Defining Risk Appetite

Early Mover Series: Integrating Corporate Performance Management and Risk Management

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INTRODUCTION

A RISK APPETITE STATEMENT SPECIFIES THE MAXIMUM ACCEPTABLE PERFORMANCE VARIABILITY AND LOSS EXPOSURE WITH QUALITATIVE AND QUANTITATIVE STATEMENTS TARGETING APPROPRIATE BOUNDARIES WHEN EXECUTING THE BUSINESS MODEL. A USEFUL STATEMENT MUST BE RELATIVELY SIMPLE IN STRUCTURE, FOCUSED IN DESIGN AND EASILY COMMUNICATED, SO THAT IT RESONATES WITH THE STAKEHOLDERS WHO MATTER.

Protiviti's *Early Mover Series* explores various aspects of Protiviti's PRIM^2 framework for integrating strategy-setting, performance management and risk management with the intent of helping companies become early movers in the marketplace.[1] We define an "early mover" as a firm that quickly recognizes a unique opportunity or risk and uses that knowledge to evaluate its options before the opportunity or risk becomes widely known. This white paper, the third in the series, discusses the importance of risk appetite to the governance process.[2] Specifically, it:

- Explains risk appetite and how it differs from risk tolerance.
- Introduces a framework for developing a risk appetite statement.
- Illustrates what a risk appetite statement looks like.
- Examines how risk appetite influences organizational behavior.
- Provides an overview of the process for defining and maintaining the risk appetite statement.
- Discusses how management and the board of directors should sustain a dialogue around risk appetite as circumstances change over time.

Many see risk appetite as a highly theoretical concept that is difficult to apply in practice. Some even assert that risk appetite is irrelevant because it cannot be applied effectively in practice. Following are four reasons for these concerns:

1. **Many people waste time looking for a "magical metric."** Beyond financial services, this effort isn't likely to be productive in the short term. Directors and senior executives need a strategic view now to ensure they are on the same page in terms of appetite for risk in executing the enterprise's strategy. A useful risk appetite

[1] Protiviti's white paper, *Performance/Risk Integration Management Model – PRIM^2: The Convergence of Corporate Performance Management and Risk Management*, provides a framework, which we call PRIM^2, for integrating strategy, risk and performance management. The central premise of the paper is that a company must consider how an integrated approach and discipline to deploy strategy and manage the associated risks can deliver superior long-term enterprise value. This premise applies whether the firm is rapidly growing, focused on establishing sustainable competitive advantage or both. This white paper, which provided the impetus for Protiviti's *Early Mover Series*, is available at **www.protiviti.com**.

[2] The first two papers in the series are *Analyzing Strategic Risk* and *Maximizing the Value of Competitive Intelligence*. Both are available at **www.protiviti.com**.

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statement must be relatively simple in structure, focused in design and easily communicated, so that it resonates with the stakeholders who matter. This isn't just about capital, earnings or cash flow at risk. Reputation comes into play, as well as other commitments and boundaries. In seeking "perfect" answers, companies miss the opportunity to adopt a simple framework that directors and senior executives not only will understand, but also can use to initiate and sustain the conversation during the strategy-setting process and reference frequently over time.

2. **Many people wonder how to drive risk appetite down into the organization.** While this is a valid point (and one we will explore later in the *Early Mover Series*), it is a separate and different conversation around setting risk tolerances and is tied to the process of defining key metrics and targets. Often, we see the two terms – risk appetite and risk tolerance – used interchangeably. Our view is that "risk appetite" is a higher-level conversation focused on driving strategic decisions and rightsizing risk profiles, whereas "risk tolerance" is a tactical one linked to metrics, measures and monitoring. We think of risk tolerances as a decomposition of the enterprise's risk appetite to enable personnel to consider risks more specifically in discharging their responsibilities.
3. **Some fail to grasp that risk appetite is an ongoing, dynamic dialogue rather than a onetime determination to be filed away until the next risk assessment.** Risk appetite is not an attempt to shackle management's ability to adapt to a changing environment. To the contrary, risk appetite establishes a baseline for framing a continuous dialogue at the highest levels of the organization as circumstances change, fresh opportunities arise and changing conditions warrant a revisit of critical strategic assumptions. Because risk appetite is inextricably tied to strategy-setting, neither is cast in stone.
4. **Those considering risk appetite to be a highly theoretical concept often fail to understand that their organization already has a risk appetite, whether they choose to articulate it explicitly or not.** Management and the board take actions every day that reflect the organization's risk appetite. The real question is whether a mutual understanding exists between the board of directors and management as to what it is.

In summary, the risk appetite dialogue will contribute to management and directors striking the appropriate balance in the conversation around the inevitable tension between creating and protecting shareholder value over time. While a risk appetite statement is not in and of itself a driver of early mover behavior, it does provide a directional tool that points to the appropriate levers of enterprise risk.

RISK APPETITE – WHAT IS IT AND WHY DEFINE IT?

We have asserted that there are four broad choices available to management in strategy-setting that impact enterprise value. One of these choices is to consider explicitly management's risk appetite by aligning risk-taking with what the organization does best.[3]

During his or her tenure, every chief executive officer (CEO) makes a number of bets with the objective of building enterprise value. These bets pertain to such actions as entering into new markets, investing in new products, innovating through technology, merging with or acquiring another entity, and expanding the market footprint through acquiring existing plants or building new facilities. Implicit in these bets is the CEO's and board's appetite for risk. In this context, risk appetite is a useful tool for evaluating strategic options and communicating with

[3] See discussion of the four choices in Protiviti's white paper, *Analyzing Strategic Risk*, available at **www.protiviti.com**.

While a relentless emphasis on strategic execution can be a good thing, the non-existence of strategic boundaries can present a significant challenge from a corporate governance standpoint.

the board and, ultimately, with the investor community. It provides the ultimate linkage of opportunity and risk during the strategy-setting process.

A CEO who operates without any boundaries is a signal to the board of directors that he or she may be unfocused strategically. While a relentless emphasis on strategic execution can be a good thing, the nonexistence of strategic boundaries can present a significant challenge from a corporate governance standpoint. For example, is it wise to execute the strategy while ignoring signs that changes in the business environment are affecting the validity of one or more critical strategic assumptions? Is it wise to execute a business model blindly without an early warning that excessive risks may be undertaken and understanding the motivating factors driving risk-taking behavior? And with respect to risk appetite, is it wise to pursue a strategy without a mutual understanding between executive management and the board as to the overall level of risk the organization can undertake?

The risk appetite dialogue helps to bring balance to the conversation around which risks the organization considers acceptable and those it intends to avoid. It provides a framework to executive management and the board for understanding the absolute level of risk the enterprise is willing to undertake in executing its strategy, as well as the nature and types of the most critical risks. More importantly, when the board and senior management focus on strategic options, the strategic choices they select should align with the organization's risk appetite. As a company evaluates its objectives and approach to achieving performance goals, it should consider *both* the inherent risks as well as its appetite for risk. Risk appetite is therefore integral to the strategic decision-making process.[4]

Risk appetite represents executive management's "real-world view," providing insights on such questions as:

- What risks do we seek to take and why?
- What risks do we want to avoid and why?
- Are there risks we manage better than our competitors; if so, what are they and how do we know we manage them better?
- Are there uncertainties inherent in our business model that we need to understand?
- What risks inherent in our business model must be reduced to an acceptable level and over what time horizon (i.e., what level of risk is management willing to take)?
- What future developments or emerging risks could alter the assumptions underlying our strategy?
- How do we want to do business (i.e., how do we communicate internally and externally the enterprise's commitment to responsible business behavior)?

A well-articulated risk appetite statement aligned with the strategy presents an opportunity for management to clarify for the board and the rest of the organization the enterprise's appetite for risk. If executive management wants to encourage personnel to take risks in executing the strategy and to transform a culture regarded as risk-averse, this may be a reason to consider developing a risk appetite statement. But the more compelling reason is to maintain strategic focus and avoid "strategic drift."[5] If the organization has appointed a chief risk

[4] *Enterprise Risk Management: Understanding and Communicating Risk Appetite*, Dr. Larry Rittenberg and Frank Martens, research commissioned by the Committee of Sponsoring Organizations (COSO), page 1: **http://www.coso.org/documents/ERM-Understanding%20%20Communicating%20Risk%20Appetite-WEB_FINAL_r9.pdf**.

[5] A term coined by Charles Handy in his book, *The Age of Unreason*, 1989. It refers to a gradual change that occurs so subtly that often it is not noticed until it is too late, as opposed to sudden and radical transformational change. For example, in the mortgage industry in the United States, loan-to-value ratios steadily increased until the point when the players in the industry realized the same house worth $150,000 10 years ago was valued at $400,000 just before the bubble burst.

When a risk appetite statement points to risks that really matter in executing the strategy, it can help sharpen the focus for organizations aspiring to be early movers … the decisiveness required of an early mover may not be possible if executive management and the board are not on the same page as to when the enterprise's risk appetite is infringed.

officer (CRO) or an equivalent executive, executive management must ask itself how a CRO can be effective in challenging strategies and business decisions if there isn't a clear articulation of risk appetite.

A risk appetite statement specifies the maximum performance variability and loss exposure with qualitative and quantitative statements targeting parameters or acceptable boundaries when executing the business model for creating enterprise value. By delineating the acceptable domain within which company personnel are empowered to act, a risk appetite statement helps the board to understand how the executive team intends to focus an empowerment culture fostering opportunity-seeking behavior. For the risk appetite statement to work, it must be actionable by management; that is, it must influence organizational behavior and have a meaningful impact on the company's execution of its business strategy. For example, it should consider strategic uncertainties inherent in the business model that must be addressed to ensure long-term success.

When a risk appetite statement points to risks that really matter in executing the strategy, it can help sharpen the focus for organizations aspiring to be early movers. If a pharmaceutical or consumer products company recognizes that reputation and brand image are vital to its long-term success and must be protected at all costs, product quality and public safety become paramount concerns. Therefore, operational risk management should be effective in enabling the organization to attain early mover status well before it approaches a crossroads where a strategic inflection point exists, and the company's market position as a leader in product quality and public safety could be harmed significantly if an imminent threat is not recognized by the right people and acted upon in a timely manner.[6] The decisiveness required of an early mover may not be possible if executive management and the board are not on the same page as to when the enterprise's risk appetite is infringed.

A FRAMEWORK FOR DEFINING RISK APPETITE

Think of a risk appetite statement as a summary of observations, which we call "assertions," around relevant parameters that, taken together, frame the organization's appetite for risk. There are three key elements of a framework for framing risk appetite assertions:

1. **Articulate risks that are acceptable or on-strategy that the organization intends to take because the risk taken is sufficiently compensated.** These risks are related to the bets management makes to fuel growth – for example, invest in the BRIC countries (Brazil, Russia, India and China), build new plants, hire more people and invest in new capabilities. These risks are inherent in the enterprise's stated strategic objectives to invest in new markets, increase productive capacity and augment the workforce, and are presumed acceptable provided management and the board have determined there is a satisfactory risk-reward balance (i.e., the upside potential for attractive returns warrants accepting the downside exposure). Risk tolerances (i.e., specific markets in which to expand, acceptable level of variation around performance targets, and strategic supplier performance targets) and limit structures (i.e., spend limits, Value at Risk [VaR] limits and concentration limits) are often set for these risks.

2. **Articulate risks that are undesirable or off-strategy that should be avoided, and for which zero/minimal tolerances should be set.** These are risks the board and management have no appetite to assume. Policy prohibitions are often established for these risks to clarify management's strategic intent to avoid them (e.g., minimum standards for dealing with foreign officials, no appetite to invest in certain high-risk countries, avoidance of certain lines of business or restrictions on the use of financial derivatives for profit-making

[6] The term "strategic inflection point" is attributed to Andy Grove, former CEO of Intel, in his book, *Only the Paranoid Survive*, 1996.

purposes, including the types of instruments used, and minimum criteria for counterparties). The organization may acknowledge these risks as part of its risk appetite assertions to communicate they are unacceptable.

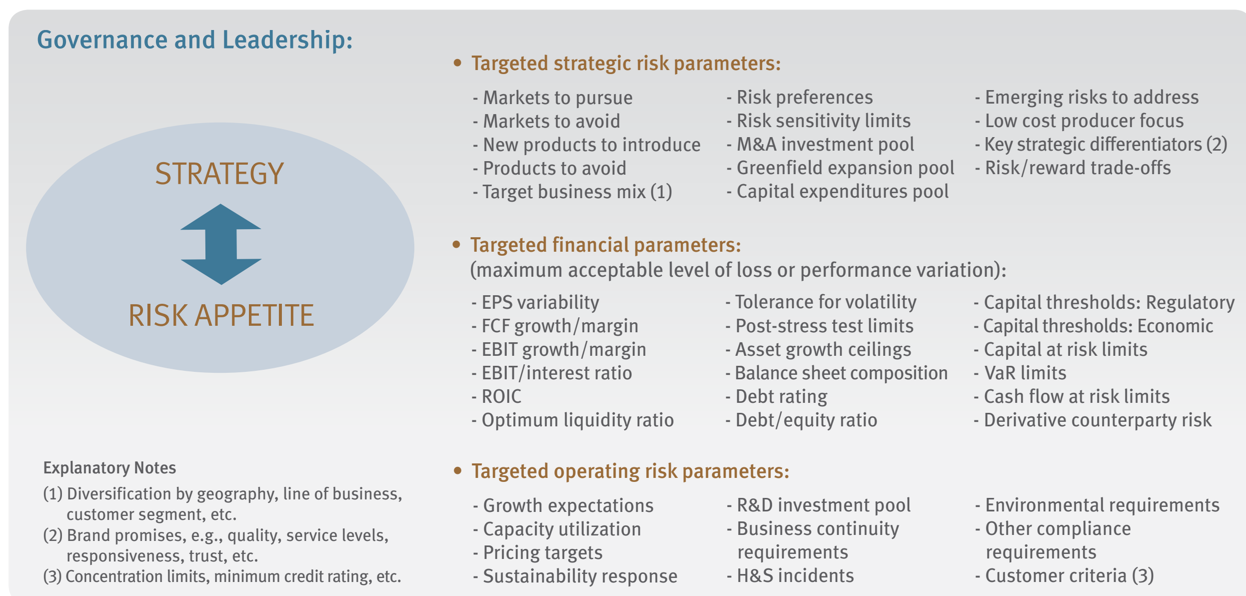
3. **Define strategic, financial and operational parameters to provide a framework within which the company's business model is executed.** Parameters impact decision-making during the planning cycle and as strategic priorities and the business plan are executed and risks are undertaken. They drive discussions between executive management and the board when unforeseen opportunities arise or parameters have been overstepped. They often constitute most of the risk appetite assertions. Parameters may be expressed as targets, ranges, floors or ceilings and provide a context for establishing risk tolerances and limit structures. They may consist of:

   - **Strategic risk parameters** – For example, new products to pursue and avoid and the investment pool for capital expenditures, hiring plans and expected merger and acquisition (M&A) activity.
   - **Financial risk parameters** – For example, the maximum acceptable level of loss or performance variation including earnings per share (EPS) variability, free cash flow (FCF) growth/margin, earnings before interest and taxes (EBIT) growth/margin, return on assets (ROA) or return on invested capital (ROIC), target debt rating, target debt/equity ratio, EBIT/interest coverage ratio and derivative counterparty criteria.
   - **Operating risk parameters** – For example, minimum capacity utilization, expected sustainability response, research and development (R&D) investment pool, existing/projected environmental requirements, safety targets, quality targets and customer criteria and concentrations.

These three elements provide a framework for defining risk appetite assertions that clarify for management, the board of directors and other stakeholders within the organization the risks the enterprise is intent on taking and the parameters within which those risks are taken.

To illustrate risk appetite assertions further, risks that are *acceptable* or *on-strategy* might include those associated with doubling investments in the R&D pipeline or conducting offshore drilling in dangerous and/or deep waters. These initiatives are undertaken because management and the board agree that the upside opportunity for future revenue streams compensates the enterprise for the up-front investment requirements and related downside risks. Risks that are *undesirable* or *off-strategy* might include doing business in countries with a high corruption risk index or unacceptable concentrations in loans, investments, major customers, certain geographies or certain counterparties.

Following are examples of *targeted strategic*, *financial* and *operating risk parameters*:



In highlighting the above examples, we are not suggesting that they all be used or apply to a single company. Our view is that management should frame the risk appetite statement in the context of the organization's business model. Following are some suggestions and ideas for doing this:

- **Start with the past** – The most practical, logical way to begin framing an initial risk appetite statement is to focus on the enterprise's historical risk-taking characteristics. The idea is to articulate risk appetite manifested through the organization's past actions, and decisions not to act, and establish a baseline to build on going forward. If any aspects of this baseline require modification, a change management initiative most likely will be required.

  To illustrate the approach of building a baseline, begin with understanding the following 10 factors:

Factors	Why Consider?
Enterprise values and beliefs	The company's purpose, mission, code of conduct and "tone at the top" set the context for the core values senior management wants to infuse and reinforce within the organization. These core values are rooted in the past and are a part of the "folklore" the organization uses to define itself.
Business model and strategic priorities	The organization's business model provides an important context for assessing risk appetite by clarifying the activities the entity undertakes, who its customers and what its products are, and how and in which markets it conducts business. A thorough understanding of an organization's business objectives, strategy and operations is very useful when articulating the enterprise's appetite for opportunity-seeking behavior. It also provides the context for understanding the risks the organization chooses to undertake and the risks it chooses to avoid as it creates value.
Competitor performance	Benchmark the organization's performance against returns generated by competitors within the industry.
Business mix	If the organization has different lines of business within its enterprise portfolio, the risk profile can vary depending on the nature of the industry, geographic reach, competition and regulatory environment. Distinctively different business segments complicate the risk appetite discussion.
Historical risk-taking characteristics	Past management behavior provides insight as to the company's propensity to take risks. Such behavior may include, for example, management decisions and actions around undertaking mergers and acquisitions, introducing new products and services, investing in R&D, entering new markets, expanding into areas beyond the enterprise's core competencies, preserving liquidity, keeping debt covenants, managing capacity, and implementing lean manufacturing.
Historical disruptive events/ losses and the company's response	The company's loss experience and responsiveness to crises provide insight regarding significant exposures to high-impact, high-velocity and high-persistent risks and the enterprise's response readiness. For example, consider such things as significant unexpected losses, near misses, limits violations, policy breaches, asset expropriations, supply disruptions, critical systems downtime, and compliance issues.
Board risk oversight	The expectations of directors are an important influence on a risk appetite statement.
Current capacity for absorbing unexpected losses	This reflects capacity to bear risk, as well as a broader understanding of the level of risk the company can safely assume and successfully manage for an extended period. Capacity must consider regulatory and contractual requirements, such as regulatory minimums on capital levels or liquidity, debt covenant requirements, equity rights and similar matters.
Existing policies and limit structures	These set boundaries around opportunity-seeking behavior, including ceilings and limits set for M&A funding, capital expenditures, R&D, derivatives trading, prohibited products and services, and concentrations in loans, investments, major customers and geographies.
Organization's risk culture	Culture provides insight into the risk philosophy of the company, effectiveness of board risk oversight, extent of balance in the compensation structure, extent of transparency within the enterprise, positioning of risk management in the organization, senior management's acceptance of surprises and "bad news," and the willingness of subordinates to escalate issues upward, among other things. In research commissioned by COSO, this focus on culture is described as "the attitudes towards growth, risk and return." [7]

[7] *Enterprise Risk Management: Understanding and Communicating Risk Appetite*, page 4.

- **Leverage sources of clarifying information** – Sources of the above information regarding risk appetite assertions include interviews with key executives and directors and the company's current and prior year risk profile assessments. In addition, risk factor disclosures, financial statements, internal reports, road show presentations to the investor community, analyst call transcripts, market intelligence and special studies commissioned by management on specific issues can be useful sources of clarifying information. The idea is to "look for the familiar" and use available information sources to understand how executive management and operating unit leaders think about risk through the choices and decisions they make over time, their responses in times of opportunity and adversity, their messaging to the street regarding future plans, and other relevant external and internal communications. It is also useful to have a historical view regarding how the investor community has interpreted and reacted to management's choices and decisions addressing strategy and the inherent risks assumed and whether the street's reaction is consistent with management's assessment.
- **Identify risks that management has implicitly chosen to accept** – Risks an organization concedes it is willing to accept outright tend to be foundational elements of the current business model and related strategy. In many cases, these risks may not be included in a risk appetite statement due to their fundamental nature. Yet, they will often appear as significant risks in a risk assessment and are an integral part of the existing risk profile. These risks are likely the ones that are "paying off," compensating the company with returns. To illustrate, choosing a nondiversified business model such as making a bet on a commodity like oil, or a precious metal such as gold, versus managing risk through diversification are examples of an acceptable risk put in play by the selected strategy and business model. For bets on a product concept, the level of acceptability is driven by the product's positioning on the product life cycle curve, as many products have a limited life and ultimately fall into decline. Global organizations accepting the challenges of operating in diverse countries, cultures and regulations are another example. Choosing to make significant investments to expand into a new line of business outside the company's current core business is yet another.
- **Identify risks management has chosen to avoid** – There are many of these risks. Prohibiting the use of exotic derivative instruments for speculative/profit-seeking purposes by limiting their use to accomplish specific, approved hedging objectives is an example. Precluding investment in politically unstable countries with significant economic uncertainty and currency risk is another (e.g., either direct investments or requiring divestiture if an otherwise strategically attractive acquisition has operations in a country that management and the board have declared "off-strategy"). Zero appetite for damage to reputation and brand image is yet another example.
- **Identify risks that management is willing to accept under certain conditions or within specified ranges of exposure** – Risk parameters provide a framework within which risks may be undertaken. These strategic, financial and operational risk parameters guide decision-making as strategic priorities are executed, and drive discussions between executive management and the board when unforeseen opportunities arise or the parameters themselves are breached. Needless to say, the CEO, chief financial officer (CFO) and chief risk officer (CRO) must be closely involved in the evaluation of these parameters along with other members of executive management. It is our experience that some of these parameters already exist to some degree. Often, they are implicit in the executive team's business plans or have been considered in linking annual budgets with the strategy and in aligning business plans with messaging to analysts and investors. They represent executive management's view of the level of acceptable variation in the pursuit of the enterprise's objectives. As noted earlier, parameters may be expressed as targets, ranges, floors or ceilings, and may have a strategic, financial or operational focus.
- **Using the above insights, decide on the appropriate assertions** – The assertions management and the board agree to include in the risk appetite statement provide the baseline for framing both their ongoing dialogue and the overall message to convey to the organization and its stakeholders. When deciding on the assertions, pay attention to the planning time horizon. Management's appetite for risk over the next five years is a much more strategic conversation than its risk appetite over the next 12 months.

- **Understand the decisions and actions the various assertions can impact** – Each of the three elements of the framework for defining risk appetite results in various assertions that are an integral part of the risk appetite statement. These elements lead to specific actionable steps for executive management to undertake, as illustrated below:

Assertions From the Three Elements …	… Drive the Following Actions
(1) Risks that are *acceptable* or *on-strategy*	Establish risk tolerances with the intent to accept, reduce, share or exploit these risks.
(2) Risks that are *undesirable* or *off-strategy*	Define and communicate policy prohibitions and restrictions to avoid, reduce or transfer these risks.
(3) Strategic, financial and operational parameters	Decompose the parameters into more specific risk tolerances using the same unit of measure supporting relevant performance metrics and drive them downward into the organization; impact the planning cycle and decision-making as strategic objectives are pursued; and trigger discussions between executive management and the board when near misses, exceptions or unforeseen opportunities arise.

- **Read the assertions in their entirety, not in isolation** – Reviewing a single assertion will seem like reading an objective. Each assertion of a risk appetite statement provides a piece of the total fabric in understanding management's core risk strategy. The full statement provides the full picture – the yin and yang of balancing the focus on creating and protecting enterprise value.

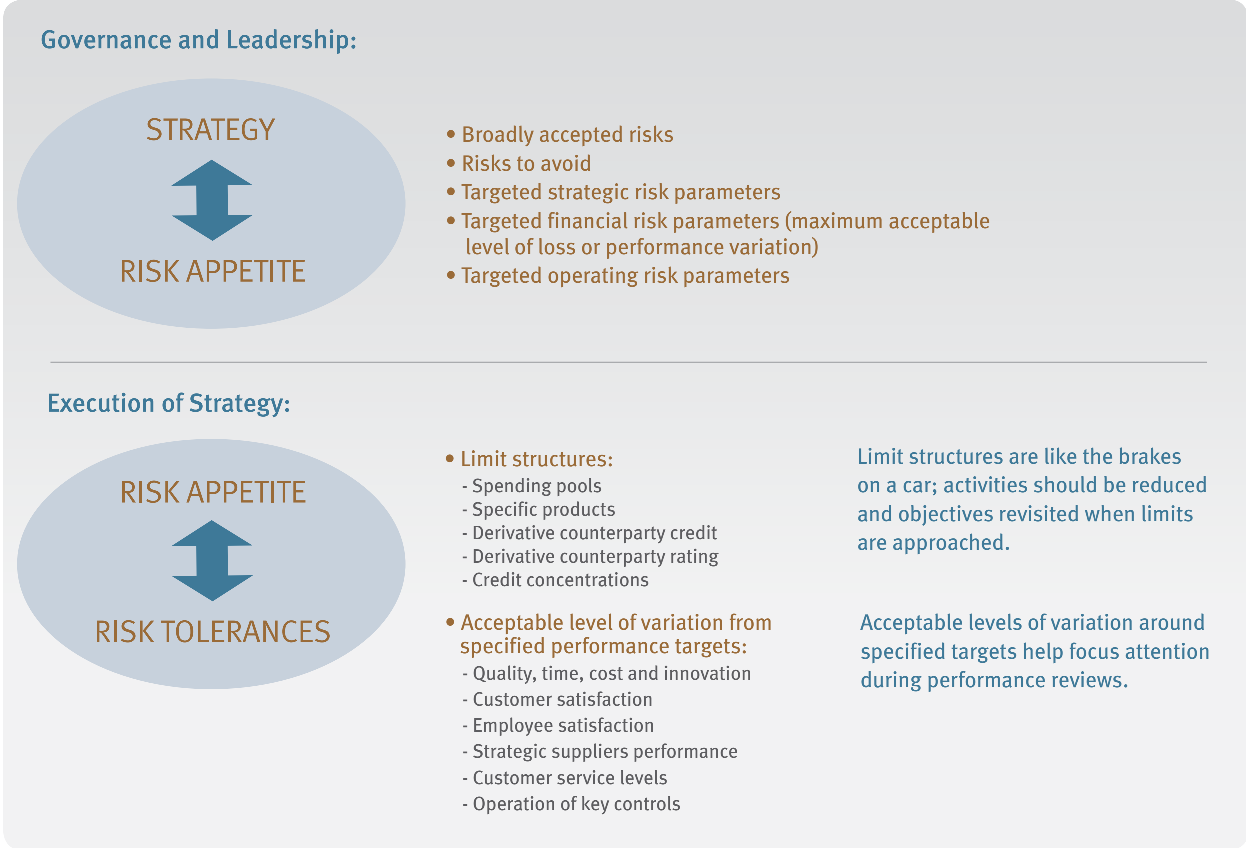
In summary, risk appetite is not rocket science, nor is it a single number or a onetime determination. It is an ongoing, strategic conversation that has specific impacts on how the business is managed and provides a directional tool for aligning risk-taking with what the organization does best: its core competencies. It is inherent in the organization's strategy and in the execution of that strategy, in the form of both risks taken and risks avoided. Accordingly, management and the board should consider (a) which risks (accepted or avoided) require assertions in the risk appetite statement around relevant parameters for managing the business, and (b) when the risk appetite statement should be reassessed as a part of the strategy-setting process.

HOW RISK APPETITE DIFFERS FROM RISK TOLERANCE

At this point, it should be clear that risk appetite is strategic. That is because it represents a joint articulation by management and the board of the level of uncertainty they are willing to assume as they pursue the rewards expected from successful execution of the strategy. This point of view is also advanced by authoritative frameworks. For example, according to the COSO ERM Framework, risk appetite is "the amount of risk, on a broad level, an organization is willing to accept in the pursuit of value" and is used as a "guidepost" in strategy-setting, providing boundaries within which risk is managed. ISO 31000 refers to risk appetite as the amount and type of risk an organization is willing to pursue or retain and that influences decisions made around managing risks based on the outcome of risk analysis. And according to BS 31100, risk appetite drives the definition of risk management objectives and is tightly linked to providing strategic direction on the appropriate recognition of risk in decision-making.

In effect, as the enterprise executes its strategy, its business objectives provide the context for understanding the risks it chooses to undertake. Accordingly, the contribution of a risk appetite statement, developed using the three elements we have introduced, is to set boundaries around opportunity-seeking behavior. According to COSO, a company with a high risk appetite may be willing to allocate a large portion of its capital to high-risk areas and newly emerging markets. Conversely, a company with a low risk appetite might limit its short-term risk of significantly eroding its capital base by investing only in mature, stable markets.

Risk appetite, by its nature, is a forward-looking view of the enterprise's acceptable risk profile. Risk tolerances, on the other hand, are specified boundaries or parameters within the overall risk appetite that the organization chooses to pursue, providing a sharper definition of the extent of risks the organization is willing to take.



So how does risk appetite differ from risk tolerance? This is an important question because the two terms are often used interchangeably.

As we've defined it, risk appetite is the mutual understanding between executive management and the board regarding the drivers of, and parameters around, opportunity-seeking behavior. It is basically the highest level of risk allowed by the board for senior management to operate under. While it is typically below any legal and other mandated requirements, it is the top shelf – the concrete barrier, so to speak. While management can exceed it, doing so can be very painful. Risk appetite, by its nature, is a forward-looking view of the enterprise's acceptable risk profile.

Risk tolerances, on the other hand, are specified boundaries or parameters within the overall risk appetite that the organization chooses to pursue, providing a sharper definition of the extent of risks the organization is willing to take. Risk tolerances are like tollgates. You can go through them without paying, but if you do, there will be fines and maybe some damage. The good news is you haven't totaled the car.[8] To take this analogy further, limit

[8] "Total the car" is an American colloquialism referring to an automobile that has sustained severe damage as a result of a collision, natural disaster or other event such that it is either damaged beyond repair or the cost of repair exceeds its current worth. In either case, it usually means the vehicle ceases to operate.

structures (e.g., concentration limits, spending limits, credit limits) are even more granular. They are like radar stations that flash a warning when you are exceeding a speed limit. There could be a small fine if traffic citations are automated, but usually it is nothing more than a warning.

As a high-level view of how much risk the entity is willing to take, risk appetite relates primarily to the business model, whereas risk tolerance relates primarily to the key metrics and targets around achieving the entity's performance objectives. An organization's risk appetite reflects how closely management desires to operate the business relative to the enterprise's total capacity to bear risk, which considers the level of risk the enterprise can safely assume and successfully manage for an extended period. On the other hand, risk tolerance is the acceptable level of variation relative to achieving a specific objective. It often is measured with the same metric used to measure performance against the related objective.

Thus, the focus and level of granularity between risk appetite and risk tolerance are quite different. While risk appetite is strategic, risk tolerance is tactical. Risk appetite is the extent to which an organization exposes its capital and sources of value to the exploitation of strategic opportunities and retention of performance variability and loss exposure. Risk tolerance decomposes assertions in the risk appetite statement to set and measure the range of acceptable performance variability against an objective that is relevant to the execution of the strategy. Once risk tolerances are set, performance measures are monitored to ensure performance is managed within the acceptable range so that the risk of performance variability is reduced to an acceptable level.

Risk tolerance may be reflected differently for different types of objectives, including those relating to earnings variability, interest rate exposure, compliance with laws and regulations and the acquisition, development and retention of people. Risk tolerance related to all of these objectives is expressed differently. In effect, risk tolerances address the question, "How much variability are we willing to accept as we pursue a given business objective?" Guidance on this question is important, as it helps managers assess their exposure in terms of the downside risks they are empowered to accept as they seek upside performance. As managers pursue opportunities for growth and new sources of profitability, risk tolerances and limits are an effective tool for countering pressures to produce results. In other words, risk tolerances and limits help managers understand that actions undertaken with the goal of being successful in producing expected results cannot be executed at all costs and without regard to the potential consequences to the organization as a whole if something were to go wrong in executing the strategy.

We will discuss the process for establishing risk tolerances and limits in a subsequent white paper addressing the setting of key metrics and targets.

ILLUSTRATING ASSERTIONS IN A RISK APPETITE STATEMENT

In financial services, risk appetite frameworks range from the high-level, brief and qualitative to the complex, lengthy and quantitative. This variation across different financial institutions reflects different views across the industry as to what a risk appetite statement should look like, as well as the different stages of maturity of the risk appetite dialogue in different firms. Even in financial services, the process of some firms in defining risk appetite is relatively immature. For example, the Senior Supervisors Group reported that while the majority of 14 global financial institutions indicated they had a risk appetite statement, more than half reported that it had been in effect for a year or less as of December 2010.[9] Outside financial services, most companies are just beginning to think about risk appetite.

[9] *Observations on Developments in Risk Appetite Frameworks and IT Infrastructure*, December 2010, issued by the Senior Supervisors Group (SSG), page 4. Available for download at: **http://www.newyorkfed.org/newsevents/news/banking/2010/an101223.pdf**. The SSG is comprised of senior executives from the bank supervisory authorities of Canada, France, Germany, Japan, Switzerland, the United Kingdom, the United States and other countries. The SSG formed a working group that met with board members, CEOs, CFOs, CROs and business heads at 14 global financial institutions to gain insight into how firms are defining, communicating and monitoring risk appetite and meeting the challenges involved in implementing a risk appetite framework. The participating firms represented a broad cross-section of the financial services industry in terms of geographic reach, business focus and experience with risk appetite.

As a result of applying the three elements of the framework introduced earlier, management and the board agree to various assertions regarding the organization's risk appetite. A risk appetite statement assembles these various assertions. This framework applies to all industries. Following is an example of what assertions in a risk appetite statement might look like for a non-financial services company, using the three elements framework we have introduced:

The Three Elements	Examples of Assertions Included in the Risk Appetite Statement
(1) Risks that are *acceptable* or *on-strategy*	• **Market growth:** We will aggressively pursue regional strategies to meet our market growth objectives (increase of 3 percent in market share) and invest in and develop key markets, with emphasis on the BRIC countries.
(2) Risks that are *undesirable* or *off-strategy*	• **Reputation and brand image:** We will avoid any situation and action resulting in a negative impact on our reputation and premium brands and, if and when an undesirable situation arises, manage it aggressively to protect our reputation and brand image. • **Financial derivatives**: We will limit our use of derivative instruments to "plain vanilla" swaps and options entered into with counterparties rated "AA" or better.
(3) Strategic risk parameters	• **Investment limits**: We will limit capital expenditures and investments in mergers and acquisitions to an amount that allows the company to achieve its annual free cash flow target of $225 million.
Financial risk parameters	• **Target debt rating**: We will seek to maintain an enterprise-level debt rating of "A" or better. • **Self-sustaining growth**: In seeking new business, we will maintain our working capital ratio between 1 and 1.5 percent. • **Financial strength:** We will maintain an EBIT/interest ratio between 4 and 5 percent.
Operational risk parameters	• **Loss exposure**: We will manage our operational activities and exposures to avoid an event resulting in a loss to pre-tax operating margin of more than $25 million. • **Sustainable business model:** We will reduce carbon emissions over the next five years with the objective of reducing energy usage costs by 40 percent. • **Customer dependence**: A single customer will not account for more than 10 percent of total sales.

Taken together, the assertions frame the organization's risk appetite. As observed previously, they should not be read in isolation. For example, the market growth assertion cannot be read independently of the assertions pertaining to reputation, investment limits, target debt rating and financial strength. By initially stating risk appetite in this way, the risks the organization is intent on taking are articulated and the parameters within which those risks are to be undertaken are made more explicit for management and the board of directors.

Note that the specific risks undertaken in conjunction with the assertion regarding market growth are intended to be implicit since the focus is on the strategy driving the related risks. While the risk appetite statement can enumerate the risks, if desired, there is also an upside that must be considered in articulating the organization's risk/reward balance. In the above example, management could assert the company is investing a stated amount over the next five years ($500 million) in specific markets (the BRIC countries) to drive a targeted growth rate (15 to 20 percent) that will increase market share by 3 percent. Implicitly, this assertion suggests that up to $500 million is at risk and that the company is assuming the specific risks associated with doing business in the stated countries that could frustrate its growth and return on investment objectives.

While not intended to "handcuff" management, the risk appetite statement becomes a benchmark for discussing the implications of pursuing value-creation opportunities as they arise. Changes in risk appetite would require a review of established risk tolerances and limits to ensure there is continued alignment with the risk appetite statement, as modified.

While the above approach is not the only way to frame a risk appetite statement, it is intuitive and one way we've seen several companies begin the dialogue successfully.

A RISK APPETITE STATEMENT IS NOT AN ORNAMENT TO HANG ON A WALL. IT IS A REMINDER TO MANAGEMENT AND THE BOARD OF THE ORIGINAL CORE RISK STRATEGY ARISING FROM THE STRATEGY-SETTING PROCESS.

HOW RISK APPETITE IMPACTS BEHAVIOR

A risk appetite statement is not an ornament to hang on a wall. It is a reminder to management and the board of the original core risk strategy arising from the strategy-setting process. This reminder can be important because corporate strategy is governed by the willingness of an organization to accept risk in the pursuit of value creation, as well as its capacity to bear that risk. A winning business model exploits to a significant extent the areas in which the company excels relative to its competitors, including the risks it chooses to undertake in executing the strategy. As there are conscious decisions to be made, a guidepost is needed.

For example, what is the desirable relationship between the capacity to bear risk and the appetite for taking risk? Does it make sense to take all of the risks an organization is capable of undertaking without reserving capital, borrowing capacity and other resources for unexpected extreme losses, investment opportunities and other contingencies? Is it appropriate to retain a significant risk when options for transferring that risk are available at reasonable cost? Are there certain aspects of the strategy that may be unrealistic and result in unacceptable risks as managers stretch to achieve established performance goals?

The point is this: From a strategy-setting standpoint, it is useful to have a notion of when the organization's capacity for bearing risk is encroached upon (i.e., when is the organization taking on too much risk?). For this reason, a disciplined approach around protecting enterprise value should be integrated with the aspirational objectives established through the strategy-setting process. The risk appetite statement facilitates this discipline as it drives the appropriate dialogue, particularly if it is defined in the cool of the day and serves as a guidepost when a new opportunity or risk emerges. The approach should be to incorporate a robust "think-out-of-the-box" process for establishing and sustaining this vital dialogue between management and the board. However, in a Protiviti survey on board risk oversight, we found that only 14 percent of the participating 200 directors reported that their discussions with management regarding acceptable levels of risk are sufficient for the board's purposes.[10]

Since market conditions cannot be forecasted over time with certainty, a risk appetite statement must be dynamic; that is, it must establish boundaries without becoming excessively rigid. It therefore must be flexible enough to respond to changes in the business environment. At the same time, the risk appetite statement must be viewed as an authoritative benchmark that has been vetted and approved by the board such that any movement away from the core risk strategy it contains will be recognized as a deliberate decision to move outside of or to alter the firm's risk appetite. If it is constantly altered to accommodate every emerging opportunity or meet quarterly forecasts at all costs, it loses its value as a disciplinary rudder for navigating through unpredictable and rough waters. If executive management is so influenced by short-term market pressures that they would allow the company to ignore the parameters set by the risk appetite statement in order to do whatever it takes to meet analyst expectations, a significant red flag emerges warranting attention of the board. Profits can mask risks, good times can drive risky behavior and tough times can drive a lack of discipline, but none of these circumstances makes risks go away. The message is: this is what gets management teams and their companies into trouble. The resulting strategic drift can lead to lack of focus in managing the organization's risk profile.

By contrast, a well-articulated risk appetite statement that is communicated effectively to operating units can reduce the occurrence of resource allocation proposals that are outside established parameters. This kind of

[10] See *Board Risk Oversight – A Progress Report*, available at **www.protiviti.com**.

Actions Arising from the Risk Appetite Dialogue

Following is a list of 10 examples of specific actions arising from an ongoing dialogue comparing the organization's risk profile with its risk appetite:

1. Facilitate more effective decisions about acquisitions, divestitures, new business lines and new products.
2. Scale down the size of a noncore or excessively risky business.
3. Influence exiting from a business that is not aligned with the firm's desired risk profile.
4. Adjust the compensation structure of a particular operating unit to (a) address incentives and constraints implicit in the risk appetite statement and explicitly reflect inherent risk levels and (b) hold unit management accountable for performance against these expectations.
5. Articulate policies codifying the types of risk the firm is willing to bear and under what conditions, as well as the risks the firm is unwilling to assume, and translate these expectations into supporting policies and processes that align the actions of individuals throughout the organization (or specific lines of business) with the expressed intent of directors and executive management.
6. Identify risk areas requiring improved measurement methodologies, including establishment of risk tolerances.
7. Align the emphasis on specific geographies and markets, customer segments, counterparties, risk areas, R&D projects, capital spending and products and services with established boundaries.
8. Recalibrate the business mix to the desired risk preferences and risk/reward trade-offs.
9. Modify the composition of the balance sheet according to established target working capital levels, regulatory and economic capital thresholds, target leverage ratios, target credit ratings, and optimum liquidity ratios, among other things.
10. Determine whether to increase VaR limits when breaches occur or take measures to reduce VaR exposures within established limits.

discipline may prevent a firm from drifting unknowingly from its approved risk appetite as market conditions change.[11] More importantly, the ongoing risk appetite dialogue may facilitate specific management decisions and actions over time. See illustrative examples below.

The above decisions can be challenging when a business is highly profitable. As evidenced by the financial crisis, profitable performance can mask significant risks. Because most measures of performance are not adjusted for risk, it takes a disciplined management team to recognize that the focus of a risk appetite statement is strategic and longer term, not short term. The process of articulating risk appetite focuses discussion on an organization's key strengths and competitive advantages, better positions the board to challenge business proposals outside of the firm's core competencies, and serves as a yardstick for discussing risk on a forward-looking basis, rather than simply comparing the results of actual performance against performance targets and risk tolerances and limits.

A risk appetite statement provides the foundation for ongoing dialogue between management and the board as circumstances change and opportunities arise. It helps an organization remain true to the integrity of the discipline of risk management that follows from a strong tone at the top. Companies with a more developed risk appetite statement set an expectation for strategy reviews by operating units and conduct regular discussions about how to manage unexpected economic or market events in particular geographies or products. Those discussions consider how business strategies may affect the consolidated entity.

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[11] Ibid., page 8.

Together, a risk appetite statement and the ensuing risk appetite dialogue provide a forward-looking process that establishes expectations about the firm's overall risk profile in a variety of circumstances. These expectations can be based on stress tests and scenario analyses conducted on a consolidated basis to augment the risk appetite articulation as well as assist management in identifying where the organization's risk profiles are most vulnerable. These points of vulnerability enable management and the board to establish a clearer road map for risk-taking, loss mitigation and employing contingency measures.[12]

Boards that invest a significant amount of time and effort in articulating a firm's risk appetite statement will have a greater stake in ensuring it not only is implemented effectively, but also is adhered to and used to guide decision-making at both the corporate and operating unit levels. When a board or its designated subcommittee challenges management and insists on a thorough vetting of risk appetite, the organization ultimately develops a more complete, well-considered articulation.[13] Once the risk appetite statement is decided upon, there should be an ongoing dialogue to ensure it continues to be relevant and reflects the thinking of the board. This means there should be a clear process for discussing and determining when the risk appetite statement should be adapted to changed circumstances.[14]

In cases where the firm does not comply with the risk appetite statement, the CEO (or his or her designee) should outline to the board the corrective action management is undertaking to address the deficiencies. For example, one bank incorporated into its risk appetite statement the principle that the board and senior management must understand and be able to identify and manage all of its risks. As a result, the firm decided to exit a specific business with risks that were not well understood, even though the business was profitable at the time. That particular line of business eventually generated significant losses for other firms during the financial crisis.[15]

COMMUNICATING RISK APPETITE

As we've noted previously, a statement of risk appetite provides a foundation for communicating internally and to investors. For the initial risk appetite statement, there is a change management aspect to the inaugural rollout to the organization so that the appropriate personnel are equipped with this vital strategic perspective as they discharge their respective responsibilities. With the additional clarity provided by established risk tolerances and limit structures, executive management can provide a framework for delegating to company personnel the responsibility to pursue the achievement of the organization's objectives within acceptable limits.

The scope of internal communications, whether initially or ongoing, is an important question. For example, is the risk appetite statement socialized to everyone and, if so, how? Is it communicated only on a "need-to-know" basis? On an ongoing basis, is it used primarily as a reminder in meetings involving risk management, capital allocation, M&A and other matters in which risk is a paramount concern? Is it used to orient new hires to assist them in understanding the company's culture and decision-making process? Is it updated primarily in the strategy-setting process?

Whether it is the rollout of the initial statement or simply "business as usual," the scope of risk appetite communications should be carefully considered because employees at lower levels of the organization may tend to focus too much on limits and constraints rather than on the big picture of strategic execution. In addition, internal communications are most effectively delivered through risk tolerances and limit structures set at the time key metrics and targets are set.[16] We think of risk tolerances and limit structures as a decomposition of the risk appetite statement for application at a tactical level in specific business units, lines of business and key business processes. To the extent that compensation incentives are aligned with this overall framework of risk appetite, risk tolerances and limit

[12] Ibid., page 4.

[13] Ibid., page 6.

[14] Ibid., page 7.

[15] Ibid., page 4.

[16] A subsequent paper will address key metrics and targets, including the incorporation of risk tolerances.

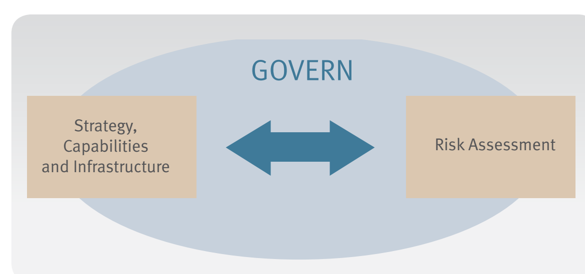
structures, the clarity of downward communications is sharpened further. This structure can provide assurance to the board that the organization is aligned effectively with the strategy, including the risk appetite statement.

Risk appetite also can be useful when communicating to the street. Investors seeking significant rewards are attracted to big bets. How management communicates its bets and the company's assessment of related risks and rewards are important aspects of investor communications. There are important subtleties as well. If a company chooses not to hedge its foreign currency or commodity price exposures, for example, then in essence it is shifting the risk of market volatility to investors. In these instances, management should consider clarifying this point when communicating to shareholders. This clarification will be important information for investors viewing an investment in the company as a "pure play" to expose their portfolios to, for example, commodity price risk, which is often the case for energy and mining companies. In such instances, the company should incorporate an appropriate assertion in the risk appetite statement as well as consider making appropriate disclosures to shareholders regarding management's intention not to hedge the exposure.

A PROCESS FOR DEFINING AND MAINTAINING THE RISK APPETITE STATEMENT

The governance process is the key to helping an organization balance its entrepreneurial opportunity-seeking activities for *creating* enterprise value with the appropriate control mechanisms for *protecting* enterprise value, so that neither one is too disproportionately strong relative to the other. The speed at which business is conducted in the current competitive environment suggests there will be times when the brakes must be tapped and the strategy revisited.

According to Protiviti's PRIM² model[17], strategy-setting articulates the organization's strategic aspirations around its vision, mission and values, and communicates clear and concise objectives to set the appropriate direction for the enterprise. Strategy-setting describes the enterprise's source of competitive advantage, as expressed through its differentiating capabilities and the infrastructure needed to execute those capabilities successfully. Therefore, it focuses on how the entity will create value for its shareholders, customers, employees and other stakeholders over a stated time horizon.



The PRIM² model asserts that risk assessment must be integrated with strategy development. Management should identify the soft spots, loss drivers and incongruities inherent in the enterprise's strategic objectives that could dramatically affect performance over time. These are the risks that really matter. In addition, the amount of risk an enterprise is willing to accept in executing the strategy – its risk appetite – is defined. Therefore, defining risk appetite falls within the risk assessment process and is a tool for enhancing corporate governance and strategy-setting.

Taken together, the two activities of strategy-setting and risk assessment facilitate the undertaking of strategic initiatives and setting of key metrics and targets. It is here where risk management begins to intersect with performance management. It is also the point where risk appetite assertions are decomposed into risk tolerances and limits that are factored into the integrated planning process and cascaded down into the organization along with the corresponding key metrics and targets.

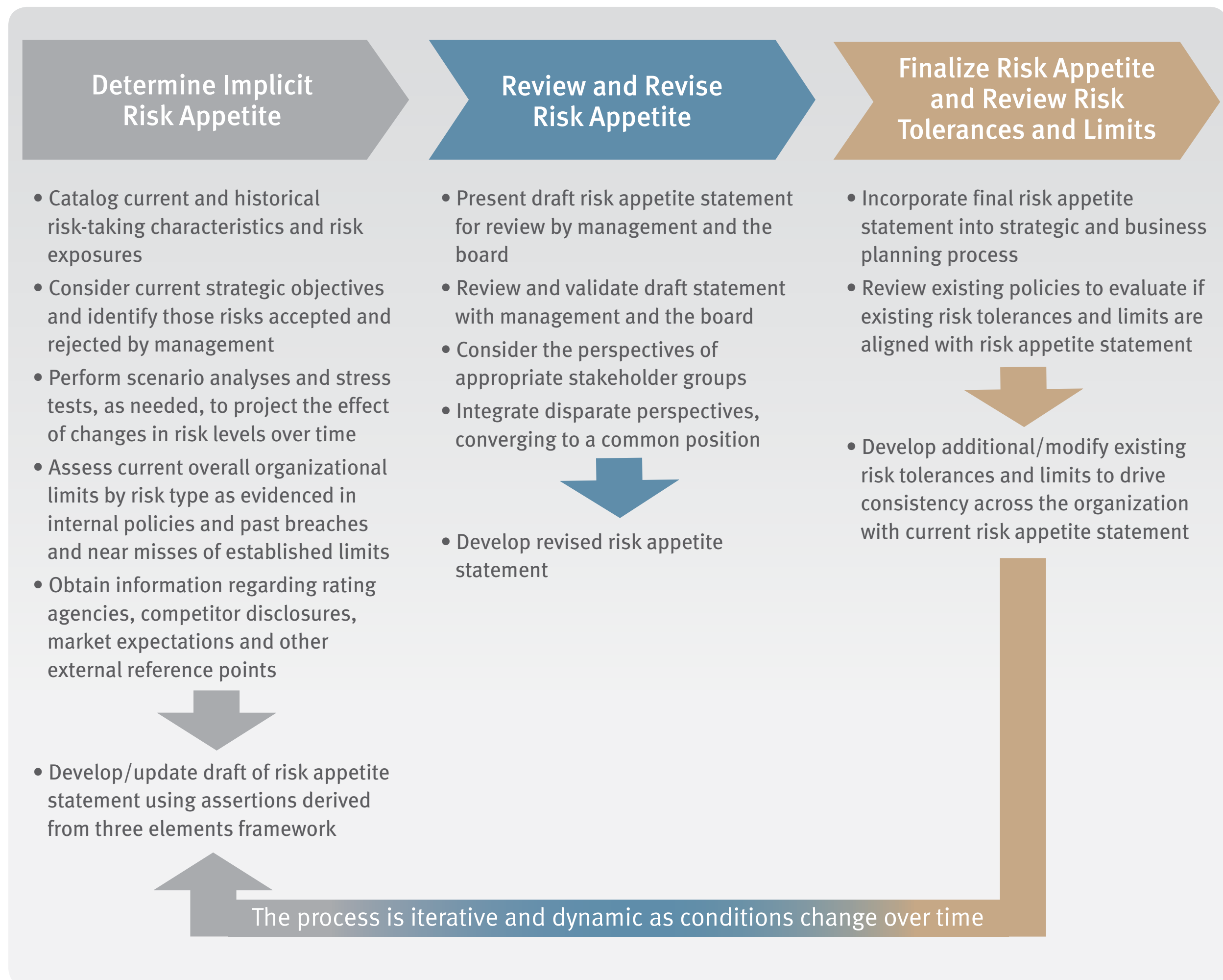
When defining risk appetite, we have suggested that companies begin with understanding their historical risk-taking behavior and frame their risk appetite in the context of their current strategy and business model. For example, what risks are unacceptable to management and the board? What ceilings are placed on M&A activity funding and R&D investments? In what areas are there policy restrictions (e.g., avoidance of certain

[17] See Protiviti's white paper, *The Convergence of Corporate Performance Management and Risk Management*, available at **www.protiviti.com**.

The process described in this white paper and the risk appetite assertions it generates provide a practical way forward for all types of companies in all industries. Once the initial risk appetite statement is developed, it needs to be updated as conditions change.

markets and types of products)? These and other elements help frame an entity's historical risk appetite and provide the baseline for initiating the risk appetite dialogue.

The following process flow illustrates the process for defining and maintaining the risk appetite statement:[18]



At the bottom of the diagram, note the reference to the process as being one that is "iterative and dynamic as conditions change over time." This is important because the risk appetite statement is not a onetime determination. It continually evolves over time as the business environment changes.

[18] This process flow was adapted from *Report of the NACD Blue Ribbon Commission – Risk Governance: Balancing Risk and Reward*, Appendix C, page 27.

The process described in this white paper and the risk appetite assertions it generates provide a practical way forward for all types of companies in all industries. Once the initial risk appetite statement is developed, it needs to be updated as conditions change. A risk appetite statement stimulates dialogue in the following ways:

- As a benchmark with the board when evaluating the impact of pursuing unexpected market opportunities that arise over time
- As a vehicle for ensuring key managers with business unit and functional responsibilities understand all elements of the enterprise's appetite for risk
- As a tool for "nipping in the bud" off-strategy behavior and containing strategic drift before a significant problem arises
- As a baseline for monitoring the risk profile and driving strategic decisions to rightsize it if it is out of line with expectations of the board and management
- As a way of setting expectations for divisional, regional or business unit strategic reviews and regular discussions around how to manage unexpected economic or market events in particular geographies and/or products[19]
- As an enhancement to communicating with the investor community

We have advanced the view that the fundamental assertions in a risk appetite statement and the range of acceptable parameters are dynamic. That's because they can be influenced by many things. We've pointed out the obvious ones, such as emerging opportunities, but some are less obvious.

Listed below are 10 questions many businesses face from time to time and are fundamental to sustaining the risk appetite dialogue:

Questions Arising from the Risk Appetite Dialogue

1. Is our risk appetite consistent with institutional investor expectations and the messaging we use on analyst calls regarding future plans?
2. Regarding the behavior of the company's competitors, are they taking more or less risk and, if so, why?
3. Is our capacity to bear risk (e.g., regulatory capital, funding) adequate given the risks we are undertaking? What is the point at which the company's appetite for accepting the risk of loss exposure is defined; meaning, is it at, or short of, the point of:
   - Cancelling projects and deferring maintenance?
   - A profit warning?
   - A dividend cut?
   - The need to raise additional capital?
   - A loan default or ratings downgrade?
   - Insolvency?

   Can the company stress-test appropriate scenarios against the point at which it has defined its willingness to accept exposure to loss? Have the company's history of performance variability and success in meeting market expectations been considered in developing the risk appetite statement?
4. Is management's operating philosophy focused on "sticking to the knitting" (i.e., operating within the company's existing core businesses) or on expanding beyond the organization's current core competencies (i.e., should the risk appetite statement focus on aligning risk-taking with what the organization does best)?

[19] *Observations on Developments in Risk Appetite Frameworks and IT Infrastructure*, page 5.

Strong CEO support is the vital tone at the top needed for successful implementation of a risk appetite statement.

5. What are our expectations regarding projections of how significant or "game-changing" market developments (e.g., carbon emission legislation, disruptive technological advances affecting products and processes, an unexpected credit crunch) will play out over the next five to 10 years?
6. What is executive management's confidence level in understanding and measuring the company's cost/competitive advantages relative to competitors?
7. As we become more profitable, are we more willing to assume more risk? Would proposals for new business generation move the company toward its desired risk profile or away from it?
8. How does our aggregate risk profile compare with the desired risk profile, as framed by our risk appetite statement?
9. Are the business units and our risk management function aligned to ensure that the desired risk profile, as envisioned by our risk appetite statement, is consistent with the risks arising from our various business activities?
10. Is our exposure to the concentrations relevant to our business (e.g., customer, loan, counterparty, investment, geographic, single-source suppliers) desirable today in the context of our strategy? Given our current strategic direction, expected market trends and the various scenarios we have stress-tested, will these concentrations be desirable next year? In three to five years?

Because the risk appetite statement explicitly describes the boundaries within which management is expected to operate the firm when executing the strategy, it is vital that everyone at the highest level of the organization is involved in its determination. Therefore, a risk appetite statement is only as effective as the strength of the relationships among the board of directors, the CEO, other C-level executives and business unit leaders.

The board, with input from senior management, sets the overall expectations for the firm's risk profile. The CEO, CRO and CFO then translate those expectations into (a) directives and incentives for the operating units to execute (e.g., expand operations by investing in Greenfield construction) and (b) constraints by which they must abide (e.g., limit capital expenditures pool to $30 million). Finally, along with the board, the CEO and executive team hold the operating units accountable for performance against the defined expectations so they manage their respective businesses within the boundaries framed by the established incentives and constraints. As noted by the Basel Committee on Banking Supervision, senior management should ensure that a bank's activities are consistent with the business strategy, risk appetite and policies approved by the board.[20] This point of view should apply to all industries.

Strong CEO support is the vital tone at the top needed for successful implementation of a risk appetite statement. Through his or her support, the CEO empowers the right people (e.g., the CRO or equivalent executive), ensures the board has access to these individuals, and sends a strong message about the importance of the risk appetite statement to other key stakeholders in the organization.

[20] *Principles for Enhancing Corporate Governance*, Basel Committee on Banking Supervision, October 2010, page 2. Available for download at: **http://www.bis.org/publ/bcbs176.pdf**.

SUMMARY

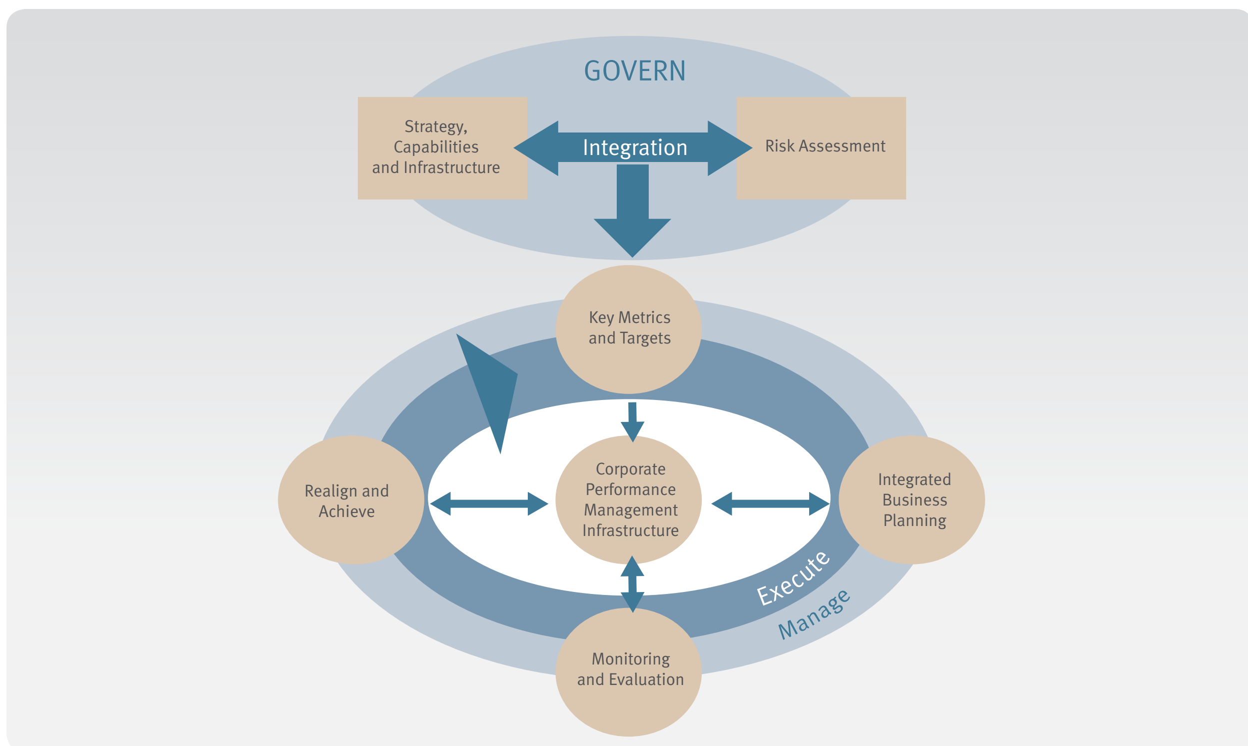
Every organization has a risk appetite whether it acknowledges it explicitly or not. Risk appetite is expressed through an entity's actions or inactions and represents executive management's "view of the world," which provides a context for making strategic choices. It is inherent in the organization's strategy and in the execution of the strategy, in the form of both risks taken and risks avoided.

Management should consider risk appetite when defining objectives, formulating strategy, allocating resources, setting risk tolerances and developing risk management capabilities. The board of directors should consider risk appetite when it approves management's proposed business strategy and plans, as well as any major new initiative. If articulated explicitly, risk appetite provides a baseline for (a) ongoing dialogue between executive management and the board as circumstances change, and (b) overall direction for managing risk. However, it should not be changed on a whim as new opportunities arise; otherwise, the risk of strategic drift arises.

The framework and process we have introduced herein provide a practical approach for initiating and sustaining the risk appetite dialogue. A risk appetite statement, as we've illustrated, contributes to positioning the enterprise as an early mover because it provides a directional tool that points to the appropriate levers of enterprise risk.

WANT TO KNOW MORE?

Protiviti has published a white paper titled, *Performance/Risk Integration Management Model – PRIM²: The Convergence of Corporate Performance Management and Risk Management*. Whether a company is rapidly growing, focused on establishing sustainable competitive advantage or both, it must consider how an integrated approach and discipline to deploy strategy while also managing the associated risks will improve its probability of achieving strategic objectives.



In this white paper, Protiviti discusses an enterprisewide program that places risk, risk management and performance management in a broader strategic context by:

- Creating real-time transparency into the operations of the enterprise to measure current performance and predict future trends in order to establish and maintain alignment of strategy, risk management capabilities and performance management processes in a changing business environment;
- Proactively identifying, sourcing and mitigating the risks inherent in the strategy, including the critical underlying assumptions, and understanding how the enterprise's risk profile relates to its risk appetite;
- Communicating and deploying strategy effectively in a consistent manner across the enterprise; and
- Ensuring the seamless integration of strategic plans, performance management and risk management in the execution of the strategy.

The PRIM² white paper is available at **www.protiviti.com/EarlyMover**.

ABOUT PROTIVITI

Protiviti (**www.protiviti.com**) is a global consulting firm that helps companies solve problems in finance, technology, operations, governance, risk and internal audit. Through our network of more than 70 offices in over 20 countries, we have served more than 35 percent of FORTUNE® 1000 and Global 500 companies. We also work with smaller, growing companies, including those looking to go public, as well as with government agencies.

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OUR SERVICES

PRIM² is a framework for converging and integrating strategy-setting, performance management and risk management with the objective of positioning the company as an early mover. Protiviti's services help your organization realize this convergence by delivering deep business insight based on a holistic view of the enterprise. Our Performance and Information Management services address the business challenges facing executive, finance and operational decision-makers throughout the organization. Using best-of-breed, state-of-the-art software, our clients have fast and easy access to trusted financial, operational and risk information, enabling a deep understanding of how value is created and protected, and delivering strategic insight so decision-makers can better anticipate future business outcomes and receive better information for decision-making.

We also recognize that risk is a vital aspect of managing an enterprise and delivering performance against strategic objectives. Our comprehensive risk management services complement our Performance and Information Management solutions by helping companies improve their enterprisewide capabilities to identify, source, measure, manage and monitor the critical risks inherent in their corporate strategy and business plans, while incorporating the foundational risk management and controls provided by powerful governance, risk and compliance (GRC) software tools. The objective is to enhance strategy-setting and performance management with the intent of positioning the enterprise to become an early mover.

For more information about the issues discussed in this white paper and/or Protiviti's services, please contact:

Jay Thompson
Leader, Performance and
Information Management Solutions
+1.713.314.4923
jay.thompson@protiviti.com

Cory Gunderson
Leader, Risk and Compliance
Solutions
+1.212.708.6313
cory.gunderson@protiviti.com

Jim DeLoach
+1.713.314.4981
jim.deloach@protiviti.com

David Johnson
+1.713.314.5020
david.johnson@protiviti.com

Michael McGarry
+1.312.476.6093
michael.mcgarry@protiviti.com

Matt McGivern
+1.404.926.4346
matt.mcgivern@protiviti.com

Jim Ryan
+1.314.656.1745
jim.ryan@protiviti.com

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