Risk Reward
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New Standards for Risk Management

Also in this issue

THE INTERSECTION – WHERE RISK, VALUE AND REWARD LINK

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Introduction

Risk and Risk Management in general can be viewed from two perspectives: A negative and a positive risk management view.

By negative risk management we mean the following:
The risk management approach in an organisation that is designed to prevent the downside consequences of a transaction, such as (1) mitigating a potential loss or (2) the cost of not complying with regulatory requirements, as two examples.

In a positive risk management framework, the upside is managed in conjunction with a risk based approach to general management. This is the starting point of Enterprise Risk Management, but we extend the argument and management philosophy even further.

The approach:

We have created our unique principles directed Risk Oriented Value Management framework consultancy solution. The overall philosophy and practical application of the model is embodied in a sound risk management framework underpinned by the convergence of Internal Auditing and Financial Controls and the Value drivers inherent in the Value Based Management approach, namely

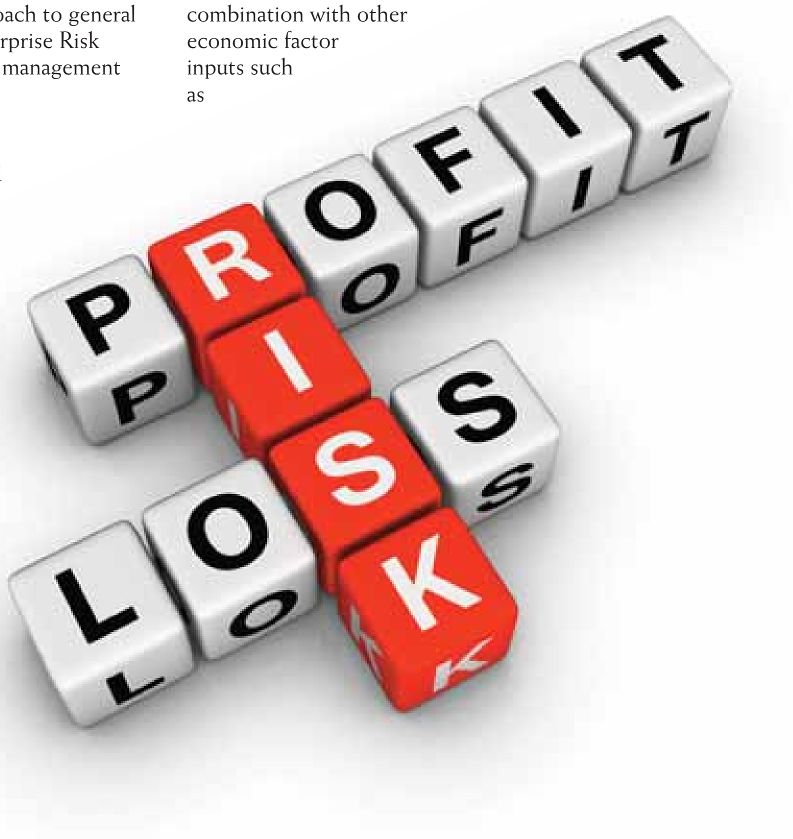
1 **Creating Value**
2 **Managing Value**
3 **Measuring the Value created**

The focus in measuring and managing for value and thus superior organisational performance is encapsulated in performance and investment drivers such as:

a. **Sales Growth**
b. **Operating Margin**
c. **Cash Tax rates**
d. **Fixed Capital Investment**
e. **Working Capital Investment**
f. **Cost of Capital**
g. **The Planning Period**

Creating Value

The departure point in creating value ultimately has to have Innovation as one of the factor inputs required to create Economic Value in any organisation. This in combination with other economic factor inputs such as



capital, land and labour are the foundation building blocks of any organisational sustainable growth approach.

Therefore, combining resource inputs such as capital and labour with innovation, in the right mix and during the right time frame are the sustained growth drivers in any organisation.

Managing the Value

In a Risk Oriented Value Management approach risk managers assist their clients in filtering the noise and distractions along the way as it exclusively focuses on the underlying Value Drivers:

Sale Growth Rate

As the starting point profit and growth planning must set a solid platform to help drive the organisation forward. Whether the approach is to focus on product or market development, or a combination of both, risk managers help identify the resource allocation pressure and decision points, in order to maximise the return on effort invested.

As a top line focus point Sales Growth helps galvanise the organisational management and employees to identify suitable market opportunities to pursue to overall sales or set-off objectives.

Operating Margin

Operating margin becomes the focal point for operational efficiency and cost management strategies. During the recession most organisations have looked long and hard at this particular area, partly because sales growth has suffered quite severely, but also because they have realised that in any growth cycle such as we experienced between 2003 – 2007, 'organisational operational padding' have added unwarranted inefficiencies to their operating processes.

The conundrum at the moment facing most organisations is the question of how to drive sales forward and upward, with the reduced operational cost base in place. The two major levers of Sales Growth and Operational Cost need to be manipulated with the utmost delicacy and 'a very steady hand on the tiller'.

Cash Tax Rates

It is a given that the focus of most western governments will be on maximising Treasury tax takes over the next few years, in order to manage the huge fiscal stimulus packages introduced to support the economies. We expect quite a militant and aggressive approach in this area and a deluge of mitigation and profit extraction strategies to drive this 'opportunity cost' of business (your licence to operate fee) down. This is an area best left to the specialist is the area, however, it is still a value investment of your time to keep a beady eye on this 'hidden value driver'.

Fixed Capital Investment

Financing and timing are the two major factors to consider in Fixed Capital Investment area of your business. A creative off balance financing strategy might assist in extracting value in this area; however, the key issue is to have the capital infrastructure in place to support your organisational objectives. Taking advantage of distressed assets values might set up and gear the organisation towards supporting the initial Sales Growth driver.

Working Capital Investment

Liquidity and liquidity risk management are the key focus areas in maximising value in your working capital management processes.

Cost of Capital

A one-off opportunity to positively manage the organisational cost of capital down has emerged at the end of this recessionary cycle; however, it is up to the astute organisational leadership to take advantage of the opportunity. We recognise that a multitude of factors currently exist which might make taking advantage of this unique opportunity quite challenging, however, if the platform and measurement dashboards, combined with the organisational structure and resources are in place to take advantage of the historically low cost of capital rates, we encourage every organisation to take advantage of this potential opportunity.

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Planning horizon

Clearly understanding that a longer term timeframe is genuinely beneficial, combined with regulatory factors encouraging the long view at the moment, will help the organisational leadership grasp both drivers of value in this factor, namely the current departure point and value calculation and the ultimate exist strategy value or Terminal Value of the organisation.

Measuring the Value

Risk managers should develop a unique dashboard and measurement instruments to help diagnose and drive the management effort towards the Value Based Management principles.

Graphical Key Performance and Risk Indicators combined with Short Interval Cycles focus management effort on taking corrective action very quickly. The unique pro-active dashboards help turn around the reactive Management Information Systems and became a vital and integral part of the overall strategic management philosophy underpinning the Risk Based Value Management practice we have developed.

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