

## **Public Sector ERM: Governance and the Strategic Triangle**

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Over the past decade, enterprise risk management (ERM) has been employed within the private sector for a variety of different purposes. Some practitioners view ERM through the lens of business continuity planning and crisis management. Others view it through the lens of financial and integrated risk management, while still others view ERM as a tool to be utilized within the audit and compliance function. These are all important ingredients that go into the overall mix of an ERM approach to risk management. However, two additional components are receiving a great deal of attention from private sector “C” suites - governance and value creation. The public sector approach to ERM has evolved to mirror the private sector, except that the adoption rate has been slower in the public sector. One reason for the slower rate of adopting ERM is that its value component may not be as clear in the public sector as it is in the private sector where an increasing stock price serves as a very public measure of success. As public sector ERM continues to evolve some practitioners are exploring the issue of if and how the value component can be melded to a fundamental public service mission. Recognizing that the electorate can and does change administrations every few years, reduced internal capabilities and tight budgets will be the rule. Extracting value from ERM means that the critical element is not initiating the risk identification and assessment process because that will only get a public entity to the starting line. Extracting value will come from a collaboration effort where the data and information from the risk identification and assessment are analyzed, interpreted, and inserted into the overall strategic plan.

Chapter 13 of *“Success Stories: Public Entities Adopt ERM Best Practices”* Kristina Narvaez introduces Mark H. Moore of the John F. Kennedy School of Government at Harvard University and his concept of the Strategic Triangle found in his seminal 1995 work *“Creating Public Value”*. As conceptualized by Moore, the three components of the Strategic Triangle are: public value, political management, and organization capabilities. In 2004, Dr. Moore and Dr. Sanjeev Khagram, as part of their work for the Corporate Responsibility Initiative, raised three key questions that must be considered together for the Strategic Triangle model to effectively work. “First - what is the important public value the organization is seeking to produce? The second – what sources of legitimacy and support would be relied upon to authorize the organization to take action and provide the resources necessary to sustain the effort to create that value? Third question – what operational capabilities (including new investments, innovations and alliances would the organization rely on (or have to develop) to deliver the desired results? “

It is the third question associated with the Strategic Triangle that opens the door to ERM. It can be argued that ERM brings the Strategic Triangle model alive because it contributes to creating the operational and administrative conditions

that make value seeking activities and favorable outcomes more likely. It is as Dr. Moore has stated - "finding the fit between the environment they face and the enterprise they lead." One way the private sector is "finding the fit between the environment they face and the enterprise they lead by the formation of board level risk committees in addition to the traditional audit committee. Twelve publicly traded companies ranging from GM to JP Morgan Chase have both committees that complement, collaborate, but do not compete with other. The reason for the two committees is the audit committee is primarily a control and monitoring function while the risk committee is a strategic function. Both committees are critical, but their responsibilities are different.

As public entities perform their day-to-day mission of servicing their constituency, they also have to plan ahead for future sustainability in the context of changing demographics, political transitions leading to entirely new view points, and a continuation or worsening of current economic conditions. Long range planning in these conditions is difficult at best. Bringing the ERM process and some of the tools associated with it to bear, improve the administrative and operational conditions thus enhancing the chances of success. One of the tools an organization can utilize is the use of scenarios. Because project development time from idea to reality can take years maybe even decades, a great deal of uncertainty is associated with most initiatives. One of the goals of the ERM process is to reduce uncertainty, or said another way, to bring greater certainty to long range planning and project development.

A great deal has been written about scenarios. The military uses them in war games and various companies are proponents. As Charles Roxburgh of McKinsey & Company stated in a November 2009 article in the McKinsey Quarterly, "Scenarios enable the strategist to steer a course between the false certain of a single forecast and the confusing paralysis that often strike in troubled times." Roxburgh continues by saying "You will think more broadly if you develop a range of possible outcomes, each backed by the sequence of events that would lead to them. This exercise is particularly valuable because of a human quirk that leads us to expect that the future will resemble the past and that change will occur only gradually. By demonstrating how – and why – things could quite quickly become much better or worse, we increase our readiness for the range of possibilities the future may hold." The financial crisis 2008-2009, the BP oil spill, and the Japan nuclear catastrophe are recent examples of events that can change public policy almost over night. Events such as these raise very legitimate questions of sustainability. These are also situations where utilizing scenarios might have contributed to better preparedness. After all, past history does include stock market crashes, catastrophic oil spills, and earthquakes that produce tsunamis in Japan and elsewhere.

To execute on these ideas requires a mind shift about ERM. It is not just a tool that should be exclusively utilized in the audit and compliance function. ERM is a process that can be employed to balance the traditional risk management mantra

of preserve, protect, and comply with value creation activities that exploit opportunities. It requires that ERM is part and parcel of the strategic planning process. ERM is the process that, if done correctly, will lead to far better decision-making and enhance the governance function within public entities.