

ERM VIDEO INSIGHTS

Transcript of Don Pagach and Bonnie Hancock *Insights from Academic Research on ERM*

Bonnie Hancock: Hi I'm Bonnie Hancock; I'm the executive Director of the Enterprise Risk Management Initiative at North Carolina State University. And I have here with me, Don Pagach, who is a professor at North Carolina State and also is our Director of Research for our ERM Initiative. To kick things off, Don, I'd like to just start by asking you about what types of academic research is going on, on the topic of ERM?

Don Pagach: Sure, so we have been doing research on enterprise risk management for about ten years, here at NC State and we've been involved in kind of three kinds of research. One is kind of survey research, and we've done some case studies, and we've also done some more traditional academic empirical research projects. Probably, I'll talk a little about each one. With empirical academic research, we've really done a series of papers with Mark Beasley and Richard Warr, who's in our finance department, that really kind of focused on one: the types of firms that have implemented enterprise risk management programs and what kind of characteristics they have. The second paper really focused on how does the market react to a company adopting an enterprise risk management. Kind of the interesting finding there was that there's kind of a significant difference between those firms that adopted enterprise risk management, if they were not in the financial or energy utility sector. And those firms that were not in those sectors really had a positive reaction to the enterprise risk management announcement. And then our third project, Richard and I worked on, was really kind of the long term performance of firms adopting enterprise risk management. The research that's been going on in the field is really been looking at the maturity of enterprise risk management and trying to get to that value proposition.

Bonnie: What are some challenges of doing this type of research around enterprise risk management?

Don: Sure, the biggest challenge is really trying to understand when did the company adopt enterprise risk management, you know, how mature their process is, and making sure that you have actually identified the firms that are doing it versus those that aren't doing it. I think the advantage of a case study, and we've done case studies, is you really learn a lot about one type of firm, and you can dig down and really understand what they are doing. Some of that may not be transferrable to other firms. The nice thing about a survey is you can reach a lot of people, you can ask some interesting questions, but it may not be specific enough to really kind of transfer that knowledge. With the kind of empirical academic research, we really want to use a big sample of firms and try to get an understanding of what's happening across industries, across time, and try to dig down on some things about enterprise risk management. The tough thing is who's doing it and who's not. And we've all used a proxy that if you have a chief risk officer or a director of risk management, that's when you start your enterprise risk management. But that's not fool proof and so we do have some error issues on that, but for the most part our findings have been pretty robust.

Bonnie: So the big challenge on the empirical academic research is you're pretty much limited to publicly available information about the companies to form the basis.

Don: Right, it would be nice if everyone just said we are starting enterprise risk management on this date, but they don't tend to do that. So we have to usually look at either when they hire an enterprise risk management director, chief risk officer, or some other kind of publicly available disclosure that they are doing risk management.

Bonnie: But do you still feel that you got enough information, that you do have some meaningful information from your surveys, from your research?

Don: Right so, when we look at our research, those would be the kind of things that would bias us against those results and so the fact that we are finding results makes us feel even better about our research.

Bonnie: Okay, well that makes sense. You've touched on this before, but maybe if you could kind of go back and sort of summarize what some of the key insights were about the types of companies that adopt ERM.

Don: Sure, so what we really found out is that companies, that are larger firms, that have more resources to do it. More importantly those companies, there's a number of findings in the paper but let me highlight this one, is that Richard and I found that companies that's stock options are in the money or close to the money, the board of the directors tend to implement an enterprise risk management program. It seems kind of, from a government perspective, pretty interesting that they want to make sure that the managers are taking on risk but they also want to manage that risk. And so that was one of the findings in that paper that's gotten a lot of citations and references.

Bonnie: That's really interesting, you know the other issue that I think enterprise risk managers grapple with and wrestle with and get criticized for a lot is what's the value of ERM? Does it really add value? How can we measure it? Tell me about the insights you have got in there.

Don: Sure, that's probably the most difficult issue that we are dealing with in enterprise risk management research. As you kind of go further from the date that we proxy the enterprise risk management program starting, there's other things that could be happening. So we have to do some kind of benchmarking against other firms in the industry and try to get an idea of why they are improving. Is it really risk management? Is it something else? In our initial papers we find some differences in results, but not significant enough to just claim that it's enterprise risk management but I think there's a number of papers that are working on that. I think going further we'll be able to do a better job and kind of think about what firms versus those firms that aren't doing it.

Bonnie: Okay, getting deeper in. So that sort of leads right into, that you're looking at that a little deeper now. What other sort of research projects can we look forward to hearing about in the future?

Don: Sure, so we are still doing the survey research at NC State through IACPA and Protiviti on emerging risk. And I know there's a number of case studies going on with people within the advisory board, and I think those will give us a lot of insight. On the academic side we are really kind of looking at how ERM and sustainability connect. Those companies are doing sustainability, those companies are doing enterprise risk management, and those companies that are doing both. Is there any benefit? Is there any synergy to doing those types of programs together? And I think that's really where we are these days.

Bonnie: Well that should be really interesting. Certainly managing risk should make you a more sustainable as a business. So we will see if the research proves that out. Thanks so much Don for sharing that with us.

Don: Thank you, appreciate it.