

Corporate Risk Management

Can your company answer the following questions? What is your expected earnings volatility for the whole business? Is this level acceptable? How should it be managed? What return on invested capital is required? Do your earnings provide adequate return on shareholder funds? How can new investments be made with reasonable risk and what new product development should be done? Where are the main risk exposures within the business? What are the best techniques and processes for controlling risk?

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If some of these are issues concerning you then applying a corporate risk management approach can help to address the solutions to these questions.

The corporate landscape is changing rapidly with the globalisation of trade and increased levels of M&A activity. As a result, companies are facing a much more complex risk profile – often incorporating multi-commodity and multi-geography risks. It is becoming increasingly clear that these risks need to be managed in a strategic manner to create value. Leading edge companies, (e.g. GE and global investment banks) are already utilising corporate risk management to realise significant benefits. Accenture's *Finance & Performance Management Practice* has developed a corporate risk management framework to address this critical business challenge.

Corporate risk management is defined as the systematic approach to identifying, categorising, quantifying and pro-actively dealing with all risk in an organisation in order to create value. By using an aggregated/consolidated portfolio approach it provides consistent new performance information to optimise decision making across geographies/commodities at a corporate level.

A successfully implemented corporate risk management framework will provide the corporate level (e.g. CFO, CRO, the Board) with aggregated performance and risk measures for strategic decision-making and compliance. This will allow the firm to better understand the benefits of diversification, increase optimisation of the portfolio and ultimately result in increased shareholder return and an enhanced P/E

(profit/earnings) ratio when well articulated to the investor community. The framework will enable the corporate level to make strategic decisions utilising the risk appetite, risk limits, capital optimisation and policies and procedures; i.e. if an organisation can understand its risk-return profile across its business units, it will be better placed to efficiently allocate risk capital to earn the best overall portfolio returns. The framework will also provide the corporate level and all other risk stakeholders with confidence that the firm is externally compliant (e.g. to regulators) and internally compliant (e.g. to Chief Risk Officer, head of middle office), through the production of consolidated risk reports. The principles of corporate risk management can be applied to most industry groups – in particular utilities, energy, mining, chemicals and financial services companies.

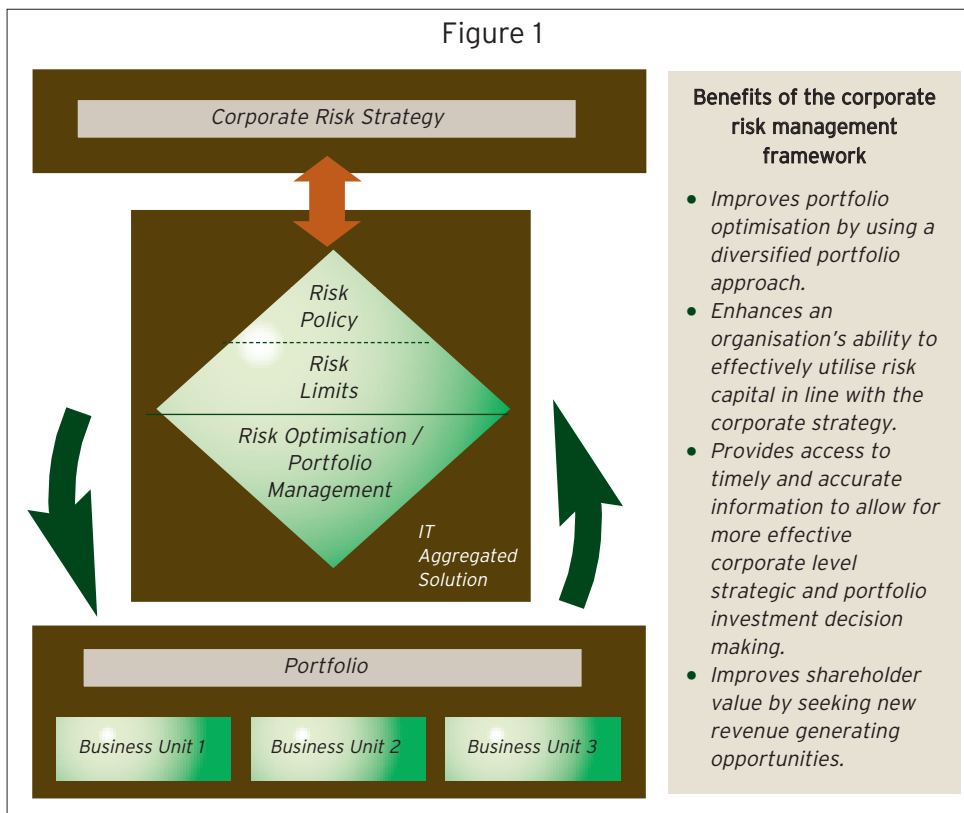
Risks Can be Divided into Different Classes

- Market Risk: the potential loss due to market factors in the portfolio
- Credit Risk: the potential loss due to changes in counterparty credit
- Business Risk: the potential loss due to changes in economic factors
- Operational Risk: the potential loss due to system, people, legal and external events

Limits are set in each of the risk areas to manage against the actual utilisation

	Market	Credit	Business	Operational
Components	<ul style="list-style-type: none"> • Commodity prices • Volume risk (e.g from swing contracts and the weather) • Interest rates • Exchange rates (e.g. euros & \$) 	<ul style="list-style-type: none"> • Counterparty defaults • Counterparty credit rating deteriorates 	<ul style="list-style-type: none"> • Economic factors (e.g. inflation, interest rates etc.) • Market competitiveness • Country risk (e.g. political) • Employment levels • Weather • Market liquidity • Inflation measures • Cashflow/Funding risk 	<ul style="list-style-type: none"> • Technology (e.g. system failure) • Data integrity • People (e.g. human error) • Reputation • Cross geographical-border • Audit • Privacy • Regulatory • Catastrophic • Force majeure • Legal
Examples	<ul style="list-style-type: none"> • Increase in fuel oil prices has a correlated effect on electricity prices and may lead to higher portfolio exposure 	<ul style="list-style-type: none"> • Third party suppliers do not fulfil their obligations • Counterparties default • Customers do not pay 	<ul style="list-style-type: none"> • Employment levels impact company staffing and lead to reduced profitability 	<ul style="list-style-type: none"> • Unscheduled system downtime

One example of Accenture's recent client work involved implementing a comprehensive risk management programme with one of the largest energy marketers worldwide. This work will enable the energy company to assess the risk across its global operations with near real-time positions, risk measures and advanced analytical capability. One of the cutting edge elements of this project is its implementation scale, encompassing concurrent implementations of multiple trading systems and enterprise-wide risk engine covering the company's largest business units in many geographies. Together with the introduction of a consistent risk management policy and setting risk limits on a global scale, it ensures a uniformity and consistent risk reporting across the business.



Accenture's Corporate Risk Management

Accenture's corporate risk management framework sets out critical elements at the corporate and business unit level for effective holistic risk management decision making to

market risk that can cause cash flow volatility or drain capital reserves, ensuring access to capital and improving capital structure optimisation by increasing debt capacity. Natural hedging between generation and retail capabilities allow an organisation to net positions to

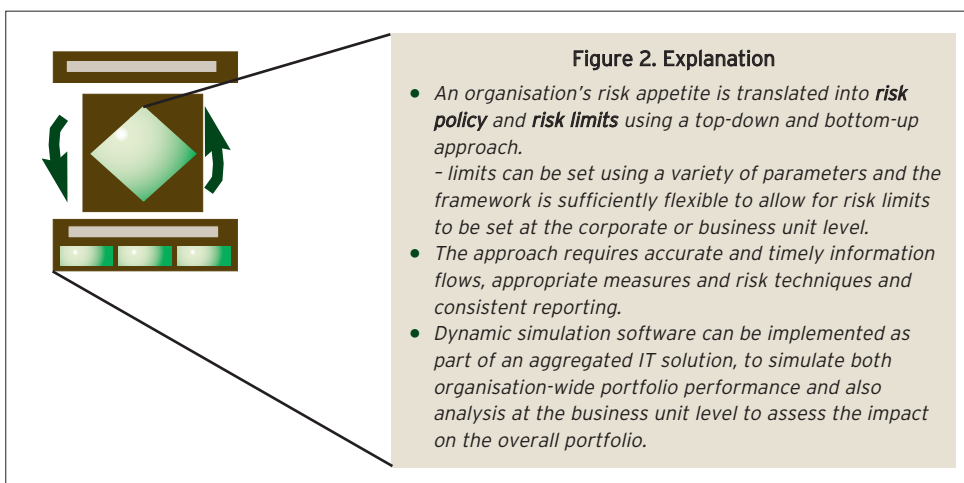
- Integrate the risks of the natural physical exposures with the financial exposures to take advantage of diversification benefits. The entire framework will require efficient information transfer between business units and the corporate level and, at the same time, will need to be backed up by a robust technical architecture. The framework will only work when the management of risk is embedded in the organisation with all risk stakeholders understanding their responsibilities and roles in the risk-centric organisation.

Summary

The motto of the corporate risk management approach is that by dynamically managing the actual risk exposures against the limits to achieve the maximum return for the minimum risk capital, a company can improve its overall earnings and reduce its costs.

In summary, undertaking corporate risk management in a proactive, dynamic manner can provide significant value for the organisation by:

- Improving portfolio optimisation.
- Enhancing an organisation's ability to effectively utilise risk capital.
- Providing access to timely and accurate information to allow for more effective corporate level strategic and portfolio investment decision making.
- Improving shareholder value by seeking new revenue generating opportunities •



enhance value (see Figure 1).

The approach takes an aggregated risk perspective, using a diversified portfolio approach (see Figure 2).

Numerous examples can be cited that illustrate the value corporate risk management can bring to an organisation: Asset diversification can increase company value by protecting the portfolio from market volatilities and enabling effective management of shareholder earnings, having a direct impact on the share price. Effective hedging strategies can also improve shareholder return by hedging against

produce a consolidated risk figure – the management of this net risk enhances strategic decision making and is more efficient than managing individual risks.

The benefits of utilising corporate risk management can be illustrated in the following example. An energy company has power stations in two countries. This company is exposed to currency risk in both countries and hence can hedge currency risk by changing the production of its power stations:

- When one currency is stronger than the other, it can increase the production of the stronger country power plant.

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