
At the Intersection

An investigation into the integration and alignment of the Balanced Scorecard with operational risk management frameworks to enhance strategic execution in the UK Financial services industry.

Conclusions

The Industry context

Conclusion

1. An reactive, indicator focused industry.

The UK Financial Services industry faces an increasingly regulated and competitive business environment. Despite the need for flexibility and adaptation to a rapidly evolving environment, there is widespread failure to adopt strategic orientated processes, frameworks and approaches to meet these challenges from a PM and ORM perspective. The industry response to date has largely been reactive, tactical, and indicator driven.

2. A lack of maturity and best practice.

There is a significant lack of maturity in relation to the development of PM and ORM processes, both within individual organisations and across the industry.

The integration and alignment of these processes has support from a conceptual perspective but questions remain as to how this may work in practice. Given the acknowledged lack of maturity in this area, the lack of best practice is expected and further contributes to reliance on 'siloes' processes and resistance to integration.

Recommendation

Organisations should take a more strategic approach, developing frameworks, processes and approaches that enable them to effectively meet the current requirements but which also develop the organisational capabilities to meet future regulatory and competitive demands.

Industry participants should look to established frameworks and processes as a starting point to developing an integrated and aligned approach. While existing frameworks and processes are focused on individual processes they will form a solid foundation of processes, technology and capabilities to move to an integrated approach. From a PM perspective, organisations should consider the Balanced Scorecard. From an ORM perspective, organisations may consider the COSO integrated framework, the Risk Standard or AS/NZS 4360:2004 or Arrow 2 as a starting point.

Performance Management & Operational Risk Management

Conclusion

1. There is a significant gap between the literature and reality in terms of Balanced Scorecard deployment.

The Balanced Scorecard literature cites numerous financial services organisations as having deployed the Balanced Scorecard; however this study found that the use of the Balanced Scorecard is not as widespread within the UK financial services industry as suggested by the literature.

2. Operational risk management is critical to managing downside losses whilst taking advantage of upside opportunities.

While still a developing area of management, ORM is critical to reducing the losses from a risk event, not just the initial loss but also tail losses.

ORM is also critical to developing the processes, peoples and systems to enable organisations to take on more risk and thus capture a greater share of the upside. There is real potential to use robust ORM processes to reduce business costs and develop risk-taking capabilities to build competitive advantage. As one of the interviewees pointed out during this study, *"the reason that a car has brakes is to allow it to go faster, and the same [applies to]... business and risk management."*

Recommendation

Integration and alignment

Conclusion

1. Integrating and aligning PM and ORM processes reduces duplication and costs while increasing the quality of decision-making.

There are considerable process, people, system and data overlaps between PM and ORM. Deployment in isolated silo processes creates duplication and increases costs; the integration of these processes removes duplication and reduces costs.

Additionally, as decision-makers will have a more holistic set of decision-making information including performance and risk dimensions, the quality of decision-making can reasonably be expected to improve.

2. Developing an execution-focused organisation takes time

The execution-focused organisations all spoke of the time taken and evolutionary nature of the journey that saw them evolve into execution-focused organisations. Whilst following the proposed R-bp methodology (or something similar) will increase the overall quality of an integrated approach, it will still take time for organisational change and learning to take place.

Undertaking the journey is a vital step in the development of capabilities to ensure sustainability and long-term success.

Recommendation

Seek cost efficiencies and decision-making quality improvement by integrating and aligning your PM and OPM processes. Use Risk-based performance or similar to provide a conceptual sound methodology for doing so.

When developing an integrated and aligned PM and ORM approach, encourage the development of organisational capabilities as part of the journey, and provide the time and resources to enable organisational change and learning to take place.

Integration and alignment (2)

Conclusion

3. Use the Strategy map to set the context for performance and operational risk prioritisation.

Managing and controlling the volume of indicators is clearly an issue within the industry, which demonstrates over-reliance on indicators. Going through the process of distilling an organisational strategy into a strategy map provides clarification and prioritisation with respect to performance objectives and operational risks to be managed and monitored.

4. Using a multiple scorecard approach, manages scope and assists in understanding of performance and risk trade-offs.

Managing the scope of an integrated PM and ORM process emerged as a challenge. Additionally, understanding the trade-offs and impacts of performance and risk decisions is also an area of concern. Using a multiple scorecard approach will enable organisations to gain control of the scope of integrated PM and ORM processes. Additionally, with the greater clarity the three scorecard approach brings, trade-offs and impacts of decisions can be better visualised and understood from a performance, risk and controls perspective.

Recommendation

Measuring and monitoring every aspect of an organisation's performance, risk and controls environment is simply not feasible. Attempting to do so will result in a 'data rich, information poor' situation. Therefore use the strategy map, and the process of developing a strategy map, to develop strategic clarity and set strategic priorities.

Use a multiple scorecard approach to manage process scope and provide clarity around trade-offs and impacts. Use performance, risk and controls scorecards, with corresponding types of indicators.

Integration and alignment (3)

Conclusion

5. Differentiate between, and be very specific about, the type of indicators used in each scorecard.

To promote the development of high quality indicators and ensure clarity of indicator information, organisations should differentiate between different types of indicators, rather than simply using KPIs to measure everything. The type of scorecard should match the type of indicator; however the same data can be re-used across different types of indicators.

6. Risk appetite, exposure and capacity should be considered and defined at the macro and micro levels.

When developing a strategy (macro level) and defining specific performance objectives (micro level), the associated risk appetite, exposure and capacity should be considered and defined. This pushes organisations to embed risk considerations in the strategy and increases the likelihood that the strategy or individual strategic objectives are achievable, thus increasing the probability that the strategy will be executed effectively and delivers shareholder benefits.

Recommendation

Use three types of indicators;
- Key Performance Indicators (KPIs),
- Key Risk Indicators (KRIs), and
- Key Controls Indicators (KCIs).

Do not mix and match scorecard types and indicator types. However re-use the same data set across multiple indicator types as appropriate to enhance quality of indicators and reduce data collection burden.

When setting strategy and strategic objectives, consider and define the associated risk appetite, exposure and capacity. Include the risk dimension explicitly to develop a strategy and strategic objectives that are executable.

Integration and alignment (4)

Conclusion

7. Use indicators to capture both hard data and soft managerial judgement.

Many organisations are overly reliant on data-driven indicators only. The nature of PM and ORM means that organisations often operate and make decisions based on imperfect information and knowledge. This is particularly applicable to low frequency - high impact risk events.

8. Linking compensation via a gateway process to indicators is an effective way to develop buy-in to the strategy and shape organisational culture.

Linking compensation – particularly bonuses – to performance and risk outcomes via a gateway process is an effective way of developing buy-in to the organisational strategy, therefore encouraging development of the right behaviours and shaping organisational culture. The gateway process enables organisations to signal priorities whilst keeping the process straight forward and understandable for front-line staff.

Recommendation

Organisations should use a mix of indicators, some based on hard data and some based on soft data, capturing managerial judgement and experience. This will enhance both the quality of decision-making information and the organisational capability to make decisions based on less than perfect information or during a crisis. It also encourages the sharing of knowledge and experience enhancing organisational learning.

Link compensation via a gateway process to an integrated and aligned PM and ORM process to drive commitment to the strategy, strategic execution and shape organisational culture.

Integration and alignment (5)

Conclusion

9. The focus of operational risk function should be on the corporate agenda while the compliance function should focus on the regulatory agenda.

Management of operational risk and management of compliance are often seen as essentially the same thing in many organisations, however this lack of understanding of the differences and similarities between the two distinct processes means that the potential benefits of both are often not realised.

Compliance should ensure that the processes are in place, understood and used to ensure that organisations meet legal and regulatory requirements and act as good corporate citizens. In contrast, ORM should ensure that the operational risk profile is clear, managed and integral to organisational decision-making. ORM should identify both threats and opportunities and should encourage risk awareness rather than risk aversion.

Recommendation

Ensure clarify of roles, focusing the operational risk function on the corporate agenda whilst focusing the compliance function on the regulatory agenda.

Strategic Execution

Conclusion

1. Strategy is necessary but not sufficient.

Whereas Porter (1985) suggests that operational effectiveness is “necessary but not sufficient”, this author takes a step further to argue that strategy is necessary but not sufficient. This argument is underpinned by current strategy failure rates (estimated at 40-70%) and the critical nature of strategy execution to the delivery of shareholder value. These issues clearly demonstrate that organisations must do more than just develop good strategy; they must focus on developing the people, processes and systems to enable strategic execution.

2. Integrating and aligning PM and ORM processes is critical to enhancing strategic execution.

Managing organisational performance and risk profiles go to the very heart of successful strategic execution. Therefore, integrating and aligning performance and ORM processes is critical to enhancing strategic execution.

Recommendation

Culture

Conclusion

1. Culture is fundamental to performance management, risk management and strategic execution.

The overwhelming conclusion to be drawn from this study is the critical importance of developing and sustaining the right culture to support effective PM and ORM and to ensure that the right behaviours are developed to enable organisations to effectively execute their strategy. The question of culture was outside of this project, but merits further detailed research.

Recommendation

Further information

Please visit <http://www.riskbasedperformance.com/> for further information related to this study and the Risk-based performance approach to the integration and alignment of corporate performance management and operational risk management.

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