

THE RISK-VALUE CURVE:

HOW TO OPTIMIZE RISK AND GENERATE VALUE FOR YOUR ORGANIZATION



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T HIS ARTICLE DISCUSSES THE ROLE RISK OPTIMIZATION CAN PLAY IN GUIDING THE ORGANIZATION TOWARD TAKING THE RIGHT RISKS TO ADVANCE ENTERPRISE VALUE. Using a risk optimization mind-set, an organization can promote a risk-aware culture, expand the conversation to include not just risk mitigation but also value creation, and create a comprehensive view of risks to drive strategic decisions. It provides a risk-value framework and an example of where it has been used successfully.

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Historically risk management was focused on preventing and reducing operational loss through risk avoidance and risk transfer. The discipline has evolved toward enterprise risk management (ERM) which is used by organizations to manage risks and seize opportunities, expanding the focus to a broad spectrum of risks including strategic, reputational, compliance and financial. An ERM approach enriches the conversation with stakeholders by evaluating the strengths and weaknesses of a strategy, and how well that strategy aligns with the organization's mission and vision. It also supports organizations in managing risks and opportunities within a defined risk appetite toward an optimal balance between risk mitigation and risk taking. This allows the organization to deploy resources effectively in pursuit of their objectives, and maximizes value.

Taking risks to deliver value requires a risk-aware culture. Many risk management processes start with the identification, assessment and measurement of risk. Even before this occurs, an organization should have an understanding of their risk appetite, which is the amount of risk they are willing to accept in pursuit of business strategy. This gives permission for managers, supervisors, and front line employees to take informed risks to further the mission. Establishing a risk appetite

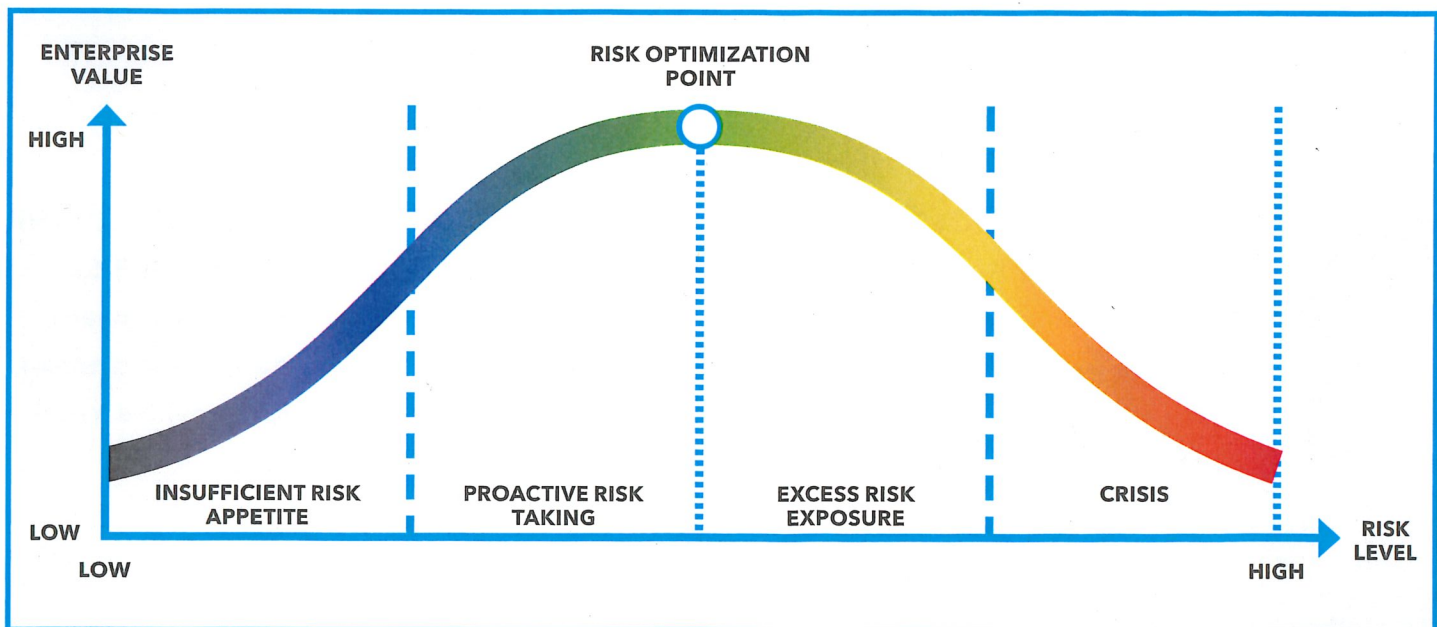
also enables the organization to develop cost-effective and efficient risk response plans within their specified risk appetite. For this to be effective, senior leaders must acknowledge that the risk managers, the Chief Audit Executive or the Chief Risk Officer do not assume risk. Risk is owned by the business units. The risk manager can help assess risks and opportunities and provide structure to risk-taking decisions.

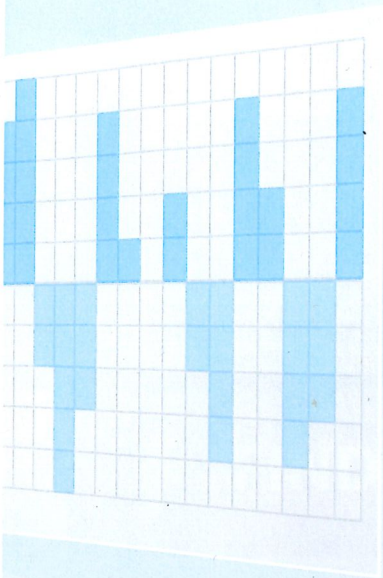
When focusing risk management activities on risk optimization, organizations have the option to purposefully engage risk in a positive way to create value. A risk-value approach is useful for decision-making and will support leaders' abilities to take smart risks that yield a positive value for the organization.

The Risk-Value curve is a tool risk managers can use to facilitate risk discussions and help decision makers know how much risk to mitigate or take. The risk-value framework was developed by the Consortium for Advanced Management International (CAM-I). CAM-I is an international consortium of private sector and government organizations who are working cooperatively to solve management problems and critical business issues that are common to the group. Organizations are using this Risk-Value curve to shift thinking

about risk, and support risk taking within the organization's risk appetite. The concept demonstrates how an organization can take on informed risks to implement an initiative or project and increase value within a risk optimization zone. Continued risk taking beyond an optimal zone could result in value decline and a possible crisis.

The diagram depicts the relationship between risk and enterprise value. A traditional view of the relationship between risk and value is inverse; as risk increases value declines. This framework changes the shape of risk to a bell curve. In the first zone, risk is low, but so is value. The organization has placed too much emphasis on mitigating and avoiding risks, and is therefore bypassing potential investments that could yield a positive return for the organization. In the second zone of the diagram, risk is optimized—the organization is taking risk up to its tolerance level. Key risk indicators which signal increasing risk exposures are important in this zone so the organization can engage the right kinds of risk that might otherwise be avoided, thereby increasing enterprise value. Once the high point of the curve has been passed, the organization is moving to the zone where excessive risk taking occurs. The organization may need to apply risk management tools to avoid a potential crisis. In the last zone,





Understanding where an initiative or project falls within the Risk-Value curve provides management with a powerful tool to provide direction and gain maximum value in the face of competing priorities. This process can help an organization take informed risks to pursue an initiative or project to realize the value. As risks are assessed to inform decision-making, it is important to consider the risk of status quo. There is inherent risk in standing still, but sometimes we forget to calculate the risk of doing nothing.

if the organization leverages risk management continuity plans and crisis management tools (insurance, active monitoring, public relations, and increases to reserves) it has the opportunity to make adjustments and move left on the curve to avoid a potential crisis.

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EXAMPLE OF WHERE THE RISK VALUE METHODOLOGY HAS BEEN SUCCESSFUL

King County, Washington, is using the Risk-Value curve to change their culture from risk-averse to risk-optimized. King County, which includes the Seattle-Bellevue metropolitan area, is the 13th largest county in the United States serving a population of

more than 2 million. Throughout the past five years, King County has experienced growth in population, construction, transportation, and business. This economic expansion affects all of King County's departments and programs, ultimately increasing the complexity of government services. King County, through its 14,000 employees, provides public health and community services, parks and recreation, wastewater treatment, building and land use services, and criminal justice through law enforcement, correctional facilities, courts, prosecuting attorneys and public defenders. King County also operates regional bus, light rail, and street car services with more than 140 million annual passenger trips, provides passenger ferry service, and owns and operates King County International Airport/Boeing Field.

With King County Executive Dow Constantine's encouragement, King County is changing its approach to risk. They are using the Risk-Value curve as a way to visualize when risk can be optimized versus placing too much emphasis on mitigating or avoiding risk. This has encouraged a more balanced approach to risk, and county departments are starting to take informed risk to increase value for their customers.

One example comes from the Public Health Department. For decades, Public Health has offered internships to college students in various medical fields. In order to participate in an internship, the student's college or university had to agree to the insurance and indemnification requirements in King County's contract. One clause required the educational institution to indemnify King County for the negligent acts of their student interns. Four-year universities would agree to the language, but two-year community colleges would not. Public Health looked at the demographics of students who attend four-year universities and students in two-year programs through an equity lens. King County is committed to equity and social justice, and creating opportunities where all people have equitable opportunities to thrive.

Public Health decided it was time to reevaluate their internship program and asked the Risk Management Office for assistance. The team looked at where the internship policy was on the Risk-Value curve (inefficient phase—risk was low but so was value) and where they wanted to be (a more optimal position of increased risk for added value). After analyzing past losses caused by student interns, the value to be gained by developing students' interest in public

health as a career, and the additional risk to King County from eliminating the indemnity protections, everyone agreed to take the risk in pursuit of value. King County amended their contract, eliminating the requirement that two-year colleges indemnify King County for the negligent acts of student interns, thereby transferring that risk to King County.

Under King County's historic view of risk as something to avoid, risk optimization would not have resonated with leaders in Public Health. King County's success with ERM gave them the tools to apply the Risk-Value Curve and accept increased risk in the student intern program to add value for Public Health, the students, and the community.

The King County Risk Management Office is encouraging smart risk taking from their

own staff as well, with a new approach to negotiating County contracts in alignment with the County's equity and social justice commitments. Insurance requirements are carefully evaluated in connection with contract exposures. When possible, terms are adjusted to expand contracting opportunities for smaller companies and community-based organizations. In some cases, this may mean accepting a lower level of insurance or allowing for more flexibility in contract provisions to open up opportunities for smaller organizations who have demonstrated effectiveness and are representative of the population needing services.

This Risk-Value curve developed by CAM-I helps introduce the concept of value when analyzing risk which in turn helps organizations take on measured risks in order to

advance their mission and values. This contemporary approach views risk in two dimensions and has the power to transform an organization's thinking. We have described the Risk-Value curve and given you an example of how it has been applied at King County. We encourage you to use the Risk-Value curve to lead a strategic discussion as you are making decisions on your organization's next initiative. ■

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