ERM PROFESSIONAL INSIGHTS

How to Leverage ERM Principles to Better Respond to COVID-19-Related Risks

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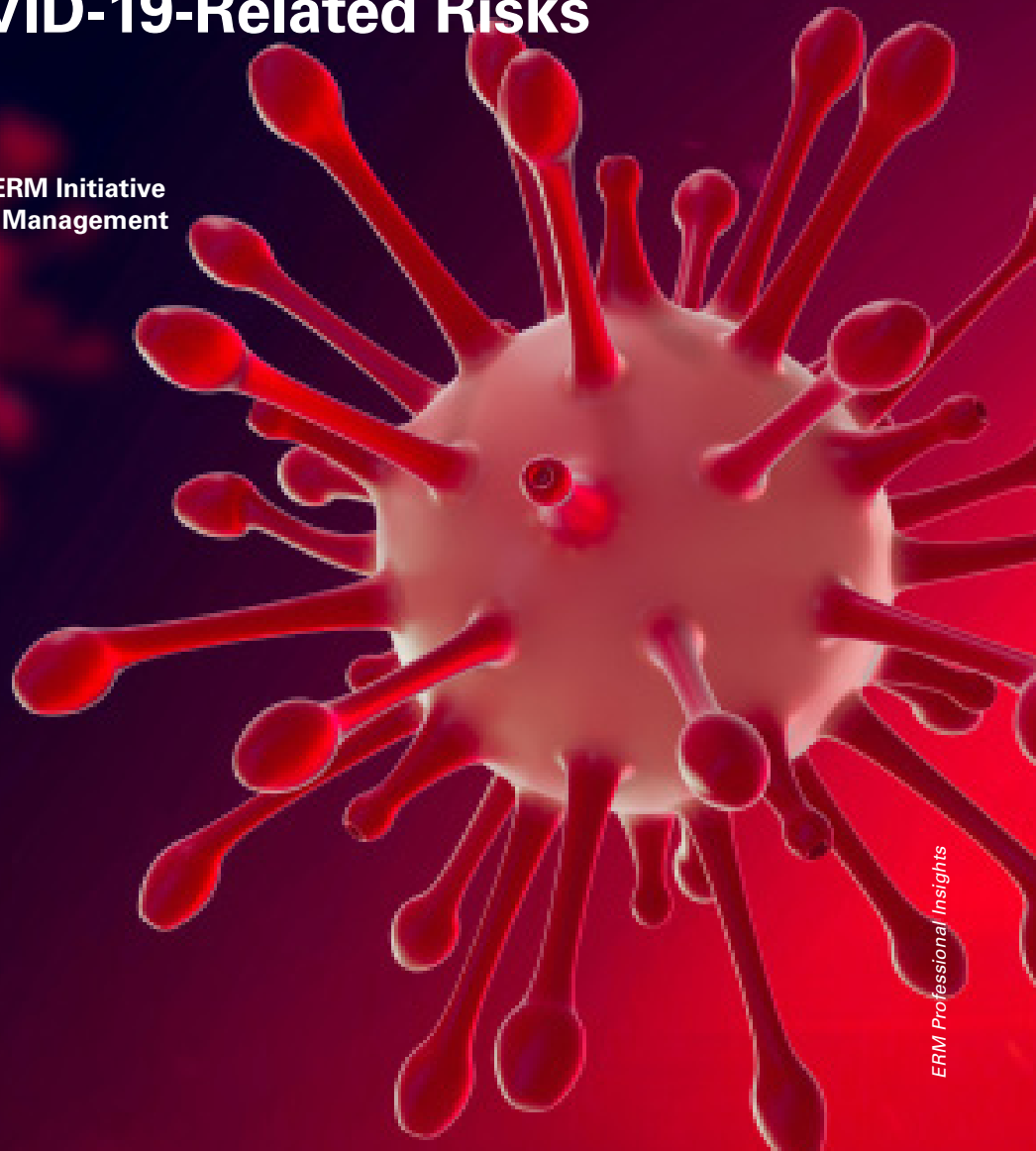
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The unfolding crisis caused by the COVID-19 pandemic is wreaking havoc on a global scale for organizations of all types and sizes and their most important asset, their human capital. The novel coronavirus represents a single root-cause event that has triggered an ever-expanding number of risks threatening all aspects of most enterprise operating models. Business leaders are scrambling to get a handle on the most critical risks affecting their core businesses in an effort to survive and recover from this tragic pandemic.

Over the past two decades many organizations have embraced the business paradigm of enterprise risk management (ERM) to help their senior leadership team obtain a top-down, holistic view of the various risks from all across the enterprise that might impact its strategic success. The ERM Initiative in the Poole College of Management at NC State University has been working with business leaders over the past fifteen-plus years to provide thought leadership on the topic of ERM to assist senior executives and boards in learning more about how they can deploy ERM principles to ensure their risk management processes generate rich insights about emerging risks that they can use to make important strategic decisions. (Note: The shaded sidebar in the appendix provides a brief overview of ERM for readers who are unfamiliar with the concept).

We are convinced that many of the core principles foundational to ERM can help inform and guide executives through the difficult task of managing risks triggered by COVID-19. This thought paper outlines how ERM thinking can help.

COVID-19 Requires an Enterprise-Wide Risk Analysis Approach

COVID-19 is providing a catastrophic lesson on how critical it is for business leaders to come together to share information about the different kinds of risks being triggered by this single root cause event. The novel coronavirus has created a number of different, but interrelated risks spread all across most organizations. No single risk associated with the COVID-19 pandemic crisis can be managed in isolation given there is an interconnected aspect to these risks and how organizations can address them. To make progress, business leaders have to find a way to rapidly obtain a top-down, more holistic view of the risks triggered by COVID-19 from a big picture, enterprise-wide perspective so they can determine which risks need to be managed first as they address the rapidly evolving crisis.

The diagram on the next page lays out the core elements of an ERM process as represented by each of the smaller ovals, which all sit inside the larger gray-shaded oval that reflects the organization's culture and leadership, which provides the foundation for an effective ERM process.

Let's take a quick look at how these elements might help guide your thinking about risks triggered by the COVID-19 pandemic. First, let's focus on timeframes associated with this crisis:

1. Dealing with the Crisis Right Now – The Here and Now
2. Assessing the Damage and Rebuilding for the Future

Dealing with the COVID-19 Crisis Today

Right now, business leaders are looking for ways to minimize the damage caused by this pandemic crisis. Unfortunately, that continues to be a moving target and executives must be flexible and willing to pivot at a moment's notice as new information arrives.

Currently, many executives are overwhelmed with all the ongoing elements to the crisis and those elements are constantly evolving. So, it is hard to know where and how to get started. Our advice is to simply start – anytime executives are managing risks the last thing they should do is become paralyzed in fear that they might not do the right or best thing. They should keep in mind that at this moment the goal isn't perfection. It goes without saying that there will be significant damage to most businesses– everyone has to accept that. Executives are looking to do everything possible to address the situation as best they can to minimize the enterprise-wide effect from this crisis for the here and now.

It might help by thinking of an analogy. Picture the scene: you have just discovered that your house is on fire and flames are blazing from multiple rooms of the structure. That is sort of where we are right now with this pandemic event.

Think About the People First

Nothing else is more important than the organization's people - employees, customers, suppliers, partners/neighbors. Secure their safety first.

The first thing to do is to think about the people so we can get them out of harm's way as effectively and quickly as possible. In all emergency situations, including the impact of COVID-19 on a business, the most critical assets are the people – they have to be located and secured first. Nothing else is more important than that. So, in the current COVID-19 environment, we need to first think about our people and address what we can to do get them to safety as best we can. An organization's people include employees, customers, suppliers, partners/neighbors. Once they are safe and feel protected, they will provide critical help in navigating the situation and they will be the ones who help sort through the rubble on the back end.

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Communicate with key people regularly and with compassion and empathy.

In many cases, leaders will need to think about where our key people are physically located. Some may be traveling or in different parts of the world. We need to determine what we can do to get them to safety as soon as we can. I'm aware of one university located in the Caribbean that has students from all around the world. They chartered planes to get those students off the island and back to mainland North America and to Europe as quickly as possible. That was the university's first move - they didn't worry about teaching their classes until they knew the students were safely evacuated. Like that university, business leaders need to determine how they can first get their people to a safe and secure spot. Then, leaders can focus on how they can engage with their key people and provide necessary resources to help them get back to some base level of productivity.

Most organizations are asking their teams to work remotely for an unknown period of time. Some organizations that must remain open in order to provide vital services (e.g., banks, groceries, healthcare organizations, etc.) have created staggered work times so some are at home while others are in the office. That also helps also to comply with recommendations on social distancing amongst team members. That is especially important as many offices have created more open and collaborative workspace environments in the past several years.

Once executives have established that their key people are in a safe location, they need to focus on how they are communicating with them to provide information to help them make decisions about what needs to be done. Business leaders must do that frequently given the ever-evolving nature of this crisis. But, as they do, they need to approach these communications with compassion, empathy, and flexibility. Many employees, suppliers, customers and other key partners are stressed for any number of reasons and executives don't want their tone or lack of clarity - or silence - on important matters to amplify insecurities. Leaders need to help key players understand how the organization is going to do its best to ensure their safety first, and that its leaders are trying to keep them in the information loop as best they can. Leaders also need to ask and thank the key players for their patience in a period of high uncertainty.

The COVID-19 crisis can be an event that really helps set an entity's culture and leadership apart from others.

In ERM, we preach the importance of "culture and leadership." We often refer to culture as "King" when managing risks – if the entity's culture and its leadership aren't supportive of better understanding the risks the organization faces, then all else is to little avail. That is why culture and leadership are in the shaded gray section of the oval in the ERM diagram shown earlier. They are foundational elements of any ERM process. Effective risk management requires leadership and focus on the people.

The COVID-19 crisis can be an event that really helps set an entity's culture and leadership apart from others. Executives should look for opportunities to demonstrate leadership and compassion during this pandemic event to positively advance the culture for the long-haul.

Pinpoint the Most Valuable Core Business Drivers

Once executives have safeguarded their people, the next step is to pinpoint the organization's most critical drivers of value for the business so leaders can focus all their efforts on keeping those value drivers up and running as best they can. To help with that, executives might identify what they believe are the most important "crown jewels" that drive the greatest success for the organization. That is, what are the most important drivers of value for the business? That might be a critical product or service that the organization sells, it might be the organization's online ordering platform that must be up and running especially now, it might be the organization's R&D activities, or it might be the high-touch customer service, among many possibilities.

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Business leaders need to pinpoint the core value driver that is most critical to the organization's survivability and focus on restoring that first.

Because the objective of an ERM process is to help business leaders identify, assess and manage risks that may impact whether the organization can achieve its objectives, ERM encourages leaders to use a strategic lens to identify and manage risks. Thus, the starting point in an ERM process for identifying risks begins with obtaining an understanding of the entity's core business drivers and new strategic initiatives - that is illustrated in the ERM diagram by the oval at the top labeled "Core Business Drivers and Strategic Initiatives."

In this current crisis, business leaders should also use a strategic lens to identify and then prioritize risks triggered by the COVID-19 pandemic. To develop this strategic lens, business leaders need to pinpoint those core value drivers that are the **most** critical to the organization's survivability. While there are numerous aspects that help drive success for a business, right now executives need to focus first on protecting or restoring the one or two value drivers that are most fundamental to value preservation.

Let's go back to our analogy of someone discovering that their house is on fire. In that situation, clearly the homeowner is worried about losing everything in the home. There are some things that are priceless that the homeowner wouldn't want to risk losing, such as a highly valued family heirloom or extremely important documents. Those would be the priority over items in the laundry room. In the fire situation, the homeowner would want to protect – if possible – those most important valuables and be willing to let others go for a while or forever.

So, just like our fire scenario affecting someone's home, at this point in the COVID-19 crisis, a substantial amount of executive focus should be on pinpointing the most important parts of the business so business leaders can begin to see if actions can be taken to keep the processes up and running for as long as possible.

At NC State, we have prioritized the teaching core driver of the university's mission. Right now we are not too worried about research, outreach, extension, and athletics. So, the bulk of our efforts are finding ways to quickly restore the teaching capabilities at NC State. The energy and activity are heavily focused on making that happen as rapidly as possible. We'll get to the other things later once things calm down a bit.

So, executives need to prioritize what is most critical to the organization and deal with that one first. Once that core value driver is secure, leaders can move to the next most critical one.

Identify and Prioritize Risks Triggered by COVID-19

Once business leaders identify the one or two most critical "crown jewels" for their organization, they should make those the focus of their attention right now. With those crown jewels in mind, they can then use that strategic view of their business to begin identifying and assessing the impact of risks to their business brought on by COVID-19.

What must go right for the most critical driver of the organization's business to continue deriving value?

Let's briefly outline a couple of techniques to help structure thinking about how COVID-19 might be impacting the success of the organization's core value driver(s). To do that, business leaders should think about the key aspects that make the crown jewel(s) of their business so valuable. There are two simple questions to ask:

1. What must go right for the organization to continue to derive value from that core driver of their business (e.g., "crown jewel") during this pandemic crisis?
2. What big assumptions are executives having to make about the organization's ability to continue deriving value from that crown jewel in light of the current COVID-19 situation?

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What are the fundamental elements that will keep the core driver of the business operating as effectively as possible?

Let's explore each of these two questions.

What must go right for the core value driver to continue providing value? Consider these questions: What are the most critical people, processes, and technologies that must be in place for this core aspect of the business to continue providing value? What are the fundamental elements that will keep the core driver of the business operating as effectively as possible?

Once business leaders have answers to those questions, they can prioritize the critical elements that need to be functioning at some level and address the most important ones first. Using knowledge of what must go right for the value driver to still function, business leaders can then think about how the massive disruption caused by COVID-19 will or already is keeping those critical elements of the process from working. That will help business leaders pinpoint which risks triggered by COVID-19 are most critical to their business so that leaders don't become distracted by less important concerns.

Business leaders will also want to think of ways they might be able to keep those core processes still in play at a reduced, but effective levels. At NC State, our leadership has said that teaching is critical and thus faculty need be able to provide content to students and students need a way to demonstrate they are learning. Faculty and staff are working to find ways to make that happen without having people in classrooms. We are recording video lectures in classrooms. While that's not the same as a live class, it is not far from the traditional experience. For those classes where recording a live lecture on video may not be feasible, faculty are looking for alternatives such as recording voice over Powerpoint or they are sending lecture notes to students. It may not be perfect, but faculty are finding different and creative ways to keep knowledge transfer continuing from professor to student.

What are the critical assumptions that core value drivers are based on? Given no business leader has a crystal ball view into the future, every strategy that an organization implements is based on certain assumptions. That reality existed long before the novel coronavirus emerged. At NC State, we have previously assumed that students could get to classes to learn in a classroom setting where content is shared live and in person.

What big assumptions are having to be made?

Now, like all universities, we are finding that assumption to no longer be valid. Just like NC State, business leaders must examine the big assumptions that they have depended upon in the past so they can assess how the novel coronavirus event is changing those assumptions. And, as they find alternative solutions to continue delivering their products and services, they need to think about what new assumptions leaders might be making so that they aren't further blindsided if the assumptions happen to be flawed.

At NC State, one assumption we are now having to make is that students have access to technologies needed for online learning. We cannot treat that as a fact – we need to anticipate what to do when students can't get access to the technology being used to deliver course content so we can think through alternative delivery options in those situations.

By focusing on the big assumptions that core drivers depend on, business leaders will be able to pinpoint additional risks that may be triggered if COVID-19 begins to undermine those critical assumptions.

Act Fast to Respond to Risks Triggered by COVID–19

Using the strategic lens to pinpoint the most significant risks triggered by COVID-19, business leaders then want to identify the most effective responses to manage the risks

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Don't over-analyze the situation. Perfection isn't the goal when addressing the risk, given time is of the essence. Risk responses can be fine-tuned.

in light of the current situation. Unfortunately, COVID-19 is rapidly triggering many risks that were not previously considered. In that effort to get their arms around these new risk conditions, some business leaders may become paralyzed when trying to determine how to respond. In some cases, they may fall into a trap of over-analyzing the situation.

While business leaders prefer to have the best and most complete information set they can obtain to make these risk response decisions, now is not the time to seek perfection. Missteps will occur given that the information is noisy and incomplete. However, it will likely be an even greater mistake if executives delay decisions waiting on more precise information.

At NC State, faculty were alerted during spring break in mid-March to be ready for online delivery in one week. The decision was made that all classes would go to a virtual format after a one-week spring break extension. While there were many unknowns about the actual implementation of the risk response, the university's leadership team determined that the best response was to no longer deliver instruction in an in-person group format. Faculty were asked to find ways to quickly move to video-recorded lectures and to begin thinking about how they can best engage students in homework, exams, and other deliverables. The leadership team and faculty know the virtual format won't be perfect, but everyone is doing their best to get things up and running with aspects of the "new normal" being fine-tuned as online classes get underway. Now wasn't the time to wait on thinking through details in search of a perfect response.

Monitor and Communicate Again and Again

In the current COVID-19 crisis, business leaders will want to keep an eye on how things are moving and whether pockets of "flames" might reappear. Business leaders should look for data that might signal when things are going awry. Once they identify data that might help them keep an eye on shifting risks as this COVID-19 crisis unfolds, business leaders will also want to determine when certain levels of risks become unacceptable so they can address those risks without undue delay (e.g., put the flames back out).

Look for data that might signal when things are going awry.

At NC State, faculty and staff will be monitoring student feedback, emails, and other issues so we can pivot when we need to pivot. We know we won't have the online delivery perfected in our first week back. It will need to be tweaked as we go. We will be monitoring data points to help us know when things may need further adjustment.

Communication is key. Business leaders need to focus on sharing information with key players who need to know that the organization has a plan and that its leaders are working to get things under control. That communication with key stakeholders – employees, customers, suppliers, investors, partners, etc. - will need to continue as things unfold on a day-by-day basis.

Bring People from Across the Enterprise Together

The task of doing all this is most effective when leaders of multiple "silos" of the business are engaged in thinking through the risks triggered by the COVID-19 crisis together. Multiple perspectives are critical to thinking through different risk responses to the impact of COVID-19 on the organization.

Bring people from across the enterprise together to help think through enterprise-level responses.

One of the biggest benefits of an ERM process is the fact that ERM requires people from all across the organization to come together to engage in rich conversation about how risks are affecting multiple aspects of the enterprise. Having business leaders from different parts of the business think through the impact of risks to the entire organization helps prioritize the best way to respond to risks – hopefully in a more coordinated

way. That should lead to greater effectiveness in managing risks and hopefully greater efficiency by responding to a given risk in a more efficient manner.

In this current pandemic situation, it is important that the organization's top executives assemble key leaders from across the enterprise together virtually or in person (with social distancing in mind!) to engage them in helping pinpoint the best solutions to the risks that are emerging. This is a time that requires discussion and dialogue to make sure business executives are thinking about the impact of COVID-19 to their organization at an enterprise level.

Assessing the Damage and Rebuilding for the Future

Focus on some high level analysis, but know it will evolve and require updates periodically.

Once the immediate pandemic is under control, business leaders will want to make a high-level assessment of the damage before they move to the rebuilding stage. Once they get the "fire" under control, it will be time to think through the near-term survivability that will provide the shelter for the organization to continue. That means business leaders will need to conduct an immediate analysis of the financial impact of COVID-19 on their business and how that might impact the entity's liquidity and ability to financially sustain its operations.

Some basic cash flow analyses and forecasting will be critical to conduct as soon as leaders can give it needed attention. At NC State, we are being asked right now to provide weekly assessments of the financial impact of event cancellations for our programs. We're trying to focus on hard costs such as financial penalties for cancelling programs and we are looking at lost operating net profits that will not contribute to the bottom line as planned.

Obtaining a sense for the biggest commitments and engaging in conversations with key players *now* may put business leaders in a better position than if they ignore making the tough calls for a while. Given that everyone has been (and will continue to be) impacted by this crisis, there is likely to be more understanding and grace now than if executives wait until later to address concerns. Executives may benefit from having those tough conversations sooner rather than later with key vendors, suppliers, bankers, customers, etc., so everyone is proactively addressing the issue. That may serve everyone well in the long run.

Engage in tough conversations sooner versus later. There is likely to be more understanding and grace now than later.

Hopefully there will be some relief coming through policy decisions at the state and national level. That may provide some financial relief. We'll just need to monitor that as it unfolds.

Once we get through this crisis, the natural tendency is to give a huge sigh of relief and relax. While everyone will be anxious to return to normal, business leaders should avoid losing the opportunity to rethink and evaluate their enterprise's risk management approach going forward.

The novel coronavirus is a real-world example of how a single root cause can trigger a multitude of enterprise-wide risk events. Hopefully this experience is convincing more business executives that their organization needs a more robust risk management process that helps them better see how risks facing their enterprise are interconnected. This crisis should provide plenty of motivation for business leaders to build a foundation of processes that helps them advance how their leadership team thinks about risk management from a traditional siloed, reactive perspective to one that provides a more holistic, enterprise-wide perspective of how risks impact the organization's most important drivers of value.

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Leverage the enterprise-level thinking that is ongoing as we address COVID-19 to build more robust risk management process for the next big risk event. Don't miss this important lesson.

Don't Miss the ERM Lessons from COVID-19

Right now, entities are engaged in enterprise risk management processes without realizing it as they navigate the COVID-19 crisis. They are bringing individuals from across the organization together to think about how emerging risks are impacting all aspects of their business. They are engaged in face-to-face conversations (hopefully virtually) about risks to their business and they are working together to close gaps or holes in that process so that they can survive this crisis. They are testing systems to understand their reliability and they are thinking about the "what ifs" to various scenarios. But, unfortunately for many, they are doing so in reaction to a risk that has already occurred.

What if they can leverage these learnings from the current COVID-19 experience to build processes and thinking that helps them be ready and prepared for the next unknown crisis that may be on the horizon? Doing so might put their organization in a much better position than where it is now. Some organizations will take key learnings from their experience and develop "playbooks" to better inform them when (not if) the next crisis arrives. These playbooks will guide future leaders and hopefully avoid the need to "recreate the wheel" in developing appropriate responses to both the immediate threat posed by the next crisis but also build resilience in the organization to best withstand the tragic losses that have been experienced by so many.

There are countless lessons we will learn from an individual, company, country and global perspective. Let's not miss the lessons that are being taught right now.

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Appendix: What is ERM Relative to Traditional Approaches to Risk Management?

For those not familiar with ERM, this is a brief description of the concept and how it differs from traditional risk management. Enterprise Risk Management (or ERM) is a process whereby an organization's executives and their boards engage in efforts to identify risks from all across the organization – risks of all types – to try to understand how those risks might impact the organization's ability to achieve its core strategic objectives. If an entity hasn't implemented ERM processes that does not mean its business leaders are not managing risks to the business. Organizations have been managing risks for centuries. However, most entities have approached risk management typically from a siloed or stove-pipe basis whereby individual business unit leaders manage risks impacting a particular business function (or silo) without really considering how the management of those silo risks might affect or inform other business functions across the organization.

As an example, IT leaders manage cyber risks, sales managers oversee risks related to customers, while the entity's legal counsel navigates legal and compliance risks to the enterprise. While that makes great sense, often these isolated risk management approaches actually create unseen risks for other parts of the business. For example, as IT tightens down procedures to minimize risks related to securing the privacy and confidentiality of data, those actions may be making it harder for the sales team to meet customer needs. That might lead to "workarounds" by the sales team or customers that ultimately create legal risks for the entity. However, because those silo leaders aren't working together to recognize the enterprise-wide impact of the risks and how they are being managed, the organization may be facing risks that its leadership team does not see.

Ultimately, ERM is an attempt to leverage that great work to better understand how risks interrelate all across the organization so management can address those risks with better coordination at a more holistic, enterprise-wide level.