Leadership in Risk Management – Board Report

Research Report by *Board Agenda* & Mazars in association with INSEAD Corporate Governance Centre

BOARD AGENDA
GOVERNANCE | STRATEGY | RISK | ETHICS

MAZARS

INSEAD The Corporate Governance Centre

Contents

Executive summary

BOARD AGENDA ASKED C-suite executives and non-executives—including chairs, chief executives and group finance directors—about their preparedness for a pandemic in the wake of the Covid-19 crisis. At the same time, we aimed to gauge their changing attitude to risk and their views of the wider current risk environment. The findings are revealing.

Despite an apparent lack of preparation for a global pandemic, board members believe existing risk management systems are coping well during the Covid-19 crisis. While only 55% are able to say they were prepared for such a pandemic, a resounding 96% say their controls and processes have performed well.

This confidence comes as a result of increased diversity to improve risk knowledge in the boardroom, and clear governance structures—and despite the belief that organisations face more risks now than five years ago.

However, this confidence has to be set in context. An alarming 43% believe that Covid-19 represents a fundamental threat to the survival of their organisation.

Putting the existential threat aside, and despite an increase in risks, the appetite in boardrooms for risk has not reduced.

Prior to the Covid-19 crisis, boards saw regulation and compliance as the number one risk, followed by financial, reputational and cyber risks. Climate change was ranked lower than risks posed by conduct, digital and business disruption, geopolitical issues, and supply chain and outsourcing threats.

And despite the increasing levels of risks, only half of board members believe they receive all the information they need to evaluate threats, relying on senior management and their own knowledge to judge the best course of action.

Covid-19 insights include:

- Boards are split evenly on whether or not they have a crisis management committee. Those that do not have a committee say that crisis management is either a matter for the whole board, the executive, business continuity group or specially convened "Cobra" teams.
- Only 55% are able to say they were prepared for a pandemic, though a resounding 96% say their controls and processes have performed well during the crisis.
- Eight out of ten are confident their response to the crisis has been clearly defined, communicated and monitored.
- Some 43% believe the pandemic is a fundamental threat to their organisation.
- Nearly six out of ten are reviewing their business strategy in response to the crisis, while a similar number are working on their post-pandemic strategy.

Risk management insights include:

- Seven out of ten believe their board is sufficiently skilled to address all the risks in its market sector.
- Nearly three-quarters have experienced unexpected and unanticipated risks during the past five years, while almost nine out of ten believe they are facing more risks than five years ago.
- Half believe their risk appetite has not reduced in the past 12 months.
- Half have changed the diversity of board membership to strengthen risk management challenges.
- Only half receive all the information required to consider all the risks faced by the organisation, with senior management and personal knowledge ranking as the most important sources of information.
- Regulation, compliance and financial risks are at the top of the board's risk agenda, followed by reputation and cyber risks, with climate change at the bottom of the list.
- A total of 79% say their boards and management are aligned on the key risks facing their companies, while 66% say management, boards and shareholders are aligned.

Taken altogether, it is clear that while boards recognise how the risk environment is changing, and that their existing processes are capable of adapting to new threats, there is a knowledge gap developing that could expose boards to future unanticipated risks that may prove existential in nature and unprecedented in impact.

Forewords

Matt Dalton, partner and head of risk management, Mazars UK, and
Anthony Carey, partner and head of board practice, Mazars UK

LEADING ORGANISATIONS, IRRESPECTIVE of size or shape, use effective risk management to make strategic decisions, respond quickly to change and crises, and build organisational resilience.

What the risk survey results reveal is that companies have significant confidence in their resilience. A total of 96% believe their procedures and controls have performed adequately to deal with the impact of Covid-19 on all stakeholders. Boards are satisfied with the level of engagement and control across the organisation when responding to the pandemic in a timely manner.

However, we see several areas where improvement is required. Almost half the respondents lack confidence that their boards receive all the information required to consider all the risks faced. This undermines resilience and should be a wake-up call for many.

In relation to risk management, the crisis has been highly disruptive, and a key lesson is that we need to get better at scanning the horizon and considering preparedness for the unexpected. Only 55% felt prepared for a pandemic. Boards need to ensure they have good external antennae on key risks.

Effective change management is crucial but only just over half of boards surveyed have developed, or are developing, a forward-looking post-pandemic strategy. Companies must continue to evolve and identify new ways of seizing opportunities.

It's important to have robust project management over all change programmes; the intense pressure of the past few months will continue for some time to come. Boards need to ensure management teams do not become fatigued or lose the drive to remain responsive and innovative, crucially in the aftermath of the crisis, where there is high debt and low customer demand.

Boards need to address a worrying lack of knowledge over some of the major risk areas, in particular cyber and climate risk. With many staff now based from home, Covid-19 has highlighted the cybersecurity risks related to remote working. This may trigger potentially significant challenges to which boards and senior management must respond rapidly. That only 38% of boards seem to be up to speed with cyber risk is deeply worrying.

It is also concerning to see climate at the bottom of boards' risk knowledge. This is a high-likelihood, high-impact issue. While companies may see it as a long-term problem while they confront the pandemic, the two are likely to come together as governments seek to tie rescue packages into climate change improvements.

Resilient and agile organisations are those that can move quickly, innovate and respond to the current crisis. These organisations will flourish in the new normal. While the survey shows much that is positive, it also shows that there is some way to go for many businesses.

INSEAD The Corporate Governance Centre

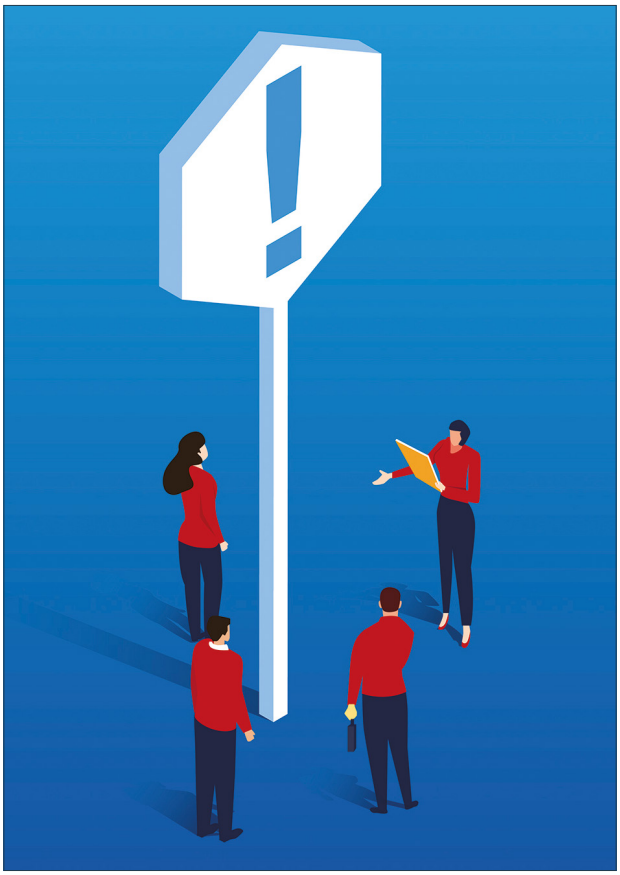
Professor Enrico Diecidue, professor of decision sciences, INSEAD, and **Professor Tim Rowley,** ICGC distinguished fellow and visiting professor of strategy, INSEAD

EFFECTIVE RISK OVERSIGHT has become a strategic imperative for corporate boards given that their main activities involve the setting up of a strategy, the monitoring of financials, the management of key people, and the evaluation and integration of potential risks.

All these activities deal, directly or indirectly, with risk. The research into the leadership in risk management uncovers the complexities and challenges in the governance of risks—both the human aspects of risk perception/evaluation and the data-driven aspects of risk management. In addition, the report highlights areas of risk that are well understood and others that need some reflection and actions. Finally, the survey offers valuable insights into board readiness and reaction with respect to managing risk related to one of the most salient crises of the past decades, the ongoing Covid-19 pandemic.

The findings of this research provide food for thought for further conversations, questions, reflections and potential remedial actions. First of all, the recent crisis has highlighted the need for preparation to face unknown risks; this preparation may be facilitated by scenario-planning. A natural question is whether boards are well-prepared to generate rigorous scenarios, and to evaluate the risks involved in each of the scenarios.

Second, the report highlights that climate risk is at the bottom of the scale, in terms of areas of concern for risk. This finding opens a lot of interesting questions. Why is climate change so low in the scale of risks? What are the obstacles to considering climate change one of the major risks boards might face in the next decades? What can be done to remove the informational obstacles on the potential effects of climate change at the board level?

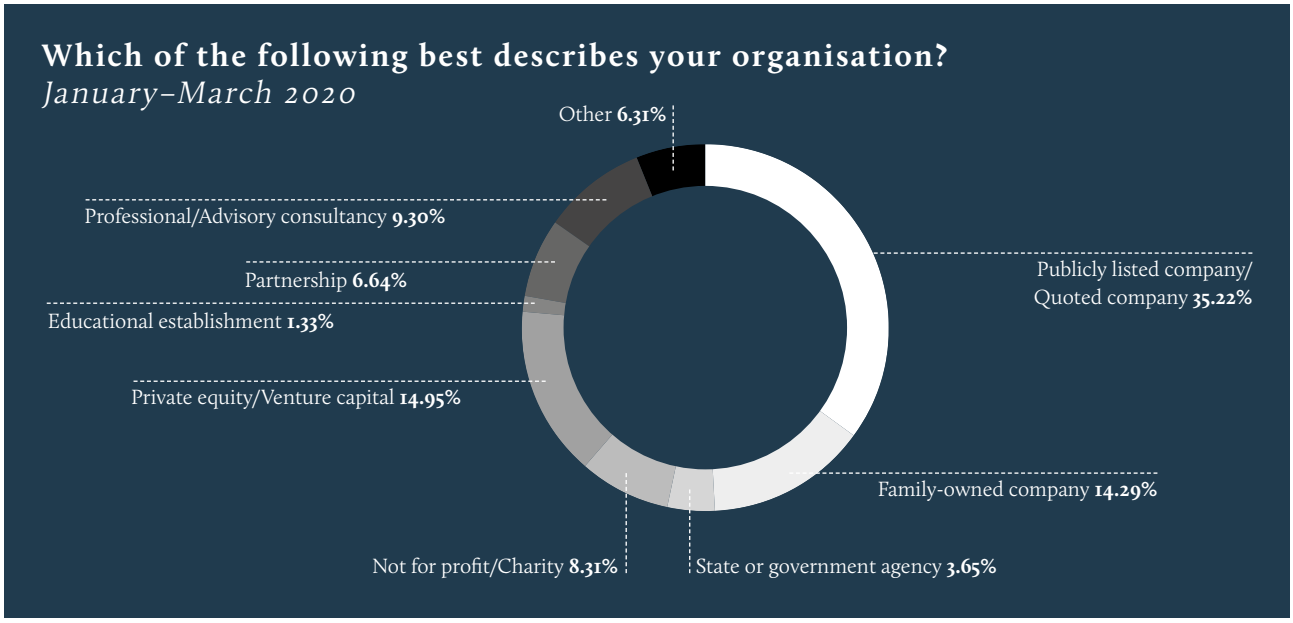


A final question also originates from the data: what are the processes that generate the risk evaluation and risk appetite of a board and how to best manage these processes?

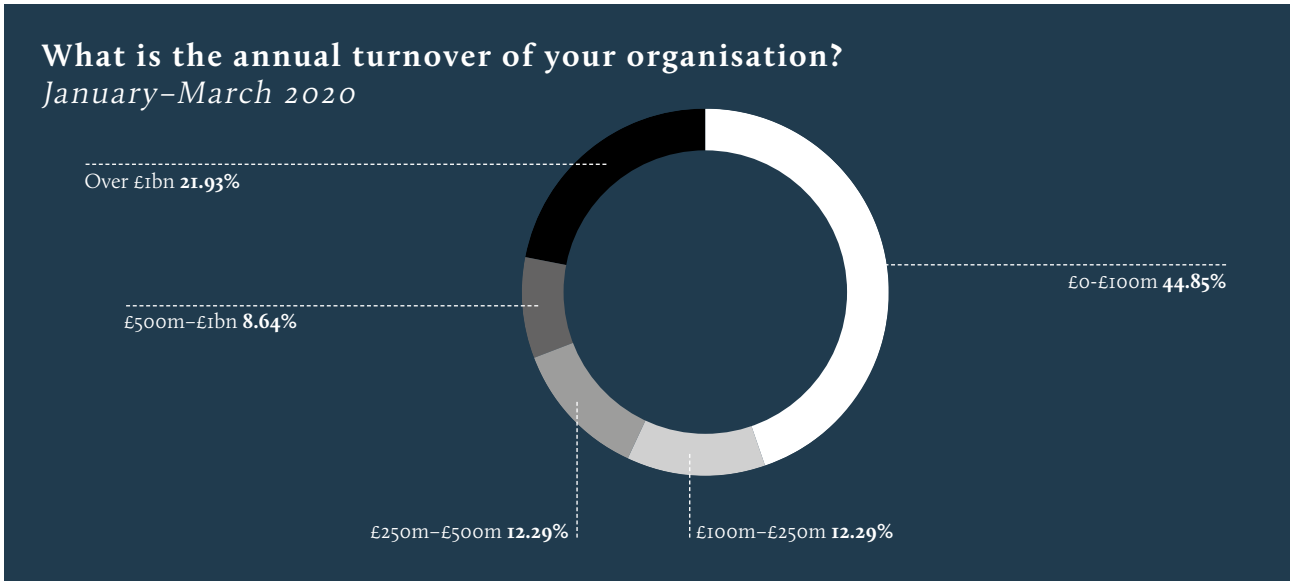
Overall the survey underscores the need for boards to have a systematic approach to address risk evaluation and integration in the face of rapid change and uncertainties in the business landscape. Therefore, I hope that the report can encourage each user to reflect on the lessons learned and the best practices in terms of risk management that have originated from the crisis.

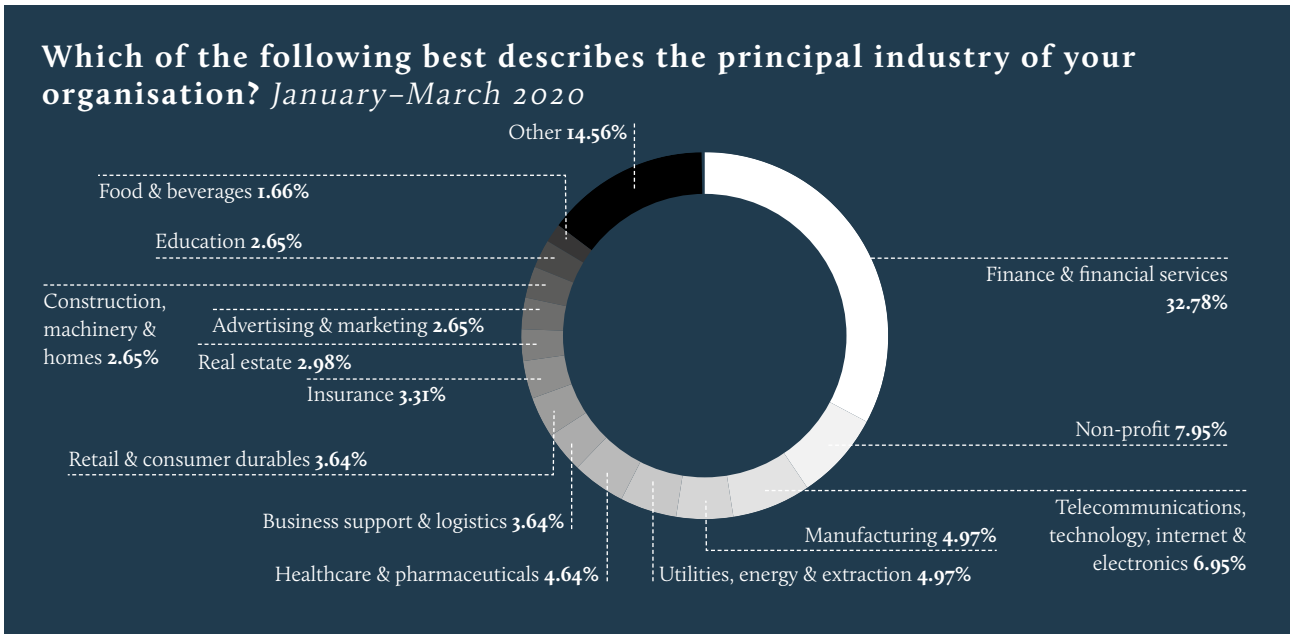
Methodology

The *Board Agenda* Risk survey was carried out between January and March 2020 among more than 300 senior business leaders, including chief executive officers, chief finance officers, board chairs, executive and non-executive directors, company secretaries and risk managers. The online survey was powered by SurveyMonkey.

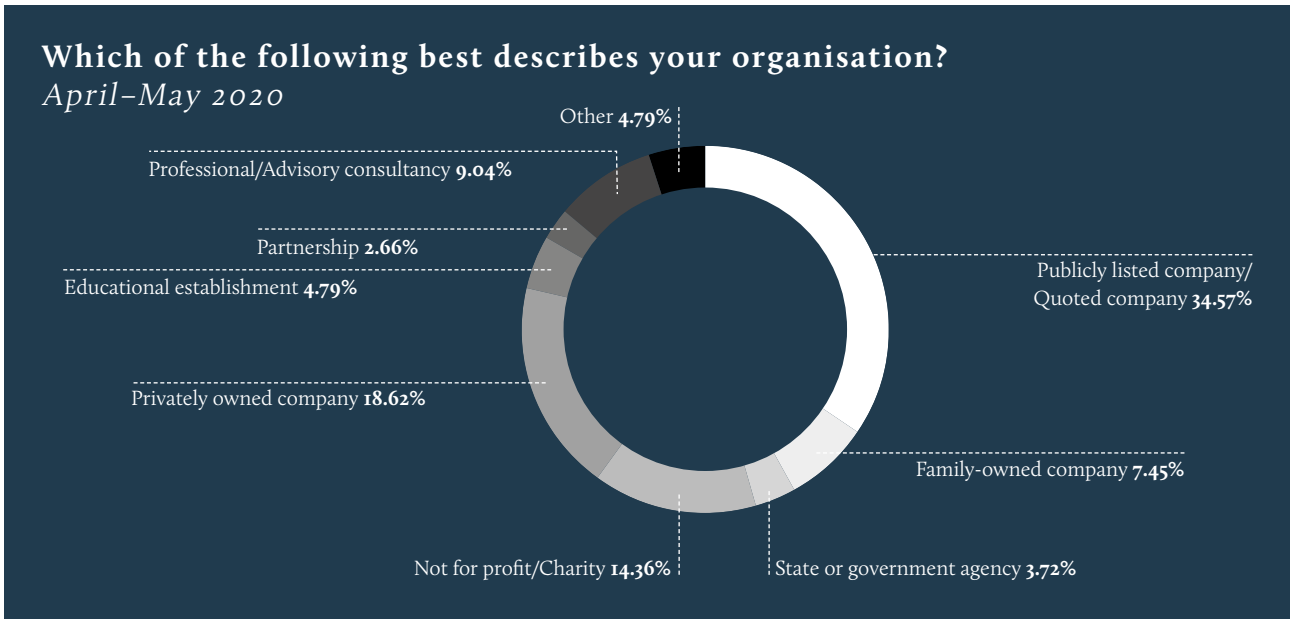


The respondents represented publicly listed companies (35%), family-owned companies (14%), private equity/venture capital investors (15%), alongside not-for-profit organisations, partnerships and consultancies (24%). A fifth of respondents were from an organisation with an annual turnover greater than £1bn, while 45% had an annual turnover of less than £100m. A third (33%) of all respondents worked in financial services.





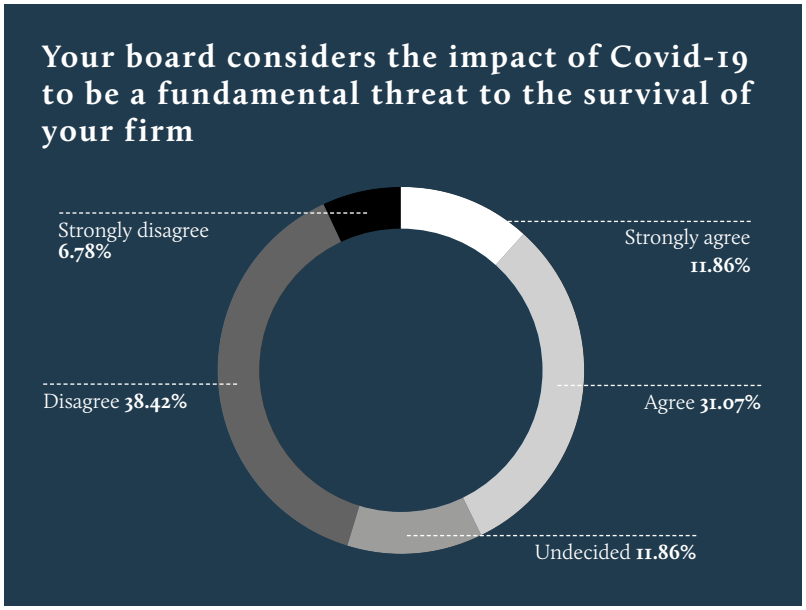
This survey was augmented by a supplementary poll between April and May 2020 focusing in detail on the impact of the coronavirus crisis among more than 200 similar business leaders. More than a third of those who responded to the coronavirus survey were from publicly listed companies, while more than a quarter (27%) were from a privately owned or family-owned business. A fifth (19%) of the organisations represented had an annual turnover of more than £1bn, while 50% had a turnover of less than £100m.



Main findings

Risks and Covid-19

For many, the Covid-19 pandemic would be classed as a "black swan" event in the same way that the near-collapse of the banking system in the financial crisis of 2008 was seen as a unique, one-off and unexpected phenomenon.



This in part reflects the even split in how boards have organised their response to the crisis: while 47% have a crisis management committee, the majority have chosen a number of different ways to manage the crisis, from making the whole board responsible for managing the event, through to making it the responsibility of the executive committee, business continuity team or a "Cobra" team.

More than half of boards believe they were prepared to tackle the crisis, although a third candidly admit that their boards were not prepared for a pandemic. Irrespective of preparations, 43% believe that Covid-19 represents a fundamental threat to the survival of their organisation, with a slightly larger proportion (45%) believing it does not.

Controls

The key finding here is that although the event was not predicted, controls and processes have performed well during the crisis. A resounding 96% answered in the affirmative when asked whether their procedures and controls have performed adequately to deal with the impact of Covid-19 on all stakeholders, including employees, customers, investors and suppliers.

As one respondent says: "We have invested heavily in business continuity planning and operations ahead of the crisis and this has been critical in our ability to continue operating without missing a beat. This is despite 99.5% of staff working from home. We have also taken the view for a long time that shareholders are not our only stakeholders and have looked at our wider role in society, so we are focused on the long term."

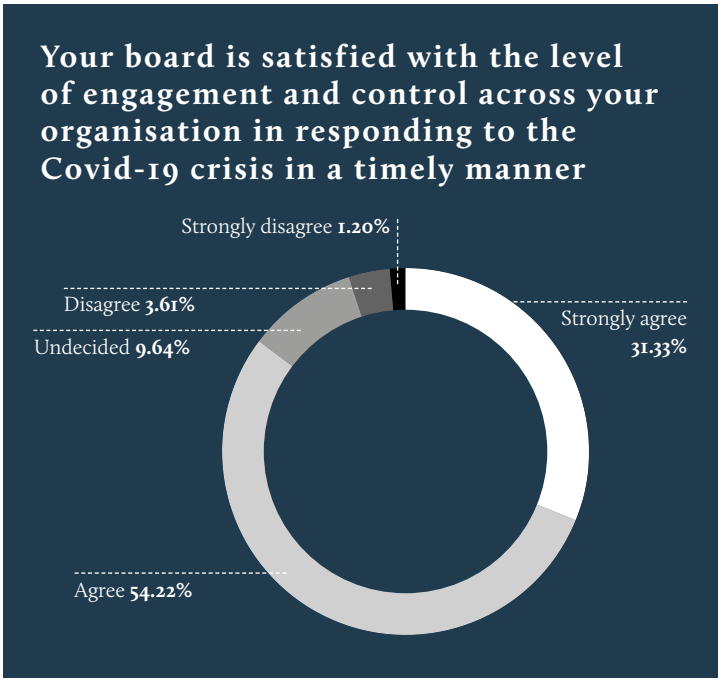
This indicates that, with appropriate planning and preparation, boards can be well-placed to deal with such events—even moments that pose an existential threat to the organisation.

This confidence is again displayed when answering whether boards are satisfied with the level of engagement and control across the organisation when responding to Covid-19 in a timely manner. Nearly nine out of ten (86%) agree that this has been the case.

Again, time spent on preparation has paid off—eight out of ten agree that the response of their boards to the crisis has been defined, communicated and monitored. Only one in ten disagreed.

And 75% agree that their board has effective oversight of emerging legislative, administrative and regulatory developments in the wake of the crisis. This demonstrates that, when required, board members are able to access the information they need rapidly and respond appropriately.

Business strategies are being reviewed in the wake of the crisis as well. Oversight of financial planning and stress testing has been effective, including adequate assessments of liquidity, credit and capital needs—88% agree this has been the case.



And despite the disruption, a clear majority (72%) agree that their board still has the capacity to consider other major risks affecting the organisation and the sectors in which they operate.

As one board member says: "I am chair of a number of organisations and each has tried to recognise that it is hard for everyone in the leadership group to focus on both dealing with the here and now and for the next phase/s of the situation; we have been clear about differentiating between these two roles."

Strategy

But there is room for improvement. When asked whether boards and management have developed a forward-looking post-pandemic strategy, nearly a third (30%) are undecided and a further 13% say they are not developing such a strategy. That said, 57% are able to be positive.

As one board member says: "With the executive team we are managing the situation effectively, but we were unprepared at the outset. The current horizon of the board is focused on near-term survival (six months) and has not had the time, nor do we have the certainty, to reflect on longer-term implications."

Other individual comments on how boards are managing the risk of the crisis are revealing:

"... the board relies on management to provide updates and offer solutions to challenges presented by Covid-19. The board and executive committee reviews management's plans and responses and offers suggestions and advice..."

"... generally, we receive updates from management on Covid-19 and we offer our perspective with the focus on protecting people and the business. We are all reliant on direction from local governments and regulators to set the stage for return to the new normal in terms of business resumption..."

"... clearly the crisis has shone a light on strategy and while we are still uncertain of what the exit plan from lockdown is in the UK, a number of scenarios require to be maintained to assess the viability of our clients and therefore how best to respond as a business..."

"... this is a very difficult time for our business. It doesn't threaten our survival because we are very large and have a significant number of very large clients. But our revenues are falling considerably and there will be downward pressure on fees..."

Risk management

Risk focus

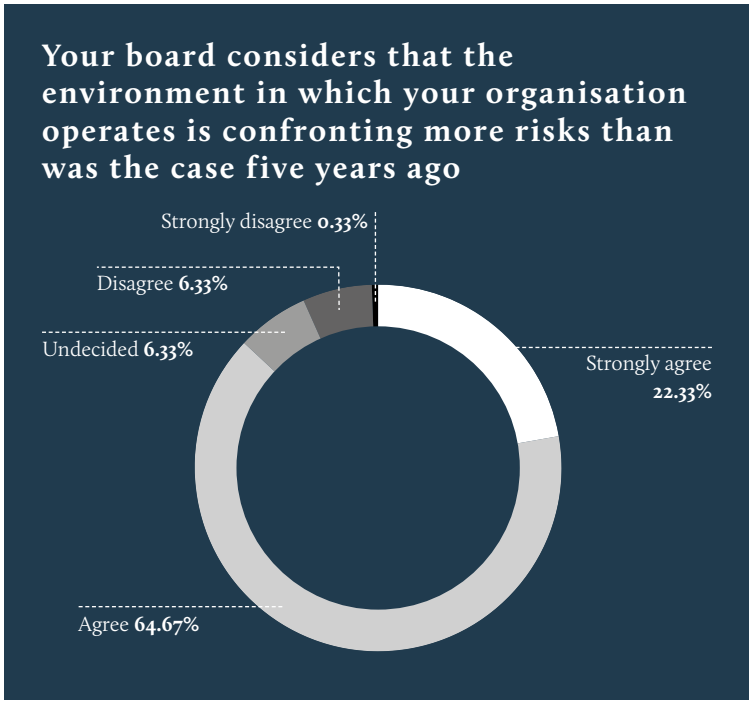
Putting aside comments and concerns over Covid-19, boards view regulation and compliance as the number one risk, followed by financial, reputational and cyber risks. Climate change risk is ranked lower than risks posed by conduct, digital and business disruption, geopolitical issues, and supply chain and outsourcing threats.

In order, boards see their risks arising from the following areas:

1. Regulation/compliance
2. Finance
3. Reputation
4. Cyber
5. Conduct
6. Digital & business disruption
7. Geopolitics
8. Supply chain/outsourcing
9. Climate change

Risk landscape

An overwhelming majority of the survey respondents believe their organisations face more risks than they did five years ago. Nearly nine out of ten (87%) confirm that their boards consider that the environment in which their organisations operate is confronting more risks than was the case five years before.



This is perhaps unsurprising when one considers the past five years have been a period of rapid change—high degrees of business disruption combined with geopolitical shifts and increased focus on regulation, compliance and reputation have combined to create an environment where risk management has never been so important. This is borne out by the responses to the question of whether organisations have faced a greater degree of unexpected and unanticipated risk during this time.

Almost three-quarters of respondents (73%) agreed that this is the case, and that unexpected risks had materialised during the past five years. With that figure in mind it's clear that board members are being required to adapt to an ever-changing risk environment like never before.

But it is not just the variety of risks that have changed. Respondents overwhelming agree that the volume of risks has increased in this time as well. This is perhaps a reflection not only of a rapidly changing world but also the increasing use of data analytics and other monitoring techniques, which have uncovered risks that might previously have been hidden, or at least not recognised as such.

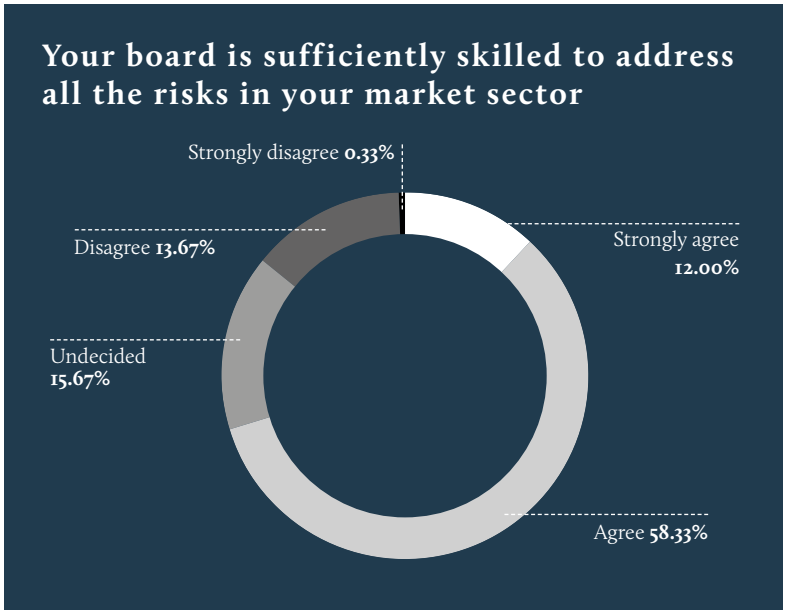
How boards have been responding to this changing environment will be key to understanding how they are responding to the current Covid-19 crisis. Those that have been operating in and developing with an ever-changing environment are likely to be well placed to deal with new challenges.

Those that have not been doing so will struggle.

Skills

When asked whether their board members are sufficiently skilled to address all the risks in their market sector, a confident 70% replied that they are. Some 14% said no, and a further 16% were not sure. This suggests a high degree of confidence in boards' capabilities to act on, and react to, the risk environment within which they operate.

This question was then followed up with a supplementary query: do boards devote sufficient time to discussing the risks they face? Three-quarters responded in the affirmative. Again, this confirms the confidence that boards have in understanding and dealing with their risk agenda. They have the time and the skills to tackle risk.



As one respondent comments: "The risk environment is extreme at present. Managing risk is top of the board agenda. It dominates our time. We are needing to be very creative in how we mitigate risk including looking at innovating with our business model. We have a relatively high tolerance level for risk."

The survey also confirms the strongly held belief that boards have a clear governance structure, or even a subcommittee, responsible for directing risk activity. Eight out of ten agree with this position, a finding that is not surprising given the recent years of emphasis placed upon having the correct structures in place, and perhaps a direct response to the risks that emerged during the last recession caused by the financial crisis.

Within this finding, it is interesting to note that 28% "strongly agree" that there is a clear governance structure—it is perhaps a clear-cut indication that many organisations have spent time focusing on this area of risk management, ensuring that not only is there a structure, but that it is one that is well-known and understood.

Information

It is often a complaint from board members, particularly the non-executive directors, that they do not receive adequate, timely information upon which to base their decisions. This clearly represents a risk in itself.

While just over half agree that their boards receive all the information required to consider all the risks faced by the organisation, a quarter do not agree, and a further quarter are unsure. This is a worrying state of affairs, and an area that needs to be addressed if stakeholders are to remain confident that the board is fully on top of its risk agenda.

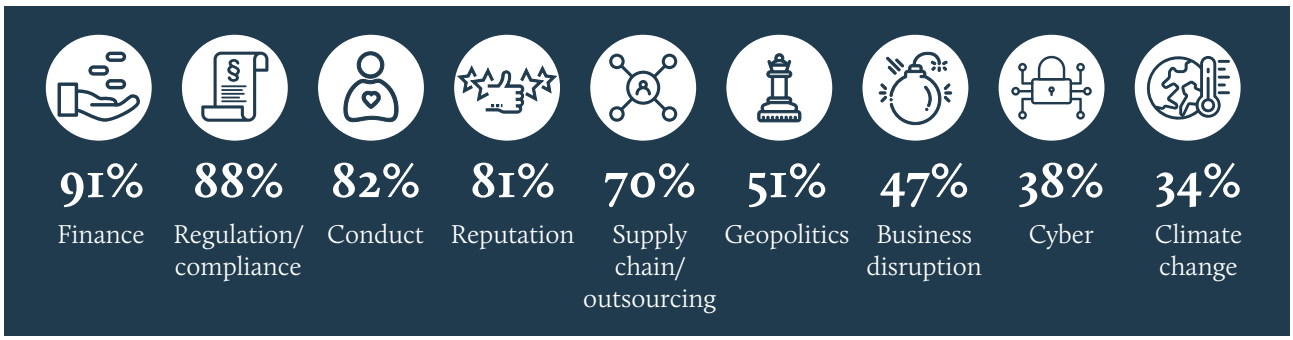
This is perhaps compounded when one considers the sources of information upon which the board members are relying. Senior management and other internal sources are listed as the primary source for boardroom information, followed closely by the personal knowledge of individual board members—a diversity of board membership would increase the diversity of information sources.

Information from reports and research are ranked third in importance, followed by that delivered by third-party consultants and professional advisers. Industry benchmarks and professional bodies bring up the rear.

Knowledge

There is considerable variance in knowledge of specific areas of risk. When asked about particular areas, respondents feel their boards were far better equipped to deal with financial risks than, say, climate change.

In order, boards are seen to have knowledge of risk in:



This list is remarkably similar in order to that set out at the start of this report. This suggests that boards are heavily exposed to areas of risk that they might not believe to be the greatest threat; but if the Covid-19 crisis shows one thing, it is that risk can come from the most unexpected areas.

Controls

This view is backed up, though not to the same degree, by the finding that just over two-thirds (67%) agree that their board is satisfied with the level of controls across the organisation when it comes to responding to risks.

In this respect it is perhaps worrying that nearly one in five (19%) are not sure—perhaps this is because the only time when a level of control is not satisfactory will be when something goes wrong.

But as one respondent says: "The board had a good understanding of the risks and the tools available to identify and manage these risks and the parts of the risk that could not be managed. The issue is that a large number of risks cannot be completely controlled or managed, so there is always an exposure that cannot be fully prevented or mitigated. As these risks materialise, the board has to react as it deems fit given the current circumstances."

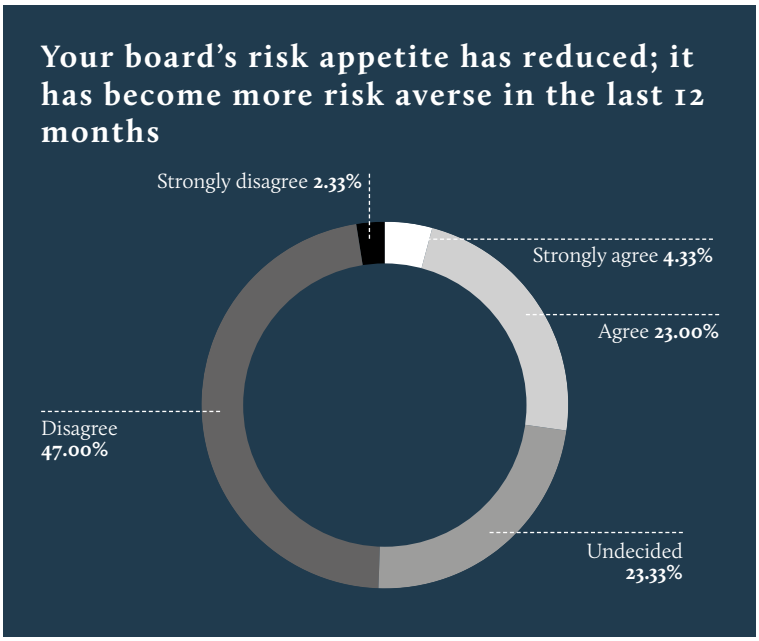
According to the survey, there is a high level of confidence that boards have plans in place to tackle the crises that may arise from all the major risks that their organisations face. Almost two-thirds (63%) say such a plan is in place.

However, more than a third either did not have such a plan (16%) or were unaware of such a plan (21%). This is a worryingly high proportion, and indicates the possibility that even if a plan is in place, its existence is not widely known or has been poorly communicated.

Appetite

Risks are an inevitable part of doing business for all organisations; they cannot be avoided, but they need to be defined, communicated and monitored. As such, the finding that 63% believe the organisation's risk profile is understood suggests that most boards have considered their appetite for risk and how it is managed.

But again, there is a significant minority who say this is not the case. Two in five either believe their boards have not carried out this process or do not know whether they have. Once more, this could be the result of failed communication: if a board has settled on an appropriate level of risk, this needs to be communicated with the wider organisation. And even then, this will fail unless this risk appetite is monitored.



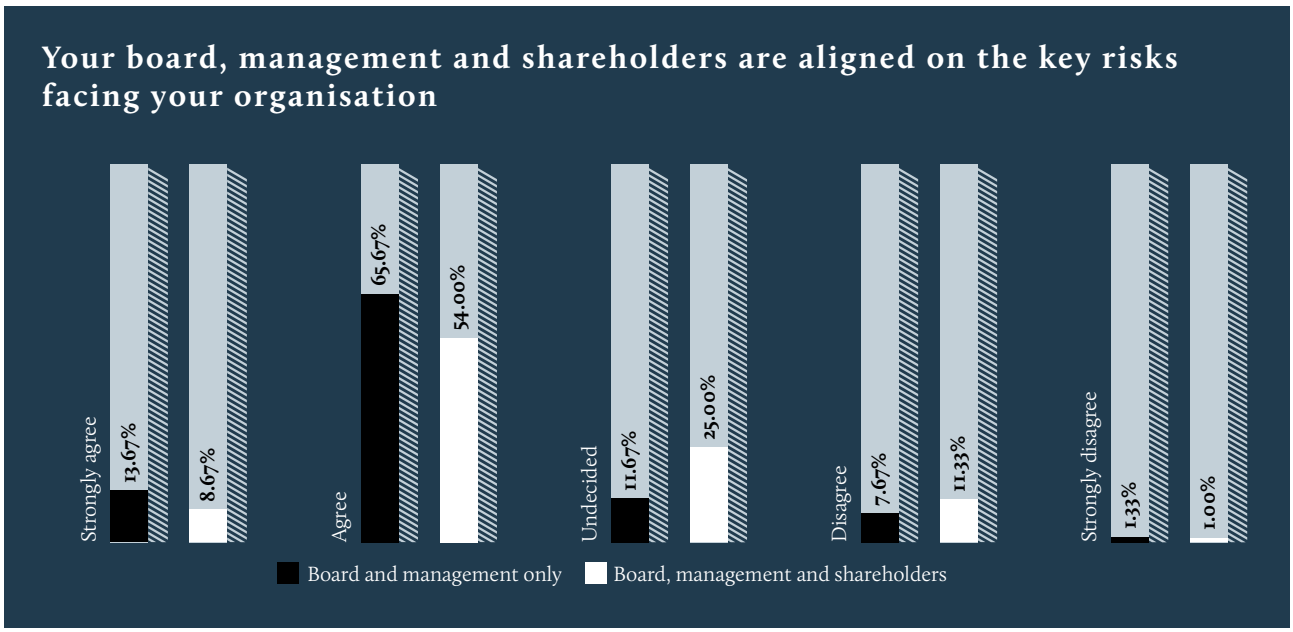
Irrespective of whether the level of appetite has been defined, communicated and monitored, it is clear that most believe the level of this appetite has not reduced over the past 12 months. Half of the respondents disagree with the notion that their boards have reduced their level of risk appetite over the past year. Nearly a quarter are undecided, while 27% feel that their boards have indeed reduced their appetite.

The indications are that respondents believe their boards have adapted to the level of threat while maintaining their own level of appetite.

But what is underpinning this clarity on appetite? It's interesting to ask whether key groupings—boards, management and shareholders—are agreed on their attitude to risk.

Asked whether they believe their boards and management are aligned on the key risks facing their organisation, eight out of ten (79%) respondents agree that this is the case, with only 9% disagreeing. A similar number—12%—are undecided.

However, the picture changes once shareholders enter the picture. When asked whether the board, management and shareholders are aligned on the key risks facing their organisation, only just over six out of ten agree. Some 12% disagree, while a quarter remain undecided.



This could be the result of poor communication or a degree of misalignment between the organisation and its shareholders. Either way, it is an important area that organisations should be encouraged to work on.

The survey results indicate that respondents believe their boards have adapted to the level of threats while maintaining their own level of appetite. For the most part risk profiles are widely understood and the appetite for risk has largely held steady over the past year. This may be a result of management teams and boards being closely aligned. There is a little less confidence in the alignment of shareholders.

Culture

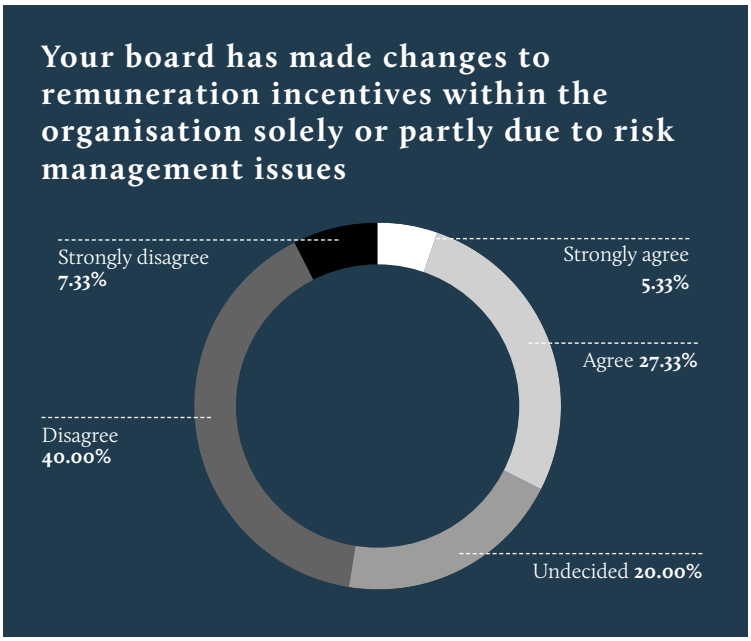
When asked whether their board understood, evaluated and monitored the wider organisation's awareness and attitude towards risk, most (61%) believe that their culture is measured. But again, more than a quarter believe this is not the case.

An organisation must be able to measure and monitor the risk awareness of its employees if it is to understand it. Without this, there is a real threat that what the board believes is the case, and what is the reality of the situation, could diverge, creating in itself a dangerous risk to the organisation.

As one respondent comments in relation to the Covid-19 crisis: "The soft controls—behaviour, culture and reputation—are more important than ever before."

Given remuneration is sometimes viewed as a proxy for culture by stakeholders it can be instructive to note whether boards link risk and executive pay. When asked whether their board has made changes to remuneration incentives within the organisation solely, or partly, due to risk management issues, only a third agree that this is the case. Nearly half (47%) disagree, with 20% undecided.

These findings are interesting if one considers that a third of respondents are from the financial services industry, a sector that has faced considerable scrutiny in recent times over the levels of remuneration and its incentive schemes.

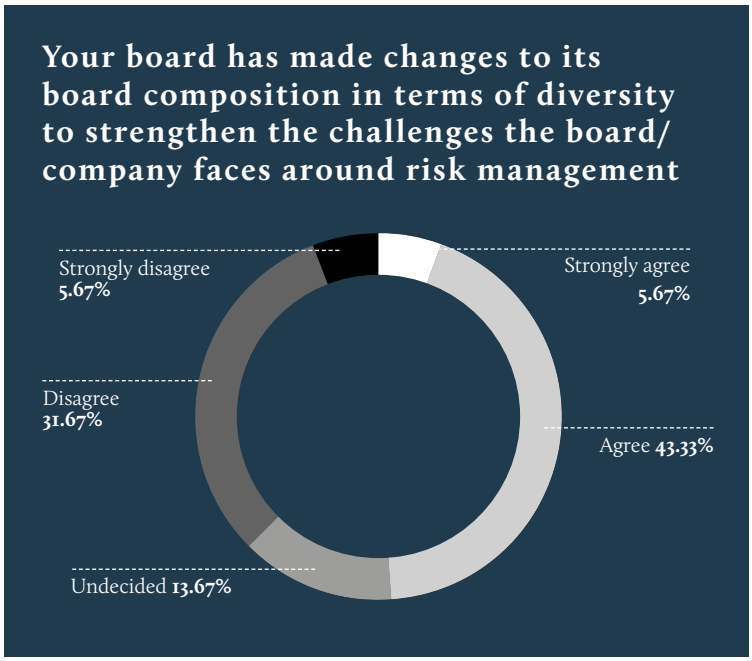


As previously stated, all businesses face risk. However, it is widely understood that with risk comes opportunity (and vice versa, of course). So perhaps it is not surprising that a clear majority (72%) agree that the board actively considers the opportunities that arise from accepting certain risks.

Diversity

Much emphasis in recent years has been placed on the composition of the board. Corporate governance campaigns have forced boards to look at themselves and ensure that they have sufficient diversity in their ranks—for instance, gender diversity was the key focus of the 30% Club campaign. Not only would this represent a diversity of opinions, but it would also present the opportunity for a diversity of challenge to existing policies and strategies.

But when asked whether changes made to their board composition in terms of diversity are strengthening the challenges the board and organisation face around risk management, the jury is still out—while 49% agree that there has been a strengthening of this challenge, 37% disagree and 14% do not know. One of the primary roles of the board is to challenge its management and seek answers to those challenges. While it is evident that progress is being made on representation on the board of historically under-represented groups, it would appear that progress still needs to be made on the level of risk management challenge.



Conclusion

There is good news here. Almost all boards say their controls and processes responded well to the Covid-19 crisis, though only around half were able to say they were prepared for a pandemic.

That may be no surprise; pandemics are rare events. Having said that, pandemics have been firmly on the agenda of international policymakers and crisis management experts for some time following other notable outbreaks. There were warnings available.

There is also much confidence that companies responded with policies that were clearly defined, communicated and monitored. Despite this, however, 43% of companies believe the pandemic represents an existential threat.

More broadly, respondents acknowledge they operate in a riskier world: there are more unexpected risks and they appear to be emerging at an accelerated pace. Despite that, there remains a clear focus on risk appetite and ensuring key parties—boards and management—are aligned. Perhaps there is some work to be done improving alignment with shareholders.

Companies appear confident that their cultures reflect the risks they face and there is a high degree of confidence in the skills available on boards. However, many boards appear to lack the information they require to tackle risks.

Perhaps one of the most significant factors is that two-thirds of companies feel compelled to review their business strategy as a result of the pandemic. Boards that are flexible enough to do this may emerge from the crisis in better shape for the future.

Key questions for boards

1. What is the board's understanding of risk and is it aligned with managers and shareholders?
2. Are all risks potentially affecting the company covered by the board and management's preparations?
3. What information does the board need to address the risks and opportunities it faces and is it readily available?
4. Which body will take responsibility when crises emerge? Is it the board as a whole, a risk committee or a special "Cobra"-style group?
5. Is your board ready to review and transform your company's business strategy as the business landscape changes in response to crises?

Leadership in Risk Management – Board Report

Contacts

Matt Dalton, partner and head of risk management
Email: matt.dalton@mazars.co.uk
Tel: London +44 207 063 4000
www.mazars.co.uk

Professor Tim Rowley, ICGC distinguished fellow and visiting professor of strategy
Email: timothy.rowley@insead.edu

Professor Enrico Diecidue, professor of decision sciences
Email: enrico.diecidue@insead.edu
www.insead.edu

Trevor Pryer, executive director
Email: trevorpryer@boardagenda.com
Tel: London +44 203 151 2653
www.boardagenda.com