Turning Risk Into Reward: Navigating a New Course Toward a Return on Risk
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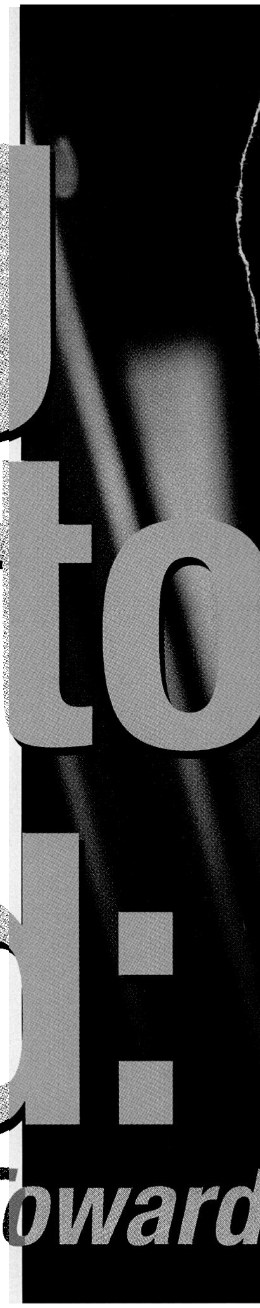


Turning Risk Into Reward:

Navigating a New Course Toward

by Gregory Morris

Is it time to think differently about risk? What if the risk perspective was inverted and looked at not as something to avoid, but as something that to manage for competitive gain? What if, in today's litigious environment and lingering hard market, well-managed risk became something that could be leveraged for financial reward?

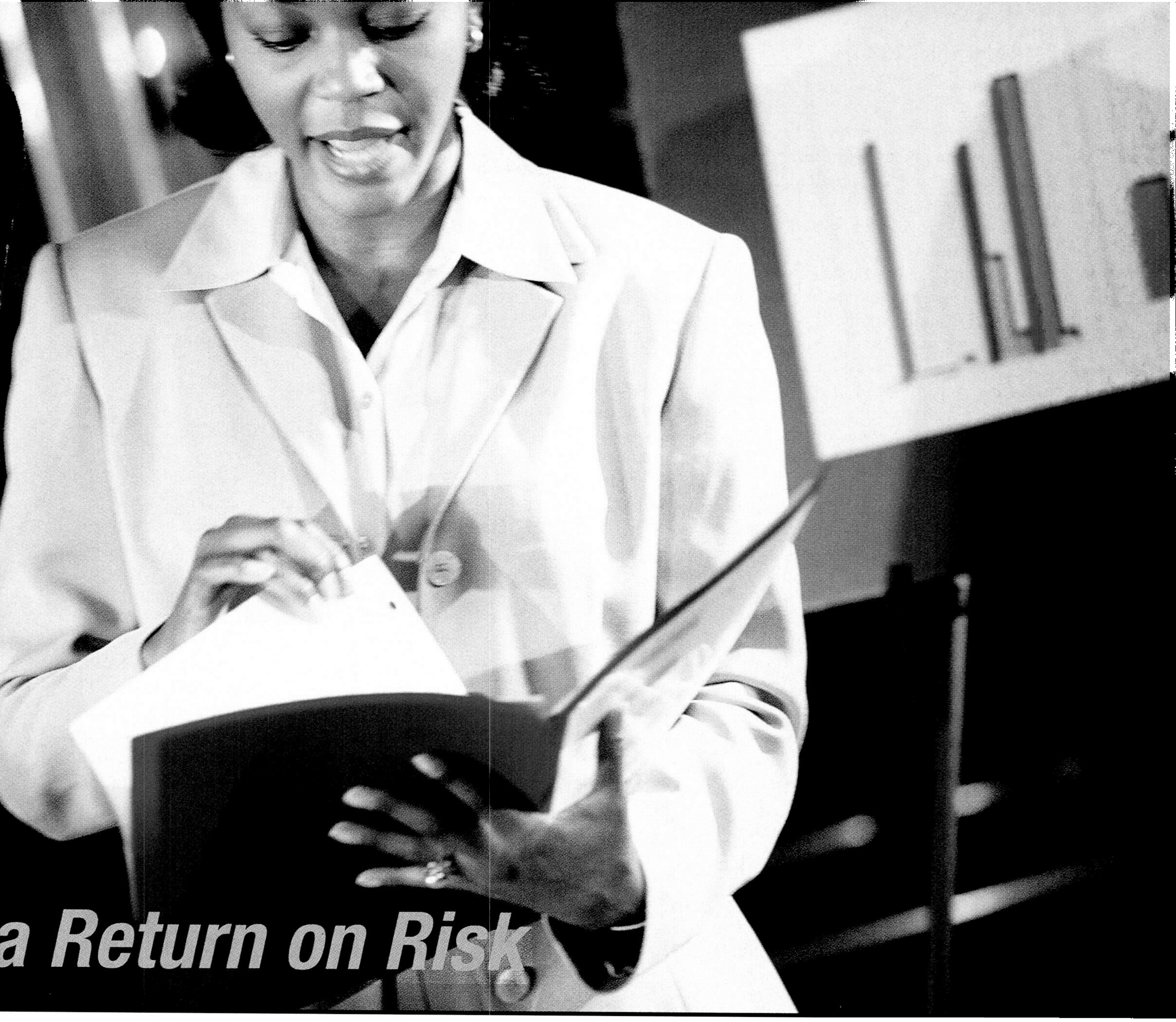
Measuring risk for a return to the organization is a revolutionary new approach. Yes, it is possible; the map, the compass and the navigational tools do exist to chart a course on these new seas.

Why a new approach? Risk managers, C-suite leaders and consultants agree: the business of risk management has changed radically in recent years. The days when the job simply meant buying a risk transfer policy for a competitive price are over. Every major aspect of an organization—its finances, its operations, its products and its human capital—either impacts or is impacted by risk, and risk management is becoming a key strategic line item on the balance sheets of organizations large and small.

How well an organization handles today's ever-increasing complexities of risk—especially compared to other organizations in its space—is about much more than the simple mitigation of loss. When risk is managed and reduced, the results are not only internal financial and operational advantages, but a measurable competitive advantage that affects every area of the company, from the costs of risk in the marketplace, to employee morale and retention, to the company's position in the marketplace.

Today's complex challenges require a new approach. With the right system, process and tools, risk can be fundamentally turned around from its traditional role as a "necessary evil" of business to a positive center of opportunity and gain for organizations of every size. What is needed is a next-generation solution that combines:

- a global approach to risk pioneered by enterprise risk management
- the technology and resources to formulate "predictive data,"



a Return on Risk

and then turn that data into advanced tools for benchmarking and measurement of returns
- the unbundling of services so that these solutions would be feasible for all organizations
- using analysis and benchmarking to demonstrate how superior risk management specifically improves the bottom line

A New Course

The strategic approach of managing for a return on risk combines these elements into a system that enables companies to leverage risk for competitive advantage and manage a portfolio of risks in an interconnected environment. By tying risk management to process improvement, a return-on-risk approach links operations, finance and marketing to produce the holistic, systemwide risk management approach that is the promise of ERM.

In order to realize this promise, however, a return-on-risk approach must be built around several key elements:

- the data for analyzing and prioritizing risk drivers
- advanced tools for benchmarking
- remedial guidance for operations and finance
- tools for measuring progress and comparing the firm to others in its local, national and international markets

These measurements allow the company to measure its degree of risk to competitors and to leverage superior ratings into financial and operational gains. Furthermore, with these factors working in concert, the return-on-risk approach shifts the whole framework of risk management from negative to positive, leveraging risk for opportunity and competitive advantage in an increasingly complex environment.

Unlike earlier programs in ERM, this process is entirely modular. It recognizes that every positive step that lowers costs and reduces claims contributes directly to the bottom line and indirectly to other parts of the organization. The more steps that are taken, the broader the results will be, ultimately yielding exponential improvement.

Organizations in every industry can apply and benefit from a return-on-risk approach. For example, a hospital that improves risk management in clinical operations will be able to see measurable improvements in medical outcomes as a result of these enhancements. Better outcomes will, in turn, result in reductions in medical liability costs, improved nurse retention, enhanced patient safety and patient satisfaction, lower workers compensation costs and a stronger reputation in the community.

A manufacturer that improves its safety practices will lower workers compensation costs by reducing the likelihood of claims, increase productivity by having fewer accidents, strengthen its reputation as a good place to work so that it can attract a viable labor force, and gain process improvements as it analyzes procedures for the safety initiative.

A bank that strengthens its fraud detection capability should be able to leverage its improved loss control record into lower insurance premiums, higher consumer confidence and loyalty, and a stronger brand in the marketplace. Organizational gains are possible with a return-on-risk approach because risk management is linked to improved output. Quantifiable, measurable improvements translate into incremental financial, operating and marketing gains.

The Tools for Return on Risk

An approach like return on risk requires next-generation tools and resources to succeed. The availability of advanced, accurate and affordable data is the essential factor to making return on risk work. Data is crucial at every stage: first, as a point of departure, measuring where an organization is starting from relative to its peers; then, as a navigation device, measuring actions and improvements for direction and effectiveness along the way; and finally, as a means to measure the returns themselves, justifying investment dollars and providing evidence of performance that can influence pricing decisions by both insurance markets and shareholders.

Data with which to measure risk drivers is available in every industry. The key is defining data that is tied to the products or output of the company. Linking the management of risk to the output of an organization is what quantifies the value of return on risk to the entire company and what ultimately cuts across functional lines to demonstrate value across the enterprise.

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Collected data is then quantified into benchmarks that can be used to compare the company to its peers. These benchmarks are another essential set of tools from the return-on-risk toolbox. They are used to identify potential areas of improvement and to help develop the action plan. An enterprisewide team collaborates on implementing the plan. When results are measured and compared again, if the plan has been successful, the company should be able to document substantial improvement using recognized benchmark data compared to peers.

This quantifiable result is a much more current and accurate measure of the organization's level of risk than past claims history, which is how firms have traditionally been evaluated by insurance markets for risk. Armed with this new data, the risk manager can make a compelling case with these markets for a more favorable evaluation of premium renewal and claims limits. In addition, this data can be utilized to demonstrate superior performance throughout the organization—in marketing, brand positioning, human capital retention and recruitment, capital finance and productivity.

Return on Risk in Action

A hypothetical example of a hospital that is especially vulnerable to adverse effects of risk can be used to illustrate how return on risk can deliver on its promise. Suppose that a medical error in the operating room results in a $10 million malpractice case. When the verdict is handed down, the hospital can expect a huge malpractice insurance premium hike.

But with a return-on-risk approach, that hospital has not just been waiting for the proverbial shoe to drop. Immediately after the incident, a systemswide analysis of the risk drivers behind the incident would begin. A team including representatives of finance, clinical care, marketing and human resources would be assigned to evaluate both the potential causes of the incident and the risk implications for patient care, for finance, for marketing and for risk and retention of staff.

Once this analysis is completed, the team would do three things. First, the data would be converted into benchmarks that could be measured against national and local standards. Key benchmarks for in this industry, which for this industry would include mortality rates, length of stay for various diagnoses and standards to prevent infections. Such data could be obtained through various organizations, including state and federal government, employer watchdog groups, insurers, regulators and consultants. Also, new resources such as clearing houses make public and private data resources more readily available for benchmarking, cost analysis and operations improvement, and compile and integrate current medical outcomes data with traditional historical claims data and professional liability studies. These major data resources provide a multi-dimensional window on risk and improvement tracking that has never been available to organizations of any size but is now available to all. Much of this data is available through a wide array of online, self-service and pre-packaged tools.

Second, the team takes this benchmarked data and compares it to other hospitals nationwide. This comparison is converted into an index that measures the organization's relative risk compared to its peers. An index greater than one, for example, indicates a less-than-average risk compared to its peers. An index less than one means a greater-than-average risk.

Third, the team develops a plan to address those areas where the hospital is vulnerable and where improvement can occur. Among the areas that may be identified for remediation are: education and training of staff; the use of technology during the operation to reduce risk; the use of hospitalists (physicians who specialize in hospital care) to manage the patients pre- and post-surgery to standardize and enhance the level of care these patients receive; and automated systems to manage medication dosage.

After implementation of that plan, the measurement process occurs again. This time, the hospital's ranking should indicate substantial improvement due to the enhanced ability to manage risk. The facility's ability to better manage risk is measured in the hospital's ability to produce superior medical outcomes—to produce a superior product. Now the hospital can leverage this information to create a competitive advantage in four key operational areas.

- *Finance.* Negotiate more favorable insurance rates and limits from insurance markets; qualify for pay-for-performance bonuses offered by insurers who set quality of care benchmarks for additional reimbursements; and negotiate more favorable contracts with payors.

- *Marketing.* Use the data on the hospital's outcomes to market the organization as a provider with superior outcomes. Improved patient satisfaction scores will provide another source of data on which to help position the hospital favorably.

- *Human resources.* Utilize the hospital's track record to recruit valuable (and scarce) physicians and health care professionals to the team and to improve retention of employees.

- *Clinical care.* Use the returns from the initial return-on-risk initiative to justify funding more quality improvement initiatives that will, in turn, further improve hospital performance, hospital rankings and the hospital's ability to achieve accreditation and safety standards.

In summary, return on risk is an approach, a process and, ultimately, a set of tools that will enable the risk manager to turn analysis, benchmarks and investment in product and operational improvement into unprecedented, positive organizational change. This change strengthens financial health, operational health, employee morale, the safety environment and the competitive position of an organization.

As these principles are institutionalized within the market leaders of various industries, return on risk will establish a new era of risk management. The market leading organizations who embrace return on risk will also lead their respective industries with lower costs, higher profits, superior products and services, and competitive advantage. RM

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