SOE Board Talk

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Recent Board Talks have shared thoughts on developing a robust performance management system for each SOE. Now we turn attention to the important topic of Risk Management

Please contact SOEMU if there are any concerns or clarifications needed.

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The management of risk is an integral part of good management practice. There is a direct relationship between risk and opportunity in all business activities, and as such, an agency needs to be able to identify, measure and manage its risks in order to be able to capitalize on those opportunities and achieve its goals and objectives (Western Australian Government Risk Management guidelines).

SOEs should have a comparatively lower appetite for risk than privately owned firms. This is because they are using public money and the ultimate shareholders, the general public, do not have the option of selling their shares if they consider the SOE is engaging in risky activities, or the return is too low for the risks being undertaken. However, as governments tend to underprice SOE's cost of capital and not insist on an appropriate dividend return, many SOEs are engaged in comparatively risky activities. Also, as government oversight of SOEs is often weak, boards are tempted to engage in activities outside of the SOE's core functions (which increases risk and undermines performance and thus is to be discouraged).

What is Risk Management?

A risk can be defined as any internal or external situation that has the potential to impact negatively on a SOE thus preventing the achievement of its goals and objectives.

Risk management is simply the practice of systematically identifying and understanding these risks and the strategies and processes that are in place to manage them. Ultimately, the risk management process aims to assist the board and management identify material risks, develop activities to manage or mitigate the risks within the context of a particular strategy, activity or function and to assign responsibilities and for the management of the particular risk.

Effective risk management strategies are not about forcing management to be risk averse. In fact, the focus is to provide a degree of confidence such that risks can be managed to an acceptable level.

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The key element in managing risk is balancing risk and reward. A culture that is risk averse will create inflexibility in the business and erect barriers to the achievement of the SOE's objectives.

An understanding of the risk exposures facing an SOE facilitates effective planning and resource allocation and encourages a proactive management culture. Risk management is most effective when it becomes integrated into normal operating procedures, processes and systems and is demonstrably driven from the board. A risk management process can be determined as:

- Establish the context – this is very much aligned to the business planning process but is also relevant as new projects or new opportunities arise. It refers to the review and assessment of the SOE vision, mission, core functions and values, legislative direction and stated objectives. This review and an understanding of the external and internal environment is the context within which risks can be identified. It is also relevant that the SOE should establish internal risk management policies or guidelines and a mechanism for how to evaluate and manage risks,
- Identify the risks – some risks such as a power interruption may be obvious and with little impact, while others are less clear and more difficult to identify. Generally, it is about a specific exercise, conducted periodically to think through all the internal and external business influences and impacts that could arise. A SWOT analysis may be helpful,
- Analyze and evaluate the risks – risk analysis involves analyzing the impact of the potential challenge or opportunity. It requires assessment of the consequences, as well as the likelihood, of a risk occurring. Evaluation refers to the appetite of the SOE for risk. In given situations, and within the SOE context, some risks will warrant immediate treatment, others will not,
- Where necessary, mitigate the risks – this is the decision; either accept the risk, avoid the risk (abandon the activity) or reduce the likelihood or consequences, for example by undertaking an insurance policy.

Most importantly, communication and consultation are a necessary prerequisite to effective risk management planning. Similarly, monitoring and review of the process is important once an active risk management process is in place and issues and risks are being recorded and managed.

Management will deal with many of the operational and process risks. The board should be involved in decisions regarding strategic and reputational risk. Directors should understand the SOE risk culture and how risks are managed and ensure the process is reviewed regularly. The risk register should be available for review and update at each board meeting.

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Next week we continue with the topic of Risk Management and its importance to SOE reform

Good luck this week in the boardroom

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