
- Less inventory and warehousing
- TQM
- JIT

SAP White Paper

Quantifying the Impact of Supply Chain Glitches on Shareholder Value

- Study of 838 supply chain glitches (1989-2001) out of Wall Street Journal/DJ News
- 11% decrease in stock price on news getting out
- 75% of stock market reactions were negative
- Destruction of shareholder value ranged from \$129 to \$145 million
- 838 glitches cost \$107 to 120 billion

Next To The Money

- Financial losses can derail strategy and growth
- Impact the long-term reputation of customers and investors
- More expensive to raise capital
- Loss of revenue from service contracts, related purchases and add-ons
- Negative publicity – resource drain

Causes of Problems

- Suppliers – 18%
- Customers – 16%
- Nature and government – 4%

Building a Good Foundation

- Systematic approach for evaluation
- Responsive supplier qualification system
- Robust and performance-based supplier selection process
- Good performance criteria, measurement and data collection
- Relationships that allow for information sharing, collaboration and visibility
- Good use of technology (internet, real time)

In Case You Think Supply Chain Has Nothing To Do With NFP

- Medical isotopes
 - Global supply under pressure - Chalk River, Ont. - much of the world's supply is produced in Canada.
- Also consider
 - FEMA and Hurricane Katrina
 - Red Cross – tainted blood



"You have to think about 'big things' while you're
doing small things,
so that all the small things go in the right
direction." -- *Alvin Toffler*



Human Resources

Key Trends

- Changing demographics
- Contract employees and outsourcing
- Inter-generational differences
- Baby boomer retirement
- Rising health care costs
- Work/life balance and work intensification to increase productivity

Ernst & Young

2008 Global Human Resource Risk

- Top 5 areas of concern
 - Talent mgt & succession planning – 65%
 - Ethics and tone at the top – 64%
 - Regulatory compliance – 51%
 - Pay and performance alignment – 45%
 - Employee training and development - 41%

Moving From Burden to Benefit

- People Source of Risk
 - Employee shortage
 - Poor performance
 - Turnover
 - Lack of commitment
 - Personal issues – divorce, chronic illness, accidental death
- Norris & Assoc. – All Losses Have Human Element
 - Product Liability – e.g. improper design, claims handling
 - D&O – failed due diligence
 - Employment practices liability: improper recruitment, poor training, harassment/discrimination, poor policy & procedure, mishandled discipline, poor career management, disability and workers comp.
- People Are Critical in Handling Risk
 - Need talent to solve problems
 - Adaption, rapport, leadership, setting example
 - People going the “extra mile”

Key Areas of HR Risk

- Regulatory compliance
- Business reputation
- Unhappy employees
- Budgetary risk
- Risk of prosecution
- Employment law

Top 5 Employer Lawsuit Risks

- Age discrimination
- Retaliation
- Equal pay
- Sex discrimination
- Disability discrimination

New Direction

- Move from managing assets to leading people
 - Leadership
 - Communication
 - Training and motivation
 - Conflict management, performance and evaluation

HR Critical to Success

- Especially in service industry
- 1999 Study (Drake & Watson Wyatt)
 - Study of 405 public companies found that a well-managed workforce can add up to 30% to market value
 - Study of 40 companies – top half in training expenditures had higher net sales and higher gross profit/employee
 - “Invisible Advantage” (book) – 20% increase in employee satisfaction can boost financial performance more than 40%

The BCD's

Benefits, Compensation, Diversity

- Composition of senior management & governance bodies (diversity)
- Net employment creation and turnover
- Benefits above what is legally mandated
- Clear org. goals, measures and matching incentives

Employee Power

- Freedom of expression and tolerance of individuality
- Training investment
- Incentives for employee volunteerism, education and career development
- Continuous improvement of EHS

Key HR Measures

- Talent acquisition
- Workforce retention
- Employee relations
- Compensation
- What makes a “great place to work”

Consider This:

- Some of your greatest organizational wealth is not money or assets but what is going up and down in the elevators – YOUR PEOPLE
- YET – HR is frequently not at the table or the drivers that affect the organization are not effective in influencing matching organizational change



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Upper Management *numero cinq (5)*

Change in Structure

- Further separation of ownership and control
 - Managers now dominant actors in decision making
 - Owners – primarily supply of capital
 - Owners widely distributed
 - Complicates oversight and lead to potential for corruption
 - Since 1980's
 - Rise of "cult of corrupt managers"
 - General public distrust
 - Shareholder activism – agency challenges
 - Stakeholders broadening
 - Milton Friedman's dictum not absolute – "*the business of business is business*"

Hey Buddy!

Can You Paradigm?

- New management order
- 50 to 90% of firm's market value can be attributed to intangibles like EHS
- 35% of institutional investors' allocation decisions are based on intangibles re EHS
- 81% of Global 500 execs rates EHS issues in top 10 value drivers

Reporting and Accountability

- 68% of the 100 largest global companies issue EHS reports
- In 2001 487 companies reported
 - 194 in 1995
 - 7 in 1990
- 200 mutual funds run by 800 portfolio managers dedicated to socially & environmentally responsible investing
 - \$2 trillion which is over 10% of the 19.9 trillion under management in the US

Management and RM

- Board and senior management now involved
- Strategy and risk are interrelated with a focus on objectives. Process is how you get there
- RM crosses the whole organization
- RM should reflect the organization's appetite for risk
- Reasonable assurance NOT certainty

Survey

- Survey of Global HR Challenges
- World Federation of Personnel Management Associations
 - TOP ISSUES
 - Leadership development
 - Change management
 - Organizational effectiveness

Note

- Not about assets, money, etc.
- It is about people, leadership and people processes and TRUST
- ***Margaret Mead*** – “Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it's the only thing that ever has.”
- Is our leadership up to the challenge?



Change (Getting Faster)

Change



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Fortune 500

1999

vs.

2009

1. GM
2. Ford
3. Wal-Mart
4. Exxon Mobil
5. GE
6. IBM
7. Citigroup
8. Altria
9. Boeing
10. AT&T

1. Exxon Mobil
2. Wal-Mart
3. Chevron
4. Conoco Philips
5. GE
6. GM
7. Ford
8. AT&T
9. HP
10. Valero Energy

How Fast Things Change

- When we were little there was no Wal-Mart
- Valero Energy
 - In 1980, Valero was a regional energy company with total assets just shy of \$800 million, operations solely in Texas and less than 1,600 employees on its payroll. Today, Valero has annual revenues of \$119 billion, including 16 refineries, six ethanol plants and approximately 5,800 retail and branded wholesale locations across North America.

Stall Points Study

- *Stall Points, Corporate Strategy Board*
- 172 companies, 50 largest companies on Fortune list with 6% sustained growth rate
- Only 5% between 1955 and 1995
- Once growth stalled only 4% were able to reignite growth
- 28% lost 75% of market cap
- 41% lost 50-75% of market cap
- 26% lost 35-50% of market cap

Percent of Valuation Based on New Investments

- Dell Computer -78%
- Johnson & Johnson – 66%
- Proctor & Gamble – 62%
- General Electric – 60%
- Wal-Mart – 50%



There is more to *life* than simply increasing its *speed*.
--Mohandas Gandhi

Think

- ATMs
- Internet
- Cell phones and Wi-Fi
- Laser eye surgery
- On line dating
- ABS brakes (once only for aircraft)
- TV remote

Investment in Technology

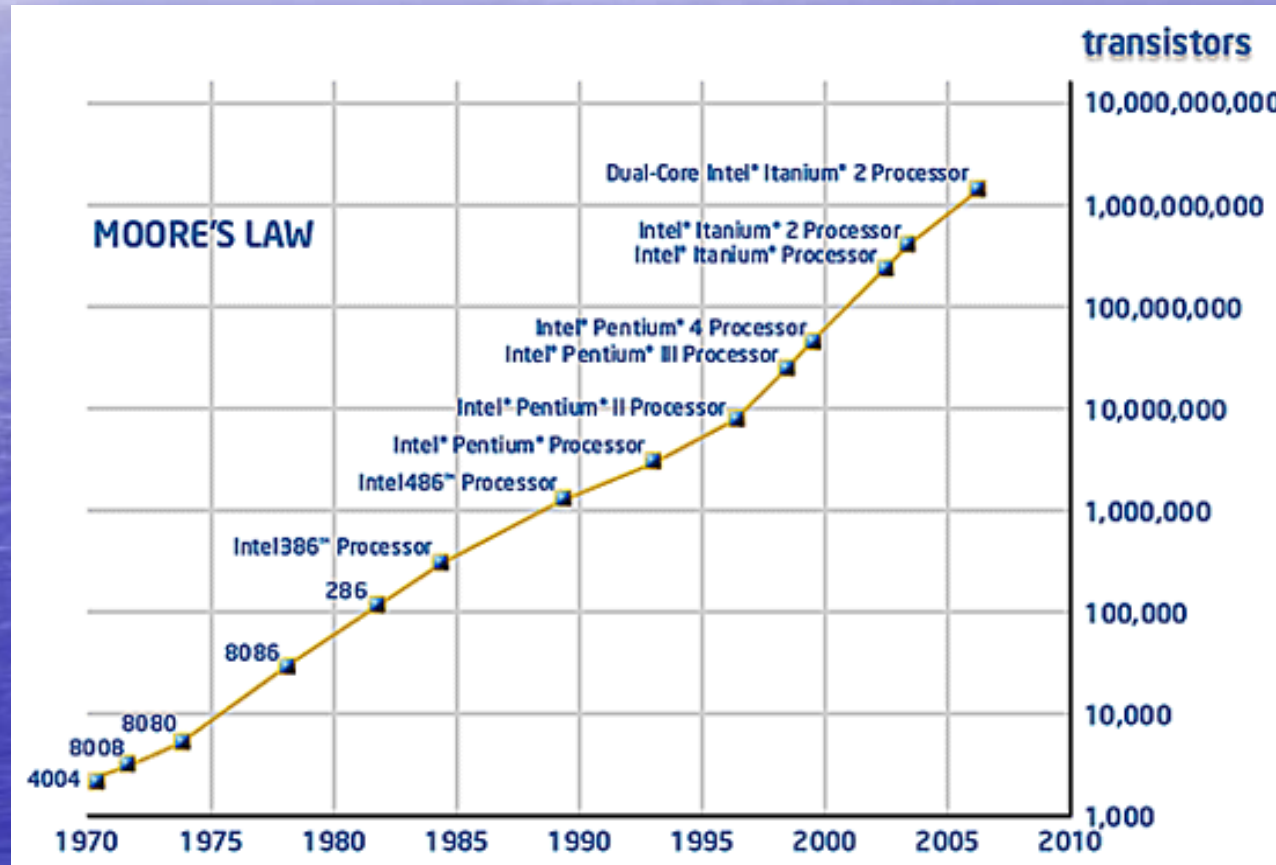
- 1974 – hi tech venture capital - \$30m
- 1998 – about \$7.6 billion
- 2000 – tech bubble - \$119 billion
- 2007 – \$27.7 billion
- 2008 – clean tech just \$4.7 billion by itself

Disruptive Technologies and Companies

- Amazon – Internet disruption of bookstore
- Charles Schwab – 1990s online trading
- eBay – online auction
- Intel – microprocessor – take out mainframes and mini computers
- Online travel – wiped out travel agency business
- Sony – video tape, cassette tape, Walkman, floppy disk
- Wireless telephony – 25 year disruption of the old phone company
- Handheld devices – Palm Pilot, Blackberry, i-phone
- Ford Model T – allowed everyone to afford cars
- Email – snail mail – magazines, bills and junk mail

Moore's Law

Computing Power Double Every 18 Months





GNR

Not That GNR



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This GNR

- Genetics
- Nanotechnology
- Robotics

- Where is it all leading?
- Don't know but it will be FAST

Change





Regulatory Risk

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Regulatory Risks

- Securities and Sarbanes Oxley
- Environmental
- Self-regulatory
 - ISO, Euro mark
- Human Resources
 - Labour
 - Human rights
 - Pension and benefits
- Corporate governance
- Taxation, source deductions, HST
- Trade and finance
- Operational
 - Health and safety
 - Food safety & testing
 - Labeling

The Big Questions

- Do we know and understand all of our regulatory requirements?
- How are we dealing with the above?
- Do we have a strategy, policies and procedures including reporting and accountability?
- Do we collect data to support reporting and compliance and does it demonstrate if our systems are working? Is it accurate?
- How do we interact with regulators?
- Do we have the capabilities and the right culture and processes?

Study: "From *Burden to Benefit*" Ace, KPMG and Towers Perrin 2008

- Economist Intelligence Unit's Risk Barometer
- Regulatory Risk by execs seen as a significant threat to business ahead of:
 - Country risk
 - Market and credit risk
 - IT and HR risks
 - Terrorism and natural disasters

Greatest Consumer of Time and Resources

- 75% - audit and reporting regs
- 35% - workforce regulations
- 32% - environmental regulations
- 27% - health and safety regulations
- 27% - technology regulations
- 18% - intellectual property regulations
- 15% - other

Factors Hindering Ability to Manage Regulatory Risk

- 66% - complexity of regulatory environment
- 46% - lack of regulatory harmonization between jurisdictions
- 32% - **lack of “risk culture” within org**
- 21% - difficulty in recruiting expertise
- 21% - lack of collaboration between departments
- 15% - insufficient budget
- 11% - inadequate support from senior mgt.
- 10% - poor relations with regulators

Benefits of Regulatory RM

- 55% - more efficient business processes
- 48% - "best practices" competitive adv.
- 46% - ability to anticipate future change
- 41% - ability to evaluate investment opportunities (quickly & efficiently)
- 34% - better relations with shareholders
- 22% - better relations with customers

Methods to Improve Reg RM

- 62% - training of employees
- 49% - formalization/documentation of compliance process
- 41% - invest in new technology
- 29% - formation of board sub-committee
- 9% - recruitment of Chief Compliance Officer

Purpose of Process

- Compliance, monitoring and reporting are *not to make* the “regulator happy”
- It is for the organization
 - Enables management to meet its required strategy
 - Ensures the risks are managed that endanger the organization

The Failure to Follow Regulations



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Black Swan Events (8)

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Black Swan

- Nassim Nicholas Telab
- *The Black Swan: The Impact of the Highly Improbable*
- Large impact, hard to predict events
- 3 criteria
 - Event appears as a complete surprise
 - Has a major impact
 - After, it is “explained” by human hindsight
- Hardwired to find evidence to support what we think to be the case

Some Black Swans

- Black Monday
- 9/11
- WW1
- Fall of Soviet block/Berlin Wall
- Personal computer
- Google vs. Yahoo or Microsoft
- Peer to peer downloads
- Internet
- Harry Potter

Financial Crisis

- Some argue it was not a Black Swan because it was predicted by a few
 - Leverage of borrowing (housing bubble)
 - Avarice and greed (exec salaries, stock options)
 - Financial instruments not approved by regulators or not understood, etc.

What is the Next Black Swan

- Financial (are we out of the woods – complex financial world – fighter jet)
- Energy (peak oil, peak gas, nationalism, and security interests, etc.)
- Political (terrorism, protectionism)
- Technology (what is the next Google or killer app?)
- Biological – nanotechnology, genetic modification, pandemic



THE SPANISH INQUISITION

Just when you least expect them.



Proper Measurement of Risk Management Success

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What gets measured gets
managed, *Peter Drucker*

We really need good performance
criteria!

Dark Suit Syndrome



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Benchmarking Risk Management (Potential Areas)

- RM frameworks (risk definition, assessments)
- Implementation (procedures and processes)
- Risk sharing (insurance, non-insurance)
- Business continuity planning
- Risk communication
- Training and awareness
- Monitoring and review
- Performance measurement

Performance Measurement

- Valid
- Reliable
- Easily understood
- Timely
- Consistent
- Focused on controllable aspects of performance
- Resistant to manipulation or perverse behavior
- Efficient and non-redundant
- Cost effective (sensitive to data collection costs)

Key Aspects of RM Performance

- What do we do and how do we do it?
- What risks are we assuming and what can go wrong?
- What drives our profit and loss and are we satisfied with the risks we are assuming?
- What is changing?
- Are we behaving the way we should?

Some Benchmarks

- Annual report (get message to C-level)
- Claims reporting
- Contract review
- Organizational changes (e.g. property values/uses)
- Communication (memos, newsletters, safety or risk manual)
- HR (hiring practices, RTW, accident investigation)
- Liability review including claims
- Policies (e.g. auto, ergonomics)
- Recognition (safety awards, loss prevention awards)
- Committees
- Workers Comp & disability cost containment
- Business Continuation Planning
- Audits and inspections



ten

Can We Bring it all Together?
ERM

ERM Context

- Deloitte & Touche observations
 - 45% have no ERM program
 - 49% have program in development
 - ONLY 6% have operational ERM

FM Global Study

Improving Risk Quality to Drive Value



FM Study cont'd

- FM Global Risk Mark score as physical risk benchmark
 - Versus
- Financial
 - Stock return
 - Stock price volatility
 - Cash flow
 - 438 publicly traded firms with market cap of \$3.4 trillion USD

Risk Management Works

- Risk Mark is positively and significantly correlated with stock return
- Risk Mark is negatively and significantly correlated to stock price volatility
- Risk Mark is negatively and significantly related to a core driver of stock price volatility (i.e. operating cash flow & earnings volatility)
- Therefore: high risk quality = positive shareholder value performance

Conclusions

- The FM study was just property risk
- What is the overall impact of a systematic way of handling risk? HUGE
- Disciplined RM is the way forward
- It is the **ONLY** way forward

Robert's Rules of Order



You Will Succeed If:

- Learn something new
- Enjoy Newfoundland
- Make a new friend
- Call home and bring gifts (especially for mom)
- Have fun



Thank
You
for
Coming!
and
helping

THANK YOU FOR ATTENDING



ENJOY THE REST OF YOUR CONFERENCE!

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