Risk Management and Strategy Perfect Partners

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Starz provides a range of consultancy services to financial and non-financial institutions seeking to be compliant and/or develop competitive advantage through optimised ERM structures. Starz offer the following risk support solutions to companies:

- Enterprise risk management implementation
- Risk analytics
- Risk Management and Insurance Underwriting Training
- Insurance company capital management
- Board Risk Advisory Services

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Risk Quote

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‘I never think of the future. It comes soon enough.’

ALBERT EINSTEIN, PHYSICIST

“The lion and the calf shall lie together but the calf won’t get much sleep.”

WOODY ALLEN, WRITER
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Agenda

- Foundational elements of Enterprise Risk Management
- Practical Advise on Implementing ERM
- Strategic Risk Taking
• The 21st century brought with it great opportunities and astonishing advances as well divers complexities.

• This has altered the dynamics of the value chain due to changes in consumer demographics and expectations, technology, outsourcing, prices, environmental concerns, availability sustainable resources, financial conditions etc.

• All these makes managing value creation a challenging game.

• List two key challenging changes in your industry:
  __________________________________________________
  __________________________________________________
  ____________
What are the new vulnerabilities?

- Changing **consumer tastes and expectations**

- **Long stretched and disintegrated supply chains** adding more points of failure

- **Social media** greatly increasing the **reputational impact** of disturbances in reliability and quality of supply

- Insurance companies and banks required to provide services that go beyond customer expectation.
  - Creating safer companies and not mis-selling products in overtraded markets.
What is the differentiating factor for companies?

- **Service** – meeting and surpassing customer needs

- **Information and communication** – early dissemination of information is a key competitive differentiator

- **Albert Einstein** – ‘I never think of tomorrow. It come soon enough’

- **Ability to manage cat events** –
The interconnected world need a holistic view of risk across the organisation.

Failure to take an overview of and fully understand the risks, managing a company’s value chain is incomplete and might result in catastrophic consequences.

It’s not good enough to manage the value chain without integrating risk.

Integrating helps bring to light interdependencies and how somewhat independent decision might adversely affect the entire organisation.
Options of implementing risk management

- **Stand alone** or **institutionalised risk management capabilities** that drive management processes

- The incorporation of risk management into company management from **top-to-bottom and across the business** is essential, not an option.
How companies are doing?

- **Value chains** has been under managed.
- A **brutal past decade** devastated balance sheets and prompted aggressive cost cutting exercises.
- This has **left most value chains weak at evaluating risks**.
Historic Return on Equity for UK Banks

“...as long as the music is playing, you’ve got to get up and dance. We’re still dancing” Chuck Prince 9 July 2007

Average ROE below 10% pa, volatility low at c.2% pa

Average ROE over 20% pa, c.30% pre-crisis and volatility much higher

Note: There is a definitional change in the sample in 1967. The latter period has a slightly larger sample of banks and returns on equity are calculated somewhat differently, including being pre-tax.
What risk management brings?

- **Risk management brings** a balance on efficiency and effectiveness through an awareness of risk issues that need to be addressed.

- **Risk management and optimisation** are of equal importance in managing today’s operations.

- **Both need a place at the corporate table** to ensure business success and resiliency.
The **ability to predict and realise** how a decision in one function may affect positively or negatively on the entire organisation.

**Failure to** proactively identify, prioritise, treat and monitor and communicate risk can be devastating:

- Interfin Bank, Jupiter Insurance, SFG Insurance, Caps Holdings, Renaissance Bank, UBS, Barclays, etc.
How can we move forward

• The **stakes are high** and companies are now seeking to enhance strengths and address weakness overlooked during the good old times

• They are taking **risk-adjusted approaches** in order to stay ahead of risks

• The are **making their businesses nimble and quick** to respond
It's not possible to avoid risk

- All business processes have inherent risk
- We need to understand and manage the uncertainties in a way that enables the achievement of objectives
- We can use ERM to take risks in a smarter and more informed way.
Zimbabwean companies and Risk Management

- As Zimbabwean companies try to transform themselves by introducing risk management they face unrelenting performance and competitive pressures.

- These pressures are leading companies to adopt cost cutting measures and focusing on core value adding activities.

- For many companies ERM remains an appendage and yet one advantage yet to be tapped.
Where ERM has been fully embraced companies are developing new operating models to help them address risk.

Remember the saying ‘Old wine for old skins and new wine for new skins’

They are mapping operating models and understanding the key value drivers.

They are realising that the effectiveness of operating models depends on the right amount of risk information and staying ahead of changes in the risk profile requires up-to-date information.
Positioning the Zimbabwean Company

- The **need for continuous communication** that helps understand changes in key risk indicators (KRI)
- This is helping companies keep abreast with **secondary effects of triggered KRI**
- **Risk has become part and parcel of operating business processes** – helping companies anticipate things before they get out of control
- Where do we stand in Zimbabwe and what things will this process address:
How do we approach this?
Assessing risk

- It's difficult to plan for and manage risks that haven't been **envisioned**

- Everything starts with the **assessment of risk**

- A deep understanding of the **components of the operating model**, the players who come in and out throughout the process, the value drivers and risk profile – strategic, operational, financial, compliance etc.
· **What happens when if something goes wrong within the process.**

· **Funding operations** can be a tricky exercise as it doesn’t only depend on the financial conditions of the firm but also the liquidity and financial conditions in the market.

· There is need to **get the whole picture** on how funding in the market can dry-up due to credit crunches – these key points all need to be considers.

· **Developing a funding strategy** includes assessing risk, selecting funding partners and managing relationships.
# THE THREE PARTS OF A COMPANY’S RISK PROFILE

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<thead>
<tr>
<th>Cash Flow from Operating Activities</th>
<th>Internal Supply of Funds</th>
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Cash Flow ties together a company’s operating, investing and financing activities.

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The primary aim of corporate risk management is to ...

- Ensure that the **internal and external supplies of funds are sufficient** to cover the demand for funds.

- Operation of **risk factors create volatility** that diminishes the company’s ability to supply the funds demanded by its strategy.

- It's crucial to understand how risk affects each of these **three cash flow components** when designing risk management programs that will protect the firm’s supply of funds.
## Cash Flow Statement under uncertainty

### Cash Flow from Operating Activities
- Net Income
- Depreciation
- Change in Working Capital
- Net Cash From Operating Activities

### Cash Flow from Investing Activities
- Additions to Fixed Assets
- Net Proceeds From Short-term Investments
- Net Cash From Investing Activities

### Cash Flow from Financing Activities
- Net Proceeds from Debt
- Dividends
- Net Cash Used in Financing Activities

\[
\text{Net Cash From Operating Activities} + \text{Net Cash From Investing Activities} - \text{Net Cash Used in Financing Activities} = \text{Funding gap}
\]

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<tr>
<th>Volatility in the Internal Supply of Funds</th>
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<th>Funding gap</th>
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Risk
Example – Zimbabwean Company Planning to go into foreign markets

- Imagine a company wants to enter one of the SADC markets and their goal is to grow 20%. Capital investment is needed. This has to be raised through internally generated funds. This investment depends on the cash flow generating power in the home market. These cash-flows can be shocked by risks.

- The firm has to understand the risks that can derail this project by looking at risk across the value chain. This can be done through scenario analysis.

- On the other hand, risks in the host country like cultural, labour, political and regulation etc can add up cost and deflate the projects.

The handicap of going into new market is that companies often do so blindly.
10-Year Historical Daily Closing Prices

Last price as of 02-Jul-2013: $1,243
One Year Gold Prices
10 Year Platinum Prices

10-Year Historical Daily Closing Prices

Last price as of 02-Jul-2013: $1,371
6 Months Platinum Prices

6-Month Daily Candlestick Chart
Last price as of 02-Jul-2013: $1,371
The Impact of the 2010 BP Oil Spill Losses

Oil spill drains BP of funding options: By Ed Crooks and Lina Saigol
Published in the FT: July 5 2010 21:32
• ---Bindura Nickel issues a cautionary statement saying management is examining alternative mining plans with the objective of improving the short term cash flow of the company and reducing the funding requirement. BNC is in the process of seeking short term bridging finance to cover the funding shortfall and continues to focus on the preservation and integrity of the business and its assets. –

16 July 2013, NewsDay pg 2
JOHANNESBURG, Jul 17 (BusRep) - AngloGold Ashanti shares dropped to a 13-year low yesterday after news that it would revise its output guidance for the year and that it expected to report an impairment of as much as $2.6 billion (about R25.8bn). The stock dropped to an intra-session low of R120.17 before closing 2.49 percent weaker on the day at R122.30 in Johannesburg yesterday after AngloGold announced its operational update for the second quarter.

The world’s third-largest gold producer said it expected annual production of between 4 million and 4.1 million ounces – a downward revision from earlier guidance of between 4.1 million ounces and 4.4 million ounces. The write-down of assets came days after ratings agency Moody’s Investors Service downgraded the company’s credit profile because of the risk of a prolonged wage strike. AngloGold now held a Baa3 rating, down from Baa2, and its outlook had worsened to negative from stable, Moody’s said on Friday. AngloGold is the second local company to announce impairments as a result of the weak gold price. Harmony Gold announced that it was likely to write down a portion of the carrying value of its Hidden Valley mine in Papua New Guinea because of lower gold and silver prices and poor performance. The gold price, which has dropped 23 percent since the beginning of the year, has complicated matters for the sector.
INTERNAL SUPPLY AND DEMAND FOR FUNDS, BY PRICE SCENARIO

 Cumulative Cash Flow ($m)

- Internal Supply of Funds
- Investment Exposure
- Internal Financing Deficit
- Operating Exposure
- Demand for fund

Commodity Price

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INTERNAL SUPPLY AND DEMAND FOR FUNDS, BY PRICE SCENARIO

Cumulative Cash Flow ($m)

Commodity Price

Total supply of Funds
Internal Supply of Funds
Total Funding Gap
Demand for fund
Internal Financing Deficit
Risk Management and Capital Structure

- **Ex-post leverage – post-loss financing**
  - Risk management, capital structure and capital budgeting decisions are jointly determined (Froot and Stein, 1998).

- **Ex-ante Leverage – Immediate Leverage**
  - Management of the capital structure and risk management are inseparable.
  - Mixed strategies in which partial hedging is matched with intermediate capital structure.

- **Ex-ante Leverage – Contingent Leverage**
  - An instrument is put in place in advance that will unlever the firm if the defined risky event occurs.
The effect of hedging

Cumulative Cash Flow ($m)

Commodity Price

Internal Supply of Funds

Demand for fund

The Effect of Hedging

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The Effect of Risk Financing on Cash Flows

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Volatility in the Internal Supply of Funds modified by gains & losses from hedging

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Volatility in the Demand for Funds

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= revised funding gap

Volatility in the External Supply of Funds
It Requires a Framework
Designing a framework to manage risk

- Assessed risks are effectively managed through a framework that integrates required key capabilities.

- A framework helps embed risk considerations into all business operations and link them to important business processes.
Framework (frām’wûrk’) n.

- A structure for supporting or enclosing something, esp. a skeletal support used as the basis in something being constructed

- an external work platform; a rig.

- A basic arrangement, form, or system: “social structure is a stronger framework for behavior than national feeling.” (Stanley Kaufman)

What a Framework Does

- It considers risks that lie along the entire value chain.

- It helps put in place a structure that will be used to assess, evaluate, analyse, treat and monitor risk across the organisation.

- Critical aspects of framework aligns risk-based decisions with corporate objectives.

- Helps develop an understanding of risks and interrelationships among components of the business model.

- Help the company develop a proactive view rather than an after fact response.
There are a number of internationally accepted frameworks or standards for ERM, COSO ERM, the ISO 31000 and Solvency II.

The framework forms the foundation for the ERM process.
Standards Hierarchy
Five pillars supporting risk-based decision making
Organisation and governance

- Well define organisational structure with explicit roles and responsibilities to manage risk.

- This helps direct and track decisions at different points in the organisations.

- Strong governance structure clarify where responsibility for results is focused – risk ownership.
Risk Management Processes

- Processes are needed to identify critical categories of the value chain

- Segmenting processes that are critical to business continuity

- Defines how risks are identified, assessed and measured and how action planning process is implemented and monitored (ensure risk is being managed and action plans followed)
Risk Management Processes

- Help put in place proactive risk aggregation methodologies to ensure:
  - Risk interdependencies are taken into account and managed.
  - Cost of managing risks is leveraged effectively
- Risk appetite and tolerance threshold defined and socialised throughout the organisation
- They ensure consistent risk management processes are in place throughout the company and links them with business processes.
Risk Analysis

- This helps quantify the impact of uncertainty
- It sharpens the company’s view about risk, provides stronger capabilities in risk prioritisation, risk measurement, scenario analysis and stress testing
- Allow company to see when operational risk appear and correlate it to management initiatives.
- Mining data to determine how risks relate to operations and how well companies manage risk and its impact on the balance sheet.
Risk Analysis

- Quantitative methodologies assess effectiveness
- Quantitative methodologies address linkages between risk and operational performance respectively.
  - Help mitigate and identify opportunities
Traditional risk reporting focused on collecting and prioritising risk reports from operations to inform senior managers are useful for corporate governance purposes, but are inadequate to develop proactive risk management and prevention strategies.

Some reports are voluminous and don’t deliver information in a timely way to enable effective management of risk.
Risk Reporting

• Reports should:
  • be relevant and usable
  • Capture relevant data

• They should include:
  • Metrics on current risk management efforts
  • Changes in the risk environment
  • Indication on when intervention is required
What's required

- Risk reporting should be visible to top management
- Structured to ensure visibility of key risks and mitigation strategies
- Distribution should be wide to ensure top management is informed on risks being raised and how they are being controlled
Managing corporate risks depends heavily on information at hand both internal and external. Performance is enhanced by synchronising processes, streamline material flows and coordinate across organisational boundaries, processes and regions. This can only be done by managing information. Communicating out, up and across the organisation strengthen risk-based decision making.
Implementing Risk Mitigation

- An appropriate risk management framework enables effective risk mitigation

- Robust plans should be designed and resourced to address risk issues

- Open and transparent communication is vital – helps highlight weak spots and creates winning strategies and superior performances

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Our Message to you
Most companies have realised that the cost of effective risk management is significantly lower than dealing with cat-losses.

Many leading corporations who previously focused on efficiency as a primary metric of success are changing their operating models to incorporate risk-based and cost-effective business operations management to balance operational efficiency and Risk Management.
Any organisation aiming for excellent performance today or to survive tomorrow must be aware of diverse risk inherent in its business operating model.

Must manage risks in a holistic manner to support risk-based decision making across the organisation.

This involves merging perspectives and processes of business operations with risks and uncertainties identified in ERM.
Starz Risk Solutions

Intelligent Intuition · Proven Solutions

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