SETSCoP Governance Training
Strategy & Risk for Boards

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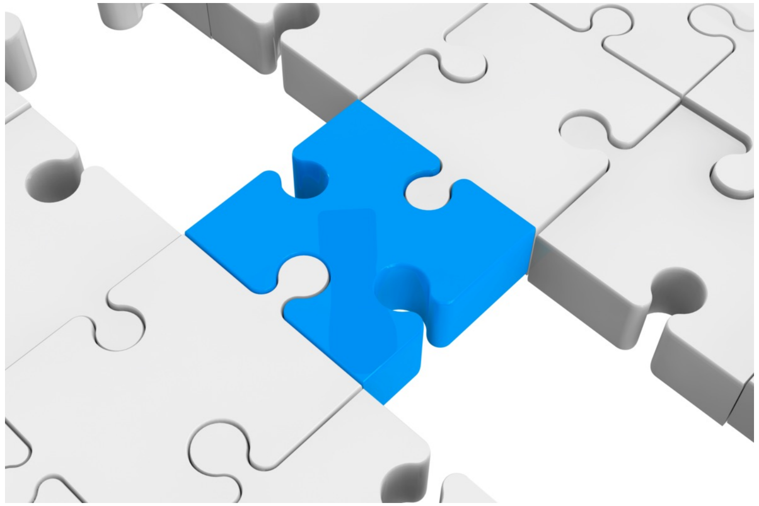
SETSCoP Governance Training

- Webinar 4 – Finance for Non-financial Board Members
- Webinar 5 – Legal issues in Governance
- Webinar 6 – Strategy & Risk for Boards



Objectives

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- ✓Achieve common definitions of Strategy and Risk.
- ✓To understand the Board’s role in setting Strategy
- ✓To understand the Board’s role in managing Risk
- ✓Key learnings as to Strategy & Risk

Strategy

What is strategy?

There are many definitions and perspectives. Some include:

1. A purposeful orientation towards success in a complex competitive environment
2. Strategy describes how the organisation intends to create value for its members and stakeholders
3. Strategy is as much about an ongoing interactive process as it is about the creation of strategic plan itself.
4. Strategy is about competitive position.

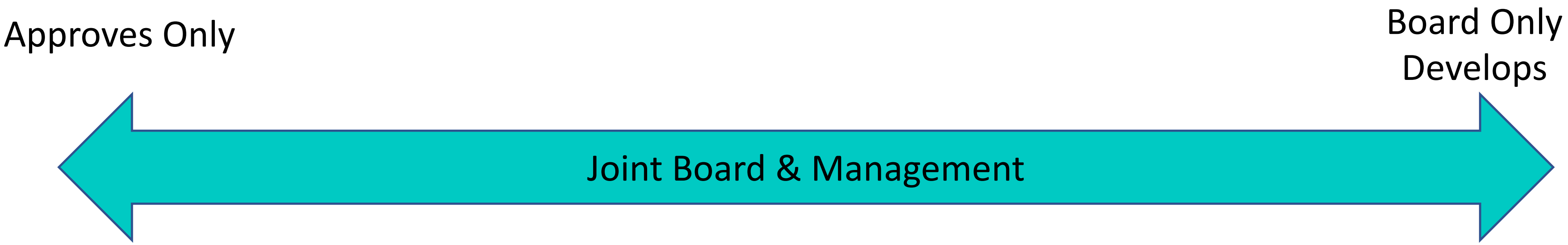
Do NFP organisations have or need strategy?

- Strategy is often related to competing, craving out the organisation’s position in it competitive environment against its competitors.
- So many believe that NFPs don’t have competitors, that this is the world of commercial organisations, and so as such they don’t have or need strategies.
- Let’s s dispel some myths and clarify some important points:
    - The competitive environment is not limited to “competitors”. Rather it represents external forces that shape the environment that organisation ability to compete (Michael Porter). These include:
        - Clients/customers, suppliers/supply chains, technology, new entrants, regulatory AND competitors.
    - NFP do compete for grants, projects, programs, so they have competitors.
    - Strategy is predominantly external in is focus and approach.

The role of the Board in strategy

1. Set the purpose (vision, strategic direction, strategic intent, etc)
2. Strategic thinking and foresight
3. Approve the strategic plan
4. Set the KPIs and monitor execution
5. Approve subsequent strategic decisions

The level of Board involvement is along a continuum



The position above is dependent on:

1. The Board and management's capabilities and skills
2. The circumstance, major strategic and transformational change versus ‘tweaking’ the edges

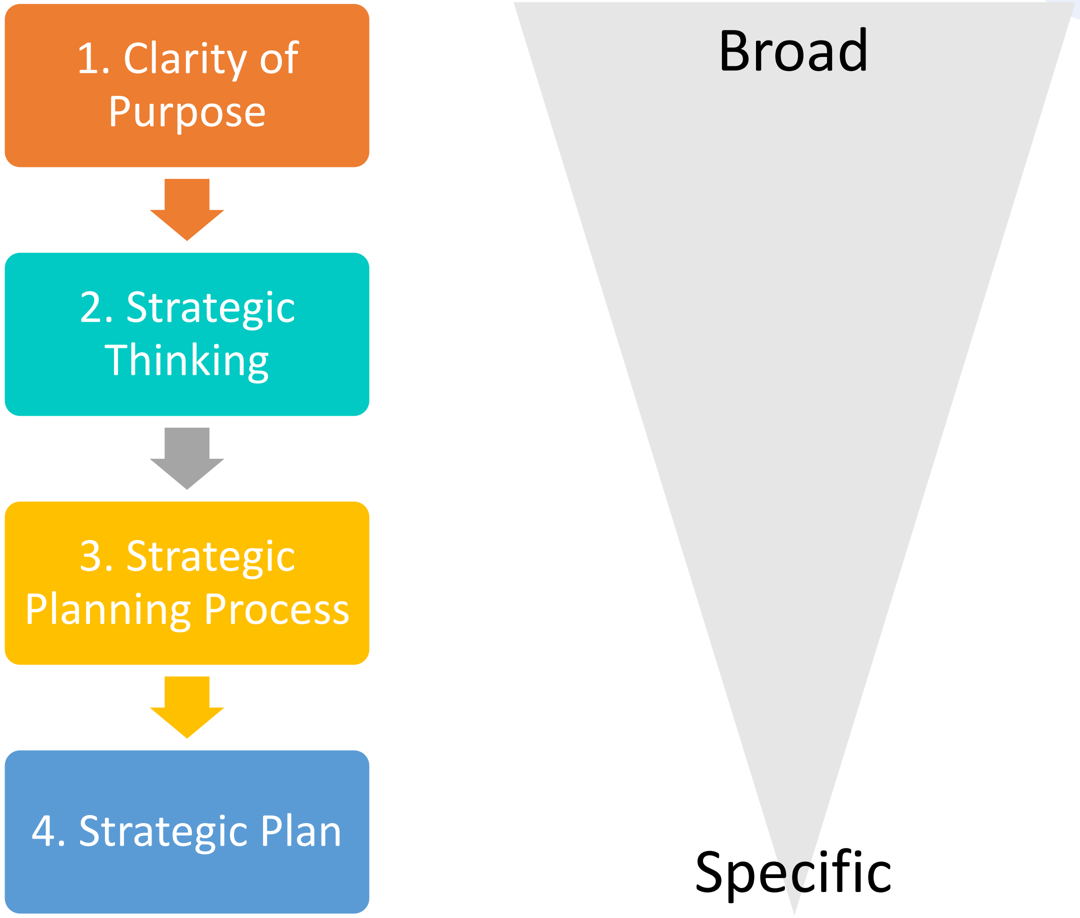
Strategy development

1. Clarity of purpose (vision, end state, strategic intent)

2. Two elements
- Insights - the true nature of the current state
- Foresight – a view of the future

3. Is a process from analysis to identification of options, decision-making, organisational readiness and determining KPIs. <u>(One size does not fit all).</u>
Appropriateness, Feasibility, Sustainability, Accountability

4. Executing the plan, monitoring, and culture



Strategic analysis tools

Strengths, Weaknesses, Opportunities, Threats (SWOT)

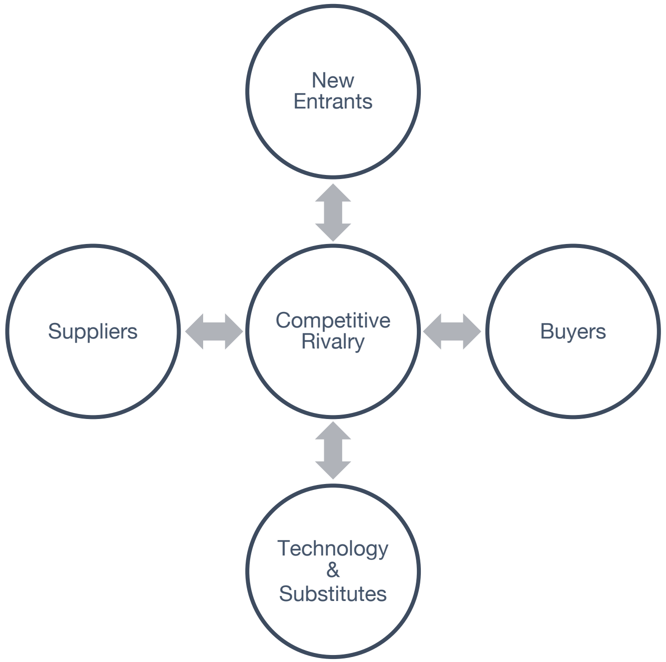
- The most commonly used tool
- Easily understood
- Generally poorly applied
- Conducted in two distinct parts:
    i. Internal – Strengths & Weaknesses
    ii. External – Opportunities & Threats

Industry analysis (Porter's Five Forces Analysis)

- Stood the test of time (42 years old)
- Excellent way to look at and develop Opportunities and Threats

Political, Environment, Social, Technological analysis (PEST)

- Used analyse macro issues



Monitoring strategy

- Joint Board and Management responsibility.
- Set appropriate KPIs to measure the progress and performance of the strategic plan. (This is Board level KPIs as opposed to management or operational KPIs).
- Board's responsibility to ensure management has the appropriate resources to complete the strategic plan.
- <u>Must</u> be integrated with risk management.
- Watch for triggers that may provide early warning to problems.

<u>An important point:</u>

The Board's ability top provide meaningful oversight as to the strategic plan is directly related to the timeliness, confidence and quality of the information provided to the Board from Management.

Risk

What is risk?

- Risk is often associated with ‘danger’, ‘peril’.
- Risk comes form the Italian verb ‘riscare’ meaning to “to dare” specifically: to take action that either succeeds or fails.

One definition of risk:

ISO31000 - “the effect of uncertainty on objectives”

Ok this is what we know about risk

- Risk is about looking to the future
- Risk involves two elements 1. ‘consequences’ (impact) and 2. ‘likelihood’ (probability)
- To move forward you have to take risk (saying no to everything is not risk management)

Types of risk

Strategic risk – risks that could affect the organisation's ability in achieving its strategic objectives.

They generally have significant consequences and as such they are the most important group of risks and are considered at Board level.

Examples could include:

- Climate change.
- Change in consumer and competitor behaviour.
- Change in government policy.
- Positive and negative change in the economy.
- Failed strategic plans or failure to act on opportunities or threats.
- Loss of the CEO.

Types of risk

Financial risk – risks that could have a significant impact on the organisation's financial position especially as they may relate to solvency.

Examples may include:

- Overdue creditors and debtors.
- Project spend overruns.
- Change to interest rates or currency & commodity markets.
- Cost of doing business (CODB) expense blowouts.

Types of risk

Operational risk – risks relating to the organisation's day-to-day operations. These are related to failed internal processes, people, systems or external events.

This group are predominantly dealt with by management with the Board maintaining an oversight.

Examples such as:

- WHS.
- Loss of key personnel.
- Legal compliance.
- Industrial action.
- Equipment or systems failure.
- Cybersecurity failures.
- Payroll process failures.

Emerging risks

- Disruptive innovations – Uber, AirBnB, Streaming Servcies,Crowd Funding,
- Disruptive technologies – Robotic, nanotechnologies, mobile communications
- Global risks – pandemics, extreme weather events, terrorism, climate change.
- Social media – who is the customer?, how safe is the space
- Interdependency (contagion) – global shocks such as subprime mortgage failure
- Cloud computing – data security and privacy on a global scale
- Cybersecurity – in top three business risks in 2021
- Environmental, social and corporate governance – increasing levels of scrutiny as to ESG

Role of the Board with regard to Risk

1. Set the risk appetite
2. Determine the structure for risk management
3. Embed risk management into the Board's governance processes
4. Supervise and monitor risk

This is in two dimensions:

A. Organisational culture
B. Crisis management

Setting the risk appetite

- Defining the risk appetite is the most important role of the Board with regard to Risk.
- Must be aligned to the strategic plan and strategic decision making.
- Risk appetite: is the amount of risk the organisation is willing to pursue to meet its goals.
- It can be in different forms; some organisations may have a ‘risk appetite statement’.
- This statement will include the ‘risk tolerance’ (upper and lower limits) for risk in different areas
- For example; the organisation may have some tolerance for risk within new business ventures such as mergers and acquisitions but no tolerance for risk within Workplace Health and Safety

Examples from a NFP risk appetite statement risks

- Strategic risks - high
- Financial risks - low
- Fundraising risks - high
- Innovation risks - high
- Program risks - low
- Advocacy risks - high
- Reputational risks - low
- Fraud and corruption - no tolerance
- Compliance – low
- Human resources – low
- Information technology – low for availability of systems, no tolerance for misuse of information
- Operational risks - low

Risk management policy

- Clearly articulates the organisations approach to risk management.
- Provides clarity as to roles and responsibilities.
- Policy must be communicated to all levels of the organisation and to key stakeholders.
- Some government contracts in social services will require such a policy to be in place and regularly reviewed by the board/management.

Risk assessment

The basic steps of risk assessment are as follows:

1. Identifying the risk.
2. Risk analysis.
3. Determining the risk consequence (impact).
4. Determining the risk likelihood (probability).
5. Mapping the impact vs. the probability on a matrix.
6. Evaluating the risk level and actions taken.
7. Reviewing the effectiveness of existing controls.
8. If controls unsatisfactory developing actions to be taken.

Ways to treat risk

1. Treatment – achieves risk mitigation (risk reduction).
   - This includes steps to reduce either the probability or and the impact of the risk.
   - Boards and management will systematically reduce the impact of the risk and/or the probability of the risk occurring.
   - The level of risk remaining after internal controls are applied is known as 'residual risk'.
   - Residual risk is often the acceptable level of risk and is in keeping with the risk appetite.
2. Avoidance – is achieved by not starting or continuing with an activity or by removing the source of the risk.
3. Sharing – or moving the risk to a third party usually achieved through insurance.
4. Acceptance – where no action is taken, and the risk is accepted. Usually taken when organisations believe they can withstand the consequences.

Some risk will always remain high due to the nature of the business and this must be accepted by Boards and management.

Risk heat map

Actions & Controls

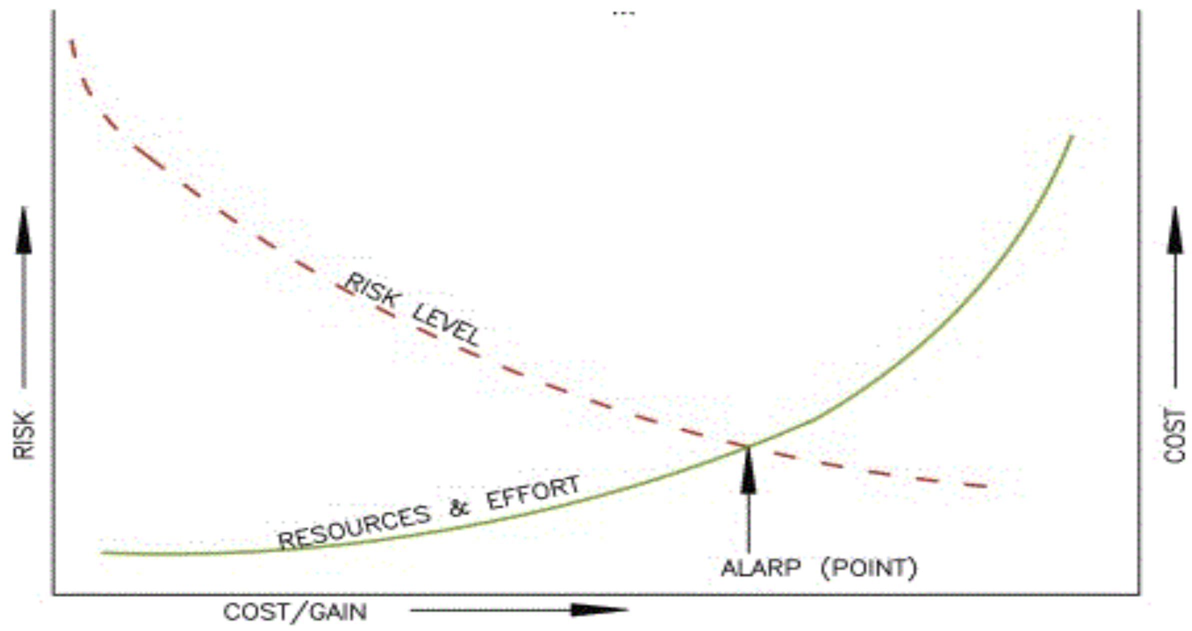
Risk

Risk Appetite

			Impact				
			1 - Insignificant	2 - Minor	3 - Moderate	4 - Major	5 - Catastrophic
Probability	A	Almost **certain** to occur in most circumstances	High	High	High	Extreme	Extreme
	B	**Likely** to occur frequently	Medium	High	High	Extreme	Extreme
	C	**Possible** and likely to occur at some time	Low	Medium	High	Extreme	Extreme
	D	**Unlikely** to occur but could happen	Low	Low	Medium	High	Extreme
	E	May occur but only in **rare** and exceptional circumstances	Low	Low	Medium	High	High

Residual Risk

ALARP (As Low As Reasonably Practicable)



A level of risk that is tolerable and cannot be reduced further without the expenditure of costs that are disproportionate to the benefit gained or where the solution is impractical to implement.

Organisational structure

The structure around risk management should be fit for purpose:

Options:

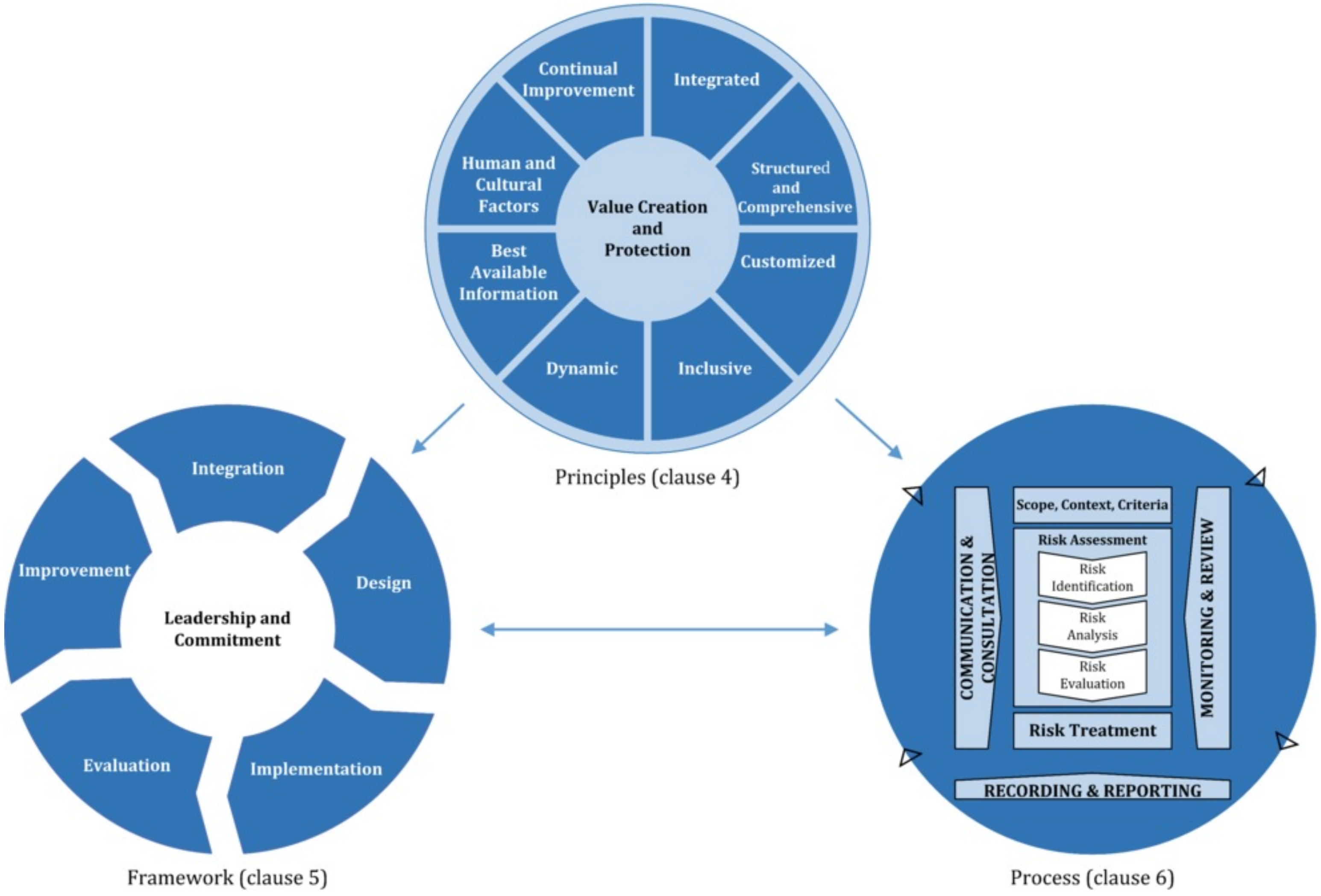
- Full board – no committee
- Audit, risk committee (NFPs often have Finance, Risk and Audit)
- Management and internal function
- External options
  - Various external auditors

Risk documents

- Risk appetite statement
- Risk management policy
- Risk management framework
- Risk registers
- Risk profile
- Risk reporting including heat maps

Risk standards

- AS ISO 31000:2018
- Promotes uniformity as risk management across organisations.
- Some government contracts may require human services organisations to have adopted risk management in accordance with AS31000.



Key learnings

- Risk and strategy are interlinked
- Risk appetite sets the high level parameters
- The Board should operate at a strategic level
- Stay abreast of emerging trends and associated risks
- Set KPIs and monitor performance.
- The Board sets the tone from the top in defining the culture

Further information…

Australian Institute of Company Directors (AICD)
www.aicd.companydirectors.com.au

Governance Institute of Australia
www.governanceinstitutue.com.au

SETSCoP Business Guides Governance Series
https://setscop.org.au/resource-type/governance-of-not-for-profits/

Australian Charities and Not-for-profit Commission (ACNC)
www.acnc.gov.au

Your local state government office

- Victoria – Consumer Affairs Victoria
- Queensland – Office of Fair Trading
- New South Wales – NSW Fair Trading
- South Australia – Family and Community
- Tasmania – Consumer Building and Occupational Services
- West Australia – Consumer Protection
- Australian Capital Territory – Access Canberra
- Northern Territory – Licensing NT

Questions?