



Developing risk resiliency

In the wake of the global financial crisis and economic downturn, risk management has returned to the top of the boardroom agenda. However, managing risk should be regarded not as an end in itself, but as a means of driving higher performance. For communications operators—facing a complex and fast-changing blend of technological, customer, and regulatory risks—it is especially critical to align and link risk and performance management in a way that creates sustainable value for shareholders. Operators that can achieve “risk resiliency” can make better, risk-informed decisions with greater confidence and clarity even in the wake of economic volatility.

History will judge the underlying causes of the current global financial crisis that has brought volatility and visible, catastrophic business failures. Whatever the storyline ultimately is determined to be, it seems certain that the failure of companies to implement effective risk management practices will emerge as a key contributor. Clearly, organizations took on excessive risk without an understanding of or regard to their ability to sustain themselves should those risks rise unexpectedly.

An explanation of these risk management failures is not to be found in the soundness of the principles or their applicability to complex businesses. Instead, the failure of risk management was in its execution, in the way companies used these principles and embedded this capability into their culture and their decision making. Thus, there is a renewed focus on both improving risk management capability and increasing the emphasis on board and executive oversight of risks.

So, what does this focus mean to the communications industry? The environment is increasingly complex for communications companies: rising competition, changing consumer habits, regulatory uncertainty and change, rate and cost pressure from customers, evolving technologies, and relentless innovation. This dynamic environment creates more pressure on boards and executive management teams to think creatively about how their organizations will navigate challenges and manage risk proactively.

Achieving risk resiliency

One of the errors in risk management in the past was the mistaken notion that risk management should be bolted on or attached to the organization, or that it was simply an oversight function or a department. With the understanding that organizations are in business to create value for their shareholders, the failings of that siloed approach to risk become clearer. To be successful, the risk management capability must become an enabler in driving performance. Organizations that have been successful in establishing a meaningful risk management capability have found that the most effective way to drive that outcome is by integrating risk management and performance to achieve resiliency.

The communications industry is very familiar with this concept of resilience, but most often it has applied the concept in the network operations arena, and often with a different language and focus. Availability and quality of service are key measures for anyone operating network infrastructure. The same core measurements also can be applied to a company's overall financial and operational performance.

To create value, a network must be operational (available) just like the organization that built the network in the first place. To create value, a network must route traffic dynamically, without interruption or degradation (quality). Like the network, the organization must sustain itself, and the services or products it delivers must be of

sufficient quality to attract and retain customers. At the level of the company or the organization, the view of these concepts is similar—unexpected variations (business results) must be managed to “prevent the network from going down” (bankruptcy or business failure).

Technologists and engineers have a myriad of tools, methodologies, and software at their fingertips to monitor the health of their networks. Node performance, network speeds, capacity, and utilization are all important indicators of network health. More granular measures, such as dropped calls or packet failures, user trends, and security monitoring, are widely used also. The engineers who oversee networks may or may not look at these indicators through the lens of risk management. At the core of strong risk management, the principles that form its foundation—event identification, risk assessment, risk response and control activities, among others—also underlie the management of the network.

The ultimate goals of these tools, measurements, and methods are clear: Maintain the performance of the network, ensure quality of service, and sustain availability to customers. Critically important in this industry example is that the efforts to manage the performance also help the network engineers and technologists manage risks.

Well-managed networks adapt and respond to changing circumstances and emerging risks. Risks are identified and assessed, and appropriate response strategies (or configuration changes) are implemented to manage or

mitigate them. The best networks act proactively and intelligently to changing circumstances—rerouting traffic to bypass a crowded network choke point, alerting network managers to needed maintenance or repairs, and maintaining performance and availability even when unexpected events occur. The best networks demonstrate resilience. This important concept, long applied to our network infrastructure, is now being applied to managing risk across the enterprise, and there are important and powerful insights to be gained as a result.

Consider the specific economic trends affecting communications companies today. The fallout from the financial crisis has left many countries facing high unemployment and sluggish (if not collapsed) housing markets. Employment rates and housing starts are both critical corollaries to growth for the industry. And with unemployment high, economic growth constrained, housing markets depressed, competition from alternative technologies increasing, and regulatory uncertainty on the rise, driving growth and delivering value have never been more challenging. In this environment, the margin for error becomes narrower, and the impact of unexpected events can be amplified.

In our network example, the analogy is a crowded network, operating near capacity, with volatile traffic patterns. Under normal operating circumstances, an isolated equipment failure in the network might be a manageable interruption. Under more challenging circumstances, it could trigger catastrophic, system-wide failure.

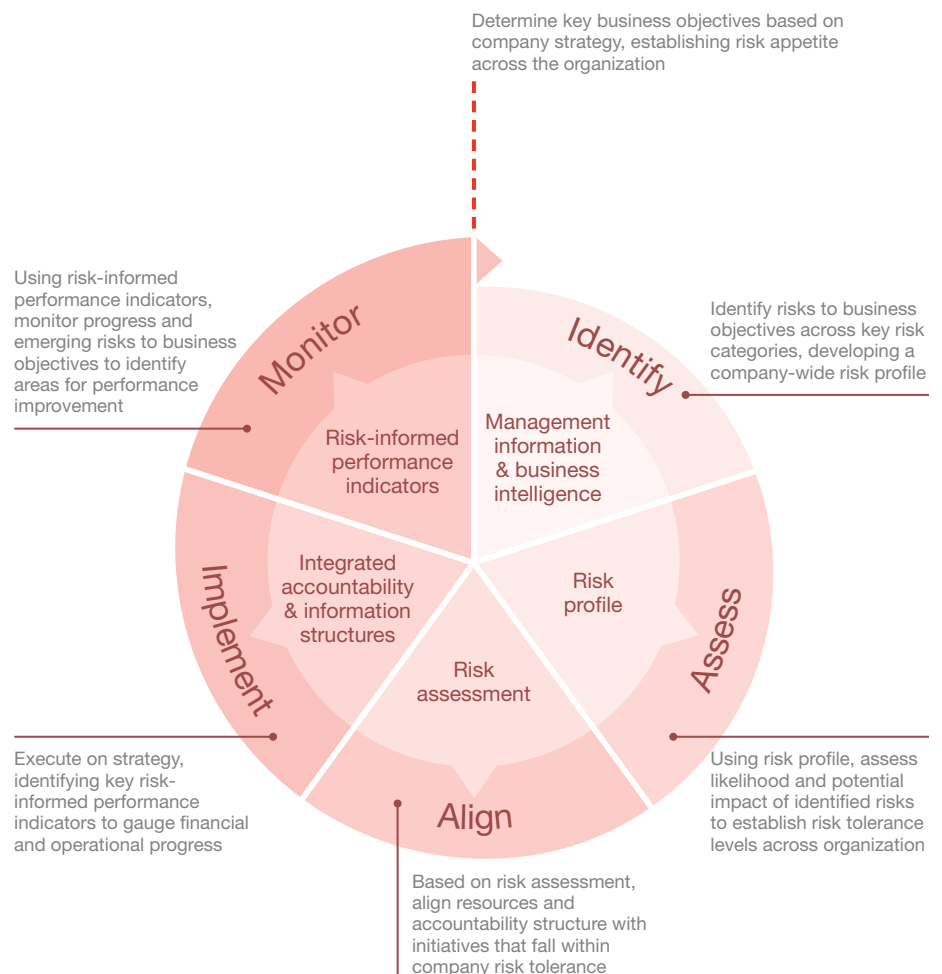
If network management practices reflect the principles underlying risk management, how can a complex and dynamic communications company apply those same principles to the broader strategic risks it faces? Implementing these principles follows the pattern and approach of our network management example. At the company's core, the performance objectives and the risk management capability must be integrated, aligned and measured together—embedding risk-informed decision making to drive performance (see Figure 1).

Integrating risk and performance

Start with strategy

Like a network focused on quality and availability, integrating risk and performance relies on a clear understanding of shared, strategic objectives. Identifying key objectives—laying out the strategy—is a core responsibility of the senior executive team, with appropriate oversight and guidance from the board. The critical first step is to understand strategic objectives and clarify the measurements and

Figure 1: Integrating risk and performance management



planning horizons associated with their achievement. Without the grounding effect of a strategic plan, integrated risk and performance management becomes a theoretical exercise. Grounded in a common cause and rooted in the language of the strategic plan, the executive team and the board can focus on the key strategic risks that matter most, and can provide a framework for the rest of the organization to follow in identifying and assessing other risks throughout the enterprise.

Strategists understand that achieving objectives is about setting clear goals, articulating the steps necessary to achieve them, measuring progress against the goals, and planning for uncertainties along the way. Often, even in the strategy-setting environment, the lens applied to the question of uncertainties is too narrow. Financial measures, the cost of capital, market growth, and product profitability all are important measurements that are commonly considered in the strategic plans of new product launches or acquisitions.

Integrating a view of risk and performance allows for a wider lens on risk, which helps the organization focus not only on the narrowly defined financial measures but also on broader operational and performance measures that will significantly impact the success or failure of an initiative. Once the measures are defined (what does success look like?), the organization can identify the measures that best illuminate the status of key risks.

For a communications company that is building out or upgrading its network, “homes passed” is a critical measure of progress. The target strategic objective may be measured in the millions of homes ultimately passed by the network and the portion of those homes in which the residents select the services offered

by the provider. That important strategic performance measure can serve also as an important risk indicator. Slowing deployment could be the result of specific decisions about capital allocation—and it could also mean performance failures by key contractors or a lack of project management infrastructure appropriate to ensure execution of the plan.

Measuring the progress is key, but so is understanding the risk factors that are creating unexpected variations to the plan. With the likely risk factors appropriately considered in the strategy-setting environment, and with the potential impact of those factors modelled and considered, the organization will enjoy a higher likelihood of achieving the plan. Issues can be managed more aggressively and resolved more quickly because plans were considered and put in place in advance.

Assess and align

Specific strategic steps or initiatives provide a platform for explicit discussion and assessment of risk and integration into defined performance measures for the initiative—but the initiative-focused risks may not fully consider or address strategic risks that impact all the initiatives or plans of the enterprise. In the current environment, one of the most compelling examples of these broader strategic risks is global regulatory change.

While the bulk of regulatory change initiatives has been focused on the financial services environment, regulators around the world also are advancing other agendas that will affect the communications industry, such as consumer protection measures, network neutrality (see article on page 30), and anticompetitive practices. Some of these regulatory framework changes

might have only a nominal impact on communications companies. But others—such as net neutrality—could create a fundamental shift that would have enormous (and potentially catastrophic) impacts on performance and the future profitability of existing business models.

Recognizing such risk is an important first step. Assessing the impact of the various scenarios that could emerge from regulatory change is the second, and more critical, step—and the step that transitions that knowledge from an interesting observation to an actionable insight.

Assessment in this case might involve a focused working session, with key members of the executive team evaluating the financial and customer impact of multiple regulatory scenarios. Modelling these scenarios against business plans and forecasts, key strategic initiatives, and earnings guidance can provide the executive team with better insight on the operating variables affected by various regulatory frameworks. With this insight, management is better able to communicate the impact of the various regulatory proposals to stakeholders, and to proactively explore strategic alternatives (such as product innovation, organizational structure and ownership, transactions, product divestitures or launches) that might help the organization perform better in the face of the regulatory changes.

Modelling scenarios raises another key point about the power of applying risk management principles in the strategy-setting environment. While we define risk resiliency as an organizational capability that enables confident, risk-informed decision making, the resilient organization also enjoys strong and sustainable financial health. To achieve sustainable financial strength, organizations must have a clear understanding of how changes

in the operating environment (such as regulatory or competitive changes) will impact core financial measures and the health of the balance sheet. Developing sufficiently robust models that help management evaluate the impact of various events and scenarios on core measures, such as cash flow and liquidity, will provide executives with the insight necessary to make better decisions and to navigate more confidently the uncertainties and changes in the external environment.

Establish accountability

With assessment complete, the next step is to establish and create clarity on where oversight and accountability lie for managing risks that have been identified. In some sectors, such as financial services, most often the chief risk officers are accountable for risk management and mitigation and they typically are members of the senior executive team. In the communications industry, the capital-intensive nature of the industry and the frequent need for ongoing capital investment often result in chief financial officers having a great deal of accountability for risk management. However, executive ownership of risk management also can rest with business unit leaders or, as discussed above, strategic planning executives.

In the final analysis, company culture and the selected executive's ability to influence his or her peers in the executive suite will be the major factors in the success or failure of a chief risk officer. In contrast, experience suggests that organizations that assign risk oversight responsibilities to less senior executives, who have little clout or narrow scopes of responsibility, likely will fail. C-suite sponsorship and active engagement are critical to driving appropriate accountability.

Driving this accountability also means recognizing that the organization will run out of resources long before it runs out of risks. Risk and performance management provides the framework through which limited resources—talent, capital, or management attention—can be allocated to the areas of highest impact. This also provides the foundation for developing the cultural understanding and organizational capability around the benefit and value of risk management in supporting executive and employee decision making. Getting sustained benefit from this view requires educating, training, and, ultimately, embedding these capabilities throughout the enterprise.

Employees at every level of the organization typically have their individual goals, measurements, and compensation criteria. The compensation and performance analysis of managers and executives is the junction at which risk and performance planning meet. Are performance incentives appropriately aligned to the strategic plan and risk assessment, as established by the senior executive team and the board? Does the board hold the senior executive team accountable by using the same framework of integrated risk and performance measurement? Do incentives encourage the unnecessary or unmeasured taking of risks in pursuit of more easily quantified targets, such as revenue or profitability?

Understanding the risk profile of decisions, and embedding that capability throughout the management team, will allow communications companies to avoid the unchecked risk taking that toppled peer companies in other industries. It also will help companies ensure that executive efforts are directed to pursuits that not only produce the greatest reward, but also do so with a rational and acceptable level of risk.

Implement and monitor

With key risks identified and assessed, management accountability established, and performance and risk criteria integrated at the operating level, implementing risk management practices and monitoring the resulting performance are the steps that remain.

Companies are not in the business of managing risk—they are in the business of taking the right risks to drive performance. Implementing appropriate risk management capability within that performance framework provides the ability to mitigate, manage, or share risks that might otherwise negatively impact or impede performance achievements. Ultimately, that comes down to planning how to address the risks and implementing those plans when circumstances warrant.

Consider how these principles can apply to a communications company experiencing high growth in a number of global markets, including in emerging economies. A typical capital allocation model might simply suggest that investments should be made in territories that offer the highest return. However, an executive team and a board that recognize the range of risks the company faces as it builds out and expands service delivery in these emerging markets might oversee the development of a specific global expansion strategy that considers operating targets, results, and risks. Embedded in the performance plans of the executives overseeing the global expansion would be performance objectives requiring that key risks be identified and measured in relation to their investments and their targeted returns.

The management team, in turn, could use externally available qualitative and quantitative data sources, as well as the knowledge and insight of the management team and staff, to create a weighted risk-scoring model for each of the territories

in which it was operating or had targeted to operate. The dimensions it might consider would be the regulatory framework of the territory, anticorruption laws, other operational or financial compliance requirements, social and political risks, reputational implications, and the prevailing competitive environment. Applying these dimensions to a risk-scoring methodology, the team could better assess opportunities for the risk-adjusted return of further investments in each of these territories. With risk-adjusted return in view, investment choices that are limited by available capital become clearer, and executive performance and compensation plans that might inadvertently incentivize inappropriate risk taking can be modified.

Finally, with plans in place, and a framework of strategic objectives and complementing measurements, the risk team can establish the monitoring process to ensure that the plans and measurement criteria are dynamically maintained and acted upon. Moving from control and transaction-level assurance, where the focus is on whether the right control activities have been designed, to a monitoring mechanism, instead, which determines the health of executive decision making and whether risks were appropriately and explicitly considered and managed, will raise the bar across the organization. Viewing risk monitoring as not just a compliance or oversight function but a strategic enabler that helps executives throughout the enterprise become better at identifying, assessing, and managing risk (in effect, improving organizational competence in risk management) creates an asset that will serve the organization for the long term.

The goal of many organizations as they create and sustain world-class communications networks and deliver innovative services and content to their customers is to create a dynamic platform that responds to ever-changing consumer needs, proactively identifies risks that would interrupt or disable delivery, and evolves rapidly to maintain a sustainable competitive position in their markets. Intelligent, self-monitoring, and self-correcting networks have advanced communications capability rapidly for more than a century. These same principles of risk management and performance integration can and should be applied across your enterprise not only to support sensible hazard avoidance, but also to drive long-term value creation and sustainability.

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