

Integrating Balanced Scorecard and Enterprise Risk Management

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Getting Ready for This Workshop...



Workshop Goals

Our Goals

- ▶ Share research, cases, and experience in BSC and ERM
- ▶ “Co-Create” the workshop as we go along to answer your questions and meet your needs
- ▶ Learn from you and your experiences with ERM and BSC

Your Goals

- ▶ Learn about the Balanced Scorecard and Enterprise Risk Management

- ▶ _____
- ▶ _____
- ▶ _____

Why Manage Risk?

- ▶ Why Manage Risk?
- ▶ A Balanced Scorecard Primer
- ▶ BSC/ERM Point Solutions
- ▶ Towards An Integrated BSC/ERM Model

Why Manage Risk?



**Washington
Mutual**



LEHMAN BROTHERS

TRUMP

Managing Risk Is ESSENTIAL In Today's Environment

- Many of the failings of companies can be attributed to the acceptance of excessive risks or the poor management of those risks
- Most companies have not formally considered what their true appetite for risk is, accordingly, they do not have effective processes to ensure they operated within the expectations of key stakeholders
- Risk appetite, tolerances, risk targets and limits are a critical element of prudent business management and an effective risk governance process

Types of Risk

Financial

- Loss of program funds and resources.

Process

- The risks associated with misaligned processes to achieve business objectives.

Intangible

- Damage to reputation, brand and lost information.

Time

- Delays, opportunity cost, mission loss.

Human

- Loss of knowledge, skills and commitment of people.

Legal

- Loss due to Governmental, federal and local regulations.

Physical

- Loss of land, buildings and equipment.

Enterprise Risk Management Is a Portfolio View of Risk



**But Enterprise Risk Management Is NOT Just
The Sum of Risks**

Enterprise Risk Management: A Formal Definition

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**.

Enterprise Risk Management Framework

4 Key Risk Management Areas



Managing Risk Requires Managing Strategy

ERM Requirements

- ▶ Focused on Strategy
- ▶ Aligned to Operations
- ▶ Regular Reporting
- ▶ Compliance



BSC Attributes

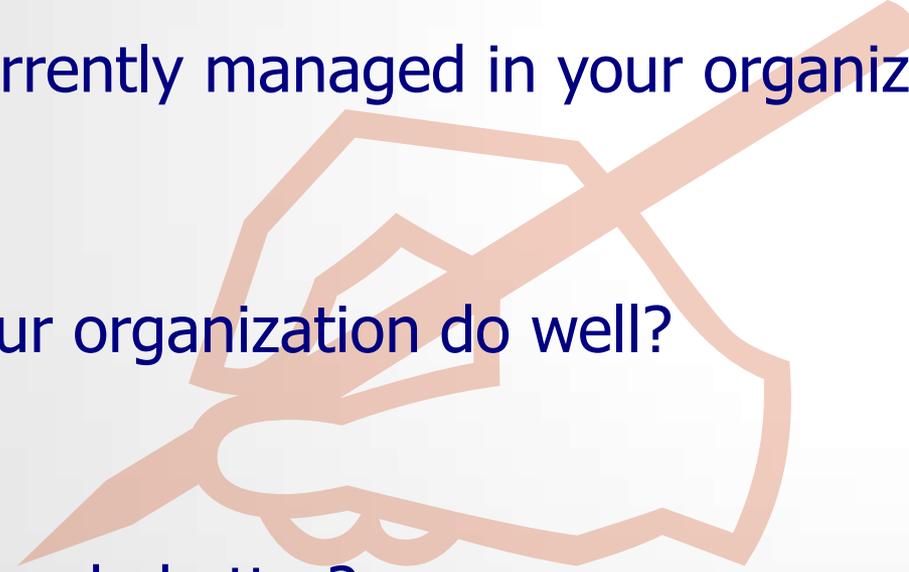
- ▶ Focused on Strategy
- ▶ Aligned to Operations
- ▶ Regular Reporting
- ▶ Let's Discuss

Why Manage Risk?

Done correctly, risk management allows organizations to:

- ▶ Align risk appetite and strategy
- ▶ Enhance risk response decisions
- ▶ Reduce operational surprises and losses
- ▶ Identify and manage multiple and cross-enterprise risks
- ▶ Seize opportunities
- ▶ Improve deployment of capital

Table Discussion

- 
- ▶ How is risk currently managed in your organization?
 - ▶ What does your organization do well?
 - ▶ What could you do better?

Agenda

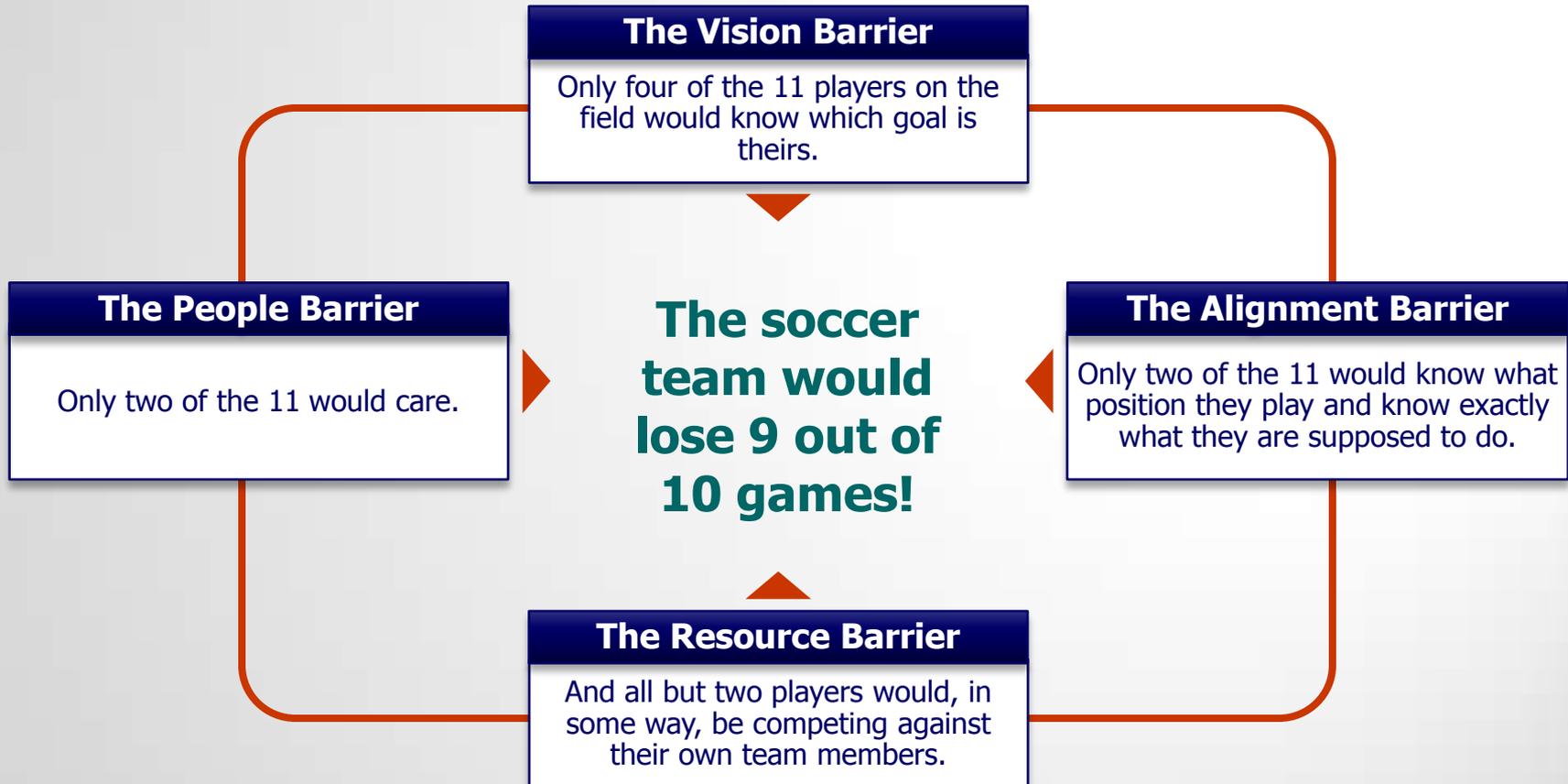
- ▶ Why Manage Risk?
- ▶ A Balanced Scorecard Primer
- ▶ BSC/ERM Point Solutions
- ▶ Towards An Integrated BSC/ERM Model

Does strategy work?



Source: Stephen R. Covey, *The 8th Habit: From Effectiveness to Greatness* ©2006

Does strategy work? Often, sadly, the answer is no.



Source: Stephen R. Covey, *The 8th Habit: From Effectiveness to Greatness* ©2006

Can these odds be improved? Yes!

Duke Children's Hospital



- Parent Sat. up from 4.3 to 4.7
- Cost per case down 33%
- Length of stay down 31%
- Nursing absentee down 42%
- Net Margin up \$15 Million

Hillside Family of Agencies



- Reduced engagement wait time 56%
- Shrank administrative overhead 25% in 2 years
- Exceeded revenue growth targets for 8 quarters in a row

Fulton County Schools



- SAT up 23 pts over nation with 89% testing vs. 48%
- 82% parent Sat. vs. 68% nationally
- Teacher vacancies and admin expenses down
- 5 pt annual improvement in state tests for 3 years

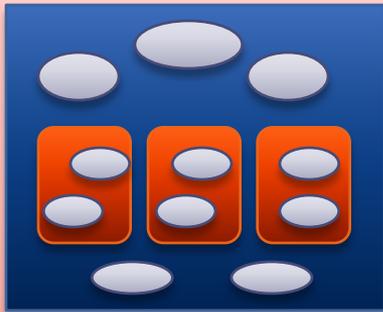
Canadian Blood Services



- 65% increase in donor satisfaction in 2 years
- 70% increase in hospital satisfaction in 2 years
- 20% increase in red blood cell yield, saving \$3 M
- Restored public trust in Canada blood supply

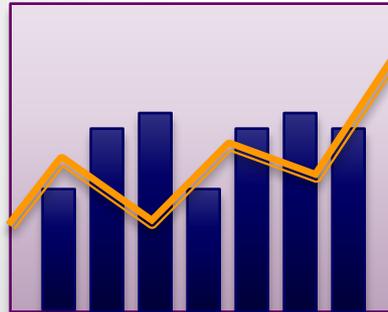
He who fails to plan, plans to fail.

Plan



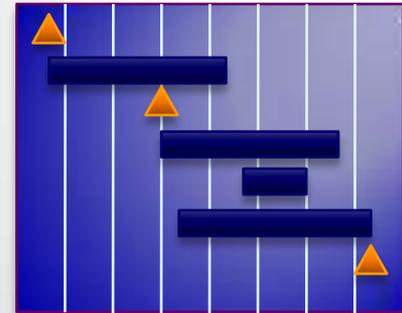
Where are we going?

Measure



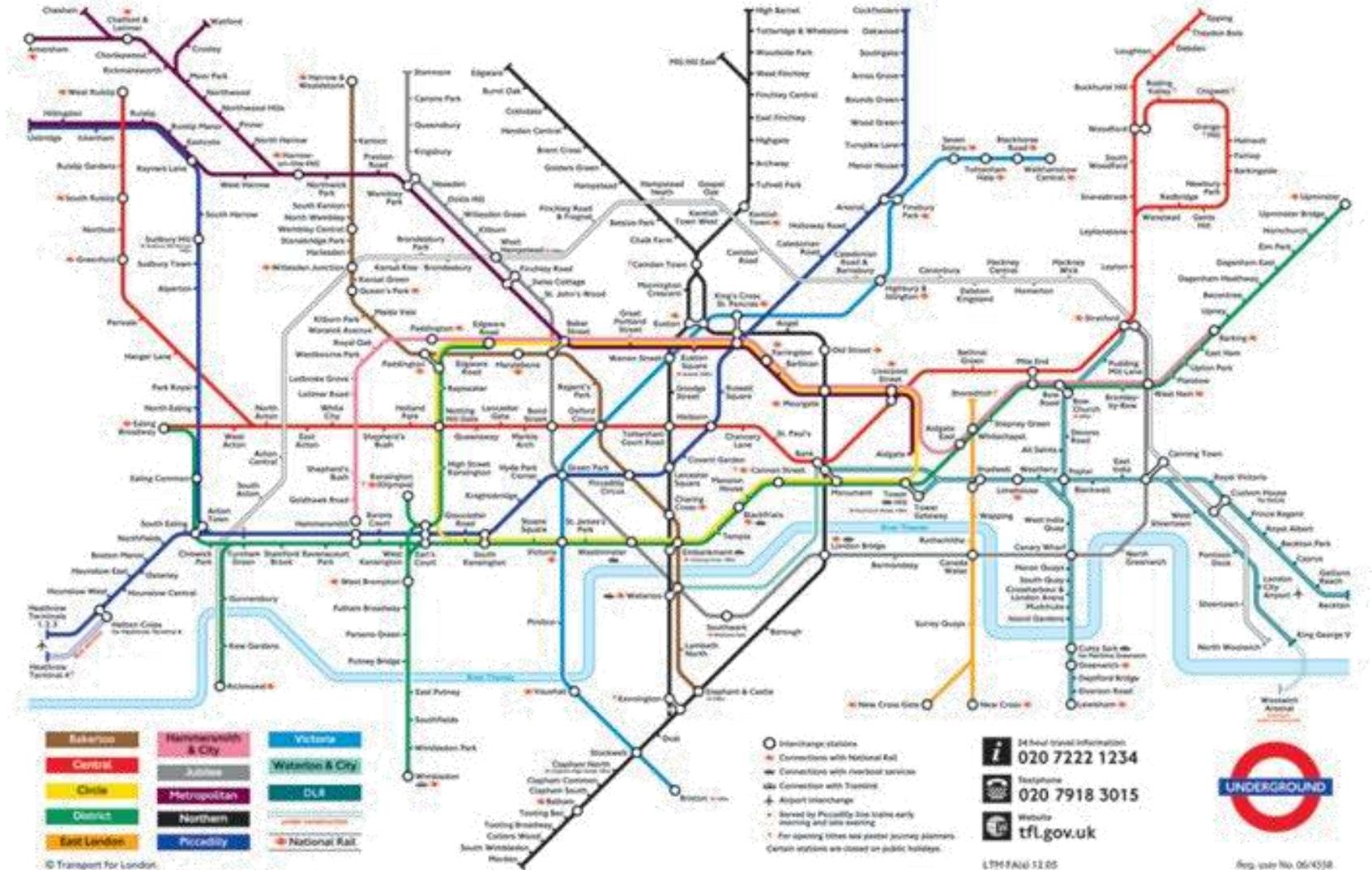
Are we there yet?

Respond



Can we afford it?

Have you ever needed a map?



Teach for America needed a map.

TEACHFORAMERICA

Background

- ▶ Founded 1990
- ▶ Placed highly qualified college grads in underserved high schools
- ▶ Started with 500 teachers

Challenges

- ▶ Mid '90s outgrew startup phase
- ▶ Lack of preparation
- ▶ Poor lesson planning
- ▶ Lack of support

More Challenges

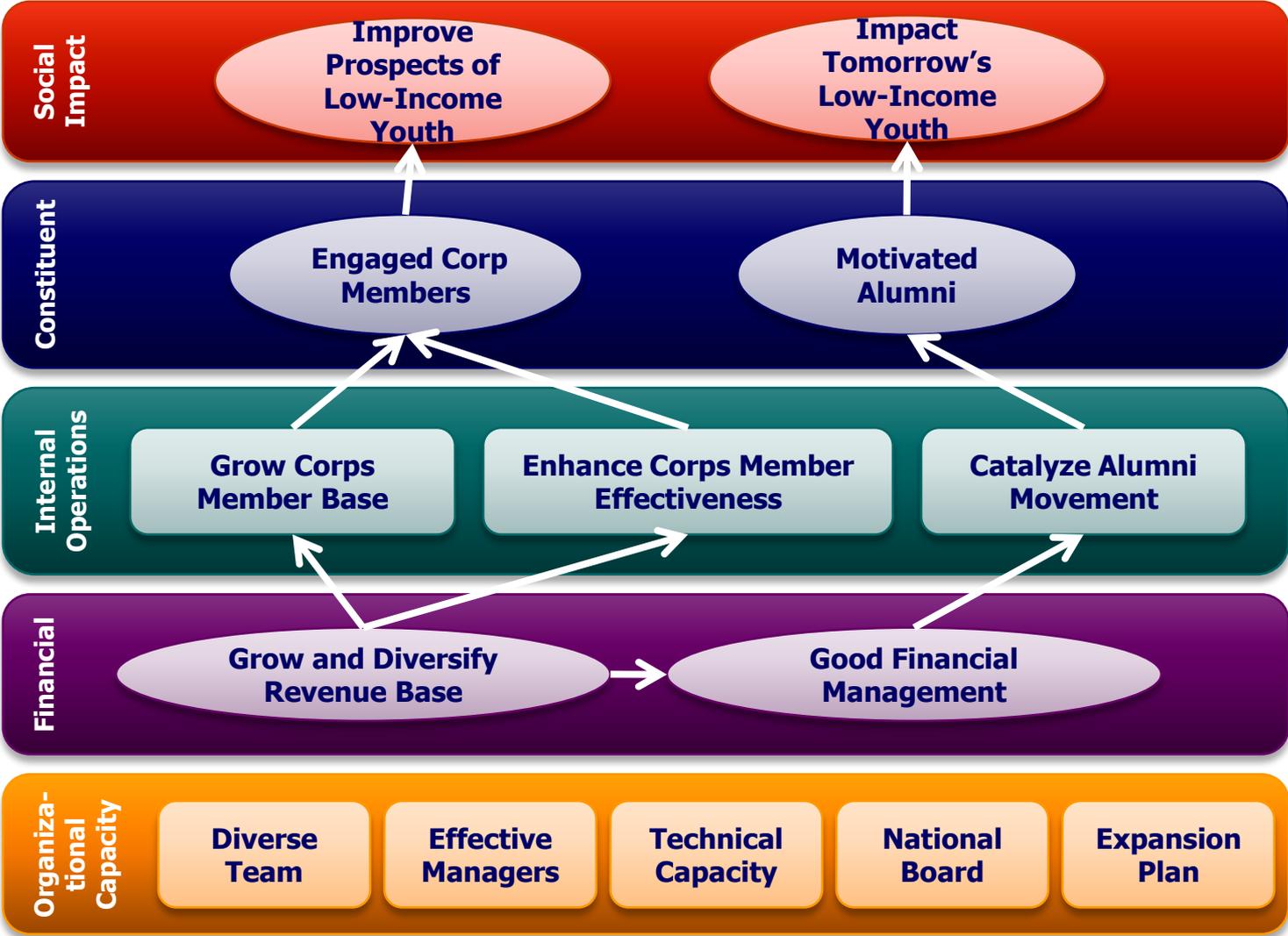
- ▶ 2001 recession job market sent applications from 5,000-14,000
- ▶ No Child Left Behind complicated Corp Qualifications
- ▶ 10 year alumni summit focused on growth and impact

First, they had to clearly define who they were.

TEACHFORAMERICA

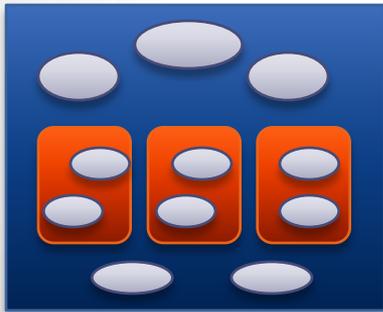
Improve the prospects of low-income youth of today and tomorrow by training and placing highly qualified college graduates in at-risk, low-income urban and rural schools.

Teach for America's Strategy Map



Measurement motivates.

Plan



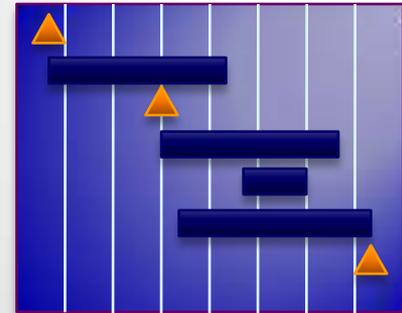
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Are we there yet?

Respond

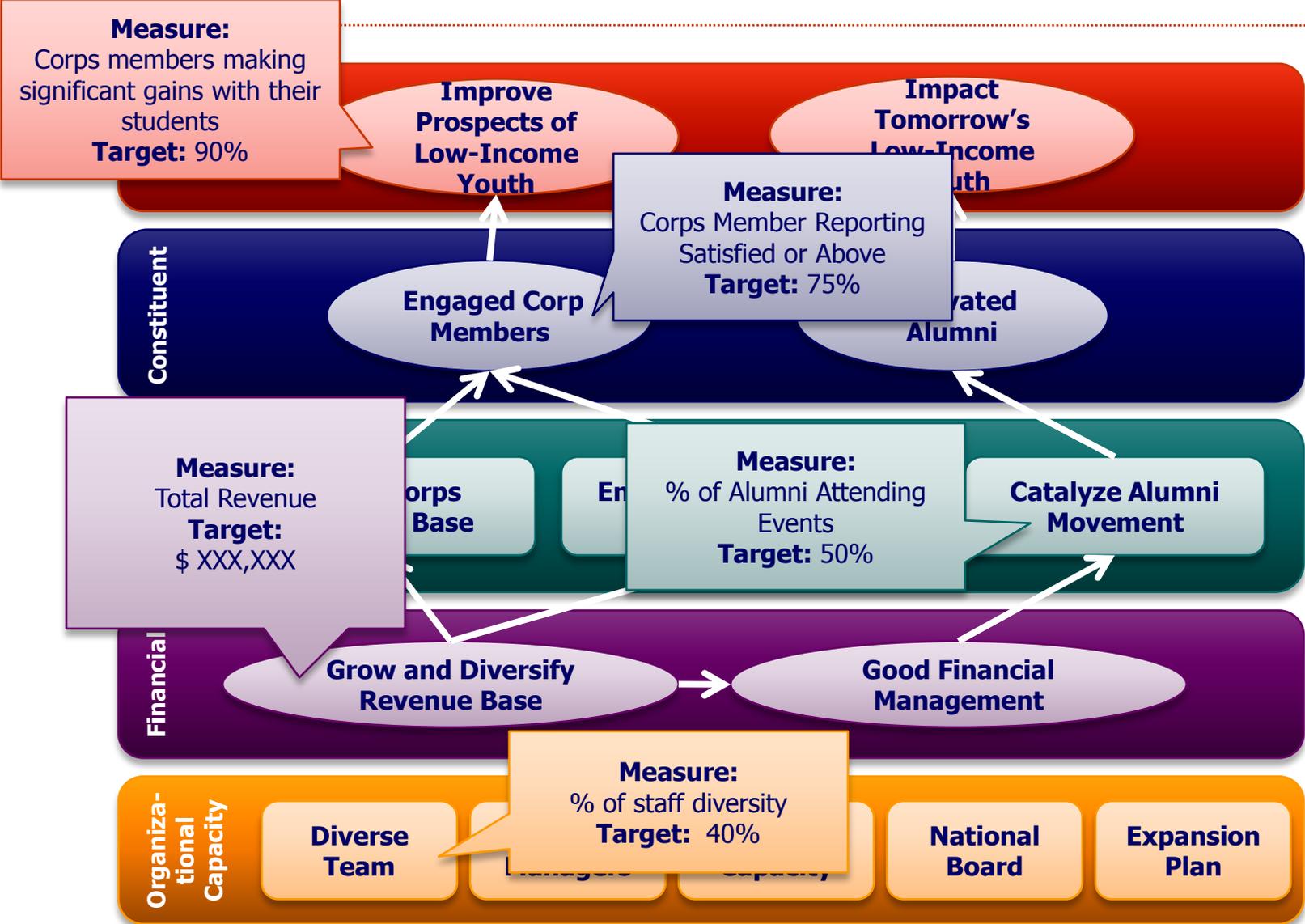


Can we afford it?

You can't manage what you can't measure.



Teach for America's Measures

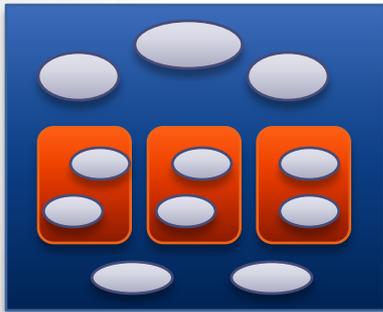


Teach for America's Scorecard

Perspective	Objectives	Measures	Targets
Social Impact	<ul style="list-style-type: none"> • Improve prospects of low income youth • Impact tomorrow's low-income youth 	<ul style="list-style-type: none"> • CM Effectiveness Measure • Results of Studies • Alumni Career Choice index 	<ul style="list-style-type: none"> • 90% • Better than not • 50% in Ed.
Constituent	<ul style="list-style-type: none"> • Engaged corps members • Motivated alumni 	<ul style="list-style-type: none"> • Percent Satisfaction • Engagement Index 	<ul style="list-style-type: none"> • 75% • 66%
Internal Operations	<ul style="list-style-type: none"> • Grow corps member base • Enhance corps member effectiveness • Catalyze alumni movement 	<ul style="list-style-type: none"> • Number of Applicants • First Review Accuracy Percentage • % of alumni attending events 	<ul style="list-style-type: none"> • 20% growth • 90% • 50%
Financial	<ul style="list-style-type: none"> • Grow and diversify revenue base • Good financial management 	<ul style="list-style-type: none"> • Total Revenue • # HNW Individuals contributing • Cost per CM 	<ul style="list-style-type: none"> • \$XXX,XXX • 100 • 20% less
Organizational Capacity	<ul style="list-style-type: none"> • Diverse Team • Effective Managers • Technical Capability • National Board • Expansion Plan 	<ul style="list-style-type: none"> • % of staff Diversity • % of key goals met • Staff Satisfaction with Technology • \$ raised through board members • # new sites 	<ul style="list-style-type: none"> • 40% • 90% • 80% • \$XXX,XXX • 4

Put your money where your mouth is.

Plan



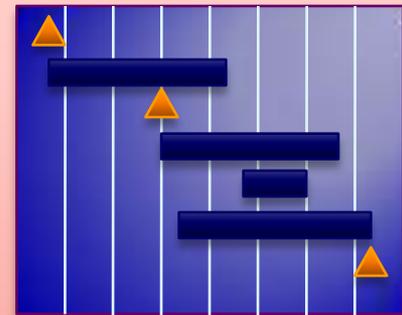
Where are we going?

Measure



Are we there yet?

Respond



Can we afford it?

Projects are like puppies.



Teach for America's Program Map

Objectives	Standardized Curriculum	Alumni Survey	Southeastern Expansion Plan	Librarian Training Program	Accounting System	Fundraising Campaign	Standardized Testing Advocacy	School Lunch Program	Knowledge Management	Board Offsite Retreat	Website Redesign	Staff Training Program
• Improve prospects of low income youth												
• Impact tomorrow's low-income youth												
• Engaged corps members												
• Motivated alumni		X										
• Grow corps member base												
• Enhance corps member effectiveness	X								X			
• Catalyze alumni movement		X										
• Grow and diversify revenue base			X			X						
• Good financial management					X							
• Diverse Team												
• Effective Managers					X				X			X
• Technical Capability	X								X			X
• National Board			X							X		
• Expansion Plan			X									

Teach for America's Program Map

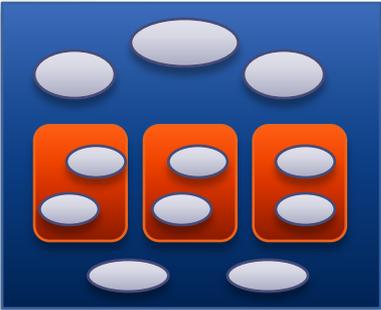
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• Enhance corps member effectiveness	X								X			
• Catalyze alumni movement		X										
• Grow and diversify revenue base			X			X						
• Good financial management					X							
• Diverse Team												
• Effective Managers					X				X			X
• Technical Capability	X								X			X
• National Board			X							X		
• Expansion Plan			X									

Teach for America's Program Map

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• Engaged corps members												
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• Catalyze alumni movement		X										
• Grow and diversify revenue base			X			X						
• Good financial management					X							
• Diverse Team												
• Effective Managers					X				X			X
• Technical Capability	X								X			X
• National Board			X							X		
• Expansion Plan			X									

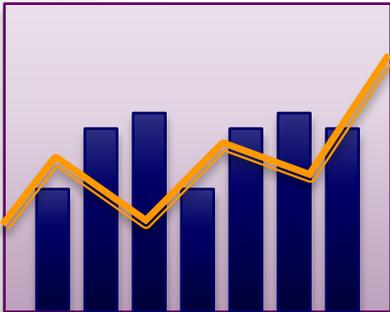
However beautiful the strategy, you should occasionally look at the results

Plan



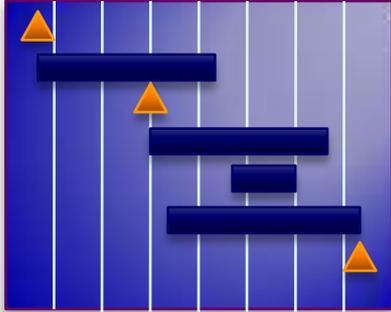
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Are we there yet?

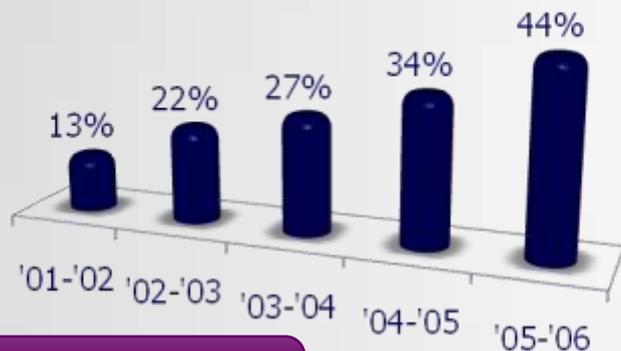
Respond



Can we afford it?

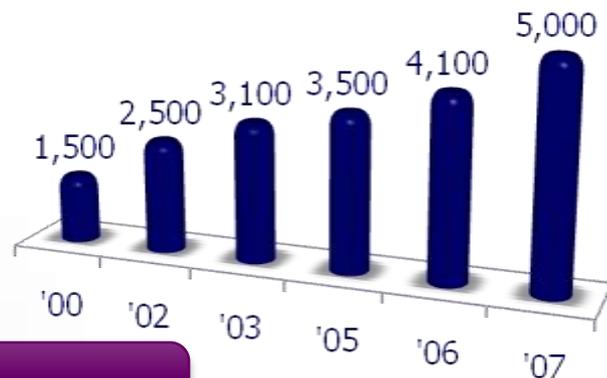
Teach for America Results

Corp members making significant gains with their students



**1.5 years progress
in 1 year**

Growth in Corp Members

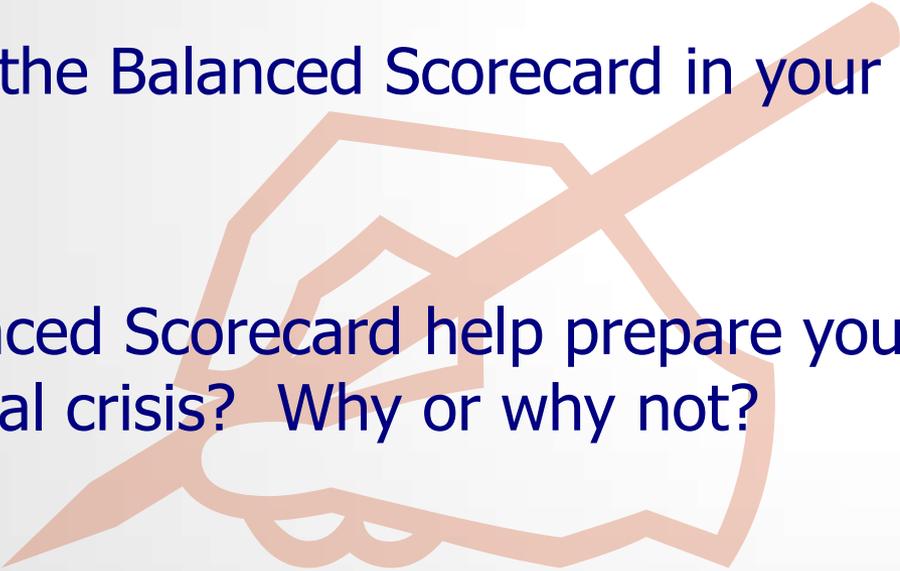


22% CAGR

12,000 Alumni

- **94% in jobs that support the Teach For America mission**
- **67% in Education (most in public schools)**
- **247 principals**
- **200+ in policy or advocacy roles (6 elected officials)**

Table Discussion

- ▶ Are you using the Balanced Scorecard in your organization?
 - ▶ Did your Balanced Scorecard help prepare you for the current financial crisis? Why or why not?
- 

Agenda

- ▶ Why Manage Risk?
- ▶ A Balanced Scorecard Primer
- ▶ BSC/ERM Point Solutions
- ▶ Towards An Integrated BSC/ERM Model

The "Traditional" BSC Does Not Address Risk Management Well

- ▶ Target setting (for KPIs) does not typically take risks into account, so "stretch" targets could be set that could drive risky behaviors
- ▶ External risks (in credit markets, for example) are often not adequately captured in the definition of measures or objectives
- ▶ There is a temptation to treat risk management as "yet another objective" and lose the benefit of an integrated risk and strategy view

Integrating BSC and ERM: Point Solutions



Source: "Integrating BSC and COSO ERM Frameworks," by Takehiko Nagumo and Barnaby Donlon, *Cost Management*, July – August 2006

Augmenting KPIs with KRIs for Key Measures Can Provide a More Balanced View

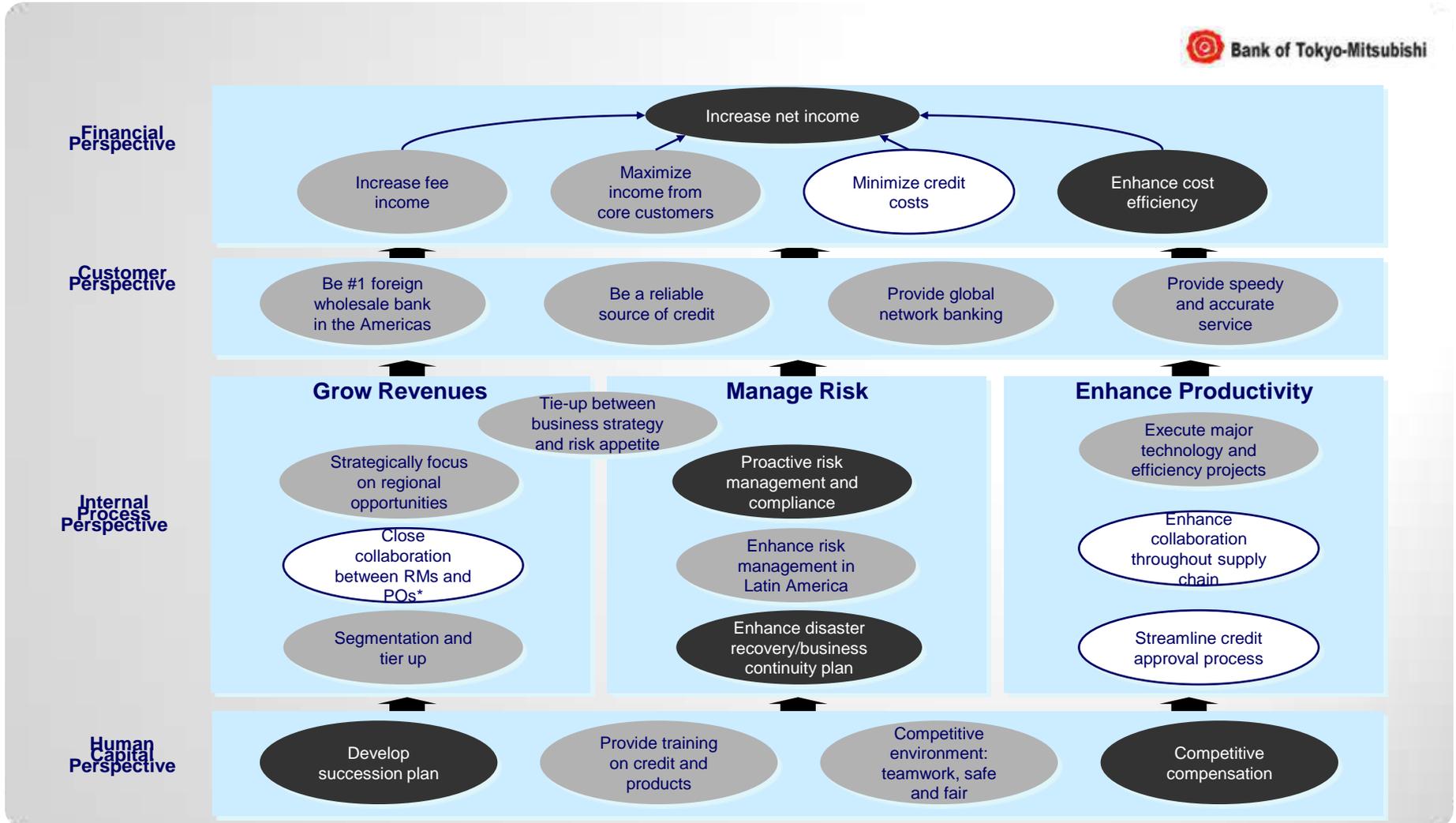
Key Performance Indicators

- Define success for an objective
- May be drive or outcome focused
- Measure of how well something is being done

Key Risk Indicators

- Define risks for an objective
- Identify the possibility of future adverse impact
- Give an early warning to identify a potential adverse event

A Risk Management Theme May Be Appropriate For Risk Driven Organizations



Source: "Integrating BSC and COSO ERM Frameworks," by Takehiko Nagumo and Barnaby Donlon, *Cost Management*, July – August 2006

There Are Shortcomings To All Risk Management "Point Solutions"

Approach	Benefit	Shortcoming
Key Risk Indicators	Adding KRIs provides a more holistic view of risk / reward.	Limited to the objectives and measures selected on the scorecard.
Risk Management Theme	Focuses organization on the key issues around risk	Does not allow for a "systems view" of risk.
Initiative Risk Management	Projects can be evaluated and managed based on risk	Strategic initiatives are not the only source of risk in an enterprise/
Risk Management Scorecard	All risk management activities are centralized on a support scorecard	Makes risk "someone else's job"

Source: "Integrating BSC and COSO ERM Frameworks," by Takehiko Nagumo and Barnaby Donlon, *Cost Management*, July – August 2006

Table Discussion

- 
- ▶ Have you tried integrating BSC and ERM?
 - ▶ What successes / failures can you share?
 - ▶ What's the biggest barrier to ERM in your organization?

Agenda

- ▶ Why Manage Risk?
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Enterprise Risk Management Framework

- ▶ Underlying principles
 - Every entity, whether for-profit or not, exists to realize value for its stakeholders.
 - Value is created, preserved, or eroded by management decisions in all activities, from setting strategy to operating the enterprise day-to-day

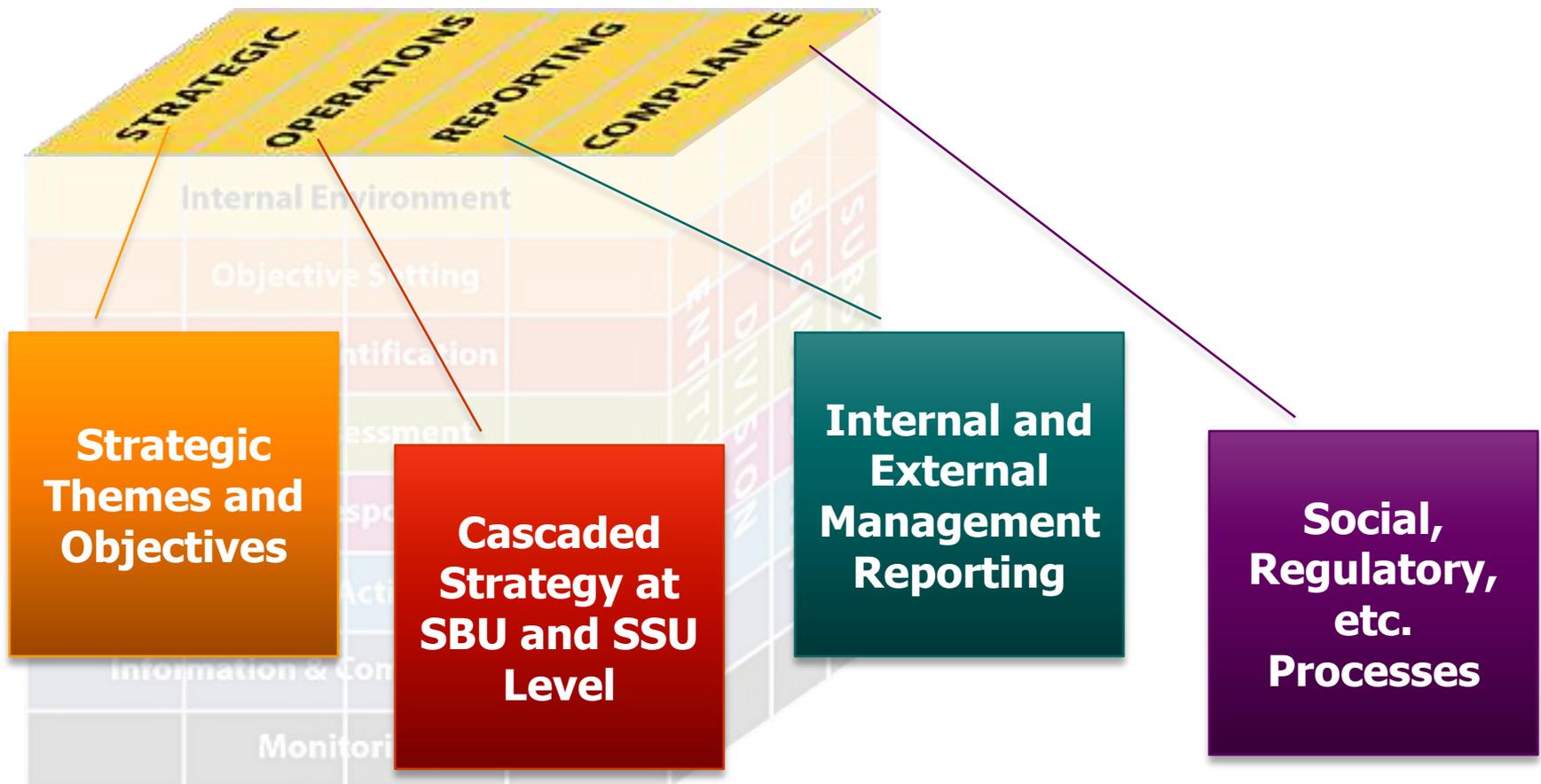
- ▶ ERM supports value creation by enabling management to:
 - Deal effectively with potential future events that create uncertainty.
 - Respond in a manner that reduces the likelihood of downside outcomes and increases the upside

The COSO Enterprise Risk Management Cube



Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a voluntary private-sector organization, established in the U.S., dedicated to providing guidance to executive management and governance entities on critical aspects of organizational governance, business ethics, internal control, enterprise risk management, fraud, and financial reporting. COSO has established a common internal control model against which companies and organizations may assess their control systems.

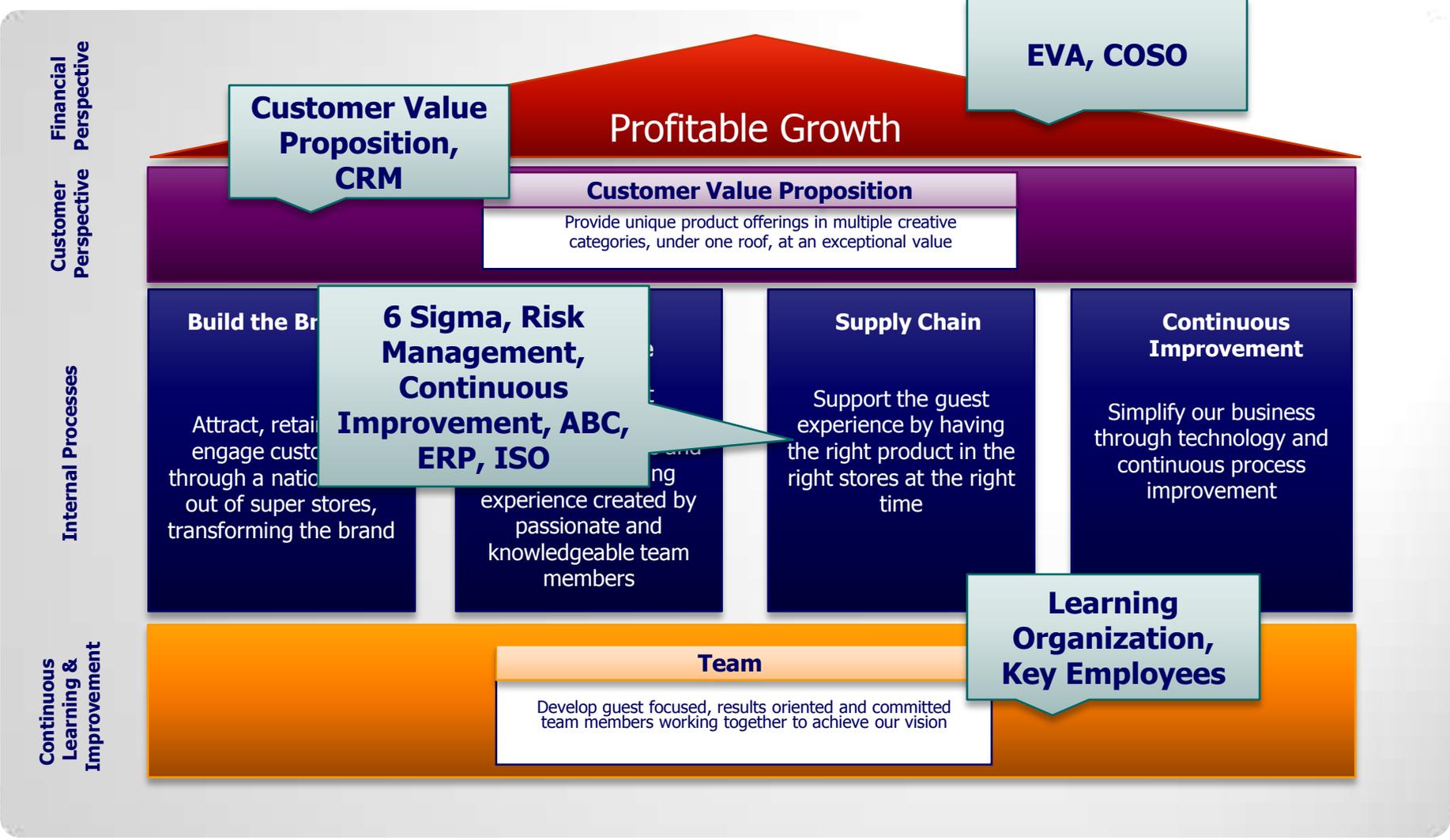
Translating The Cube: Management Objectives



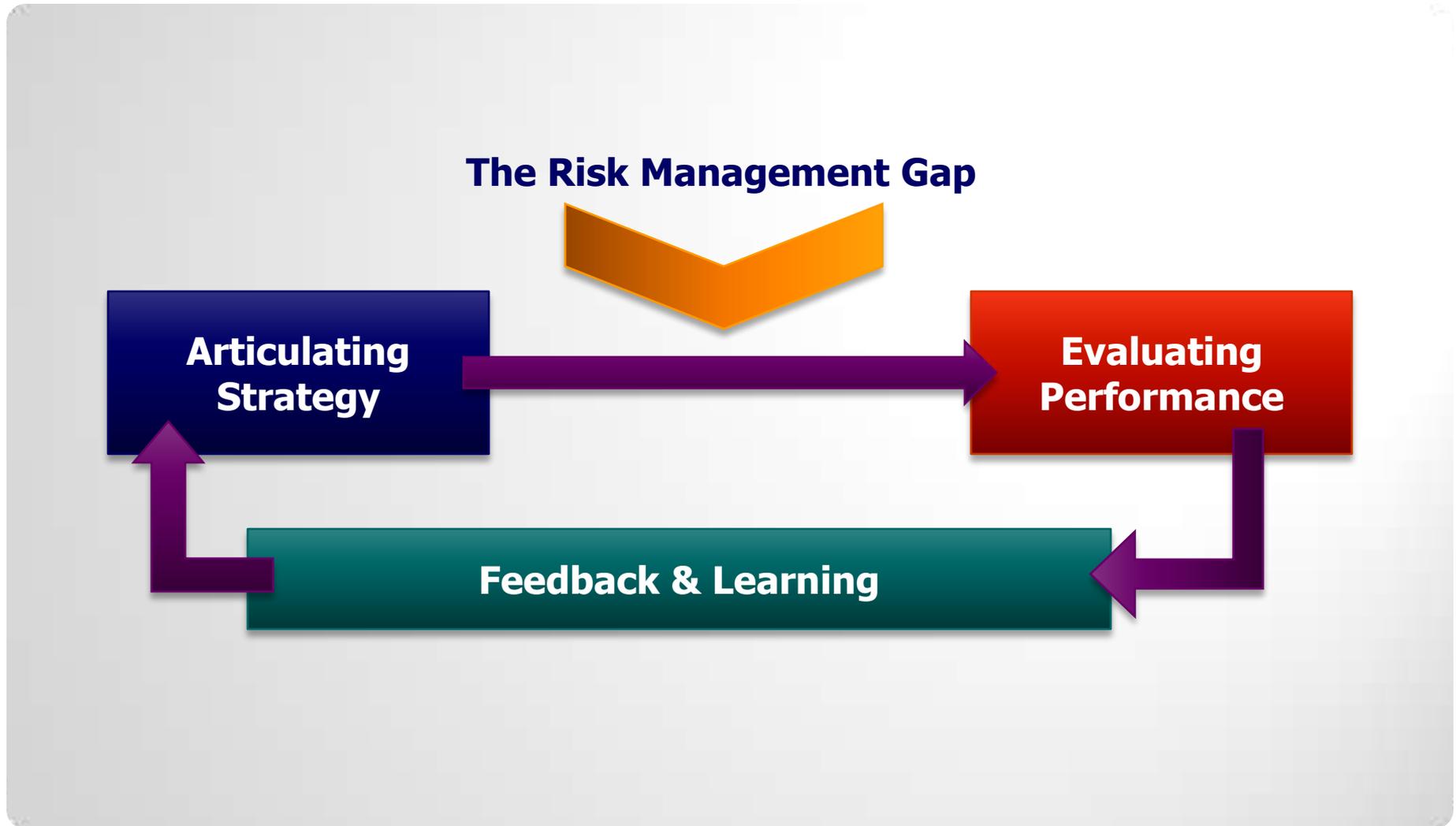
Translating The Cube: Management Objectives



The Balanced Scorecard Is A Natural Integrator of Management Methodologies



"Traditional" Balanced Scorecard Management System

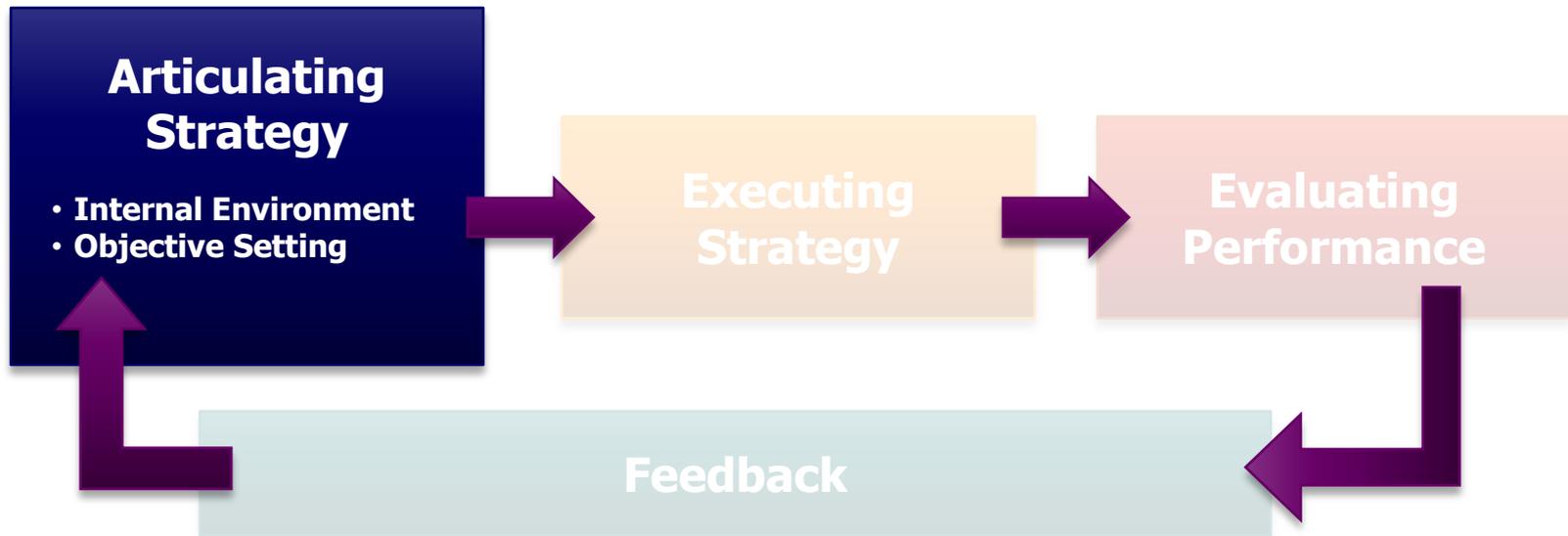


Balanced Scorecard and Enterprise Risk Management: Towards An Integrated View



Source: "Integrating BSC and COSO ERM Frameworks," by Takehiko Nagumo and Barnaby Donlon, *Cost Management*, July – August 2006

Articulating Strategy



Integrating Risk Into Your Strategy Map

Gain Understanding of external factors and stakeholder Views

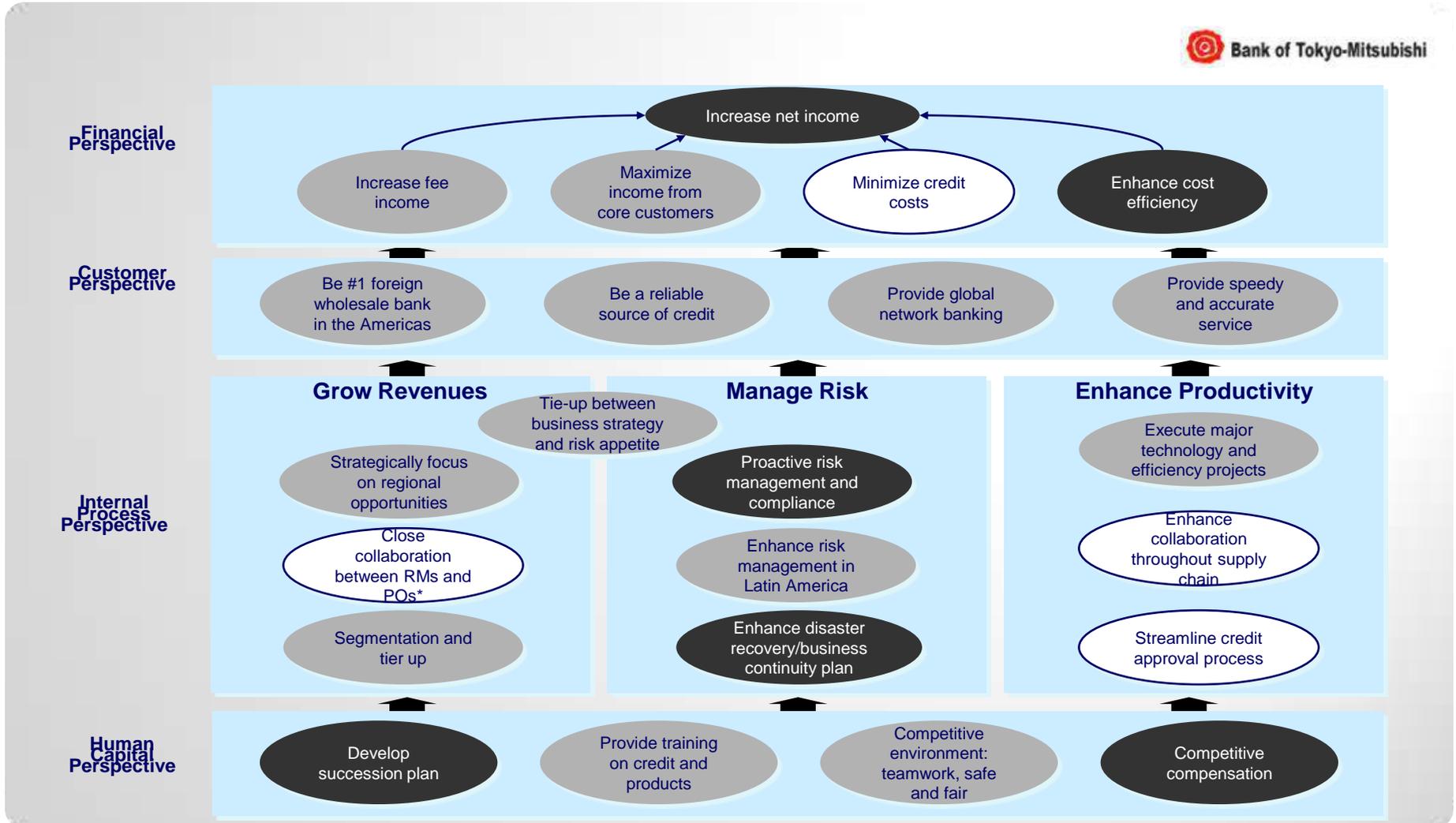
Evaluate internal factors and perform evaluation of capabilities

Develop Consensus on Risk Appetite Essentials

Management to Draft Appetite, validate and circulate for comment

Gain concurrence from Board

A Risk Management Theme May Be Appropriate For Risk Driven Organizations



Source: "Integrating BSC and COSO ERM Frameworks," by Takehiko Nagumo and Barnaby Donlon, *Cost Management*, July – August 2006

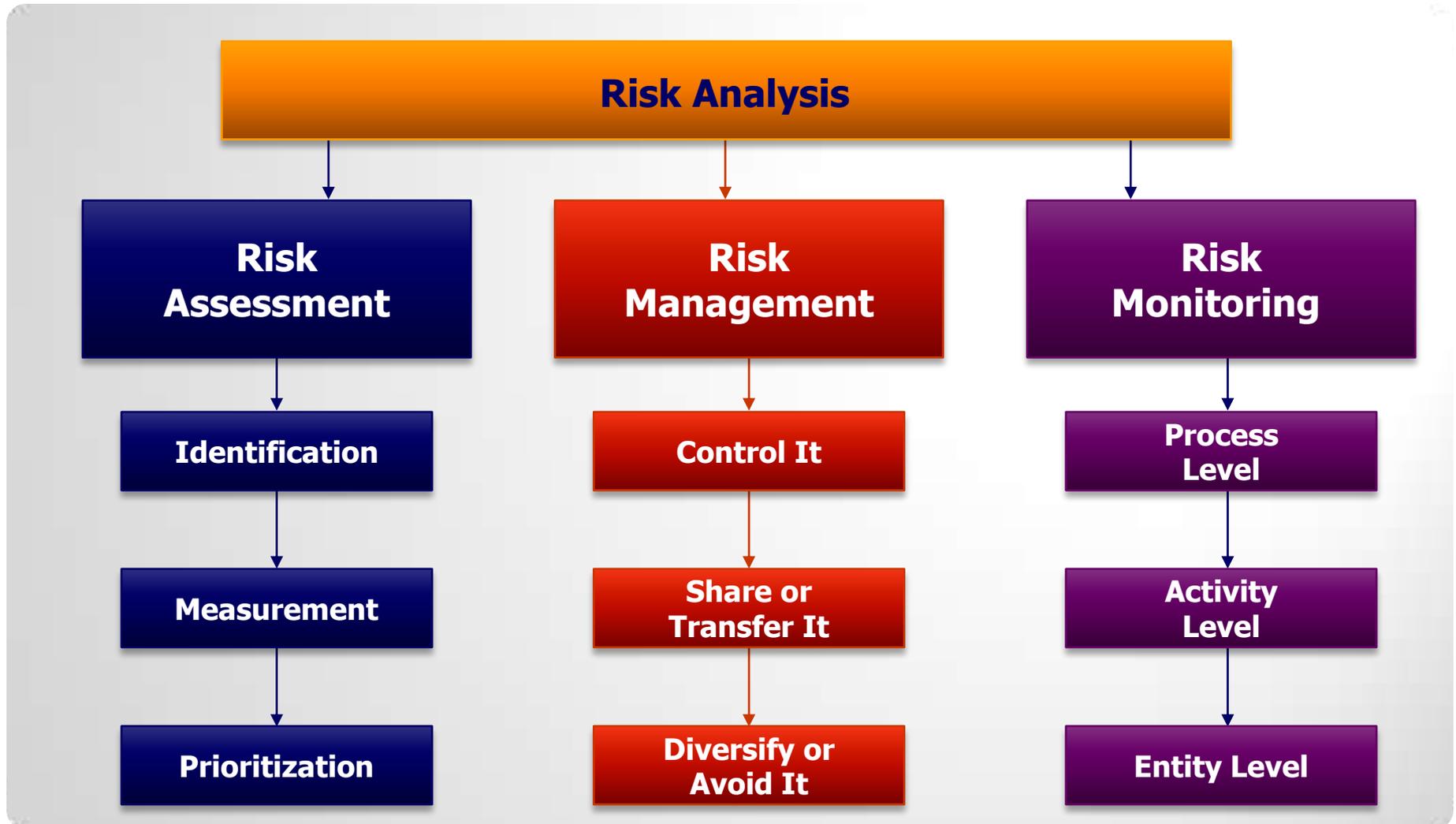
Capturing Risk When Designing Your Balanced Scorecard and Strategy Map: Key Questions

- ▶ What is your organization's risk management philosophy?
- ▶ What is your appetite for risk?
- ▶ What are your core values?
- ▶ What risk environment do you work within?
- ▶ Have you cascaded to capture operational risk?
- ▶ Do you have a regulatory / compliance risk theme?

Risk Management



Risk Assessment



Determine Risk Appetite

- ▶ Risk appetite is the amount of risk — on a broad level — an entity is willing to accept in pursuit of value.
- ▶ Use quantitative or qualitative terms (e.g. earnings at risk vs. reputation risk), and consider risk tolerance (range of acceptable variation).
- ▶ Key questions:
 - What risks will the organization not accept? (e.g. environmental or quality compromises)
 - What risks will the organization take on new initiatives? (e.g. new product lines)
 - What risks will the organization accept for competing objectives? (e.g. gross profit vs. market share?)

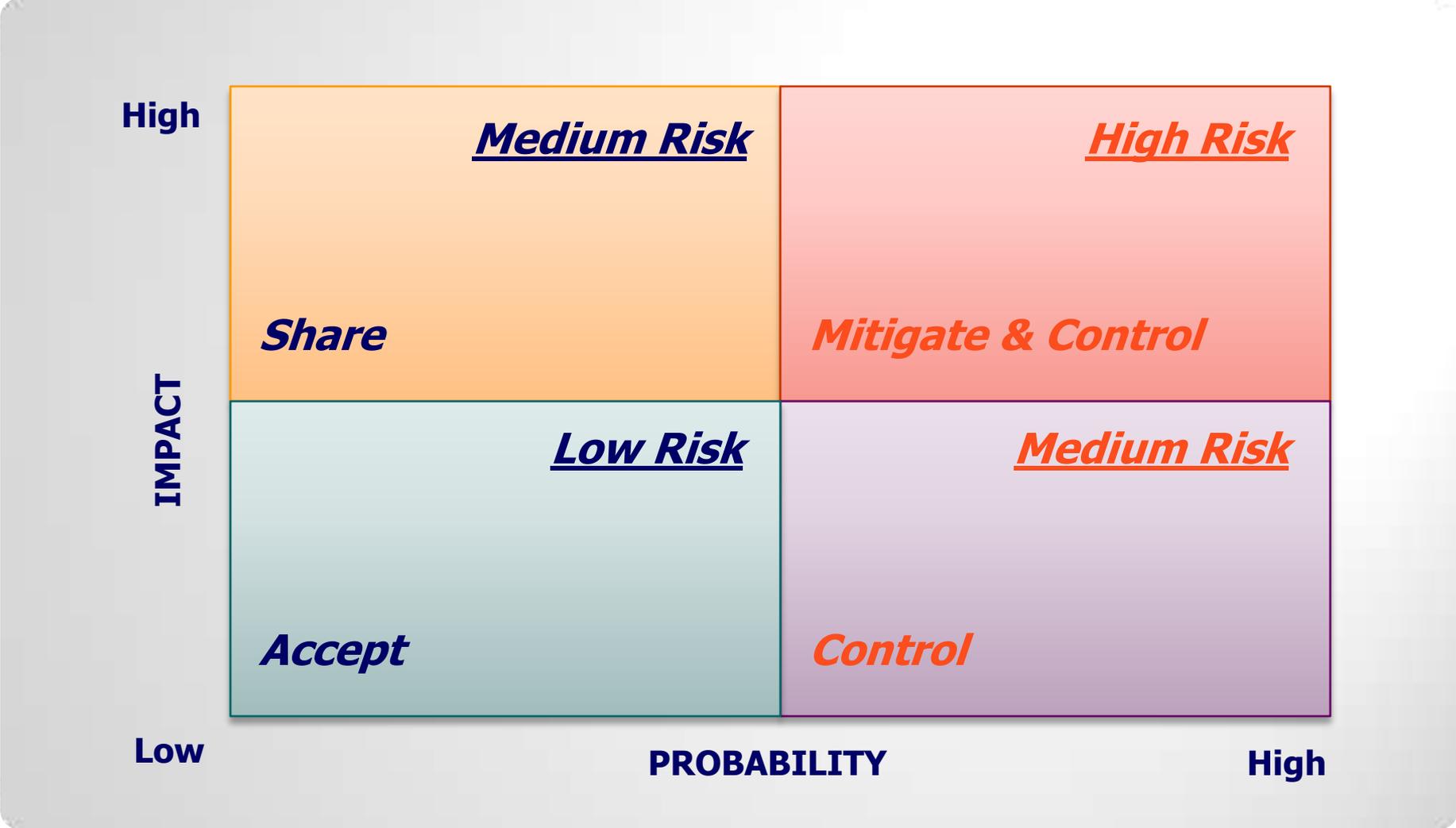
Identify Risk Responses

- ▶ Quantification of risk exposure

- ▶ Options available
 - Accept = monitor
 - Mitigate = eliminate (get out of situation)
 - Control = institute controls
 - Share = partner with someone (e.g. insurance)

- ▶ Residual risk (unmitigated risk – e.g. shrinkage)

Impact vs. Probability



Example: Call Center Risk Assessment

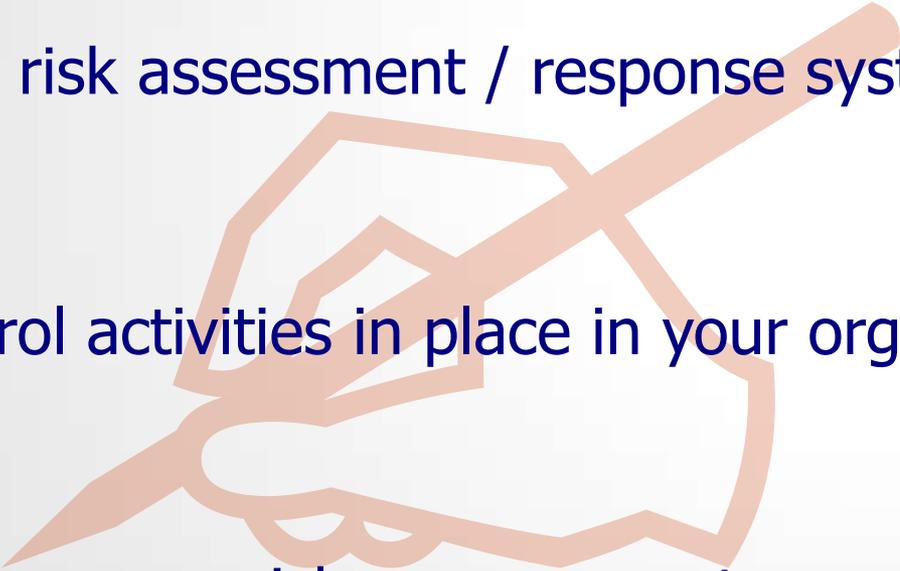
IMPACT	High	<p><u>Medium Risk</u></p> <ul style="list-style-type: none">• Loss of phones• Loss of computers	<p><u>High Risk</u></p> <ul style="list-style-type: none">• Credit risk• Customer has a long wait• Customer can't get through• Customer can't get answers
	Low	<p><u>Low Risk</u></p> <ul style="list-style-type: none">• Fraud• Lost transactions• Employee morale	<p><u>Medium Risk</u></p> <ul style="list-style-type: none">• Entry errors• Equipment obsolescence• Repeat calls for same problem
		Low	High

PROBABILITY

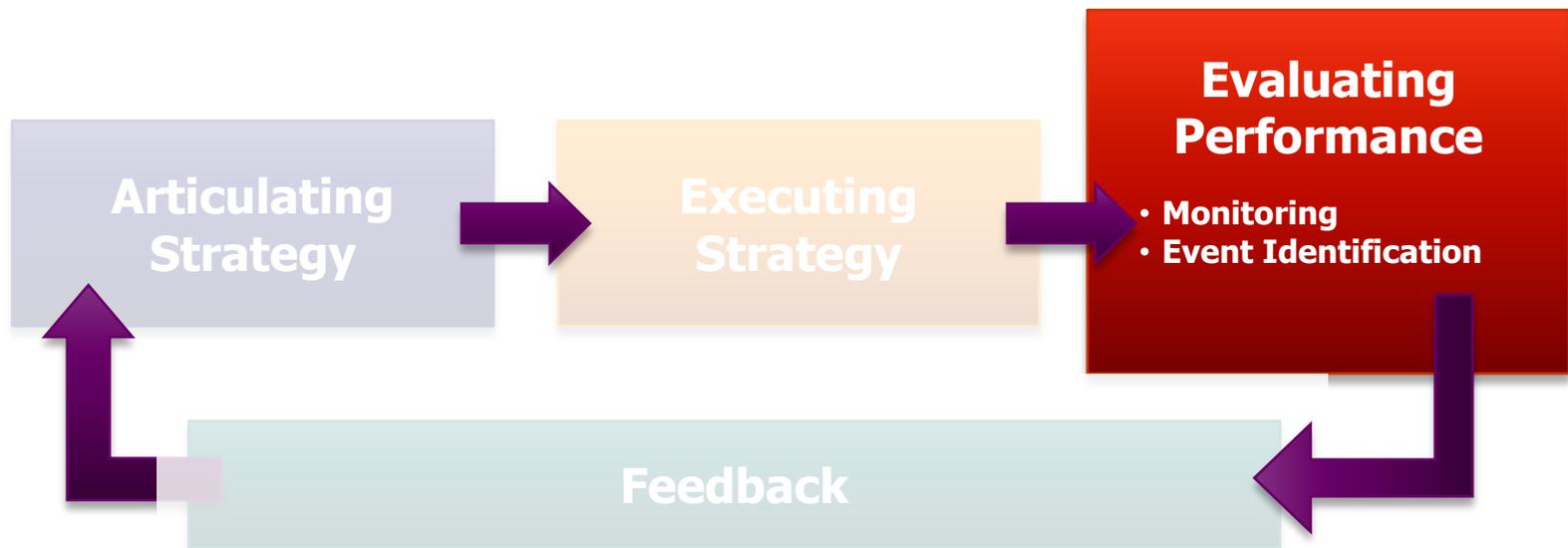
Risk Management Office vs. Office of Strategy Management: A Balance



Table Discussion

- 
- ▶ Do you have a risk assessment / response system in place?
 - ▶ Are there control activities in place in your organization?
 - ▶ How granular are your risk management programs?

Evaluating Performance



Capturing Risk When Conducting Management Meetings: Key Questions

- ▶ How are you evaluating risk during your management meetings?
- ▶ Do you have a separate risk management team?
- ▶ How are internal or external events identified?
- ▶ How are risks classified?
- ▶ What is the feedback loop back to the corporate strategy?

Feedback and Learning



Communicating Risk: Key Questions

- ▶ How is strategy and risks communicated to the organization?
- ▶ Does communication happen up, down, and sideways in the organization?
- ▶ How does the risk management process facilitate learning in the organization?

Table Discussion

- ▶ What have you learned during this session that you can use next week?
- ▶ How will your management processes change as a result of learning about ERM/BSC?
- ▶ What's the one thing that surprised you during the workshop?

Thank You

If you have more questions on Enterprise Risk Management and the Balanced Scorecard, please contact us at:

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