

Enterprise Risk Management in Europe

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EDITED BY

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*To those whose fearless dedication in the face of COVID-19 risk
is securing our health in these difficult times*

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Hunziker, S., & Durrer, M. (2020). Risk Management aus der Sicht der Unternehmensführung. Perspektive von Geschäftsleitung und Verwaltungsrat – eine Studie der Hochschule Luzern und Swiss ERM. *Expert Focus*, (3), 118–123.

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- Hunziker, S., Renggli, S., & Fallegger, M. (2018). *Interne Kontrollsysteme im Finanzbereich: Wirksame und effiziente Steuerung, Kontrolle und Überwachung*. Wiesbaden: Springer.
- Hunziker, S., & Durrer, M. (2020). Risk Management aus der Sicht der Unternehmensführung. Perspektive von Geschäftsleitung und Verwaltungsrat – eine Studie der Hochschule Luzern und Swiss ERM. *Expert Focus*, (3), 118–123.

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Preface

I am delighted to write the preface to this book on ERM in Europe. The book is powerful evidence that academic research on risk management in Europe is alive and well. Amazingly, it is now over a decade since, with a small group of academics from the UK, Italy and Germany, I founded the European Risk Research Network. Funding from the EU allowed us to organize a series of annual conferences across Europe that served to facilitate networking amongst existing researchers and introduce young academics to this fascinating field. It is great to see that such work continues to thrive.

One of the key contributions of the book is its geographic breadth of coverage. Nonetheless, the story that emerges from across Europe is a universal one: despite the fact that it is almost 20 years since the COSO ERM framework was first issued, companies continue to struggle to implement ERM. The main challenge seems to be its integration into the DNA of the organization, so that risk-based thinking penetrates the culture, strategic planning and decision making at all levels.

Regulation across most countries has served to push organizations into adopting some form of ERM, but the degree of maturity of systems is widely variable. In places like Norway and the Netherlands, it would seem that ERM is relatively well developed, although there is a recognition that systems remain immature and in need of further improvement. In contrast, companies in Poland and Greece are perhaps behind the curve in developing their thinking on risk management, especially in non-financial sectors. For many, risk management remains a compliance issue and reflects a silo-based mindset that is in direct conflict with the organizational breadth implicit in ERM.

Large listed companies appear to lead the way on ERM, although even then there are few that integrate risk thinking into the wider stakeholder perspective on planning. Linking ERM to sustainability remains something in the future for most organizations. This book includes some interesting and useful examples of how risk management practice is evolving.

One very clear message from the book is that ERM is a concept that is well defined in terms of regulation, but open to very widespread interpretation in practice. National contexts, corporate history, and industrial sectors all serve to influence how risks are managed, and ERM interpreted. A proliferation of associations and networks for risk managers exist across Europe to help in the exchange of ideas and new initiatives but risk management remains a practice that is organizationally specific. Unsurprisingly, therefore, the book also confirms that

evidence on the impact of ERM on company performance and shareholder value remains unclear. There is clearly much research that remains to be done, and I look forward to reading more work from this book's authors in the future.

Margaret Woods

Foreword

Studying Risk Management in Europe

The contributors of this book set out to document, understand and explain risk management practices (codified under the acronym ERM, Enterprise Risk Management, by corporate governance advocates) and to influence the theory and practice of risk management in organizations. The study and teaching of risk management in a business context is important, as the “risk universe” that surrounds corporations and influences their success (and indeed, survival) has expanded significantly, from financial and operational concerns to risks related to culture, reputation and sustainability. The foundational and shared assumption of this volume, underlying all its chapters, is that risk management as a discipline could help organizations and managers run their businesses better and avoid idiosyncratic pitfalls, and that it could help organizations and society solve important and vexing social problems that no organization can tackle alone. However, risk management has its own risks and, as a field, it needs a good deal more self-reflection and a critical understanding of the conditions of its own successes and failures.

The volume focuses on the study of risk management within the paradigm of accounting and management control systems. Management controls have been shown not only to monitor performance in organizations but also to empower them to innovate and navigate uncertainty. But while risk management practices have been proliferating, the failures in risk oversight – some of them globally disastrous – keep on coming. The book highlights that an important reason for this apparent failure of risk management could be the “lack of coordination” between enterprise risk management (ERM) and governance processes – calling for “integration between ERM and accounting practices”.

So why is the operationalization of ERM so far from realizing the promised benefits of the discipline? The book provides important empirical evidence across different countries in Europe that allows us to reflect on the contextual dependencies and conditions of risk management’s failures (and successes). We get a sense of the varied forms, effects and contexts of risk-management practice, both in corporate and public settings. Overall, the studies confirm that risk management has to be contingent on, and tailored to, the conditions it is deployed in.

The unique pan-European reach of the studies collected in this volume is the first study to capture the contextual variation in ERM across 13 countries,

brought about by the varied domestic economic conditions, cultural, academic and professional developments, and last but not least, the diverse legal and regulatory frameworks. Second, the contributors attempt at a closer look at the maturity and spread of risk management practices, collectively revealing a gap between the general practices and aspirations of ERM. Instead of being a strategically central, interactively used control practice, in more than half (seven) of the sampled 13 countries, ERM attracts “mixed level of engagement” in corporate governance and accounting practices, with a focus on compliance with internal control and audit practices. Yet in six countries, research attests to an “increasing focus on strategic risk management”, which raises important challenges for risk managers who will need to construct the specific risk management tools, principles and processes in deliberating, measuring, acting on and reporting an ever-widening universe of risks.

As a researcher, teacher and observer of risk management practices, I have to admit it still remains a challenge to define the phenomenon of risk management. Are these the control practices that are explicitly called “risk management” (and/or labelled as “ERM”) by the executives who design and implement them? Certainly, in the financial services industry, risk-management practices are more clearly identifiable due to regulatory and corporate governance imperatives to create a specialist staff function headed by a chief risk officer (CRO). There I (and many others) have observed the variation in senior risk officers’ attitudes to risk modeling and in the resulting instrumentation of risk management. Elsewhere, the job of identifying risks and helping business lines manage them falls not only to risk specialists, but also to internal auditors, strategic planners, finance staff, management accountants, and importantly, to the business lines. Given the evolving nature of risk control, it is unclear which of the tools and practices now in use will ultimately make up a common body of knowledge that can define the (future) profession of risk management. Risk management may indeed evolve into an “umbrella function” for the discussion of certain kinds of risk. Its advocates, the risk managers, may gain control of important organizational agendas, such as planning, resource allocation, and reward systems and be able to standardize tools and reports that allow their companies to manage universal risk concerns. On the other hand, risk management may remain highly contingent on situational politics, opportunities, and demands, “plugging” the control gaps left unaddressed by other control agents. Either way, its survival or failure depends on whether risk managers succeed in making their function both *seem* and *be* important to the control agents and processes already in place.

This book underlines a lesson I have learnt in my first 10 years of doing intensive fieldwork in organizations, and adds an international dimension to it: Risk management is neither universally beneficial nor indifferent to managerial practice – its contribution is contingent. The essence of a contingency theory of risk management is to find “fit” between contingent factors and firms’ risk-management practices, and to establish propositions of fit that will result in desired outcomes. Moving towards a contingency theory requires a more sophisticated understanding of not only the nature of relevant contingencies, but

also the nature of risk management itself. Building on a growing strand of field-based studies, including the research presented in this volume, we could propose a practice-based definition of risk management with more confidence:

Risk management consists of active and intrusive processes that (1) are capable of challenging existing assumptions about the world within and outside the organization; (2) communicate risk information with the use of distinct tools (such as risk maps, stress tests, and scenarios); (3) collectively address gaps in the control of risks that other control functions (such as internal audit and other boundary controls) leave unaddressed; and, in doing so, (4) complement—but do not displace—existing management control practices.

While some risk management frameworks suggest that risk managers should focus mainly on operational risks (as an enhancement of the internal audit process), others suggest that the risk-management mix should focus mainly on strategy execution risks (COSO, 2004¹; International Standards Organization, 2009²). This book and previous studies suggest that risk management will be most effective when it matches the organization’s context and circumstances.

Yet even a world-class, thoughtfully tailored risk management system cannot prepare a company for everything. Some risks are so remote that any individual manager or group of managers could never imagine them. And even when firms envision a far-off risk, it may seem so improbable that they are unwilling to invest in the capabilities and resources to cope with it. Such distant threats, “novel risks”, cannot be managed by following a standard playbook. Future research – and much ingenuity from practitioners! – are needed to explore the defining characteristics of these risks, explain how to detect whether they’ve materialized, and then describe how to mobilize resources and capabilities to mitigate their impact. The current challenging environment will offer therefore important lessons about the strengths, weaknesses and the potential still unrealized in contemporary risk management practices. Finally, in the context of the Purposeful Company movement and climate-risk and sustainability concerns, the remit of risk management is being expanded, which again calls for ongoing critical and field-based research on its continually emerging instrumentation, processes and ability to address the global challenges we are facing.

Oxford, 21 September, 2020.

Anette Mikes

¹Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Enterprise Risk Management Framework*, 2004.

²International Standards Organisation (ISO), *ISO 31000:2009, Risk Management—Principles and Guidelines*, 2009.