LEVERAGING ERM BEYOND COMPLIANCE

July 25, 2017
RSM’s manufacturing focus

• RSM US LLP serves over 3,200 industrial manufacturing companies from across the country
• They include local, national and internationally recognized companies with diverse organizational structures
• Our practice covers many manufacturing segments, including chemicals, general manufacturing, automotive and energy
• To sign up for our monthly manufacturing industry newsletter or learn more about our industry focus, visit our website at rsmus.com/manufacturing
RSM’s Manufacturing Monitor Survey

• Since 2006, the RSM Manufacturing Monitor survey has identified industry-leading practices and assessed the confidence in the manufacturing economy

• With a planned release in September, the 2017 report will share industry insights, including key risk issues for manufacturers today
Among the factors affecting business, manufacturers say that regulations are not the biggest barrier to growth:

<table>
<thead>
<tr>
<th>Barriers</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Downturn in broader economy</td>
<td>46%</td>
</tr>
<tr>
<td>Currency fluctuations</td>
<td>45%</td>
</tr>
<tr>
<td>Fluctuation in commodity pricing</td>
<td>40%</td>
</tr>
<tr>
<td>Foreign regulations</td>
<td>35%</td>
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</tbody>
</table>
2017 Manufacturing Monitor survey preview

• Enterprise Risk Management or ERM guidelines are the most common way to address operational issues. Yet only a third or fewer leverage ERM for operations, and even worse for other risks (financial and accounting issues and cybersecurity)

• Most manufacturers—particularly in the United States—do little to improve technology security beyond enhancing passwords and updating security protocols
2017 Manufacturing Monitor survey preview

• Manufacturers and industrial product companies sometimes operate in a globally active, fast changing world in a politically charged environment. Changes are fast and the future is less certain.

• Utilizing ERM protocols properly can help identify and manage the key risks to each company.

• Today’s webcast will provide insights and examples of ERM practices.
• Current state of risk management
• What is enterprise risk management (ERM) and benefits
• Incorporating ERM into strategic planning
• Some current risk themes
• Risk management lessons learned
**Why ERM?**

Business volatility, complexity and increasing risk is dominating the landscape for all organizations. Boards have started to respond but the journey is challenging and new thinking is needed if risk management is to improve resilience and enhance value creation.

| Business volatility and economic uncertainty are here to stay – increasing resilience is the order of the day |
| Business model complexity is stifling performance and creating inefficiency |
| Speed of business change is rapid – increased speed of response and corporate agility is needed |
| The current internal and external environment has created increased risk, risk complexity and risk velocity |
| Exercising control across the business model is challenging - dominated by a critical web of third party relationships and geographic spread |
| The emergence of new/changed risks requires improved oversight rigor and access to new skill sets |

“It is impossible, as an executive, to separate risk from broader business issues – and in many cases the most important variable – in every decision made in business” Ian Tyler, CEO, Balfour Beatty Plc – March 2011

| Stakeholders are asking more demanding answers to more challenging questions - regulation continues to drive onerous compliance requirements |
ERM IS...

✓ An approach to enhance communication, decision-making and strategy setting
✓ A means to enhance Board performance
✓ An enabler of “upside” risk-taking within a firm’s risk appetite
✓ A bit of a cultural change (for most organizations)
✓ Applicable to most organizations/industries
✓ A potential cost-saving program (i.e. insurance premiums)

ERM ISN’T...

✓ = risk assessment
✓ An academic activity focused on list management
✓ Simply the risk factors in the organization’s 10K
✓ Limited to “downside” risks
✓ An extension of Internal Audit or Compliance
✓ A regulatory requirement…yet
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ERM Processes

An ERM Framework should include:

• Risk governance
• Risk appetite setting
• Enterprise-wide risk management processes
  - Identification of risks
  - Assessment / measurement of risks
  - Monitoring of risks and actions to address risks
  - Management of risk through controls/risk responses
  - Reporting of risks and the status of action plans
• Integration with business decision-making
• Establishment of a strong risk culture
Example maturity model for risk management (RM)

- Governance and Culture
- Risk Identification
- Risk Assessment
- Response/Control
- Monitoring and Reporting

Ad Hoc
- Informal or inconsistent
  - RM considered at certain levels of the business
  - Ad hoc risk identification
  - General sense of most critical risks
  - Loose association of business activities & risks
  - Informal communication of risk
### Example maturity model for risk management (RM)

<table>
<thead>
<tr>
<th>Governance and Culture</th>
<th>Risk Identification</th>
<th>Risk Assessment</th>
<th>Response/Control</th>
<th>Monitoring and Reporting</th>
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<tr>
<td><strong>Ad Hoc</strong></td>
<td><strong>Basic</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Informal or inconsistent</td>
<td>Meets basic stakeholder needs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RM considered at certain levels of the business</td>
<td>Risk committees with basic mandates and periodic interaction</td>
<td></td>
<td></td>
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<td>Ad hoc risk identification</td>
<td>Infrequent risk identification performed by limited departments/functions</td>
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<tr>
<td>General sense of most critical risks</td>
<td>Basic definitions for impact and likelihood</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Loose association of business activities &amp; risks</td>
<td>Responses are delineated between existing controls and recommended actions</td>
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<td>Informal communication of risk</td>
<td>High-level RM reporting (e.g. risk dashboard)</td>
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Most companies live here!
Example maturity model for risk management (RM)

**Governance and Culture**
- **Ad Hoc**: RM considered at certain levels of the business
- **Basic**: Risk committees with basic mandates and periodic interaction
- **Managed**: “Three lines of defense” of RM operating

**Risk Identification**
- **Ad Hoc**: Ad hoc risk identification
- **Basic**: Infrequent risk identification performed by limited departments/functions
- **Managed**: Ongoing risk identification through formalized approaches

**Risk Assessment**
- **Ad Hoc**: General sense of most critical risks
- **Basic**: Basic definitions for impact and likelihood
- **Managed**: Consistently applied criteria assessing risk both inherently and residually

**Response/Control**
- **Ad Hoc**: Loose association of business activities & risks
- **Basic**: Responses are delineated between existing controls and recommended actions
- **Managed**: Response/control has accountability, specificity, and can be measured

**Monitoring and Reporting**
- **Ad Hoc**: Informal communication of risk
- **Basic**: High-level RM reporting (e.g. risk dashboard)
- **Managed**: RM ‘check and challenge’ at all levels of the business
### Example maturity model for risk management (RM)

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<td>RM directly informs business planning and supports decision-making</td>
<td>RM outputs used to optimize planning and decision-making</td>
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<td>Informal or inconsistent</td>
<td>Infrequent risk identification performed by limited departments/functions</td>
<td>Basic definitions for impact and likelihood</td>
<td>Risk identification embedded across operations and activities</td>
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<td>Ad hoc risk identification</td>
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<td>Consistently applied criteria assessing risk both inherently and residually</td>
<td>Evaluation of risk appetite for each risk type</td>
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Benefits of ERM

• Increase the range of opportunities – By considering all reasonable possibilities, management can identify opportunities for the entity and unique challenges associated with current opportunities.

• Identify and manage entity-wide risks – Every entity faces myriad risks that can affect many parts of the entity.

• Reduce surprises and losses – ERM allows organizations to improve their ability to identify potential risks and establish appropriate responses, reducing surprises and related costs or losses.

• Reduce performance variability – For some entities, the challenge is less about surprises and losses, and more about performance variability.

• Improve resource deployment – Obtaining robust information on risk allows management to assess overall resource needs and enhance resource allocation.
“The Number One enterprise risk is failing to deliver on your strategic plan.”

-Client SVP Treasurer
Two types of enterprise risks

**Downside risks**
*Mitigating threats in order to preserve value*

- Customer/vendor concentration
- Loss of production, disruption of supply chain
- Compliance violations
- Fraud
- Lawsuits / penalties
Two types of enterprise risks

**Upside risks**
Exploiting opportunities that could enhance value

**Downside risks**
Mitigating threats in order to preserve value

**Examples:**
- Timing of pricing strategies
- Introduction of new products
- M&A activity
- Customer/vendor concentration
- Loss of production
- Compliance violations
- Fraud
- Lawsuits / penalties
Evaluating strategic enterprise risks
Basic architecture of a strategic plan

ILLUSTRATIVE

VISION/OBJECTIVE
(Enterprise / Region-Specific / BU-Specific)
Evaluating strategic enterprise risks
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Values and culture
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Organizational factors
Values and culture
Evaluating strategic enterprise risks
Basic architecture of a strategic plan

ILLUSTRATIVE

VISION/OBJECTIVE
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SWOT analysis (including key business assumptions, enterprise risks)

Organizational factors
Values and culture
Evaluating strategic enterprise risks
Basic architecture of a strategic plan

ILLUSTRATIVE

VISION/OBJECTIVE
(Enterprise / Region-Specific / BU-Specific)

May already include KPIs, risks, etc.

Strategic Imperative #1
Strategic Imperative #2
Strategic Imperative #3
Strategic Imperative #N

Organizational factors
Values and culture

SWOT analysis (including key business assumptions, enterprise risk)
Assessing strategic “upside” risks
Integrating strategic planning with ERM

Critical questions to explore through ERM

- Underlying business assumption
- Strategic imperative
- Identify risk / exposure
- Playbook / response
- Monitoring / reporting

Is the strategy itself a risk to the organization?

Under what scenarios could our SWOT/business assumption be wrong?
Assessing strategic “upside” risks
Integrating strategic planning with ERM

Critical questions to explore through ERM

- What is our value-creating or value-preserving imperative?
- Is the strategy itself a risk to the organization?
- Under what scenarios could our SWOT/business assumption be wrong?

Underlying business assumption
Strategic imperative
Identify risk / exposure
Playbook / response
Monitoring / reporting
Assessing strategic “upside” risks
Integrating strategic planning with ERM

Critical questions to explore through ERM

Underlying business assumption

Strategic imperative

Identify risk / exposure

Playbook / response

Monitoring / reporting

Is the **strategy itself** a risk to the organization?

Under what scenarios could our SWOT/business assumption be wrong?

What is our value-creating or value-preserving imperative?

What factors could cause us to under/over-perform on this imperative? (i.e. what are the risk drivers?)

Optionally: What is the estimated exposure (e.g. $XMM EBITDA)?
Assessing strategic “upside” risks
Integrating strategic planning with ERM

Critical questions to explore through ERM

- What is our value-creating or value-preserving imperative?
- What are our business functions doing about it?
  - Who is responsible?
  - Do we have a sufficient plan/resources?
- Is the strategy itself a risk to the organization?
- Under what scenarios could our SWOT/business assumption be wrong?
- What factors could cause us to under/over-perform on this imperative? (i.e. what are the risk drivers?)
- Optionally: What is the estimated exposure (e.g. $XMM EBITDA)?
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Critical questions to explore through ERM

Underlying business assumption
What is our value-creating or value-preserving imperative?

Strategic imperative
What factors could cause us to under/over-perform on this imperative? (i.e. what are the risk drivers?)
Optionally: What is the estimated exposure (e.g. $XMM EBITDA)?

Identify risk / exposure

Playbook / response

Monitoring / reporting
How can we identify triggering events early?

Is the strategy itself a risk to the organization?
Under what scenarios could our SWOT/business assumption be wrong?

What are our business functions doing about it?
Who is responsible?
Do we have a sufficient plan/resources?

What is our value-creating or value-preserving imperative?

What is our playbook for addressing change?
Assessing strategic “upside” risks (cont.)
Example of aligning strategic planning and ERM: Product Demand

Underlying business assumption:
Demand for our largest product category will continue to decline X% per year

Enterprise risk:
Declining demand
Assessing strategic “upside” risks (cont.)
The business assumption and its strategic imperatives

If business assumption is right...

**Enterprise risk:** Declining demand
Demand for our largest product category will continue to decline X% per year

Strategic imperative A
Diversify product mix

Regardless of correct business assumption...

Strategic imperative B
Improve margin on declining category to offset volume loss
Assessing strategic “upside” risks (cont.)
Decomposing the imperative to its associated risk drivers

Enterprise risk: Declining demand
Demand for our largest product category will continue to decline X% per year

Strategic imperative A
Diversify product mix

- Regulatory compliance
- R&D costs
- Plant capability
- Labeling/packaging

Risk drivers: Business function-level factors could cause us to under/over-perform on these imperatives

Strategic imperative B
Improve margin on declining category to offset volume loss
Assessing strategic “upside” risks (cont.)

Decomposing the imperative to its associated risk drivers

**Enterprise risk:** Declining demand

Demand for our largest product category will continue to decline X% per year

**Strategic imperative A**

- Diversify product mix
  - Regulatory compliance
  - R&D costs
  - Plant capability
  - Labeling/packaging

**Strategic imperative B**

- Improve margin on declining category to offset volume loss
  - Formula (cost) rationalization
  - Contractual obligations
  - Co-packing costs

*Risk drivers: Business function-level factors could cause us to under/over-perform on these imperatives*

These risk drivers are “bite-sized” and can be managed like a project!
Assessing strategic “upside” risks (cont.)
Establishing risk ownership and teams

Enterprise risk: Declining demand
Demand for our largest product category will continue to decline X% per year

Strategic imperative A
Diversify product mix

- Regulatory compliance: Owner
- R&D costs: Owner
- Plant capability: Owner
- Labeling/packaging: Owner

Strategic imperative B
Improve margin on declining category to offset volume loss

- Formula (cost) rationalization: Owner
- Contractual obligations: Owner
- Co-packing costs: Owner

Agile methodologies like Scrum can be used to manage risk drivers
Assessing strategic “upside” risks (cont.)
Taking action and preparing to measure outcomes

Enterprise risk: Declining demand
Demand for our largest product category will continue to decline X% per year

Strategic imperative A
Diversify product mix
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Strategic imperative B
Improve margin on declining category to offset volume loss
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This is the phase where risk owners and their teams develop risk responses, optimize controls, and develop monitoring plans.

Interdependencies

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Assessing strategic “upside” risks (cont.)
Taking action and preparing to measure outcomes

Enterprise risk: Declining demand
Demand for our largest product category will continue to decline X% per year

Strategic imperative A
Diversify product mix
- Regulatory compliance: Owner, Playbook / metrics
- R&D costs: Owner, Playbook / metrics
- Plant capability: Owner, Playbook / metrics
- Labeling/packaging: Owner, Playbook / metrics

Strategic imperative B
Improve margin on declining category to offset volume loss
- Formula (cost) rationalization: Owner, Playbook / metrics
- Contractual obligations: Owner, Playbook / metrics
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This is the phase where risk owners and their teams develop risk responses, optimize controls, and develop monitoring plans

Auditable?
Assessing strategic “upside” risks (cont.)
Taking action and preparing to measure outcomes

Enterprise risk: Declining demand
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Strategic imperative A
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Strategic imperative B
Improve margin on declining category to offset volume loss
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This is the phase where risk owners and their teams develop risk responses, optimize controls, and develop monitoring plans.

Process improvement needed?
Assessing strategic “upside” risks (cont.)
Taking action and preparing to measure outcomes

**Enterprise risk: Declining demand**
Demand for our largest product category will continue to decline X% per year

**Strategic imperative A**
Diversify product mix
- Regulatory compliance
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- Labeling/packaging

**Strategic imperative B**
Improve margin on declining category to offset volume loss
- Formula (cost) rationalization
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This is the phase where risk owners and their teams develop risk responses, optimize controls, and develop monitoring plans.

Contract compliance?
Assessing strategic “upside” risks (cont.)

Consolidating reports to drive discussions and decision-making

**Enterprise risk:** Declining demand

Demand for our largest product category will continue to decline X% per year

### Strategic imperative A

**Diversify product mix**

- Regulatory compliance
  - Owner
  - Playbook / metrics
- R&D costs
  - Owner
  - Playbook / metrics
- Plant capability
  - Owner
  - Playbook / metrics
- Labeling/packaging
  - Owner
  - Playbook / metrics

### Strategic imperative B

**Improve margin on declining category to offset volume loss**

- Formula (cost) rationalization
  - Owner
  - Playbook / metrics
- Contractual obligations
  - Owner
  - Playbook / metrics
- Co-packing costs
  - Owner
  - Playbook / metrics

**Risk drivers:** Business function-level factors could cause us to under/over-perform on these imperatives

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Assessing strategic “upside” risks (cont.)
You don’t have to swallow the whole elephant at once

**Enterprise risk:** Declining demand
Demand for our largest product category will continue to decline X% per year

**Strategic imperative A**
- **Diversify product mix**
  - Labeling/packaging
  - Owner
  - Playbook / metrics

**Strategic imperative B**
- **Improve margin on declining category to offset volume loss**
  - Formula (cost) rationalization
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**Enterprise risk-level reporting**
## Current risk themes

<table>
<thead>
<tr>
<th>Category</th>
<th>Risks</th>
</tr>
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</table>
| Operational   | • Adequate systems  
• Cyber / security  
• Supply chain disruptions  
• Third party risk (non supply chain)  
• Product liability / reputation |
| HR            | • Succession planning for key roles  
• Manufacturing/other labor shortages |
| Political     | • Pressure on US manufacturing vs. offshoring  
• Future tax liabilities for WIP and finished goods distribution |
| Competition   | • Product obsolescence / emerging products and markets  
• Speed to market |
| Sales/marketing| • Shift in traditional sales channels |
Lessons learned

• Tone at the Top

• Crawl – Walk – Run

• Build on Tools / Processes in Place

• Simplicity at the Outset

• Culture – Culture – Culture
QUESTIONS AND ANSWERS?
Before we conclude

How did we do?
• Please take a moment to participate in the attendee survey by following the link in the Resource List

CPE credit
• Eligible participants will receive 1.0 credit for attending today’s event
• Visit the Certification center and click the download icon to access your certificate
• Be sure to download and save your certificate to your computer before the event concludes
  − Certificates are not available for download from a smart phone. Download your certificate from any computer using the same link you are using to view the webcast
  − You must have Javascript and Cookies enabled to download the certificate
  − RSM employees: CPE will automatically appear on your MyLearning transcript (no further action is required)
  − Group CPE is not available for this event

Follow-up
• We will respond to questions following today’s event
• The presentation slides and a link to the call recording will be sent to all participants within a few days
THANK YOU FOR YOUR TIME AND ATTENTION
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