VIDEO INTERVIEW ON THE ERM PROCESS AT XERUM TECNOLOGIES

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Interviewee: Fred Caloggero, VP of Audit Services & Compliance Officer, Xerium Technologies

THE ERM PROCESS AT XERUM TECNOLOGIES PART 1

Hancock: Hello. I am Bonnie Hancock, Executive Director of the NC State's Enterprise Risk Management Initiative in the Poole College of Management. I am speaking with Fred Caloggero who is the Vice President of Audit Services and Compliance Officer at Xerium Technologies. Fred leads the enterprise risk management efforts at Xerium Technologies, a publicly traded company headquartered in Raleigh, NC.

When we think about ERM and talk to people about ERM and enterprise-wide risk oversight, a lot of people immediately react with, "Oh, this is some other compliance effort that's going to result in a lot of bureaucracy," and they're turned off by that. How would you describe ERM to them and the value that it's brought to Xerium Technologies, to convince them to see it in a different light?

Caloggero: Well, that's a good question. It's funny that you ask that. When we did first suggest that we put in ERM, one of the first things that we came back was someone had—one of the senior executives came back and asked if this would be a bureaucratic exercise. And after going through the Sar-Ox exercise, and implementation of Sar-Ox, I think everyone thought that this would be an add-on to that, or just another piece of that whole, you know, compliance-driven exercise, and it wasn't. Um, the benefit that we saw and what we tried to tell the executives was that it was going to change the culture of the company; that it was going to change what happened or the way people went about doing their jobs.

And for instance, we had a lot of people who considered themselves firefighters, and everything was done reactively. We never really got in front of the curve, that the heroes of the company were always those who tended to spend a lot of time putting out the fires that, because there was no planning, no foresight, no one really looked and addressed what the risks were ahead of time and how to plan to address or mitigate those risks, we were really a reactive company. And with the ERM put into place, we then became more forward looking. We were able to put in plans in place. We were able to address those issues that we thought were important to the company.

Hancock: Just to follow on with that, can you give some specific examples. I know Xerium has been through a bankruptcy proceeding and I would like to hear how ERM had an effect on that process.

Caloggero: Yes, um, we—the CEO of the company actually carried the event tree that we put together with him, and really followed that as a roadmap to how he went about going through the process. Ah, we spent a lot of time in the risk area looking at this and trying to decide how we were going to approach the bankruptcy with everything that's involved and all the factors that happened throughout our bankruptcy. We found that the only way to really do that was to sit down and map out what was happening, and ERM provided us with that—with a great framework to do that. Specifically, what did we want to avoid? What were some of the things that we wanted to get out of the bankruptcy? What did we not want to lose, and what did we want to maintain? We wanted to—obviously customers, we wanted to make sure we maintained our listing. We wanted to make sure that we didn't have to, in any way, try to hurt the shareholders and try to maintain the shareholder value that was there, or what was left, at that point.

So there was an awful lot of things that were going on, ah, that we wanted to make sure happened and happened properly, and we used this process in the ERM framework to do that.

[TECHNICAL COMMENTS]

Hancock: What were the benefits of having ERM in place through the bankruptcy and reorganization process?

Caloggero: Good question. Um, regarding bankruptcy and how we structured ourselves and had the ERM framework in place before that really helped us. The framework was put in place, oh, probably two years before we went into the bankruptcy process and the reorganization. This process helped us, or helped the CEO, identify those areas that we wanted to maintain: certain relationships with clients, market share. It also helped us during this period to maintain a listing with the New York Stock Exchange, how to avoid some issues that we didn't want to get into, primarily going into fresh data counting, and possibly dealing with a whole number of issues with shareholders, or maintaining the value that they had. So there was a number of things that we used ERM in that whole framework for, as we went through the bankruptcy process.

Hancock: A lot of organizations struggle in the beginning with getting started in ERM. We talked about the value proposition, but now I'm ready to start implementing, and the first step most companies go through is a process for identifying risks, and we've heard—there's lots of different ways to do it, whether it's interviews, surveys, questionnaires, etcetera. I wonder if you could share with us how you got started with it at Xerium? What process did you use to identify risks and have you changed or tweaked things going forward, in terms of how you go about identifying the risks that you face?

Caloggero: Yeah, identifying the risks is a multi-stage process, and I think it takes a little bit of experience to get where you need to be with this, with any company. Um, I can actually go back to my days with a prior company where we used to sit a lot of the executives in one room and do a full download that day of what they thought were risks. And then we'd go off and develop a list.

At Xerium, how we do it is we do a questionnaire-based, um, format—a web-based format, and we'd do different levels of management. We'll do the board and executive management. We'll also do plant managers. Um, initially, how we got into this at Xerium was it was basically the CEO and myself, and the CFO sat down. We said, "What do we think the major risks are for the company?" And developed a list of that—maybe about 15 of them. We went back to the board, and we said, "Here's a list of risks, that—

approximately 15 that we feel are important. What do you think of these? Can you rate these for us? Do we have them all?"

We had most of them. They added probably six or seven on top of that. Since that time, it has evolved into now an annual risk process, which is web based, and a questionnaire based upon the prior year's risks. Those that have fallen off the list, those that have been well mitigated and fallen off the list don't get asked again. We do leave blank areas in there to say, "Are there any that we've forgotten about or we haven't mentioned?" However, those that are on the list and have been ranked throughout the year will then go back into the survey and will say, "Okay, now please tell us where do you think these risks are and how good of a job are we doing with these risks?"

Hancock: So would you say when you're starting out that you believe it's a lot more effective to use interviews and group discussions as opposed to a web-based tool, in terms of identifying risks?

Caloggero: Yeah, I believe it probably is more effective to use a smaller group and a smaller sample of risks. I think some people get bogged down with the sheer number and the administrative tasks of identifying all these risks, and then understanding what do they mean to the company, tying them back eventually to the strategic plan of the company. So I think what happens is, if you can start small, start with a smaller group and then build on top of that. I think you're much better off and much more effective, from the get-go.

THE ERM PROCESS AT XERUM TECNOLOGIES PART 2

Hancock: Let's talk about the risk assessment process. You touched on it a little bit, but you have your list of risks that have been identified. Most organizations assess risks on a two factor scale; one, they look at what's the probability that it will occur, and two, they look at what the impact is if it does occur. But other organizations have added a third factor and I understand that Xerium is using a third factor. Could you tell us why you did that, what the factor is, and how it's helped?

Caloggero: Uh huh. Yeah. In addition to the two areas—the probably and the impact—we also look at the speed of onset. And some people would call that the velocity. We feel that it's very important to know that. We, in our industry, sometimes have things happen pretty quickly. Ah, and so we want to know if that speed of onset has any impact on the risk itself, and I can draw, you know, current day scenarios—things that happened in the news recently—but you also look at those areas that—[TECHNICAL COMMENTS]

As far as the indicators that we use, the impact and also the probability of the risk happening, we also use speed of onset. The speed of onset helps us to gauge how quickly something will happen. Some people call that velocity; we call it speed of onset. In our industry, things could happen quite quickly, and you can draw the scenario to current day events that happen—you know, an earthquake or a tsunami—and you know, those happen relatively quickly. The speed of onset definitely has an impact on the risk that maybe a company has in that area, that lies in one of those earthquake zones, or something like that. So I believe that it's very important to have that as one of the elements. It doesn't have to be weighted as much as some of the others—as the other two—but it's certainly something that should be considered.

Hancock: Can you tell me what kind of indicators you use to monitor risks?

Caloggero: Yeah, we got in key performance indicators. Um, we use a lot of those at Xerium. We actually take, ah, what we consider intermediate events or events that happen externally and internally, and flow those through out to what we fit here, or what we think is the key event that we're trying to avoid. And those key performance indicators can be as simple as things that we look at, as what's the inventory that our customer holds or what are the mills producing in our industry? What are the customers buying? Have they historically bought this level more or less? So all those indicators are things that we look at based upon those, we can then look at the intermediate events that could be—you know, what's the impact on our financial statements? What impact does that have to the company? Ah, are we running our plants properly, at the proper capacity? Do we do proper, um, planning and materials purchasing? And those type of things. As we go out to try to maybe avoid a possible default on our debt or whatever the risk is that we're trying to mitigate or manage, we'll use those key performance indicators to make sure that we work backwards from the event that we're trying to mitigate, back to that indicator and see what the flag is that comes up on those, and monitor those key performance indicators on a monthly basis.

Hancock: So a lot of people talk about key performance indicators versus key risk indicators. Can you distinguish one from the other?

Caloggero: We don't—you know, they are—they are separate and different. At Xerium, we kind of intermingle those pretty closely. Um, the key risk indicators not used as permanently as the key performance indicators. We usually try to measure things and to see what the end risk we're trying to mitigate—how that flows back to what we're looking at and monitoring as that performance indicator. So the risk indicator isn't something that is used as much at Xerium, so I can't really give you a good comparison. It's just not used prevalently where we are.

Hancock: So maybe another way to describe it, when you look at the ultimate risk event you're concerned about, you look back over all the data that Xerium has and determine what performance measures are in place that might give an early indicator of this risk?

Caloggero: That's correct.

Q: So you're looking at performance indicators that are used in another way, as an indicator for a risk.

Caloggero: Correct. Correct. That's what we're doing.

Caloggero: What we try to do, using the key performance indicators, we try to look at the risk and understand what the risk is, and how these key performance indicators have an effect on that risk, and what happens during the process of understanding how that performance indicator affects or how we can monitor that to mitigate the risk event from happening. Does that answer it? Is that not quite what you were looking for?

Q: No, that goes. I think that answers it. It's—you've shared these indicators—

Hancock: When you look at the performance indicators you use to help monitor when risk events may be coming up in the future, you share that information publicly, and I think some people reacted to the sheer volume of data., thinking that's got to be really hard or very resource intensive to be monitoring all those things. How would you respond to that?

Caloggero: That's a good question. I think in order to use a lot of the key performance indicators that we've put forth, and with a lot of people saying that there's a lot of information there on a lot of indicators that have to be monitored, some people would say that it is quite bureaucratic, or there is a lot of work that needs to be done. But I would say also that a lot of that work and a lot of the key performance indicators are really looked at by numerous people during the course of their jobs. If I look at a backlog, for instance, for a company like us, in understanding how we should manage our inventory and how we should manage the inventory of our customers, um, there's a lot of key performance indicators that we would look at as we go into this, and manage this risk.

We—there's probably four or five people throughout the organization at lower levels in the organization, from clerks, and accounting personnel, to key management, ah, the CEO and presidents of units, that would look at similar and somewhat, uh, key performance indicators during the normal course of their business, during the course of their work. And so I don't think it's an add-on; it's just identifying which pieces you need to key on to avoid which risk. And so that's why we placed them all out there, and it seems like a lot, but in reality, it's a number of people providing the information and the feedback on those key performance indicators.

Hancock: What are some of the more challenging aspects that you've faced, in terms of your implementation of ERM?

Caloggero: I'd say one of the bigger, ah, challenges that I've faced during the course of the implementation of ERM is that the administrative part of just controlling the set of risks, understanding who the owner of those risks are, updating that, that risk list on a quarterly basis, and just, you know, the ongoing maintenance of the ERM process is something that can be somewhat problematic because of the amount of people that are involved and the number of risks that the list could eventually grow to. And that has been one of the biggest challenges that I've had to deal with at Xerium.

Hancock: Can you tell me how you've tried to change that equation and get more people involved in owning the risk themselves and managing the process?

Caloggero: I think one of the ways to try to, um, to alleviate the administrative part of the ERM—the whole process—is trying to push the ownership of those risks, or the monitoring of those risks out to the risk owners. And what I do on a quarterly basis is I have templates that I've put together for each one of our divisions and I have assigned an individual to each one of the risks, and I will mail those, email those to the risk owner, and ask them on a quarterly basis to give me an update on the risk. What are they doing to mitigate the risk? Tell me what they're doing—if there's any movement of the risk. If there isn't movement, which was is it going? And if it's increasing, tell me why it's increasing or why it's decreasing. So on a quarterly basis, I'm trying to move that out and have them respond back to me, have them be the owner of the risk as opposed to me being the owner of the whole process.

Hancock: About how many of those templates would you say you send out quarterly?

Caloggero: I'm going to say there's probably about 50, so there's a relatively good size. Some of them are duplicates, because some of the risks are owned in a region, and so they don't get duplicated somewhere else, but some of the risks that we have are company-wide and so we do get each of the regions to get back to us on. As a rule, we usually try not to get much above 25 risks a year that we concentrate on. Ideally, we'd like to keep that in the 15-20 range, but we've had that creep up over time, especially when the company is going through some turmoil that Xerium had gone through recently with, uh, reorganization and a Chapter 11. Um, there were more risks that were put on the list so we had to monitor those. Ah, more recently, the debt and some of those things associated with the reorganization have moved off the list, so the number of risks has moved down. So that has come down recently. So it's not as hard to manage it and the number of templates going out tends to go down with that.

Hancock: Thank you, Fred, for being here. For our audience, I'd like them to be aware of the fact that on our ERM Initiative website, we have many resources that could be useful if you are trying to understand the value proposition for ERM or are beginning an implementation process. I would encourage our audience to take advantage of that ERM Initiative website.

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