ENTERPRISE RISK MANAGEMENT IN EUROPE

Edited by

MARCO MAFFEI

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To those whose fearless dedication in the face of COVID-19 risk is securing our health in these difficult times

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Durrer, M., & Gruber, M. (2020). Der Verwaltungsrat als erste Verteidigungslinie im integralen Risikomanagement. Zur Weiterentwicklung des Three-Lines-of-Defense-Modells im Licht von Art. 716 ff. OR. *Expert Focus*, (3), 124–127.

Hunziker, S., & Durrer, M. (2020). Risk Management aus der Sicht der Unternehmensführung. Perspektive von Geschäftsleitung und Verwaltungsrat – eine Studie der Hochschule Luzern und Swiss ERM. *Expert Focus*, (3), 118–123.

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Hunziker, S. (2017). Efficiency of internal control: evidence from Swiss non-financial companies. *Journal of Management and Governance*, 21, 399–433.

Hunziker, S., Renggli, S., & Fallegger, M. (2018). *Interne Kontrollsysteme im Finanzbereich: Wirksame und effiziente Steuerung, Kontrolle und Überwachung*. Wiesbaden: Springer.

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Preface

I am delighted to write the preface to this book on ERM in Europe. The book is powerful evidence that academic research on risk management in Europe is alive and well. Amazingly, it is now over a decade since, with a small group of academics from the UK, Italy and Germany, I founded the European Risk Research Network. Funding from the EU allowed us to organize a series of annual conferences across Europe that served to facilitate networking amongst existing researchers and introduce young academics to this fascinating field. It is great to see that such work continues to thrive.

One of the key contributions of the book is its geographic breadth of coverage. Nonetheless, the story that emerges from across Europe is a universal one: despite the fact that it is almost 20 years since the COSO ERM framework was first issued, companies continue to struggle to implement ERM. The main challenge seems to be its integration into the DNA of the organization, so that risk-based thinking penetrates the culture, strategic planning and decision making at all levels.

Regulation across most countries has served to push organizations into adopting some form of ERM, but the degree of maturity of systems is widely variable. In places like Norway and the Netherlands, it would seem that ERM is relatively well developed, although there is a recognition that systems remain immature and in need of further improvement. In contrast, companies in Poland and Greece are perhaps behind the curve in developing their thinking on risk management, especially in non-financial sectors. For many, risk management remains a compliance issue and reflects a silo-based mindset that is in direct conflict with the organizational breadth implicit in ERM.

Large listed companies appear to lead the way on ERM, although even then there are few that integrate risk thinking into the wider stakeholder perspective on planning. Linking ERM to sustainability remains something in the future for most organizations. This book includes some interesting and useful examples of how risk management practice is evolving.

One very clear message from the book is that ERM is a concept that is well defined in terms of regulation, but open to very widespread interpretation in practice. National contexts, corporate history, and industrial sectors all serve to influence how risks are managed, and ERM interpreted. A proliferation of associations and networks for risk managers exist across Europe to help in the exchange of ideas and new initiatives but risk management remains a practice that is organizationally specific. Unsurprisingly, therefore, the book also confirms that evidence on the impact of ERM on company performance and shareholder value remains unclear. There is clearly much research that remains to be done, and I look forward to reading more work from this book's authors in the future.

Margaret Woods

Foreword

Studying Risk Management in Europe

The contributors of this book set out to document, understand and explain risk management practices (codified under the acronym ERM, Enterprise Risk Management, by corporate governance advocates) and to influence the theory and practice of risk management in organizations. The study and teaching of risk management in a business context is important, as the "risk universe" that surrounds corporations and influences their success (and indeed, survival) has expanded significantly, from financial and operational concerns to risks related to culture, reputation and sustainability. The foundational and shared assumption of this volume, underlying all its chapters, is that risk management as a discipline could help organizations and managers run their businesses better and avoid idiosyncratic pitfalls, and that it could help organizations and society solve important and vexing social problems that no organization can tackle alone. However, risk management has its own risks and, as a field, it needs a good deal more self-reflection and a critical understanding of the conditions of its own successes and failures.

The volume focuses on the study of risk management within the paradigm of accounting and management control systems. Management controls have been shown not only to monitor performance in organizations but also to empower them to innovate and navigate uncertainty. But while risk management practices have been proliferating, the failures in risk oversight – some of them globally disastrous – keep on coming. The book highlights that an important reason for this apparent failure of risk management could be the "lack of coordination" between enterprise risk management (ERM) and governance processes – calling for "integration between ERM and accounting practices".

So why is the operationalization of ERM so far from realizing the promised benefits of the discipline? The book provides important empirical evidence across different countries in Europe that allows us to reflect on the contextual dependencies and conditions of risk management's failures (and successes). We get a sense of the varied forms, effects and contexts of risk-management practice, both in corporate and public settings. Overall, the studies confirm that risk management has to be contingent on, and tailored to, the conditions it is deployed in.

The unique pan-European reach of the studies collected in this volume is the first study to capture the contextual variation in ERM across 13 countries, brought about by the varied domestic economic conditions, cultural, academic and professional developments, and last but not least, the diverse legal and regulatory frameworks. Second, the contributors attempt at a closer look at the maturity and spread of risk management practices, collectively revealing a gap between the general practices and aspirations of ERM. Instead of being a strategically central, interactively used control practice, in more than half (seven) of the sampled 13 countries, ERM attracts "mixed level of engagement" in corporate governance and accounting practices, with a focus on compliance with internal control and audit practices. Yet in six countries, research attests to an "increasing focus on strategic risk management", which raises important challenges for risk managers who will need to construct the specific risk management tools, principles and processes in deliberating, measuring, acting on and reporting an ever-widening universe of risks.

As a researcher, teacher and observer of risk management practices, I have to admit it still remains a challenge to define the phenomenon of risk management. Are these the control practices that are explicitly called "risk management" (and/or labelled as "ERM") by the executives who design and implement them? Certainly, in the financial services industry, risk-management practices are more clearly identifiable due to regulatory and corporate governance imperatives to create a specialist staff function headed by a chief risk officer (CRO). There I (and many others) have observed the variation in senior risk officers' attitudes to risk modeling and in the resulting instrumentation of risk management. Elsewhere, the job of identifying risks and helping business lines manage them falls not only to risk specialists, but also to internal auditors, strategic planners, finance staff, management accountants, and importantly, to the business lines. Given the evolving nature of risk control, it is unclear which of the tools and practices now in use will ultimately make up a common body of knowledge that can define the (future) profession of risk management. Risk management may indeed evolve into an "umbrella function" for the discussion of certain kinds of risk. Its advocates, the risk managers, may gain control of important organizational agendas, such as planning, resource allocation, and reward systems and be able to standardize tools and reports that allow their companies to manage universal risk concerns. On the other hand, risk management may remain highly contingent on situational politics, opportunities, and demands, "plugging" the control gaps left unaddressed by other control agents. Either way, its survival or failure depends on whether risk managers succeed in making their function both *seem* and *be* important to the control agents and processes already in place.

This book underlines a lesson I have learnt in my first 10 years of doing intensive fieldwork in organizations, and adds an international dimension to it: Risk management is neither universally beneficial nor indifferent to managerial practice – its contribution is contingent. The essence of a contingency theory of risk management is to find "fit" between contingent factors and firms' risk-management practices, and to establish propositions of fit that will result in desired outcomes. Moving towards a contingency theory requires a more sophisticated understanding of not only the nature of relevant contingencies, but also the nature of risk management itself. Building on a growing strand of field-based studies, including the research presented in this volume, we could propose a practice-based definition of risk management with more confidence:

> Risk management consists of active and intrusive processes that (1) are capable of challenging existing assumptions about the world within and outside the organization; (2) communicate risk information with the use of distinct tools (such as risk maps, stress tests, and scenarios); (3) collectively address gaps in the control of risks that other control functions (such as internal audit and other boundary controls) leave unaddressed; and, in doing so, (4) complement—but do not displace—existing management control practices.

While some risk management frameworks suggest that risk managers should focus mainly on operational risks (as an enhancement of the internal audit process), others suggest that the risk-management mix should focus mainly on strategy execution risks (COSO, 2004[1]; International Standards Organization, 2009[2]). This book and previous studies suggest that risk management will be most effective when it matches the organization's context and circumstances.

Yet even a world-class, thoughtfully tailored risk management system cannot prepare a company for everything. Some risks are so remote that any individual manager or group of managers could never imagine them. And even when firms envision a far-off risk, it may seem so improbable that they are unwilling to invest in the capabilities and resources to cope with it. Such distant threats, "novel risks", cannot be managed by following a standard playbook. Future research – and much ingenuity from practitioners! – are needed to explore the defining characteristics of these risks, explain how to detect whether they've materialized, and then describe how to mobilize resources and capabilities to mitigate their impact. The current challenging environment will offer therefore important lessons about the strengths, weaknesses and the potential still unrealized in contemporary risk management practices. Finally, in the context of the Purposeful Company movement and climate-risk and sustainability concerns, the remit of risk management is being expanded, which again calls for ongoing critical and field-based research on its continually emerging instrumentation, processes and ability to address the global challenges we are facing.

Oxford, 21 September, 2020.
Anette Mikes

[1]Committee of Sponsoring Organizations of the Treadway Commission (COSO), *Enterprise Risk Management Framework*, 2004.
[2]International Standards Organisation (ISO), *ISO 31000:2009, Risk Management—Principles and Guidelines*, 2009.

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Introduction

Marco Maffei

To act with prudence,
to act while thinking of continuity,
to act to serve the common good.

This volume investigates the state of development of enterprise risk management (ERM) in Europe and identifies the factors preventing its full application. This work recognizes the lack of coordination between ERM and governance processes as well as emphasizes the need for integration between ERM and accounting practices. Also, it acknowledges the huge divide between theory and practice in this field and poses the bases for greater efforts, above all at the policymaking level, towards better overall ERM.

Many reports and papers support the concept that to reach an efficient, competitive, sustainable, healthy and long-term business, it is fundamental for entities to consider the importance of risk management in their decision-making process. In this regard, ERM is often understood and cited as the reference model to be applied. Nevertheless, it is also well-acknowledged that the operationalization of ERM is far from realizing its benefits. Although it is documented that European entities are progressively enhancing their risk management fundamentals, due to some unresolved idiosyncrasies, these practices are producing an explicit added value only to a limited extent.

Academics and practitioners are well aware of the importance of understanding and eliminating these idiosyncrasies, but this aim remains hardly reachable due to the incomplete cognition of the theoretical boundaries and the practical implications of many concepts. For example, it is still unclear whether there is a difference (if any) between risk management and ERM. Moreover, there is neither generally accepted measures of risks nor generally accepted principles for monitoring, managing and controlling them. Suffice to say that there are several published standards and guidance proposing their own ERM model, as, for example, the ISO 31000 "Risk Management Guidelines" and the COSO framework "Enterprise Risk Management Integrating with Strategy and Performance". This implies that how ERM is tailored to the features of an entity is left to the management, and without an appropriate operationalization, there is the "risk" of losing the benefits related to an effective integration of ERM into corporate processes.

Enterprise Risk Management in Europe, 1–5

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Previous studies on how risks are managed by entities provide an overview of the field, often focusing on specific kinds of risks, using a wide range of methods, and attempting to tie together theory and practice. However, despite the common calls for an effort to manage risks, awareness is lacking of the reasons for non-successful ERM practices in different entities. In this regard, I posit that it is not enough to analyse how ERM principles are embedded in daily operations and how entities can be equipped when any risk occurs to examine ERM in practice. This volume analyses ERM from a different perspective; especially, it investigates the characteristics of the institutional contexts and the state of diffusion of the culture of risk in which ERM operates.

Arguably, there are many reasons why it could be necessary or desirable for entities, operating in different contexts (industries and countries), to apply common ERM principles. In intertwining ERM with operations through the appropriate functioning of governance mechanisms and accounting practices, entities could respond to real-time situations more effectively, thus minimizing losses and maximizing benefits. The core idea here is that there is the need to operationalize ERM in entities not only in the interest of the entity itself but also for the stability of the economy. For this reason, relevant entities should be subject to clear and consistent requirements around ERM.

This volume moves from the consideration that, more recently, several firms have adopted ERM in response to either certain factors, such as the globalization of capital markets, the last financial crisis and the changes in corporate regulations, or certain trigger events, such as financial scandals or relevant company defaults. Therefore, the way entities design ERM in their organization depends, on the one hand, on the domestic economic development and specific regulation adopted in the country in which they operate and, on the other hand, on the state of knowledge among practitioners of the risks that could hit their sector or the firm itself. In light of an extensive background of the economic and legal environments of many European countries, this volume includes a verification of the ERM principles and self-regulatory agencies that govern each national system.

It is well-known that firms are operating in an economic environment characterized by a slowdown. The Global Risk Report 2020, published by the World Economic Forum, warns that the downward pressure on the global economy from macroeconomic fragilities and financial inequality is increasing the risk of economic stagnation. This report documents that the economy could also be hit by the risks deriving from cyberattacks, climate threats and accelerated biodiversity loss and digital fragmentation. We also know that the economy could be hit continuing fallouts from the COVID-19 pandemic.

The European Union is increasingly committed to ensuring that entities monitor their risks. In the financial sector, the aim of the EU rules is that banks curb excessive risk taking, and thereby help to ensure financial stability. Besides specifically strengthening the banking regulation, in March 2019, a political agreement was reached on the Regulation on disclosures relating to sustainable investment and sustainability risks. Also, the Capital Markets Union is complementing the Banking Union to strengthen the Economic and Monetary Union by suggesting private risk-sharing mechanisms, which could play a particularly important role in cushioning country-specific shocks in the Economic and Monetary Union and contribute to risk reduction in the financial sector. More recently, the European Supervisory Authorities (ESA) warned that every relevant entity should effectively manage ICT risk, including cybersecurity risk, with appropriate governance, operational and control measures in place. Also, specific EU regulations are related to money laundering, corruption and privacy risks.

It is worth noting that the EU is essentially oriented toward the enforcement of risk management and mitigation requirements in the financial sector. However, the EU rules tend to approach risks from a silo-based perspective, with no emphasis given to the holistic approach to risk management. In spite of the growing concern that regulatory interventions address the issues of risk and of its (possible, auspicious) management, the EU continues to neglect the importance of ERM practices being rooted in governance mechanisms and intertwined with accounting processes. This neglect leads to relevant misalignments between regulated and under-regulated corporate practices, which, indeed, are strictly integrated and addressed to satisfy common needs and reach common aims. Notably, under-regulated practices could even undermine the effectiveness of the regulated ones if they are not correctly embedded in the corporate processes. Generally, these aspects are not addressed, even in the domestic regulations of each European country.

Given all the above, the purpose of this volume is to identify the obstacles to the spread and appropriate application of ERM in Europe and to lay the groundwork for overcoming these barriers.

In designing this volume, a preliminary aspect concerned the choice of the European countries to include in the analysis. There were some difficulties in deciding how to establish the coverage of the European countries and, therefore, which countries to include in the guide. As well, there was a concern about limiting it to only those countries belonging to the European Union. The limited space in this volume and the degree of repetition that was likely to arise for certain areas with some well-known commonalities fostered the selection of the European countries.

Each of the following countries is examined in a dedicated chapter: France, Germany, Greece, Italy, Lithuania, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. I hope this guide can be developed in the future and further countries included in order to broaden the debate by considering all the EU countries.

A further relevant issue to solve concerned the content of each chapter. Despite the variety of methods used to investigate ERM in each country, the authors conducted their analyses following a common path to ensure comparison. In this regard, to make sure that a comparative analysis could be conducted, and therefore a lesson could be derived from this volume, it was also necessary for some common topics to be discussed in each chapter. The following list summarizes the main topics.

- Country economic highlights: The description of the economic context and the development of most relevant businesses and political investments are features that characterize the way ERM could be widespread and accepted by entities.

- Domestic legal regulation of ERM: Regulation plays a huge role in the way entities implement the mechanisms of ERM. For example, some regulations require the implementation of internal control systems, while others focus solely on specific risks and require a monitoring process. Therefore, domestic regulation frames the models of ERM used by entities.
- Impact of academic research on ERM practices: Academic research on ERM develops knowledge and suggests ways to implement effective EMR models; a description of the state of the art of domestic academic research on ERM provides a comprehensive picture of its actual application, as well as the interest in this topic.
- Domestic professional bodies/associations: It is well-known that long-established professional tasks, such as accounting, are strongly represented by domestic professional bodies/associations; less evident is the role of domestic professional bodies/associations in ERM. Therefore, an understanding of what they are and what they do could shed light on how ERM is generally accepted and applied in each country.
- Domestic ERM principles and practices: Despite the existence of regulations and professional bodies and associations, it is relevant to know which particular principles are adopted by entities.
- The degree of integration of ERM practices with governance mechanisms, accounting practices and disclosure in annual reports.

The volume also includes a chapter on ERM in practice from a European perspective, and concludes with a comparative analysis, addressing some concerns useful to practitioners, policy makers and academics.

The contribution of this volume is twofold. First, although there is a general acceptance by entities in their efforts to manage risk, the theory is unable to promptly capture the new emerging risks and the changes in the complexity of risk management. By conducting a country-specific analysis of ERM, it is possible to shed important light on the perceived risk management needs and on the priorities established by countries in promoting a risk culture and proposing risk management tools.

Second, this volume emphasizes that the risk culture is different in each country (and not only in each entity) and that the widespread adoption of ERM among entities also depends on the role played by researchers and professional bodies. In this regard, international research on ERM is mainly focused on specific economic contexts and sectors, with the effect of discouraging ERM adoption in countries with different settings. In addition, there are some domestic professional bodies not specialized in risk management that propose round tables on risk management, but do not give the appropriate value to ERM.

This book could be of interest to European risk practitioners, as they would benefit from an operational ERM that involves, from an integrated perspective, the governance, accounting and disclosure processes of the organization. Practitioners could also learn from the application of ERM practices in different countries, and multinational companies could benefit from a deeper knowledge of the determinants of the success or failure of the application of these practices.

Additionally, this volume could be useful to policy makers, who could learn from the country diversity and re-think the existing regulations. Their awareness of the evolution of these practices could be expanded in order to develop an appropriate regulation addressed towards the creation of a set of generally accepted ERM principles. Specifically, we hope that the European Union will put into its agenda the proposal to develop ERM principles, applicable beyond the financial sector and integrated with the corporate governance, financial accounting and disclosure rules.

This volume could also be useful to academics, as it fills some gaps in the existing literature. Despite the dominance of the international ERM framework, to the best of my knowledge, there are no studies that examine how the domestic economic and regulation context and risk culture influence the widespread adoption of ERM and investigate the way it is implemented and used by management. This volume provides essential country-specific reading for students and scholars interested in understanding the diverse features of ERM.

Moreover, I hope this volume will be useful to different kind of readers. It would indeed be gratifying to see this book appreciated beyond the European borders. I am aware, however, that the next challenge will be to develop a new edition increasing the country coverage and providing a deeper analysis of ERM operationalization. This will surely be the view for the future.

I acknowledge an intellectual debt to the ERM community. I am aware that it could have been possible to provide even deeper insights using rich qualitative case studies. I also realize that a comparative analysis among countries should be based on a more sophisticated analysis of differences in order to explain institutional and cultural diversity. However, this volume mainly aims to fill a relevant gap in the literature related to the lack of knowledge about how ERM is perceived and applied in different institutional settings that are linked by a common geographical and political ground.

Finally, I would like to extend my deepest appreciation to all the authors of the chapters in this book. Their enthusiasm and professionalism have been an incentive for me to develop this work, and this will continue in the future.

Marco Maffei
(the editor)

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Chapter 1

Enterprise Risk Management in France

Mohamed Taieb Hamadi, Caroline Aubry and Sami El Omari

Chapter contents

Abstract

Risk management (RM) is a rapidly developing field in France. Several associations are trying to promote an approach of ERM that is far removed from insurance and compliance. In practice, we note that the RM in French companies is still very strongly rooted in internal control. Risk managers in France do not have yet the "risk champion" role of the chief risk officer.

Keywords: Enterprise risk management; internal control; corporate governance; chief risk officer; risk-based regulation; risk management practices

Enterprise Risk Management in Europe, 7–21

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1. Introduction

As a management lever, risk management (RM) helps to create and preserve the company's value, assets and reputation, to secure decision-making and processes for achieving objectives, to promote the consistency of actions with the company's values, as well as to mobilize the company's employees around a common vision of the main risks which creates the awareness of the risks inherent in their activity.

Over the last 30 years (1990–2019), risk has become a strategic variable in French companies' organizational thinking as a result of five factors: (1) the broadening of the field of risk, with the emergence of new risks stemming from technological changes, for example, and a multiplication of the terms used to clarify its nature (ethics, reputation, etc.); (2) the subjectivity of risk and the notion that differing perceptions of risk exist depending on the person in question or the hierarchical level within the company; (3) the reluctance of insurers to take on new risks; (4) cases such as the Lubrizol factory fire, Renault-Nissan and the detention of Carlos Ghosn, or the Enron bankruptcy, to name only the most recent and high-profile examples; and finally (5) the actors-amplifiers, such as legislators and the media, who have spread the image of a riskier world in the period since 2004.

In France, the precautionary principle is enshrined in the constitution. It is therefore a very interesting context for examining the development of RM and for determining whether the context itself has been favourable or unfavourable to the implementation of an ERM-based approach and to the emergence of risk managers who are free from internal control (IC) and who play more of an advisory-partnership risk role, oriented towards management.

2. Key Characteristics of the French Economy

France is the sixth largest power in the world and is the world's leading tourist destination. It is a services country – its tertiary sector produces more than 70% of its added value (as a percentage of GDP) and accounts for more than 76% of total employment. Industry represents 20% of employment and 17% of added value (INSEE, 2018a).

Unemployment in France is high for a developed country (8.6%) and the inflation rate was 1.2% in 2019 (INSEE, 2020). However, the French economy has become more resilient to the various European and global crises due to the latest batch of reforms and its social security system.

The largest industries in the manufacturing sector are chemicals (23%), followed by the food industry (20%), both of which have a high risk of public exposure (INSEE, 2018b). Incidents in these industries occupy the public arena for long periods of time with very significant social and political repercussions (e.g. the fire at the Lubrizol factory in 2019 and the Lactalis contaminated milk case in 2018).

The economic fabric in France is characterized by a very high proportion of VSEs and SMEs (over 97%). French SMEs and medium-size firms are predominantly family-owned; they are more agile and have a lower risk of failure.