TEC

THE 5 GAME CHANGERS IN RISK MANAGEMENT

LEARN ABOUT 5 COMMON TRAPS IN RISK MANAGEMENT AND DISCOVER EFFECTIVE WAYS TO AVOID THEM.

ABSTRACT

Opportunity and risk management is a very complex topic in every company. For example, early warning indicators may indicate the imminent scenario of a pandemic or a massive disruption of the value chain. But this will only work if all possibilities of risk management in the company are recognized and fully exhausted.

The fact is that the traditional business management of risks often only uses a "rear view". Such a perspective, however, only focuses on risk scenarios that are already in the past and have led to deviations from plans or targets. Naturally, subsequent treatment or mitigation of these risks comes far too late.

On the one hand, risk management should draw clear conclusions from the past, on the other hand, the focus should be clearly directed towards the future. Only a forward-looking view can link risk management with corporate strategy and the long-term goals of an organization. In this regard, communicating the direct business impact of risks to decision makers is essential.

It is equally crucial to take into consideration the interdisciplinary interplay between people, organization, and technology. Only through a holistic approach is it possible to determine the risk coverage potential and overall scope of risk in concrete figures or scenarios.

© GBTEC Group, 2023

INDEX

INTRODUCTION	04
5 COMMON TRAPS IN RISK MANAGEMENT AND HOW TO OVERCOME THEM	04
TRAP NO. 1: RISKS OF REARVIEW MIRROR VISION	04
WAY OUT: FOCUS ON THE FUTURE	04
TRAP NO. 2: OVERLOOKING THE BIG PICTURE	05
WAY OUT: LINKING RISK MANAGEMENT TO THE BUSINESS STRATEGY	05
TRAP NO. 3: MISUNDERSTANDINGS CAUSED BY INCOMPREHENSIBLE LANGUAGE	06
WAY OUT: CLEARLY COMMUNICATING THE BUSINESS IMPACT	06
TRAP NO. 4: ORGANIZATIONAL SILOS DUE TO INCONSISTENT METHODS & REPORTS	06
WAY OUT: INTERDISCIPLINARITY AS THE KEY	07
TRAP NO. 5: VULNERABILITY THROUGH IMPRECISE SOLUTIONS	07
WAY OUT: ILLUSTRATING POTENTIAL SCENARIOS	08
SUMMARY	09
YOUR SOLUTION WITH BIC GRC	09

INTRODUCTION

When dealing with opportunity and risk management, the focus should be on effectively implementing concepts and offering real added value to the organization and Management.

However, it is precisely at this "effectiveness test" that many risk managers fail.

Because the majority of methods used are either not future-oriented enough or not suitable at all as a means to enable companies to react to future surprises. In the past, inefficient early warning indicators rarely succeeded in predicting pandemic scenarios or far-reaching disruptions to value chains. In practice, most of the existing risk management approaches can be classified as "bureaucratic paper tigers".

The reason for this is that many systems today still rely too much on the rearview mirror view. Consequently, this means that measures are only sought while reacting to risk scenarios that have already occurred.

- But does such a backward-looking approach create real added value in business?
- Does this make a company more resilient?
- And does such a system provide a real benefit for Corporate Management?

The answer to these questions is likely to be "no". What is actually needed is a proper risk management toolbox that allows one to turn one's gaze to the future. This toolbox is presented to you in this whitepaper. Below, you will find a summary of the most common pitfalls that risk managers stumble into, as well as 5 game changers that will help you get back on track in no time.

5 COMMON TRAPS IN RISK MANAGEMENT AND HOW TO OVERCOME THEM

TRAP NO. 1: RISKS OF REARVIEW MIRROR VISION

Management boards do not like to deal with things that are already in the past and have caused business goals not to be met as planned. The problem with this: many common risk management methods are predominantly just that, namely past-oriented. This circumstance makes it difficult from the outset to be heard by Management.

The following should serve as a comparative example: Imagine a car driver whose windscreen is fogged up and who therefore only drives with the help of the rear-view mirror. What will happen? Such behavior inevitably leads to restricted and dangerous driving situations. Potential dangers lurking further down the road are not recognized, the probability of damage occurring increases, and collateral damage cannot be ruled out.

In fact, this situation translates beautifully to risk management. Risks that are only recognized when they are already appearing in the rear-view mirror can only be partially mitigated, carry a high potential for massive damage, and often even cause further problems due to risk dependencies. The gain in knowledge through this form of "risk accounting" therefore remains low and potential risk scenarios continue to be hidden.

After all, many companies would, in fact, already be required by law (§ 91 Para. 2 AktG & § 1 StaRUG - Corporate Stabilization and Restructuring Act) to set up a functioning ***early*** risk warning system.

WAY OUT: FOCUS ON THE FUTURE

There is no doubt that companies can learn from past experiences. But looking ahead is a lot more exciting!

Because risk management is the art of professionally anticipating both risks and opportunities, while getting through turbulent times as unscathed as possible!

Against this background, it is in Management's interest to receive risk analyses that relate to the company's future. Risk managers should therefore primarily find answers to the following questions:

- Which risks are relevant for our own business model?

© GBTEC Group, 2023

- What are so-called "weak signals" that already point to critical developments in the future?
- Which critical scenarios should we deal with in the next few years?
- Are there any preventive measures we should take now?

Even if certain events do not have a high or immanent probability of occurrence, it is worth making provisions for such cases. The COVID pandemic has impressively shown how quickly the occurrence of such scenarios can threaten the existence of companies.

Too many politicians and companies only started looking for fire extinguishers when the fire was already there, and the damage had already been caused. Claims that the risk of a pandemic could not have been foreseen at all cannot be verified in this form.

It is true that there is no crystal ball for risk managers to predict the future. With the help of certain risk management methods, however, it is possible to effectively counter and prevent future risk scenarios of all kinds.

These methods include:

- Deterministic and stochastic scenario analyses
- Simulation scenarios
- System dynamics

And who knows: Behind some risks there may even be an opportunity hidden that the company can take advantage of in case of occurrence.

TRAP NO. 2: OVERLOOKING THE BIG PICTURE

Over the past few years, rather rigid "risk accounting" approaches have been in practice for the most part. These traditionally include long and confusing Excel spreadsheets used to document risk scenarios and internal controls.

However: It is difficult to systematically record threatening or even critical scenarios with such an overly bureaucratic form of documentation. Not only does the large number of different and ineffective approaches open the door to errors, but the unstructured and fuzzy findings that these approaches generate are ultimately also of no value to Management.

This is simply because they do not contribute to receiving a realistic overview of the risk situation or lead to an actual increase in knowledge. As a result, the exciting topic of risk management is wasted, and the internal standing of risk managers suffers.

In addition, overlooking the big picture harbors a huge risk potential for companies. In the context of Industry 4.0 and digitization, around 50 to 60 percent of company values are at risk of being destroyed by strategic risks. Such a serious occurrence of damage can also have serious legal consequences for managers if they cannot prove that appropriate risk information was available at the time far-reaching business decisions were made regarding investments, acquisitions or changes in strategy.

WAY OUT: LINKING RISK MANAGEMENT TO THE BUSINESS STRATEGY

As can be seen from the previous point, it is also in Management's private interest not to neglect risk management.

But how to get out of the trap?

First of all, one should find a risk management solution that is not based on the manual filling of Excel spreadsheets but allows risk data to be entered and processed directly in the tool. This allows the findings of a preparatory risk analysis to be precisely documented and processed in a meaningful way.

Furthermore, it is essential to link risk management with the strategy and goals of the organization. This integration avoids inefficient risk accounting and automatically focuses on the relevant and most important scenarios. As a result, risk managers are able to present actions to Management that make sense for business and help transform painful surprises into harmless events.

© GBTEC Group, 2023

Finally, when looking at the big picture, it should not be forgotten that risks, which by definition refer to mere target deviations, can also be opportunities. For example, ISO 31000 defines a risk as "effect of uncertainty on objectives". This effect can be both positive (upside risk) and negative (downside risk).

In this regard, identified opportunities should always be used, since their non-use or misuse - just like a failure to avoid risks - can lead to massive disruptions in the company.

TRAP NO. 3: MISUNDERSTANDINGS CAUSED BY INCOMPREHENSIBLE LANGUAGE

The common technical language in risk management is sometimes quite complicated and confusing: *Value at Risk, Expected Shortfall, Probabilities, RORAC, RAROC, Risk Adjusted Capital, SCR, MCR, PSD2, RDP* etc. At times, listening to it may even be perceived as tormenting.

The frequent use of such abstract terms can quickly overwhelm the recipient and lead to a defensive attitude. If you express yourself in an overly complex manner, it will be challenging for you to find a ready ear for risk management in your company, particularly in Management. If what you say cannot be fully understood, all the risk data you have gathered becomes worthless and cannot be used for strategically important decisions.

In addition, it is often the case that only qualitatively assessed risks are presented to Management. This means that risks are entered into a risk matrix in the form of a traffic light, which, in the end, may look something like this: the IT risk is "medium", the supply chain risk is "high", and the business interruption risk is "low".

However, Management cannot do much with such abstract valuations alone, as they contain neither a concrete value nor can be compared with each other. What exactly is meant by a "high probability of occurrence" or a "high damage potential" is ultimately left to subjective perception.

WAY OUT: CLEARLY COMMUNICATING THE BUSINESS IMPACT

Organizations are not governed by mere probabilities or purely qualitative risk assessments. If you as risk manager want to create added value, you should name and evaluate specific risk scenarios.

Any risk assessment should therefore always include the effects on the company‘s liquidity, its turnover, and the operational results (EBIT). For this, various methods are available.

Scenarios should always be thought through to the end - starting with their cause and ending with their effect or business impact. This can usually be done by looking at financial indicators.

Here it is important to understand that a company is an open and highly complex socio-economic system. Its heterogeneous and interconnected elements are linked to other environmental elements by a wide variety of relationships and can change sharply and abruptly at any time. This complexity, diversity, and internal legality is generally associated with a high level of uncertainty entailing a number of systemic risks.

To be able to deal with these risks in the best possible way, specific methods are required. Quantitative risk analyses using simulation make it possible to analyze risk scenarios in their entirety well in advance and to predict their probability of occurrence as well as potential business impact.

By using these methods, you are able to communicate existing risks in a language that Management understands - the language of numbers. By conducting quantitative scenario analyses you can minimize the scope for interpretation of your risk assessments and lay the foundation for strategic decision-making in your company.

TRAP NO. 4: ORGANIZATIONAL SILOS DUE TO INCONSISTENT METHODS & REPORTS

In a company, there are many organizational units that deal with risks. These include Controlling, Quality Management, IT Risk Management, Internal Auditing, Legal/Compliance, and Finance.

Each employee in these departments is a "little risk manager" in their own right.

In practice, it can be observed that many of these little risk managers work exclusively with their own methods

© GBTEC Group, 2023

(FMEA, FTA, ETA, BIA, etc.) and often also create their own reports for Management. The result: a confusing conglomerate of various qualitative as well as quantitative methods and reports that can no longer be meaningfully structured or understood.

It is therefore difficult for decision-makers to get a concrete picture from such a collection of risk information or to find meaningful solutions for managing and controlling the company.

The fact is that reports without a company-wide uniform approach offer Management little added value and therefore often disappear into a drawer. Another problem that arises from this is that of "silo thinking".

The various organizational units often act in isolation from one another and do not communicate sufficiently about their results and findings. As a result, important information is lost, redundancies arise, and the overall view of the company's risk landscape blurs.

WAY OUT: INTERDISCIPLINARITY AS THE KEY

The key to disarming this trap is to look at the bigger picture: at the interaction of people, organization, and technology.

Risk management is an innately interdisciplinary field and works similar to the human organism or other network structures found in nature. Networks are adaptable, scalable and flexible, have common goals, interact, and avoid hierarchies. In the human body, for example, the brain, heart and nervous system must work together and be coordinated to keep the system running.

This metaphor can be transferred wonderfully to the process of risk management, since also in organizations, all elements should work together and speak the same language. The more uniform the methods and tools that are used at all organizational levels are, the more efficient risk management will be.

The reports will become clearer and more compact, the transfer of information will be more valuable, the information overload will be reduced, and finally, Management will receive a uniform picture that it can understand and use as a basis for decision-making.

Therefore, you should make sure that your risk management is interdisciplinary and structured in a way that is understandable and meaningful. As a result, not only do you have proper governance, but you also enjoy the benefits of using your resources effectively and efficiently.

These include:

- open communication and exchange of knowledge between teams.
- deeper integration of different perspectives and expertise.
- improved risk identification and assessment.
- increased resilience to unforeseen events.
- increased transparency and comprehensibility throughout the company.

TRAP NO. 5: VULNERABILITY THROUGH IMPRECISE SOLUTIONS

As already discussed, qualitative risk assessments are easy to carry out. However, due to their inaccuracy and subjective character, qualitative assessments also make the risk management industry more vulnerable to attack. This is because Management generally finds it difficult to make important decisions with a clear conscience based on a colorful risk map or a collection of qualitatively assessed risks.

One reason for this is that such assessments are often based on empirical values, personal estimations, and unstructured data. This can lead to a certain unpredictability that makes it impossible to find concrete solutions, and calls into question the credibility of risk management itself. A lack of transparency quickly raises doubts about the validity and integrity of risk assessments among supervisory authorities and stakeholders.

If no solution for this issue is found, not only risk managers themselves, but the entire risk management sector becomes vulnerable. This circumstance can cause a lot of damage because it means that the status of risk management itself deteriorates in the long term.

.

© GBTEC Group, 2023

WAY OUT: ILLUSTRATING POTENTIAL SCENARIOS

Management is primarily interested in aggregated risk portfolios that immediately provide all relevant information. In such portfolios, various risks are logically interrelated, combined, and analyzed to obtain a comprehensive picture of the overall risk landscape.

Above all, aggregating risks lets you effectively point out dependencies and combination effects that often require a closer look to prevent serious crises or even insolvencies.

Reliable aggregation results rely on the use of quantitative methods as these are based on the principle of measurability and thus provide a clear basis for assessing risks. Quantitative methods use mathematical techniques such as probability distributions, Monte Carlo simulations, and statistical tests to model a range of potential risk scenarios and quantify their business impact.

This enables the calculation of potential losses, financial ramifications, and risk metrics such as Value at Risk (VaR), and generates valid information on the financial health and performance of the company.

Furthermore, it must be mentioned that the analysis of risk scenarios is not only in the sole interest of Management but is also clearly required by external regulations. Since 1998, the essential requirements for an early risk warning system have been summarized in the auditing standard of the Institute of Public Auditors in Germany (IDW PS 340). With each adaptation of the standard, the necessity of aggregating risks quantitively has been emphasized more and more.

To precisely assess the condition of a company, the aggregated overall risk should then be compared with the risk coverage potential as a final step. This will help you generate particularly meaningful reports you can use to meet all the expectations of Management and make your contributions even more valuable.

© GBTEC Group, 2023

SUMMARY

For better clarity, here is a summary of the 5 game changers, in a nutshell:

1. FOCUS ON THE FUTURE

Many traditional methods in risk management are backward-looking, making it difficult to get a hearing from Management. That is why you should focus on the future by trying to anticipate risks and opportunities.

2. LINKING RISK MANAGEMENT TO THE BUSINESS STRATEGY

A rigid and fragmented accounting of risks can lead to threatening scenarios that put the organization at risk. To escape this trap, link risk management to corporate strategy and thereby achieve a clearer assessment of risk scenarios.

3. CLEARLY COMMUNICATING THE BUSINESS IMPACT

Using a language that is too complex and technical, in combination with an exclusively qualitative assessment of risks, leads to misunderstandings and a lack of credibility. Therefore, analyze your risks quantitively via simulation to provide Management with real solutions based on the actual business impact.

4. INTERDISCIPLINARITY AS THE KEY

Different organizational units often act in isolation from each other and do not speak a uniform language. Thus, align risk management in an interdisciplinary manner within your company and improve communication between teams.

5. ILLUSTRATING POTENTIAL SCENARIOS

Subjective and inaccurate assessments of risks make risk management vulnerable. Therefore, carry out a risk aggregation using quantitative methods to receive valid information on the financial health of the company and provide Management with meaningful reports.

YOUR SOLUTION WITH BIC GRC

To use these five game changers in risk management effectively, it is essential to have a comprehensive GRC strategy and an efficient risk management tool. BIC GRC provides the perfect solution!

With BIC GRC, you get an automated, all-in-one GRC tool that lets you easily identify and analyze risks, manage internal tasks and controls, as well as treat and monitor risks in the best possible way.

The software enables a future-oriented risk analysis by using various quantitative methods, above all the Monte Carlo simulation. The direct integration of these methods in the software makes it possible to create holistic aggregated risk portfolios at the push of a button. Via scenario analysis, you can reveal risk dependencies and effects, as well as reliably predict the overriding business impact.

The seamless integration of BIC GRC at all company levels optimizes cross-departmental cooperation, preventing redundancies and the development of an inefficient "silo thinking" in the company.

In addition, the workflow-based software effectively supports compliance with internal regulations as well as external legal requirements, leading to more transparency in the entire risk management process.

All this enables you to tackle difficulties head-on, use opportunities sustainably, and contribute to the long-term value-oriented development of your company.

Further information on BIC GRC can be found at https://www.gbtec.com/de/software/.

© GBTEC Group, 2023

YOU WANT TO LEARN MORE?

Are you interested in how BIC can power your GRC? Contact us by phone or email or simply participate in one of our numerous free webinars!

Phone +43 1 3670876-0

E-Mail grc@gbtec.com

CLICK HERE TO DISCOVER MORE ABOUT BIC GRC!

GBTEC GROUP

We are motivated by the firm belief that digitalizing GRC processes in a sustainable way drives the success of innovative organizations. Our efforts center on anchoring these processes efficiently in everyday business activities and corporate culture.

We achieve this through our GRC software BIC GRC, which offers clients a choice of flexible custom or standard solutions, with minimal implementation work and fully adaptable to each company's unique needs. With BIC GRC, we provide a tool that helps our clients achieve goals reliably, cope with uncertainty, act with integrity, and continually improve the maturity of their organizational GRC processes.

The world's largest and most successful energy providers, insurance companies, banks, telecommunications companies, and retailers place their trust in us and manage their GRC processes with BIC GRC.