
FINAL REPORT & EXECUTIVE SUMMARY

FY 2001-- KATIE INSURANCE SCHOOL RESEARCH GRANT PROGRAM

TITLE: Enterprise Risk Management: Why Isn't It Catching On?

GRANT DATES: FY 2001

PROJECT DATES: Project initially scheduled to begin in June 2000 and to be completed in September 2001.

Michael R. Williams
Department of Marketing
Campus Box 5590
Illinois State University
Normal, IL 61790
(309) 438-7144
mrwilli@ilstu.edu

David T. Russell
Department of Finance, Insurance, & Law
Campus Box 5480
Illinois State University
Normal, IL 61790
(309) 438-7991
dtrusse@ilstu.edu

September 14, 2001

ENTERPRISE RISK MANAGEMENT: WHY ISN'T IT CATCHING ON?

PROJECT OVERVIEW

Since enterprise risk management (ERM) became a “hot” area some four years ago, many different companies and academic programs shifted focus towards this promising new field. One company, Reliance Insurance Group, even introduced the ultimate enterprise risk product: earnings per share insurance coverage. However, Reliance soon found itself under regulatory supervision, while several other commercial ERM initiatives have been curtailed or terminated. Academic programs such as the University of Georgia and even ISU have considered a dramatic change in favor of an ERM emphasis throughout their programs. But these changes have been put on the back burner while the marketplace accepts—or at least catches-up with—this seemingly perfect application of portfolio theory to all of an enterprise’s exposure to uncertainty. The purposes of this research study were to explicate the factors influencing the lack of adoption of enterprise-wide risk management and develop prescriptive guidelines for managerial use. As such, this study targets two overarching purposes: (1) to identify the nature and extent of ERM practice and (2) to discover why companies have been reluctant to adopt the enterprise-wide risk concept.

RESEARCH METHODOLOGY

The research design for this study blended secondary and primary data sources. First, an extensive review of commercial property and casualty insurance literature was conducted. This information was then validated and further enriched through interviews and direct inputs of industry professionals and knowledge experts. Based on these qualitative findings, a structured survey instrument was developed, tested, and then employed in the main study--a telephone survey of U.S. commercial insurance buyers and risk managers.

To maximize validity and allow generalization of findings to the larger population of U.S. commercial insurance buyers, a probability sampling methodology was employed to randomly select and contact risk managers and insurance buyers from organizations in the Fortune 2000. Out of the 417 risk managers originally called, 254 were successfully contacted. Of this sample of 254 risk managers, 133 agreed to cooperate and completed the telephone interview for a response rate of 52.4 percent.

Description	Frequency	Percentage
Total Risk Managers Called	417	
Less: No Contact Made	163	
Total Risk Managers Successfully Contacted	254	100.0%
Less: Not Interested or Too Busy to Participate	121	47.6%
Completed Structured Phone Surveys	133	52.4%

SELECTED FINDINGS

The Degree to Which ERM is Practiced

The degree to which enterprise-wide risks have been adopted by and diffused within risk managers' thinking and practice was explored through an indirect series of projective questions. Respondents were asked to identify the types of risk they perceived as being significant to their organization. As detailed in Table 2, a broad array of risk types were cited as being significant with two types of traditional insurable risk—"workers' compensation" and "general liability"--being cited substantially more often than others. On average, the broader forms of enterprise-wide risk are mentioned by fewer than 20 percent of the respondents underscoring the premise that enterprise risk has not been widely diffused into risk management practice.

TABLE 2. WHAT TYPES OF RISK ARE SIGNIFICANT TO YOUR ORGANIZATION?		
Summary Response Category	Respondents Indicating this Item	
	Number	Percent
Workers' Compensation	121	91.0%
General Liability	120	90.2%
Employment practices	118	88.7%
Property damage or loss	118	88.7%
Business interruption	102	76.7%
Fluctuation in financial markets	97	72.9%
Data integrity and security	93	69.9%
Operational failure	68	51.1%
Third-party liabilities	67	50.4%
Intellectual property protection/violations	66	49.6%
Errors and omissions	65	48.9%
Sexual harassment	61	45.9%
Global regulatory changes and political changes	52	39.1%
Embezzlement	44	33.1%
Natural Catastrophe	27	20.3%
Competitive threats	26	19.5%
Loss of key supplier	24	18.0%
Failure of information systems	24	18.0%
Customer credit risks	21	15.8%
Climatic extremes	21	15.8%
Loss of image and reputation	20	15.0%
Commodity cost fluctuations	20	15.0%
Loss of customer loyalty	17	12.8%
Product misalignment with market	15	11.3%
**Note: Multiple responses allowed, thus total will equal over 100%		

A second indirect question explored the extent of enterprise risk management’s adoption in the organization by asking respondents to identify other areas (areas other than the responding risk manager or insurance buyer) in their organization where risk information is collected and tracked. As illustrated below, the “*Finance Area*” (87.2%) and “*Accounting*” (72.9%) received the highest levels of recognition for collecting and tracking risk information. Also active in tracking risk were “*Health and Safety*” (69.2%), “*Personnel*” (64.7%), and the “*Legal Department*” (63.9%). It is interesting to note that while “*Production and Operations*” (40.6%) is also perceived to be a significant area for risk awareness and tracking, other areas such as “*Research and Development*” (28.6%), “*Purchasing*” (26.3%), “*Distribution and Shipping*” (14.3%), “*Information Systems*” (12.0%), and “*Customer Service*” (9.0%) are perceived as playing minor roles in the collection and tracking of risk information.

TABLE 3.		
WHAT OTHER AREAS OF YOUR ORGANIZATION FORMALLY COLLECT AND TRACK RISK INFORMATION?		
Summary Response Category	Respondents Indicating this Item	
	Number	Percent
Finance	116	87.2%
Accounting	97	72.9%
Health and Safety	92	69.2%
Personnel	86	64.7%
Legal	85	63.9%
Production and Operations	54	40.6%
Research and Development	29	28.6%
Purchasing	23	26.3%
Distribution and Shipping	19	14.3%
Information Systems	16	12.0%
Customer Service	12	9.0%
**Note: Multiple responses allowed, thus total will equal over 100%		

These indirect responses seem to indicate that ERM is not highly diffused through the organizations participating in this study. To further validate this interpretation, respondents were also asked several direct questions regarding the degree and nature of ERM practice in their particular organizations. The first direct question asked, “*Does your organization currently practice integrated, enterprise-wide risk management?*” Only 25.6% of participants responded “yes” to this direct question and 69.9% responded “no,” which further confirms the low levels of adoption and practice of ERM.

TABLE 4.			
Question Item	Percentage Indicating YES	Percentage Indicating NO	Percentage Indicating UNKNOWN
Does your organization currently practice integrated, enterprise-wide risk management?	25.6%	69.9%	4.5%

The operative word in the previous question was the modifier “integrated.” To better explicate the level of integration across the organization, a follow-up question was included for the 34 respondents (25.6%) indicating that their organization did practice integrated, enterprise-wide risk management. This subsequent question was, “*If yes, to what extent would you estimate enterprise risk management is integrated and coordinated across organizational functions and units within your firm?*”

TABLE 5.			
Question Item	Highly Integrated	Mid-Levels of Integration	Very Low Levels of Integration
If yes, to what extent would you estimate enterprise risk management is integrated and coordinated across organizational functions and units within your firm?	14.7%	23.5%	61.8%

As illustrated in Table 5, within the 25.6% of respondents indicating that their organization did practice integrated, enterprise-wide risk management, only 14.7% described the actual level of integration as being “*Highly Integrated.*” A mid level of integration was cited by 23.5% of respondents and 61.8% indicated “*Very Low Levels of Integration.*” These findings parallel those of a recent Marsh study, which found the majority of ERM efforts are in the very early stages of identifying risks.

Why Isn't It Catching On?

The findings from this study highlight that the concept of ERM remains slow in catching on in actual practice. In an era in which management strategy and regulatory changes both seem to increasingly favor ERM, one is left to question why its practice remains so scarce. A primary purpose of this study was to explore why the adoption of ERM has been slow. Toward this end, buyers were asked questions regarding (a) their asking for enterprise risk solutions from suppliers and (b) suppliers offering them enterprise risk solutions over the previous 12 months. It is interesting to note (see Tables 6 and 7) that while 21.8% of respondents indicate that they have requested enterprise risk solutions, only 8.3% indicate that they have been offered such solutions by their suppliers in the system.

TABLE 6.			
Question Item	Percentage Indicating YES	Percentage Indicating NO	Percentage Indicating UNKNOWN
Have you requested an enterprise-wide risk solution from your brokers or carriers over the previous 12 months?	21.8%	72.9%	5.3%

TABLE 7.			
Question Item	Percentage Indicating YES	Percentage Indicating NO	Percentage Indicating UNKNOWN
Have you been offered or presented an enterprise-wide risk solution over the previous 12 months by your brokers or carriers?	8.3%	86.5%	5.3%

The low number (21.8%) of participants indicating that they have sought enterprise risk solutions further underscores risk managers' low level of adoption and practice of this concept resulting in a low level of demand. At the same time, the even lower percentage (8.3%) of firms having been offered enterprise risk solutions by their suppliers indicates the presence of a very significant supply-side problem. Indeed, the interplay of these two parallel responses would point to the existence of both demand-side and supply-side issues impeding the magnitude of ERM adoption and practice.

To better explicate the more exact nature of the barriers that might be impeding the diffusion and adoption of ERM, participants were asked to identify and describe what they perceived as possible problems and barriers to the practice of enterprise risk management. As illustrated in Table 8, respondents commonly cited seventeen items. The most often mentioned impediment was *"Standardized, cookie-cutter products/services offered in the market cannot deal with non-traditional risk situations that differ from firm to firm"* (cited by 80.5% of respondents). Following close behind were the following six items:

- *"Lack of effective communication between risk managers and functional unit managers"* (78.2% of respondents),
- *"Lack of standardization in definition, nature, and scope of enterprise-wide risks"* (cited by 76.7% of respondents),
- *"Lack of sufficient actuarial data to reliably assess, model, and forecast"* (74.4%),
- *"Occurs outside the risk manager's authorized area of responsibility within an organization"* (74.4%),
- *"Difficulty in measuring and developing quantifiable methods for intangible risks"* (71.4% of respondents), and
- *"Represents many operational and distribution/marketing uncertainties that are not insurable, transferable, or manageable risks"* (70.7%).

The above items highlight the need for leadership within the risk management community to undertake the development of industry-wide educational programs. These programs should be

designed to heighten awareness, build understanding, modify attitudes, and develop the skills and competencies of buyers and suppliers required to adopt and effectively practice ERM.

TABLE 8. WHAT DO YOU PERCEIVE AS POTENTIAL BARRIERS TO THE ADOPTION AND PRACTICE OF ENTERPRISE-WIDE RISK MANAGEMENT?		
Summary Response Category (Note: Multiple responses allowed, thus total will equal over 100%)	Respondents Indicating this Item	
	Number	Percent
Standardized, cookie-cutter products/services offered in the market cannot deal with non-traditional risk situations that differ from firm to firm	107	80.5%
Lack of effective communication between risk managers and functional unit managers	104	78.2%
Lack of standardization in definition, nature, and scope of enterprise-wide risks	102	76.7%
Lack of sufficient actuarial data to reliably assess, model, and forecast	99	74.4%
Occurs outside the risk manager's authorized area of responsibility within an organization	99	74.4%
Difficulty in measuring and developing quantifiable methods for intangible risks	95	71.4%
Represents many operational and distribution/marketing uncertainties that are not insurable, transferable, or manageable risks	94	70.7%
Lack of common understanding regarding risk and its management across the firm	73	54.9%
Lack of commitment from senior management	72	54.1%
Incompatible data and information technology across the enterprise	70	52.6%
Organization's culture obstructs the required integration across the firm	69	51.9%
Functional-based organization formats resist and inhibit centralized enterprise management of risk	67	50.4%
Competition for control between risk management and individual business units inhibits coordination of risk management activities	57	42.9%
Too complex for typical risk management departments to assess and manage by themselves	43	32.3%
Internal opposition and competition between functional units	37	27.8%
Just another fad – not a realistic insurance product or service	39	29.3%
Just another consultation concept designed to increase fees and sell more product	21	15.8%

These findings also illustrate that a significant amount of communication, education, and change must take place *within* the buying organization and across the internal and traditionally silo-oriented functional units. For example:

- “*Lack of common understanding regarding risk and its management across the firm*” (54.9% of participants),
- “*Lack of commitment from senior management*” (54.1%),
- “*Incompatible data and information technology across the enterprise*” (52.6%),
- “*Organization’s culture obstructs the required integration across the firm*” (51.9%),
- “*Functional-based organization formats resist and inhibit centralized enterprise management of risk*” (cited by 50.4% of participants),

Summary and Conclusion

Current literature represents enterprise risk management as a more effective risk management concept for today’s complex, dynamic, and fast-paced business environments. Yet, this research indicates that ERM is actually being practiced within very few organizations and that few vendors are offering true ERM solutions. Education and training is urgently needed for the dual purposes of (a) increasing the awareness of this new concept and its benefits, and (b) building risk managers’, functional managers’, and vendors’ understanding and competencies in practicing enterprise risk management.

For the purpose of providing meaningful content for posting in the Katie School’s Working Paper Series, the previous discussion has presented *selected* findings from the larger overall research study. These reported findings will be further integrated with additional outcomes from this stream of research and disseminated in the form of conference presentations and research manuscripts submitted for publication in applicable journals in the field.