



ICAEW BUSINESS OPINION

IMPROVING RISK MANAGEMENT IN RESPONSE TO THE CHANGING ECONOMIC CLIMATE

March 2010 Research Report



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FOREWORD

Corporate governance and its perceived shortcomings have come under severe scrutiny in the last 12 months. Many governance reviews have been initiated as governments sought (and still seek) to find ways to improve regulation and the governance of companies.

Risk management has not been overlooked in this process. For UK-listed companies a new provision of the UK Corporate Governance Code (C.2.1 based on the wording used in paragraph 34 of the Turnbull Guidance) provides that a board should be satisfied that appropriate systems are in place to identify, evaluate and manage the significant risks faced by the company. The Turnbull Guidance (originally published in 1999 and updated in 2005) sets out best practice on internal control for UK-listed companies.

In addition, the Financial Reporting Council has flagged in its publication *2009 Review of the Combined Code: Final Report* that there will be a limited review of the Turnbull Guidance on internal control, on which there will be a further consultation, some time in the second half of 2010. So the area of risk management will continue to come under close scrutiny as we move through 2010. This all means that greater emphasis on risk management will be placed on boards and their supporting teams in the coming year.

Risk management is not a fixed or static pursuit. It has become clear that risk management procedures designed for boom times may not be suitable for recessionary periods and vice versa. Differing economic conditions require different management responses. This *ICAEW Business Opinion* report vividly illustrates that many firms have improved their risk management processes following changing economic conditions. Businesses have needed to make some fundamental changes. It has also become clear that risks are linked to people and their behaviours (people risks) as much as anything else. Existing risk management methodologies have not always proved effective and some fundamental changes have been necessary. The survey demonstrates that companies are taking a fresh look at their risk management strategies.

As part of the scrutiny that followed the credit crunch in the Banking, Finance and Insurance sector, it has become clear that in some institutions risk oversight had become technical and fragmented, managed more on a product or division basis and not on an enterprise basis. As a consequence, risk management had little effect on board decisions in some organisations. Risk managers were often separated from management and strategy. There is now an acceptance that this needs to change and new ways of thinking about risk at board level need to be developed.

A new supporting principle in the UK Corporate Governance Code will state: 'To function effectively all directors need appropriate knowledge of the company and access to its operations and staff.' Code provision B.4.2 will further impose an obligation on the chairman to agree and regularly review a personalised approach to training and development with each director. Attitudes and mindsets have changed and this new guidance could represent an opportunity for risk management to make progressive moves forward; to set a new agenda for risk management and for training in risk management to take a higher profile than perhaps has been the case in the past. About a third of the businesses surveyed offer training in risk management. Firms may have to recognise that greater emphasis on risk management training may pay dividends.

There is no right or wrong model for risk management and it has to be for each company to decide how best, given its unique circumstances, to handle board delegation in these critical areas. Perhaps more emphasis

should be placed on the risks arising from external change and risk management should be re-focused so it is not looking inward and instead takes full account of the risks arising from outside of the enterprise.

Boards will be more receptive to risk management initiatives than they have ever been before and those that report clearly and communicate effectively their risk management initiatives have much to gain. Effective risk management does not have to require huge resources but it does need a commitment from the board and clear communication of responsibilities as well as the training of key staff.

The time is right to extend the sphere of activity of risk management and to focus on people risks. This *ICAEW Business Opinion* report illustrates the types of actions that businesses have taken in relation to their risk management practices: more change is to be expected as companies seek to gain competitive advantage by understanding their risks better and by implementing risk management strategies which give them real advantage.

Vanessa Jones

Head of Corporate Governance

March 2010

INTRODUCTION

Between 2 November 2009 and 21 January 2010, 863 ICAEW members were interviewed on the subject of risk management in the economic downturn. We asked them how confident they were that their organisation understands and is able to effectively manage the risks it may be exposed to in the economic downturn, and what steps it has taken in communicating responsibilities for as well as managing those risks.

The economic crisis has challenged businesses on many fronts, and has clearly increased the awareness of risk they are exposed to. This report offers insights into how businesses have responded to the economic crisis and what practical steps they have taken to adapt their risk management, highlighting areas for further improvements.

The research shows that many businesses (including smaller ones) have made a broad spectrum of changes to the way they manage risks, reflecting a fairly good understanding of the risks they are exposed to in the changing economic climate. Better communication around risk management responsibilities within the organisation, more training offered and setting some form of formal procedures will all further increase a business's confidence in dealing with those risks.

The individuals we interviewed came from small, medium and large companies across all regions of the UK and all industry sectors. When reading the results, bear in mind that the ICAEW membership is biased towards larger businesses, so the sample is not strictly representative of businesses in the UK, but of organisations employing our members. You can find information about the profile of the organisations covered in this research in the technical details section on page 12.

The ICAEW works in the public interest to promote enterprise, innovation and sustainable growth in a socially responsible business environment. Our strength and knowledge is drawn from the expertise of over 134,000 members worldwide who hold world-class finance qualifications. Their experience gives us a detailed understanding of the dynamics which drive our economy.

EXECUTIVE SUMMARY

- Many businesses have communicated responsibilities for risk management (76%) and strengthened their risk management processes (66%) in order to deal with the economic crisis.
- Over two fifths (44%) of businesses had formal risk management procedures in place before the economic downturn, whereas a third (33%) introduced such procedures in response to the crisis.
- Firms have made a broad spectrum of changes in order to cope with the changing economic climate. Most commonly, these were focused on improving existing procedures, identifying new risks and creating a broader base of responsibilities for risk management across the organisation.
- Training in risk management is currently offered by around a third (35%) of companies. While most of those who have attended training in the last two years are positive about its quality, only 13% rate it as excellent in enabling them to deal with risk management in the economic downturn, suggesting an opportunity for further improvements.
- The majority feel reasonably confident about their understanding of the risks arising from the economic downturn and their ability to manage these. Having clearer communication on risk management responsibilities and on the organisation's attitudes to risks, as well as more training will further increase this confidence.
- In general, larger firms have done the most to improve their management of risks. This is possibly driven by the wider range of resources at their disposal as well as risks to which they are exposed to. Smaller businesses have also adapted their risk management practices. There may be scope for them to do more but the options to mitigate risks are lower the smaller you get.
- Across sectors, businesses in the Banking, Finance and Insurance sector have been most proactive in reacting to the economic downturn. This is perhaps not surprising given that this sector has been under most pressure to review its risk management approach. Just over half (55%) of firms in this sector had formal procedures before the economic downturn, whereas 39% set them up in response to the crisis.

FINDINGS

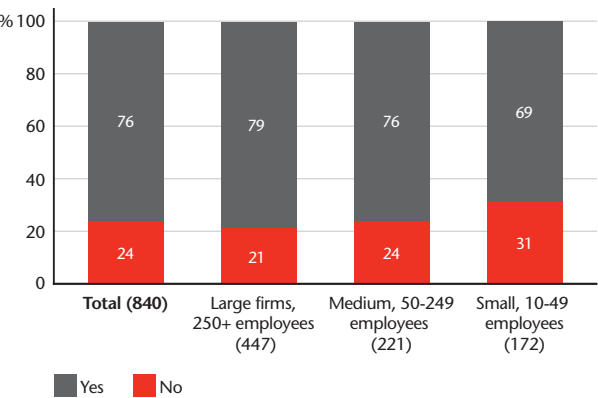
I. COMMUNICATION ON RISK MANAGEMENT

The majority of businesses have been proactive in internally communicating their organisation’s attitude to risk during the economic downturn (79%) and also, more importantly, communicating responsibilities for risk management (76%, Fig. 1).

Not surprising, large organisations are more likely to have communicated risk management responsibilities to their employees, possibly driven by the wider range of risks they are dealing with as well as the larger pool of resources available to them, although one fifth of those firms (21%) have not done this (Fig. 1). Many medium enterprises have also talked to their employees about risk management responsibilities.

Fig. 1 Communication on responsibilities for risk management

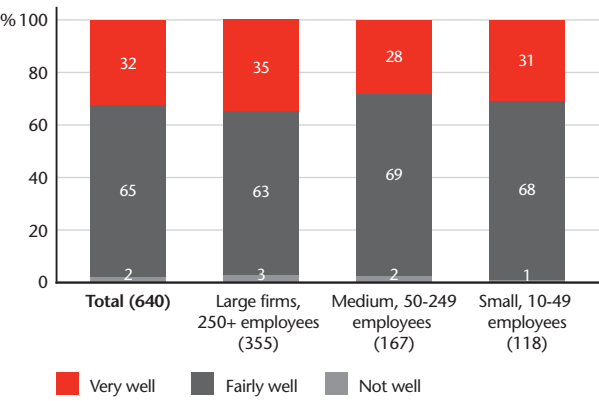
Have responsibilities for managing risk in the credit crunch/economic downturn been communicated in your organisation?



While nearly all firms are positive about the quality of these communications, just around a third feel that they have been done very well, suggesting scope for clearer communication.

Fig. 2 Communication on responsibilities for risk management – how well communicated

How well, would you say, have responsibilities for managing risk in the credit crunch/economic downturn been communicated by your organisation?



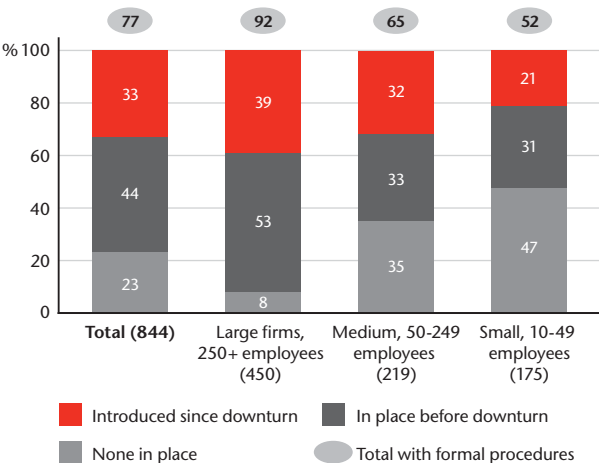
II. CHANGING RISK MANAGEMENT APPROACH

Formal procedures for managing risk

Over two fifths of businesses had formal procedures in place before the economic downturn, while a third introduced such procedures as a result of the crisis (Fig. 3). Large organisations are much more likely to have implemented such procedures, but still 8% of them claim to have no formal procedures in place.

Fig. 3 When were formal procedures introduced

Does your organisation have formal risk management procedures in place?



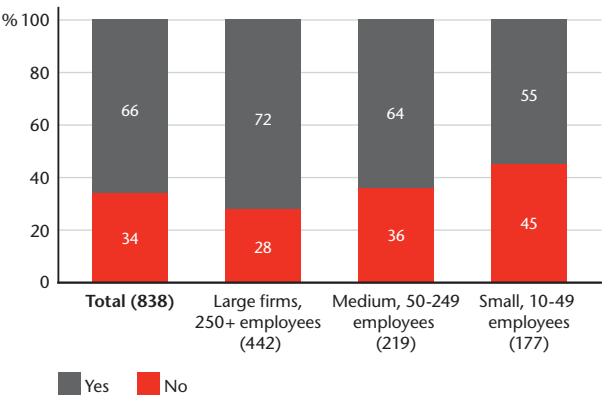
Those which do not have formal risk management procedures in place tend to be small businesses, which often feel that they are too small to require formal procedures. Active senior management involvement in the day-to-day aspects of risk management and the nature of some business activities, make up the reasons for most of the remainder. Procedures of a kind are in place for some of these businesses, but they have not been formalised.

Strengthening risk management to deal with the economic downturn

Businesses have been proactive in responding to the economic crisis, making a broad spectrum of improvements. Overall, two thirds (66%) have changed what they do in order to deal with the economic downturn (Fig. 4). Large companies are significantly more likely than small businesses to have done this.

Fig. 4 Changing risk management to deal with the economic downturn

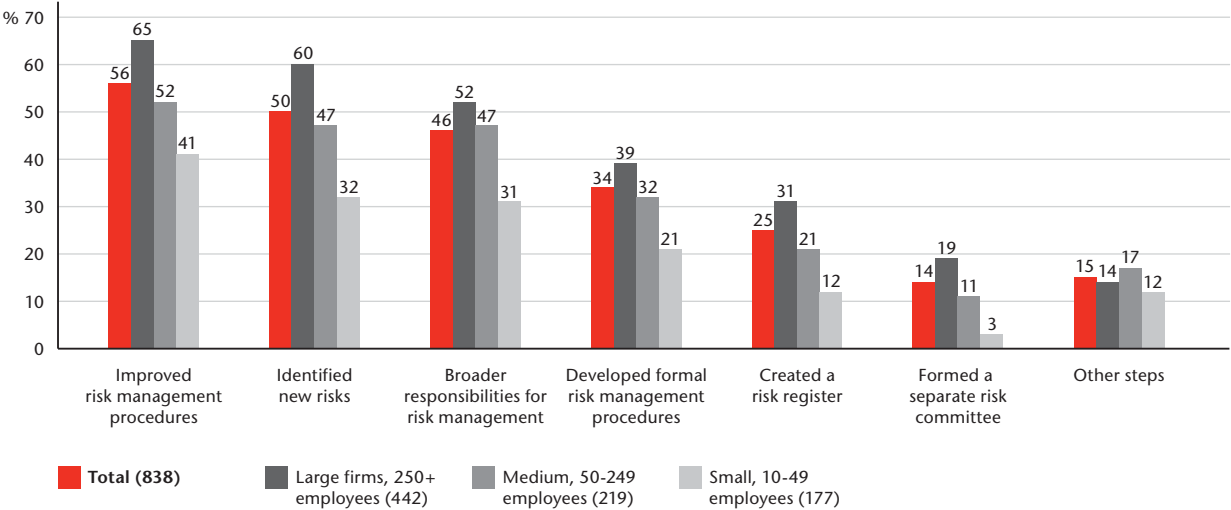
Has your organisation changed or improved its risk management in order to deal with the credit crunch/economic downturn?



Across all sizes of companies, the most common changes made are the improvement of existing procedures, the identification of new risks, and broadening the role and responsibilities for risk management. In general, the range of activities undertaken increases with size, but even small firms have implemented a wide range of changes.

Fig. 5 Changes made to risk management in response to the economic crisis

Which of the following has your organisation changed or improved, in order to deal with the credit crunch/economic downturn?



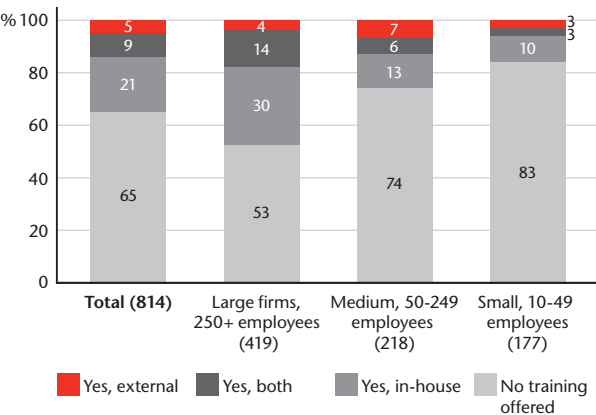
III. TRAINING ON RISK MANAGEMENT

A third of all businesses (35%) offer risk management training to their staff (Fig. 6). Large companies are by far more likely to offer such training, perhaps not surprisingly, as their risk responsibilities are broader and they employ more dedicated staff to deal with them. By contrast, less than one fifth of small firms provide risk management training.

Most companies offer training in-house – these being mostly larger companies, which is perhaps not surprising.

Fig. 6 Offering risk management training

Is your organisation currently offering any training on risk management, either delivered in-house or by an external supplier?

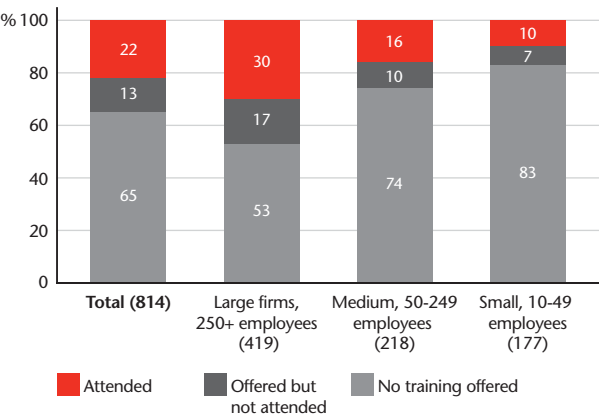


The majority of businesses that do not offer any training believe that they have ‘everything under control’ as it is. Many smaller companies feel that they are too small to warrant risk management training.

Just over one fifth (22%) have attended such training in the last two years (Fig. 7).

Fig. 7 Attending risk management training

Have you attended any such training on risk management in the last two years?



Over half of those (54%) who have attended such training see it as being good in enabling them to deal with risk management in the economic downturn (with a further 31% saying very good). But only 13% think of it as excellent, hence providing some room for further improvement.

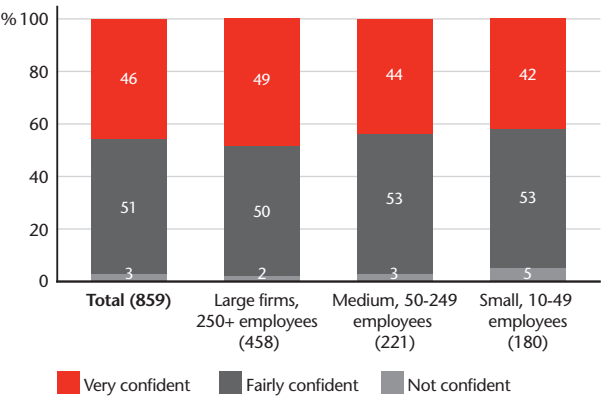
IV. UNDERSTANDING OF RISK MANAGEMENT

Levels of confidence in a company’s understanding of business risk in the current economic climate are high, with over half (56%) being very confident and most others (43%) fairly confident.

Confidence that their business has the capabilities to manage those risks in the economic downturn is not as strong, but nonetheless is still high – 46% are very confident (51% fairly confident, Fig. 8), possibly indicating a degree of exposure and vulnerability these firms feel with the changing economic conditions.

Fig. 8 Confidence in ability to manage the business risks potentially arising from the economic downturn

How confident are you that your organisation has the capability to effectively manage those risks in the credit crunch/economic downturn?



Training in risk management and communication on risk management responsibilities clearly have a positive impact on confidence in their company’s ability to manage business risk (Fig. 9).

Fig. 9 Confidence in ability to manage risks increases with relevant communication and training on risk management

How confident are you that your organisation has the capability to effectively manage those risks in the credit crunch/economic downturn?

Have responsibilities for managing risk in the credit crunch/economic downturn been communicated in your organisation?

Is your organisation currently offering any training on risk management, either delivered in-house or by an external supplier?



Having formal procedures in place also has a positive impact on confidence levels in managing the risks arising from the economic crisis – where these are in place, levels are significantly higher.

V. RISK MANAGEMENT IN THE BANKING, FINANCE AND INSURANCE SECTOR

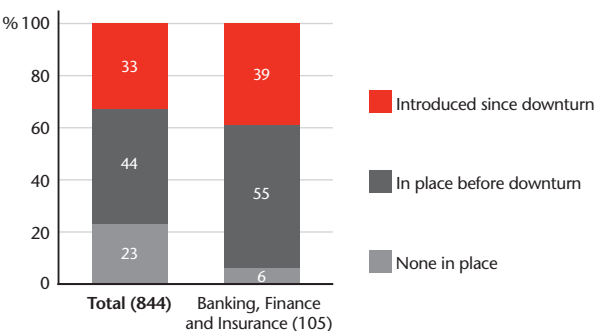
Communication on risk management

Across sectors, businesses in the Banking, Finance and Insurance sector have been significantly more active in communicating senior management views on their company’s attitude to risk as well as the responsibilities that come with managing risk throughout the organisation. This is perhaps not surprising given this sector has been under pressure to reassess the ways it manages its risks since the start of the economic crisis.

Changing risk management processes

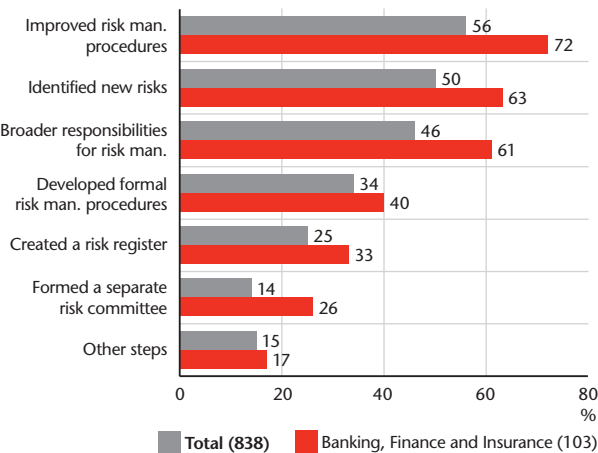
Nearly all businesses in this sector now have formal risk management procedures in place. Over half (55%) had these procedures in place before while the rest (39%) introduced them in response to the economic downturn. This leaves 6% of businesses in this sector with no formal procedures in place.

Fig. 10 When were formal procedures introduced in the Banking, Finance and Insurance sector



Firms in this sector have been the most active in making improvements to their risk management in response to the economic crisis (77% versus 66% overall) as they have been under particular pressure to assess their risk management approach.

Fig. 11 Changes made as a result of the economic downturn in the Banking, Finance and Insurance sector



Training on risk management

Many more firms in the Banking, Finance and Insurance sector are offering training in risk management to their employees than in other sectors, although a quarter of companies in this sector still offer none. Training attendance is also high in this sector (53% have attended the training on offer) but, interestingly, perception of the quality of this training is no better than average.

Understanding of risk management

Businesses in the Banking, Finance and Insurance sector are significantly more confident in their understanding of the increased business risks brought to bear by the economic crisis (70% very confident versus 56% overall average). By contrast, confidence that they have the capability to manage these risks is more in line with a still strong average (50% very confident versus 46% overall). This may suggest that companies in this sector feel as vulnerable to the changing economic conditions as firms in other sectors.

APPENDIX

The table below shows the key findings across different sectors:

Showing % for each column	Banking, Finance & Insurance	Business Services	Construction	Manufacturing & Engineering	Primary	Property	Retail & Wholesale	Transport & Storage	Other Services
How confident are you that your organisation understands the business risks that it may be exposed to in the credit crunch/economic downturn?									
Very confident	70	51	55	52	65	65	51	56	54
How confident are you that your organisation has the capability to effectively manage those risks in the credit crunch/economic downturn?									
Very confident	50	53	41	42	46	58	44	41	44
Has your organisation changed or improved its risk management in order to deal with the credit crunch/economic downturn?									
Yes	77	71	64	64	67	64	71	62	55
When were formal procedures introduced?									
In place before downturn	55	34	41	41	55	41	38	49	44
Introduced since downturn	39	48	27	30	32	29	32	28	32
Total with formal procedures	94	81	68	71	88	69	70	77	76
Have responsibilities for managing risk in the credit crunch/economic downturn been communicated by your organisation?									
Yes	90	75	72	68	85	78	74	84	71
Is your organisation currently offering any training on risk management, either delivered in-house or by an external supplier?									
Yes	75	32	32	24	52	25	21	27	26

NOTE: Only sectors with base 40+ are shown here, although those sectors with a base less than 50 should be treated with caution.

TECHNICAL DETAILS

This research was conducted by the ICAEW.

Between 2 November 2009 and 21 January 2010, we interviewed 863 members of the ICAEW who work in industry and commerce (ie, outside accountancy practice), to find out how their organisations manage business risk.

The interviews were carried out as part of the ICAEW's *UK Business Confidence Monitor*, and conducted by telephone.

Those interviewed are from small, medium and large companies, located across the UK and based in a broad range of industry sectors. About half (403) are from small and medium-sized enterprises (up to 249 employees); the other 460 represent companies of 250 or more employees.

The sample of smaller and medium businesses compared to large ones is not in line with the incidence of sizes of those business in the UK as a whole. You should bear in mind that, due to the types of firms in which ICAEW members tend to be employed, the companies covered have a natural emphasis towards the larger end of small and medium companies (those with 50 – 249 employees).

The figures in this report are based on those answering each question (they exclude 'Don't know' responses. The actual base of those being able to answer a question is shown in each case.

The table on the following page describes the profile of the businesses contacted in this survey.

Further information

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REGION	No of interviews
London	134
South East (excl London)	115
South West	65
East England	76
East Midlands	62
West Midlands	63
North West	91
Northern England	67
Yorks & Humber	72
Scotland	60
Wales	57
Northern Ireland	1
TOTAL	863

SECTOR	No of interviews
Banking, Finance and Insurance	106
Business Services	89
Communications	26
Construction	66
Health and Education	21
Hotels and Catering	28
IT	34
Manufacturing and Engineering	151
Other Services	42
Primary*	65
Property	60
Retail and Wholesale	118
Transport and Storage	57
TOTAL	863

*Primary includes agriculture and fisheries, energy, water and mining

SIZE (EMPLOYEES)	No of interviews
Small (10-49)	181
Medium (50-249)	222
Large (250+)	460
TOTAL	863



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As a world-class professional accountancy body, the ICAEW provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry to maintain the highest standards.

Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

Because of us, people can do business with confidence.

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