ERM: Prepare for the Worst

Paper: “Enterprise Risk Management in Financial Intermediation”
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Link to video on Olin Business School
What is enterprise risk management?

**A:** Enterprise risk management is really a formulation that seeks to aggregate all risks within the enterprise so that they can be seen in their full flowering. You get a picture of the risks that the enterprise faces in its totality. This is a more sophisticated approach to the management of risk.

Were there events that led to greater attention to ERM?

**A:** The origin of the idea is the very, very disturbing failures that we’ve encountered going back to Enron and WorldCom, Health South, and failures associated with the Great Recession. Many of these failures were seen, in retrospect, as failures in risk management.

What are the advantages of implementing companywide ERM programs?

**A:** They foster a broader recognition of all of the hazards that the institution faces, so you’re encouraged to take steps to manage these risks in a rational way. Denial is not a rational response.

Should the responsibility for ERM start with the board of directors and spread downward?

**A:** That’s considered best practice. In public companies the ultimate responsibility for managing enterprise risks resides with the board of directors. But it doesn’t end with the board of directors. There will be people on the management team who will be responsible for risks, then committees that will usually be communication channels so that new risks can be communicated up and down and across the organization. You’re building an organization within the organization, one that’s addressed to safety, risk mitigation, risk control, hazard control, and security. Once you acknowledge the hazards, then you begin to think of ways to control them.

If companies want to optimally implement ERM, how do they do it?

**A:** The first things that are involved are making a commitment and the willingness to accept the cost of managing risks. Then, either examine what best practices are in the industry, see what others are doing and make judgments, or hire a consultant. There are many consultants available to help you structure an ERM program. Practically all the large accounting firms do this. Actuaries do this; they’re particularly adept. Large organizations have chief risk officers who guide their programs. They usually build an organization within the organization around this risk management. The best large organizations do this in a very disciplined and structured way.

“ERM is a process, but it is also a frame of mind, a culture. It is a collective assertion that the organization will bring its best talents to bear upon the challenge of avoiding surprises that threaten sustainability.”

- Stuart Greenbaum