

Where Strategy and Risk Meet ©

Alma Grove Consulting

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Corporate Strategy

Incorporating Risk Appetite into Strategy Development – The Four Quarters Strategy Framework

Corporate collapses litter the business landscape all over the world. Post mortems, bankruptcy / insolvency investigations, government enquiries and media reporting inevitably focus on a small number of identifiable failings:

companies understand the real learnings, when seeking to improve strategic planning and decision making. Often the specific business decision – such as the decision to make an acquisition, undertake a major project, expansion or initiative –

... abstract determinations of “poor management” or “strategic failures” do not however assist boards and management of companies understand the real learnings, when seeking to improve strategic planning and decision making.

“poor management”, “excessive risk taking” or “strategic failures”.

Business schools also pour over such financial calamities and document the specific business decisions that take place leading up to the company’s demise.

Relatively abstract determinations of ‘poor management’ or ‘strategic failings’ do not however assist boards and management of

was in isolation a sound business decision.

What however was not a sound business decision was the significant increase in financial or business leverage that the investment or initiative entailed.

In many corporate failures, it is clear that whilst there may have been a sound business rationale for the acquisition or investment, the key issues was the accompanying increase in

About Alma Grove Consulting

Alma Grove Consulting is an Australian based, specialist consulting firm servicing Banks, Financial Institutions, Corporate & Government clients, in areas of Strategy and Risk Management.

Alma Grove Consulting provides support to Boards, CEOs, Senior Executives and management teams in the following areas:

- Strategic Planning; and General Strategic Advice
- Establishment of Risk Appetite / Risk Boundaries
- Enterprise Risk Management
- Strategic Planning Workshops
- Change Management and Organization Restructuring
- Independent Project Quality Assurance Reviews
- Independent Reviews of Problems / Issues
- Credit Risk and Client Engagement Training
- Coaching & Mentoring in Strategy, Risk and Finance for Senior Executives

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financial leverage or financial risk.

Alma Grove Consulting has developed a strategy framework that incorporates an assessment of risk appetite into the strategic planning and development process. This is the missing link in many strategic planning frameworks.

The Four Quarters Strategy Framework looks to address strategic issues in four sequential steps.

- **Assessment of Core Strengths.**
- **Assessment of Growth Opportunities.**
- **Assessment of the Marketplace and Competitive Positioning.**
- **Determination of the Firm's Risk Appetite**

Future newsletters will go into further detail on ways to improve the assessment of the first three quarters of the Four Quarters Strategic Framework. For the moment however we will focus on the fourth quarter.

The outcomes of the detailed strategic assessment of the organization from the first three quarters will be a long list of growth opportunities, new products, strategic initiatives and (potentially) acquisitions. In simple terms, however an organisation is constrained in that it will potentially not be able to do everything.

An organisation usually has a finite amount of physical, personnel and financial resources. These are usually tangible and measurable constraints. Less tangible however is the concept of a constrained or finite 'risk appetite'. How much 'risk' is the firm prepared to take in growing

with the increased financial leverage ?

- **Downside Stress Testing.** If there is an increase in financial leverage – have new downside scenarios been undertaken on the new financial profile ?
- **New Markets Risk.** Will the new initiatives or new strategy involve an increased

The final step in using the Four Quarters Strategy Framework's is a determination of the Firm's Risk Appetite.



and expanding its businesses ?

Key considerations when finalising new business plans and strategic initiatives will include:

- **Adequacy of Financial Resources.** Does the organisation have the financial resources to accommodate the new initiatives or investments and continue to support growth initiatives in existing businesses ? Can the organization comfortably accommodate any increased financial leverage ? If there are existing borrowings, will lenders and/or other debt providers be comfortable

risk exposure by entering these new geographic markets ? Is the organization comfortable with the changed risk profile ?

- **Operational Risks.** Is there an increased or new Operational Risk profile ? Even a lateral move into related business fields can result in an organization having a vastly different operational risk profile.

An example of this is where a retail supermarket chain expands into petrol (gasoline) retailing. The latter has a significantly different (and higher) operational risk profile to grocery retailing.

- **Government & Regulatory Risks.** Has consideration been given to any new risks from a Government or Regulatory perspective ?

These are a small selection of the issues that should be considered when assessing strategic options and developing a new strategic plan. Too often risk management issues are

addressed after a plan has been developed and approved.

Risk Management in Business

SPOTLIGHT ON: FINANCIAL MODEL RISK

As outlined in last month's newsletter, Alma Grove Consulting has been developing a comprehensive - yet easily to understand - framework for the identification, assessment and management of risk issues in the business world.

In this newsletter we focus on an important Financial Risk – **Financial Model Risk.** Financial Model Risk is the risk that a financial or other technical or quantitative model that is supporting key business decision making processes is inaccurate or flawed.

Model risk is not widely understood nor appreciated. In mid 2001, the Australian bank, National Australia Bank discovered a flaw in the financial model it was using to manage the interest rate risk in the home loan portfolio of its US subsidiary, Homeside. The error resulted in total losses of \$3.6bn.(including \$858m in goodwill writedowns).

Key steps to ensure that a firm reduces the risk of Financial Model Risk arising can include:

- Identification of key financial models used within the organisation. A register should be maintained of these key models.
- Ensuring all key models are subject to an initial comprehensive review or audit, and have documentation in place detailing the model methodology.
- Ensuring that any financial models used for one off activity such as a large project (feasibility and/or bankability) or an M&A transaction are carefully reviewed. This can be undertaken internally or externally, depending on the resources of the organisation.
- Ensuring that the scope of internal and external audit functions included a regularly review of the use of key Financial Models.
- Ensuring adequate resources are in place to maintaining and update financial models.

Next Month in the *Risk Management in Business Series:*

SPOTLIGHT ON: COUNTRY RISK

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