

STRATEGIC THOUGHT GROUP RISK MANAGEMENT WHITE PAPER

risk-adjusted corporate performance

Strategic Thought's new approach to business performance management is based on the traditional concept of score-carding as a means of reporting actual performance against objectives-based targets. Now, in addition to reporting historical performance, Risk-Adjusted Corporate Performance also presents information regarding the likelihood of the organization meeting its objectives in the future.

This more insightful performance scorecard can be presented by bringing in a quantitative risk management process, enabling the assessment of future performance against future objectives.

Background

The use of scorecarding for corporate performance management, measurement and monitoring is now widespread: it is found in most organizations in the form of Balanced Scorecard methodology.

Many organizations, both public and private now use scorecarding to measure and monitor performance against corporate, divisional, programme and even employee goals and objectives. The fundamental concept is to ensure that the strategies and actions that the business is undertaking are linked to the corporate goals and objectives. This linkage ensures both optimum prioritization and direction of effort & resources in order to meet corporate goals.

Lights represent historical performance data measured against quantified objectives, giving the business red, amber, or green lights depending on performance in relation to goals and objectives.

However, this methodology does not take into account the possibility that future events (i.e. risks) will impact the business's ability to meet its targets. In our view, a vital "time view" into the performance management process is lost through this omission.

Some organizations and software vendors have tried to address this requirement by creating scorecards and objectives specifically related to risk. This approach however, can only partially identify the events that may impact overall corporate performance as there is no direct linkage to each "non-risk" objective. Without a direct linkage between the core performance objectives and the risk process, it is not possible to identify trends and future implications these could only be identified by mentally, or manually aligning the business objectives with the risk objectives. As a result, key trends and risks that should be highlighted against each performance objective are not brought together to offer the value (i.e. predicted risk adjusted future performance) that is possible if they are linked.

	2004						Owner
	Qtr 1 2004			Qtr 2 2004			
	Actual	Plan	Trend	Actual	Plan	Trend	
Net Profit and Loss							
Revenue							Pellow, Frank
Product Revenue	\$5,052,978.76		●	\$5,253,813.68		●	Hanson, Mark
Units Sold	5,829		●	18,990		●	Hanson, Mark
Average Price Per Unit	86.17		●	73.24		●	Holt, Holly
Costs							Penor, Lori
Product Cost	\$4,186,276.67		●	\$5,185,894.64		●	Adams, Jen
Average Discount	6.32%		●	6.77%		●	Adams, Jen
Net Profit							Allen, Tony
Net Profit	\$86,702.29		●	\$1,067,919.24		●	Adams, Jen
Net Profit Margin %	17.15%		●	17.07%		●	Adams, Jen

Under the Balanced Scorecard method, performance information is normally presented to users in the form of a "traffic light" score card interface such as that shown here in Microsoft's Business Scorecard Manager system. The traffic

In our opinion, the only logical method of monitoring the ability of the business to meet each of its core objectives over an extended period of time, is to relate the risk management process directly to these central objectives.

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Linking your Risks and your Performance

The following screen shot shows our Risk Adjusted Corporate Performance method of doing this, where the results of a formal quantitative risk management process (including risk mitigation strategies) are both reported against the plan and against actual performance information for each objective.

	Current	Plan	Trend	Current Risk	Target Risk	Mitigation Cost
Community First						
% homes meet the decency std as % of total stock	65%	65%	→	25%	60%	£1,200,000
% PG bodies spending that have Equality policy	90%	90%	→	70%	90%	800,000
% Education and learning indicators at top quartile	10%	10%	→	5%	5%	£125,000
Customer First						
% Residents satisfied with overall service	55%	55%	→	50%	55%	£200,000
% Enquiries dealt with fully on first contact	75%	75%	→	0%	0%	0
Funding the future						
Contract variance compared to contract price	-£280,000	-£280,000	→	-£800,000	-£250,000	£210,000
Cap budget spent against programme	£8,500,000	£8,500,000	→	£10,500,000	£8,000,000	£125,000
% of cost indicators in best quartile	10%	10%	→	2%	10%	0
Material budget accounts within target	85%	85%	→	65%	84%	£657,000
Performance						
% of brownfield land use	55%	55%	→	30%	55%	0
% of BIPFs in top 25%	12%	12%	→	5%	10%	£950,000
No. staff awards for innovation class	8	8	→	0	0	0

In this case, we can see a typical scorecard for a Local Authority, with drill down/cascading objectives, actual, plan and trend indicators as traditionally presented. Also presented are the results of a formal risk management process conducted against each performance objective, which may contain multiple risks, different impact types and risk assessments against each objective. These results are a quantitative financial or percentage impact assessment of the likelihood of the performance objective being met.

From this example, we can immediately see that each objective has been assessed in terms of risk (and opportunity), and that the current risk assessment has been managed to achieve a target risk level (through the implementation of a mitigation strategy). This brings performance back into alignment with objective targets by managing the risks around the individual objective.

The numbers in the “Current Risk” and “Target Risk” columns are a reflection of the performance assessment factored by the risks of not achieving set targets. So, for the “Capital budget spent against program” objective, the planned target (not displayed) is £8.8m and actual performance to date is £8.5m. This is within the “acceptable” tolerances band set in the scorecard system and so the traffic light of actual against plan is showing green.

However, the risk assessment that has been performed against this objective (and there can be many risks that affect each objective), shows for the current risk assessment that the estimated spend could be £10.5m if the identified and measured risks occur. This may be because of increased industrial action, increased materials cost, or failed projects

for instance. These risks have been assessed in the risk management system and their financial impact including what has been spent to date totals £10.5m.

As this is unacceptable, the risk team has worked to identify mitigating actions that can reduce these risks through the expenditure of £125,000 on risk mitigation actions and controls. As a result they can actually reduce the estimated total spend for the year to £8m. The business has thus turned what could be a significant budget over-run into a budget saving over current performance of £500,000 by spending only £125,000.

Better decisions, more often

With this information, management can make better informed decisions about the authorization of mitigation funding and its likely direct impact on the ability of the business to meet its stated objectives.

The over-riding benefit of bringing quantified risk management results into the performance management process, is that management can be better informed about the potential for non-delivery of objectives, and therefore, can act on this information to ensure successful delivery of corporate objectives.

While it is important to understand the status of performance against target to date, it is more important to manage future performance; this can be influenced - past performance cannot. The ability to assess the return on investment of mitigation spend versus the cost if the risk were to impact, is also an important benefit as this encourages positive decision making and resource planning as opposed to reactionary behaviour.

Strategic Thought can offer you the 3 components that you require to achieve this:

- a formal quantified risk management process
- a performance management and scorecarding solution, and
- a methodology for bringing these two components together.

Risk Adjusted Corporate Performance (or RACP), is our unique methodology for achieving the above and is part of our software solution pulling together both disciplines of Risk and Performance Management.

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