Gaining a Competitive Advantage Through Operational Risk Management

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The closest we will get to time machines to correct events of the past is to reduce the likelihood or impact of future pitfalls. As organizations try to elevate their strategies for Operational Excellence, their leadership teams must know and show the risks they face in order to solve problems before they happen. Now you can take your business to new heights by turning operational risk management into a driver for superior performance.

There is only one universally accepted approach: identify the areas of risk, study the potential failures and their effects, recommend a mitigation strategy, implement controls, and continuously monitor and assess the residual risk. The broad principles of operational risk management have been codified, tested and refined for decades in countless mission-critical situations by groups as diverse as the U.S. Department of Defense and the International Organization for Standardization.

Every organization can benefit from a standardized, systematic approach to risk management in operations. If the fear of a breakdown in business continuity, enforcement action by a regulatory body, harm to employees or customers, or a catastrophic event is not enough motivation to implement a comprehensive risk management program, there are numerous cost avoidance drivers.

While an investment in an enterprise-wide risk management program can be daunting, the invisible costs of a lack of a risk program are played out in many ways – excessive insurance costs, failure to meet project goals, allocation of capital and resources that don't mitigate the most significant risks to the organization and access to capital markets. The identification of a new warehouse location, vendor selection and sourcing, toxicological effects of material handling on workers, process hazard analysis, or undertaking a new capital project are some examples of areas that require continuous risk assessments and processes that eliminate undesirable consequences.

Most executives are convinced that they have a suitable risk management program in place, until something unexpected happens. Usually, at some level, workers and managers have summarized their perceptions of risk, to some standard or methodology, and produced reports that are then collated and provided to senior leaders. Executives are then making decisions based on subjective data with little formality for studying and assessing operational risks as they apply to the entire organization. For example, the highest priority risks may not be the top risks from each report.

When executives realize that a risk management program may require thousands of risk studies across global operations, they often see the cost as too high and continue to rely on a strategy of hope. Yet, the cost of a catastrophic event can range from several million into the billions of dollars in hard costs, along with loss of reputation and shareholder value.

Considering the size and scope of an enterprise risk program, managers all have the same questions:
- Where do we start?
- How do we prioritize what risk studies are performed first?
- How do we realize benefit without waiting on the last risk study to be complete?
- How do we know we are measuring, ranking risk and managing risk to the same standards?
- How do we tackle a project of this proportion with limited resources?
- How will we realize benefit from the investment?

Start Small, Grow Quickly

The closest we will get to time machines to correct events of the past is to reduce the likelihood or impact of future pitfalls. As organizations try to elevate their strategies for Enterprise Sustainability Management, their leadership teams must know and show the risks they face in order to solve problems before they happen. Now you can take your business to new heights by turning operational risk management into a driver for superior performance.

Every company knows their most profitable or impactful product, customer, location, or line of business. Unless there is a regulator or customer driving you in another direction, the place to start should be evident. As your company builds a larger sphere of knowledge libraries and risk assessment studies, the speed at which other areas will develop risk assessments and adopt the processes will increase exponentially with an operational risk platform. Knowledge from one operation can be shared with others and previous controls or workarounds can be passed from one manager to the next.

Commonalities in processes exist in every organization. The basic elements of any risk program are typically at hand, but largely under-utilized; personal experience of employees is hard to scale without a mechanism for knowledge management. Engineers and subject matter experts typically spend only 5% of their time on studying risk and often in a vacuum. Productivity of their core jobs can't decline and most companies do not hire to address the soft costs of risk. Thus continues a wasteful, manual, location-specific risk program. Use of an operational risk management solution can reduce risk assessment time by 85%. Operational risk software can vastly increase productivity, standardize, control, and report on risk with no additional headcount or full-time equivalent needed. As a result, executives can realize a new approach to making strategic decisions – based on hard facts and deep subject matter expertise, aggregated companywide at a surprising rate of return.

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Accenture 2013 Global Risk Management Survey

Understand the Benefits

Multiple financial benefits include better access to capital, improved credit ratings, higher stock prices and lower insurance costs. In 2007, Standard and Poor's announced that for non-financial companies it would increasingly rely on the company's business risk management practices and RAMP scores in determining its credit rating. Policy costs for some customers are the single driver in their rate of return justifications for an operational risk program. 99% of companies believe risk capabilities are an important means to achieving their compliance objectives - yet only 29% are effectively achieving this but the majority (52%) do not believe they are very effective managing those risks. Consequently, there is ample opportunity for your company to achieve a competitive advantage.

Risk studies can range from detailed process hazard analysis, to thousands of level-one asset assessments, or the analysis of hundreds of repeat incidents and root cause analyses to a simple single-page checklist and control plan. Regardless of the complexity, once a cross-functional team completes a subset of risk assessments or converts existing studies, standards and libraries can be rapidly set up to increase the through-put of additional studies.

Reporting and graphical analytics in the form of heat maps, bubble charts, and trends displaying the most significant risks by location, region or line-of-business can then be produced immediately after study completion and mitigation strategy approval.

Process improvements are made apparent by linking information from risk assessments that have dependent processes – improving the speed of Operational Excellence initiatives. Strategic decision making based on qualitative and quantitative data is then enabled, versus estimates and gut feelings. Senior management has aggregated real-time risk information to make more informed decisions faster.

Some companies have required new capital projects to include evidence that risk has been studied and controlled for the project itself as well as the total impact to corporate risk as a justification component for the project. Why invest in any project if there are other areas that pose greater risk to the company and remain un-mitigated?

In 2010, one IHS customer, a Fortune 100 process manufacturer realized more than $2 million in cost savings in the first three months after implementing a global risk register to assess risk and adjust capital allocation and operational spend across facilities.

Find Your Path to the Summit

Widespread adoption of an enterprise-wide operational risk management programs is just beginning. Almost all finance organizations have implemented some form of GRC (governance, risk, compliance) tools to manage financial controls. Process manufacturers have adopted OSHA 1910.119 for Process Safety Management and manufacturers in life sciences are adopting Quality by Design guidelines. Yet little is done beyond meeting minimum compliance standards. Observing a deviation or investigating an incident and performing a root-cause analysis, is a top down, rear view mirror approach to risk. Only with a ground up approach, using a cross-functional study of risk to a particular product, process, or location with proven hazard and failure mode methodologies can operational risks be mitigated or eliminated.

Industry leaders who are past the curve of using risk management to prevent disaster are using their risk program as a competitive advantage through making more capital available to the real priorities and strategically aligning the available resources to initiatives that will benefit the top and bottom line, customers, employees, and shareholders. Every company takes risks. Your appetite for risk needs to match operational reality. In order to gain true competitive advantage and act more strategically, companies must move from a compliance culture to a proactive strategy of risk prevention.

About IHS

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