An Enterprise Risk Management maturity model

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An ERM Maturity Model

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ABSTRACT

In the recent years, Enterprise Risk Management (ERM) has emerged as a new risk management technique aimed to manage the portfolio of risks that faces an organization in an integrated, enterprise-wide manner. Unlike traditional risk management, where individual risk categories are managed from a silo-based perspective, ERM involves an holistic view of risks allowing to take into account correlations across all risk classes.

The academic literature on ERM is focused on two main aspects: the analysis of the factors that influence ERM adoption and its effects on firms performances. No studies have been conducted yet to propose robust and rigorous models to evaluate the quality, or maturity, of ERM programs implemented by firms. The aim of the research described in this paper is to fill this gap in the literature.

In order to build a rigorous ERM maturity model, we have run an e-mail Delphi procedure involving a panel of worldwide experts on ERM and reached their consensus on the selection of a set of ERM best practice parameters, which are used to develop a structured questionnaire to be administered to firms.

Experts consensus in obtained also on the scales and the scores for each questionnaire answer option. The output of the Delphi method is a scoring model that can be used to assess the maturity of an ERM program by administering a questionnaire composed of 22 closed-end questions to firms: answers are collected and scored, and all scores are combined in a single final score, the ERM Index (ERMi).

The robustness of the model has finally been tested on a small sample of firms.

We foresee two different uses of the ERMi maturity model, one by scholars for further quantitative research on ERM topics, and one by practitioners, as ERMi is suitable to be used by firms for a self-assessment of their ERM programs (internal use), and by consultancy firms, auditors and rating agencies (external use). The difference with other existing maturity models is its solid scientific base, the rigour with which it has been designed and the fact that it is derived from a Delphi procedure involving leading ERM experts who reached consensus on the model detailed design.

Keywords: Enterprise Risk Management, Maturity model, Delphi method

JEL codes: G32

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1. INTRODUCTION

Enterprise Risk Management (ERM) is an integrated way to manage risks. It differs from traditional risk management, where risks are managed separately according to their category or the company department where they arise.

ERM tries to align strategic objectives given by the Board of Directors with daily operations. A peculiar characteristic is that “risk” is not only seen from a down-side perspective, but also as an opportunity that can be exploited for competitive advantage.

In literature the name ERM is sometimes substituted by synonyms like Enterprise-Wide Risk Management, Holistic Risk Management, Integrated Risk Management and Strategic Risk Management.

In addition, the definition of ERM is not unique, but several definitions have been proposed by different authors and entities; for the purpose of this research project, the definition adopted is the one given by the CoSO “A process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives”.

The implementation of an ERM system is a big change management issue and absorbs plenty of resources both in terms of finance and human resources. So why should firms embrace ERM? A number of theoretical motivations apply.

According to CoSO, ERM is intended to promote awareness of the sources of risks and address them by improving strategic and operational decision-making. As a result of improved efficiency, firm performance should increase, volatility should decrease and cost of capital should be reduced, thus firm value should increase (Beasley et al. 2008).

Another hypothetic benefit of ERM is the creation of synergies between different risk management activities: by integrating risks across classes and departments, firms are supposed to be able to avoid duplication of expenditures (e.g. insurance) by exploiting natural hedges (Meulbroek, 2002).

Despite the theoretical motivations, if and to which extent ERM adds value is yet to be proven.

In fact, there is little evidence in literature of empirical studies on the effect of ERM on firm value and most of the available studies target only financial institutions. The few studies available generally report positive correlation between ERM adoption and firm value, but all suffer from the lack of a measure of the quality of the ERM implementation, which forces the authors to consider ERM implementation as a binary variable.

This paper aims to fill the gap in literature by building a rigorous and robust measure of the quality, or maturity, of ERM implementation.
In order to design such a measure, first of all a thorough literature review is performed to identify best practices and recommendations given by academics and practitioners. The validity of such indicators and their relative importance is determined with the use of a Delphi procedure, that is a group technique to obtain consensus from a group of selected experts. The experts are asked to select the best indicators of maturity of ERM implementation. In the following rounds of the Delphi procedure, the indicators are transformed into questions which make a questionnaire to be used to collect data from firms. The Delphi procedure output includes the key to assign a score to all the answers and therefore obtain a final score of the maturity of the ERM system implemented by the surveyed firm.

Finally, the robustness of the model is verified with a pilot test run on a small scale survey of real cases. The scoring model thus built, named ERM Index (ERMi), has scientific and practical relevance and two different uses can be foreseen, one by scholars and one by practitioners, the latter probably being the most relevant. In fact, the ERMi is suitable to be used by firms for a self-assessment of their ERM programs or as a check list during the ERM first implementation phase (internal use), and by consultancy firms, auditors and rating agencies (external use). It can also be used by scholars in further research studies using econometric models both as a dependent or an independent variable to investigate the determinants of ERM adoption and its effects on firms value and performances.

2. IDENTIFICATION OF ERM BEST PRACTICES

A literature review is conducted in order to identify the best practices in terms of Enterprise Risk Management to be fed as starting inputs to the Delphi procedure, which requires experts to select a number indicators of ERM maturity from the given list or to add others of their own choice. In order to identify best practices, not only academic literature, but also reports and articles written by practitioners and consultancy firms and the most common ERM standards are reviewed.

Evidences from the literature can be categorized in three main areas:

i) risk culture;
ii) organization;
iii) process.

2.1 Risk culture

Risk culture regards values, norms and behaviours shared by all members of an organisation, which determine how they act towards the enterprise risks (Abrahim, Henry, & Keith, 2012). The risk culture influences decisions at all levels of the organisation and therefore the possibility to reach the strategic goals, thus influencing enterprise value (IIF, 2009).

Farrel and Hoon (2009) argue that developing a risk culture is a basic necessary element to implement good ERM practices. The importance of risk culture is also evident in the CoSO – ERM Integrated
Framework, which considers the internal environment the basis for a correct functioning of the control system, including the ERM. Organisations lacking a strong risk culture may find themselves operating against their own policies, resulting in the inability to reach their strategic, tactical and operating goal and in reputational and financial losses (IRM, 2012). Brooks (2010) argues that the risk culture is not an intangible concept but it can be measured using the level of consistency between the decisions about risks and the existing policies and the desired risk profile.

Several aspects characterise a solid and well-developed risk culture:

- **Board of Directors and Top Management commitment**
  (Lam, 2003; COSO, 2004; Lawrence, 2005; Beasley & Frigo, 2007; Farrel & Hoon, 2009; IIF, 2009; Shenkir & Walker, 2011).

- **Clear definition and communication of an ERM policy**
  (Lam, 2003; COSO, 2004; Aabo, Fraser, & Simkins, 2005; DeLoach, 2005; Deloitte, 2006; KPMG, 2008; Lawrence, 2005; Moeller, 2007; PwC, 2008; Cendrowski & William, 2009; ISO, 2009a,b; Rochette, 2009; AIRMIC, ALARM, & IRM, 2010; Fraser & Simkins, 2010).

- **Definition of risk appetite and of an explicit risk-appetite statement**
  (COSO,2004; DeLoach, 2005; Deloitte, 2006; Barfield, 2007; Moeller, 2007; Chase-Jenkins & Farr, 2008; KPMG, 2008; Dean & Giffin, 2009; IIF, 2009; Rochette, 2009; Ernst & Young, 2010; Govindarajan, 2011; Milliman, 2011; Protiviti, 2011 & 2012; Rittenberg & Martens, 2012).

- **Definition, considering the risk appetite, of a risk tolerance threshold for each objective of the organization**
  (COSO, 2004; DeLoach, 2005; Barfield, 2007; Deloitte, 2008; KPMG, 2008; PwC, 2008; Dean & Giffin, 2009; Ernst & Young, 2010; MoR, 2010; Govindarajan, 2011; Milliman, 2011; Rittenberg & Martens, 2012)

- **Clear communication of objectives, policies, risk tolerance thresholds throughout the entire organisation**
  (COSO, 2004; Deloitte, 2008; KPMG, 2008; Ernst & Young, 2010; Cendrowski & William, 2009; ISO 2009a,b; AIRMIC, ALARM, & IRM, 2010; Rittenberg & Martens, 2012).

- **Sharing a common risk language within the organisation**

- **Sharing and communicating risk information**
  (COSO, 2004; Frigo, 2007; Frigo, 2008; Rochette, 2009; ISO, 2009a,b; Frigo & Anderson, 2009; Lai & Samad, 2010; ZURICH & HBRAS, 2012).
Organising learning programs for the employees

Designing a remuneration and incentive system
(Lam, 2003; COSO, 2004; Deloitte, 2008; Farrel & Hoon, 2009; Rochette, 2009; David-O' Neill & Stephens, 2010; Segal, 2011; IRM, 2012; Rittenberg & Martens, 2012).

Integrating the ERM with the Performance Measurement System (PMS), in particular with the Balanced Score Card (BSC)
(Beasley, Chen, & Wright, 2006; Calandro Jr & Lane, 2006; Oracle, 2009; Protiviti, 2010b).

2.2 Organisation

As one of the distinctive features of ERM is its integrated approach, adequate organisation choices are fundamental to spread the risk culture, to gain commitment to the program from the personnel and to guarantee that the ERM process is effected in the correct way and policies and procedures are respected.

There is agreement in literature on the necessity of a high level champion to conduct ERM activities and of a structure that supports his job. More in details, a proper organisation design should consider the following elements.

Appointment of a Chief Risk Officer (CRO)
(Lam, 2001 & 2003; Liebenberg & Hoyt, 2003; Economist Intelligence Unit, 2005; Moeller, 2007; Deloitte, 2008; Frigo & Anderson, 2009 & 2011; Rochette, 2009; Segal, 2011).

Building a dedicated ERM Function
(Lam, 2001; Moeller, 2007).

Designation of an ERM group or team to support CRO's job
(Moeller, 2007; ZURICH & HBRAS, 2012).

Independence of the ERM function (direct reporting of CRO to the Board or to the CEO)
(Lam, 2000; Lam, 2003; Moeller, 2007; Deloitte, 2008; Rochette, 2009).

Identification of the risk owners responsible for the identification and management of each risk
(DeLoach, 2005; Fraser & Simkins, 2010; Aabo, Fraser, & Simkins, 2005; Beasley, Branson, & Hancock, 2010; ISO, 2009a,b).

Clear definition and communication of roles and responsibilities for the management of risks
(COSO, 2004; DeLoach, 2005; Deloitte, 2006; Deloitte, 2008; ISO, 2009a,b; Rochette, 2009; Lai & Samad, 2010).

- **Integration of the process of ERM among all the business functions and units**
  (COSO, 2004; PwC, 2008; ISO, 2009a,b; Frigo & Anderson, 2011).

- **Involving all employees, at all levels, in the ERM process**
  (COSO, 2004)

### 2.3 Process

A description of the ERM process is common to all the main frameworks proposed in literature. They all describe the phases that compose the process, from the setting of the objectives to the risk identification and valuation to the treatment and control of risks, and their reporting. The ERM frameworks and the literature provide a series of key elements that should be included in the design of ERM systems, as listed below.

- **Integration of ERM in the strategic and business plans**
  (Lam, 2001; COSO, 2004; DeLoach, 2005; Lawrence, 2005; Beasley, Chen, & Wright, 2006; Deloitte, 2006; Beasley & Frigo, 2007; Frigo, 2007; KPMG, 2008; PwC, 2008; ISO, 2009a,b; Rochette, 2009; Protiviti, 2010a; Protiviti, 2011).

- **Implementation of an efficient and effective process to identify all relevant potential risks**
  (COSO, 2004; DeLoach, 2005; Frigo, 2008; ISO, 2009a,b; Moeller, 2007; PwC, 2008; Rochette, 2009; Lai & Samad, 2010).

- **Creation and maintenance of a risk register**
  (Meulbroek, 2002; Nocco & Stulz, 2006; Giorgino & Travaglini, 2008; Melnick & Everitt, 2008; Vose, 2008; Antonucci, 2011).

- **Classification of risks into risk categories (e.g. strategic, operational, financial and compliance, or strategic, operational, financial and hazards)**

- **Definition of a formal process for risk assessment with qualitative and quantitative techniques**
  (Covello & Merkhofer, 1993; Altenbach, 1995; Coleman & Marks, 1999; Miccolis & Shah, 2000; CAS, 2003; COSO, 2004; PwC, 2008; Risaliti, 2008; ISO, 2009a,b; Rochette, 2009; Lai & Samad, 2010; Berta, 2011).
Periodical repetition of the risk assessment process
(Giorgino & Travaglini, 2008; KPMG, 2008; Paape & Speklé, 2012).

Prioritisation of risks on a residual basis
(COSO, 2004; Aabo, Fraser, & Simkins, 2005; PwC, 2008; ISO, 2009a,b; Antonucci, 2011).

Integration of all risks in a risk portfolio and evaluation of correlations between them
(Meulbroek, 2002; CAS, 2003; Lam, 2003; Nocco & Stulz, 2006; Beasley & Frigo, 2007; Moeller, 2007; KPMG, 2008; Rochette, 2009; McShane, Nair, & Rustambekov, 2010; Lin, Yu, & Wen, 2011).

Definition of a treatment strategy (avoidance, reduction, sharing, retention) for each risk, considering a trade-off between costs and benefits
(Lam, 2000; CAS, 2003; ACT Insurance Authority, 2004; COSO, 2004; Frigo, 2008; Giorgino & Travaglini, 2008; PwC, 2008; ISO, 2009a,b; Fraser & Simkins, 2010; Lai & Samad, 2010)

Development of adequate contingency plans
(CAS, 2003; Protiviti 2010a; Milliman, 2011).

Development of a KRI system to monitor risk exposure and ensure it is coherent with KPIs and firm strategy, inclusive with a correction and escalation plans if risks exceed the limits
(Beasley & Frigo, 2007; Frigo, 2008; Giorgino & Travaglini, 2008; Lam & Associates, 2008; PwC, 2008; Beasley, Branson, & Hancock, 2010; Ernst & Young, 2010; Lai & Samad, 2010).

Existence of a periodic risk reporting system targeted at the different levels of the organisation with different information granularity
(Lawrence, 2005; Beasley & Frigo, 2007; Farrel & Hoon, 2009; Giorgino & Travaglini, 2008; Beasley, Branson, & Hancock, 2010; Shenkir & Walker, 2011).

Proper use of the technology as an aid to support risk management activities
(Lam, 2000; Lam, 2001; COSO, 2004; Lawrence, 2005; DeLoach, 2005; Giorgino & Travaglini, 2008; Shenkir & Walker, 2008; Deloitte, 2010).
3. **RUNNING THE DELPHI PROCEDURE**

In literature there are plenty of indications about ERM best practices and recommendations, but the absence of rigorous studies aimed to evaluate the level of maturity and quality of ERM systems and practices from which information and quantitative data could be obtained to develop the ERMi, forces to use an alternative methodology based on experts’ opinion to obtain quantitative measures of the available best practices. Plenty of best practices, recommendations and indicators of ERM implementation quality are available in academic literature, reports and articles written by practitioners and consultancy firms and in international ERM standards (ISO 31000, CoSO, the Australian Risk Management Standard, AS/NZS 4360 etc.), but they are of a qualitative nature only.

In absence of relevant literature, to build a quantitative measure for ERM maturity *experts opinion* is solicited, where experts include scholars, practitioners and managers with ERM-specific experience. To be able to consult experts dispersed in many countries and to reach their consensus in a scientific way, a *Delphi procedure* is applied.

Skulmoski et al. (2007) report that “*The Delphi method is an iterative process used to collect and distill the judgments of experts using a series of questionnaires interspersed with feedback. The questionnaires are designed to focus on problems, opportunities, solutions, or forecasts. Each subsequent questionnaire is developed based on the results of the previous questionnaire. The process stops when the research question is answered: for example, when consensus is reached, theoretical saturation is achieved, or when sufficient information has been exchanged*”.

Rowe and Wright (1999) argue that the Delphi method is based on four key elements: anonymity, iteration, controlled feedback and statistical reports of group answers.

The literature on the Delphi method reports that there are not specific guidelines on the number of experts required, that can range from 10 to 1000, and on the minimum grade of consensus, which is a subjective choice of the researcher (70% is a typical value); what is important is instead the experts selection.

Two key elements are the anonymity of the experts (experts identity is known to the researchers but is not disclosed to other participants or other parties) and the controlled feedback, defined as a synthesis of the result of the previous iteration (Hsu & Sanford, 2007), which ensures group learning and consensus reach (Rowe and Wright (1999).

The Delphi method is particularly useful in the case of a geographically dispersed group, when organising a physical meeting would be impractical or excessively expensive.

The Delphi method advantages and disadvantages are debated in the literature. The main disadvantages are actually connected more with the efforts required to complete the procedure than to the quality of the method itself:

- Barnes (1987) argues that the method relies on the opinions of a selected group of people which could be not significant; however it has to be noted that statistical significance is not the objective
of the Delphi method. Instead, the method is based on group dynamics to arrive at a consensus among experts who have a deep knowledge of the investigated topic (Okoli & Pawlowski, 2004);

- It is a time-consuming, labour–intensive method, thus expensive (Fitzsimmons & Fitzsimmons, 2001). Witkin and Autschuld (1995) argue, instead, that the problem of the cost is overcome by the use of modern electronic technologies (email, video/audio/web conferences), which speed up the process, make feedback elaboration easier and improve anonymity;

- Sackman (1975) argues that anonymity may induce a lack of engagement and poor efforts because answers are not traceable;

- The method requires the facilitator to have strong written communication ability to avoid introducing involuntary bias (Barnes, 1987);

- It requires long time and big effort on the participants’ side (Barnes, 1987);

- In literature there are not universally accepted indications on the optimal dimension of the panel and on the consensus level to be employed, which usually varies between 55% and 100% (Powell, 2003).

Once the cost issues are solved, the method proves to give strong results. One of its advantage is that it leaves the participants the time to reflect on their answers, also in light of other participants’ answers, without the time pressure of face-to-face meetings; this improves the quality of the answers (Hanafin, 2004). It is also helpful when the presence of dominant personalities may influence other participants’ ideas or prevent some of the participants from freely expressing their opinions.

Another important advantage is the high scientific relevance of the results obtained through this method. In fact, Mitroff and Turoff (1975) argue that an empirical generalisation can be considered objective, true or factual, if there is a sufficiently ample consensus of a group of experts.

Finally, it has to be noted that the results of a Delphi are well accepted by the scientific community because its leading experts have contributed with their own ideas to those results.

This study uses the ranking-type Delphi, a widely used variant of classical Delphi method especially convenient to reach consensus in a panel of experts on the relative importance of issues (Okoli and Pawlowski, 2004).
3.1 **EXPERTS SELECTION**

Three categories of experts have been identified and invited to participate in the Delphi procedure:

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>SELECTION CRITERIA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ACADEMICS (nr. 20)</strong></td>
<td>▪ The top 20 cited authors in ISI Web of Knowledge for a paper on the ERM topic</td>
</tr>
</tbody>
</table>
| **CONSULTANTS (nr. 20)** | ▪ Executives of leading global consultancy firms on ERM topics  
                          ▪ Consultant serving as members of committees built for the definition of one of the main ERM frameworks                                                                                           |
| **PRACTITIONERS (nr. 20)** | ▪ Well-known figures in the ERM field, opinion leaders, executives operating in firms renowned to be excellence of ERM  
                          ▪ Practitioners serving as members of committees built for the definition of one of the main ERM frameworks                                                                                   |

The final panel is made of 16 experts who accepted to participated and completed all the phases and rounds of the Delphi procedure; its composition follows:

- Academics: 5 (31.25%)
- Consultants: 3 (18.75%)
- Practitioners: 8 (50.00%)

3.2 **PILOT TEST**

Before running the procedure with the full group of experts, a pilot test is run on a smaller group made by only five experts, whose selection is based on their ample availability to go through the procedure and, in addition, to provide a detailed feedback on usability of the tool and clarity of the instructions and questions, at each step. The entire procedure is fine-tuned with the pilot test group.

The pilot test is also used to determine the optimal number of parameters to be included in the full Delphi procedure in order to obtain an acceptable trade off between completeness of data and length of the questionnaire, which should not be too long to discourage firms to complete it when use in surveys for empirical studies and state-of-the-art reports. The result is 22 parameters, obtained as the arithmetic average of the five replies, which are all comprised between 20 and 25.

3.3 **CONSENSUS LEVEL**

Unanimity is not required in the Delphi method; instead, an agreement (or consensus) level has to be pre-determined. While there are no universally accepted rules on the minimum level of consensus to be employed, Sumsion (1998) suggests 70% consensus is achieved in each round; 70% is a commonly used level and considered to be “strong consensus”.

The present study employees 70% consensus in each round.
3.4 QUESTIONNAIRE ADMINISTRATION AND FEEDBACK REPORTING

The procedure is run on the web platform powered by SurveyMonkey®. Experts receive at the beginning of each round an email containing the link to the questionnaire and detailed instructions and examples on how to compile the questionnaire of the specific round. The main elements of the instructions are repeated at the beginning of the questionnaire web page.

The questionnaire provides the space to add comments and to suggest elements or parameters not originally considered by the researchers.

After each round, a statistical report of all the answers in an aggregated form is circulated to all participants, together with the comments/addition received, reported in the report in an unanimous way.

After receiving the feedback, at each round the participants are given the possibility to change their initial answers however they desire.

The process is iterated for each round until at least 70% consensus level is reached.

3.5 PHASES

The Delphi procedure is made of several rounds, which can be grouped in different phases, each with its own objective and output. The phases description follows.

**Phase 0 – best practice preliminary identification**

The best practices are identified from a thorough literature review and transformed into specific parameters by the researchers.

**Phase 1 – parameters selection by the experts**

After having received comprehensive information on the purpose of the Delphi method and what kind of contribution is expected from them, experts are asked to select 22 parameters from the original set of best practices obtained from the literature review and/or to suggest new parameters and justify their choices.

**Phase 2.5 – transformation of parameters into questions**

The 22 selected parameters with consensus ranging from 70% to 100% are transformed into questions by the researchers making the Delphi team and possible answers are provided to make the questions closed-end.

**Phase 3 – Assignment of question weights and answers scores**

In this phase the experts are asked to review the transformation of parameters into questions and review the possible answers suggested by the Delphi team. They are also asked to assign a score ranging from 0 to 10 to all the possible answers of each question, where a higher score means a greater maturity of the ERM system. It has to be noted that the value of the ‘best’ answer is not predetermined (i.e. it does not
have to be the maximum, 10, necessarily), but reflects the expert’s opinion on the importance of each question. Experts’ opinion on the weights of the questions is therefore obtained in an indirect way, before asking the experts to confirm.

Also for this phase, the consensus obtained is over 70%.

4. **THE ERM INDEX (ERMi)**

The final output is a questionnaire made of 22 closed-end questions on ERM practices, analyzing company risk culture, the organization and the ERM process of ERM.

Each possible answer has a scored attached to it, reflecting the consideration that the experts have of those ERM choices.

Depending on the type of consensus obtained, each score is obtained in one of the following ways:

- Consensus greater or equal to 70% on a single score (at least 12 identical answers out of 16) on a single score:
- Consensus greater or equal to 70% on a narrow range of scores (at least 12 out of 16 answers in the range): score is obtained as the arithmetic average of the score reaching consensus (in the range). The range can include 2 or maximum 3 scores.

The second way is introduced in order to avoid iterating the procedure too many times, which could cause to force consensus instead of obtaining it in a spontaneous way and to lose the experts’ attention, considering that, anyway, the incremental decision would have been low, at least too low to justify the extra effort by the experts and the risk of incurring in the above dangers.

The total score of a company is calculated by simply summing up the 22 scores of associated to the company answers to the 22 questions of the scoring index ERMi. The maximum score, obtained by selecting the ‘best answer’ for all the 22 questions, is the decimal number 197.77.

For a better clarity of the score reporting, a final step is applied to normalize all the scores to a 100-score scale. In order to do so, each score obtained by the Delphi procedure is divided by 97.77 and multiplied by 100. This way, ERM maturity ranges from 0 to 100 and can be expressed as a percentage.

The ERMi is illustrated in Table 1: for each answer both the score assigned by the experts panel (second column) and the normalized score (third column) are reported.
1. **Does the organization have an ERM program (process) in place?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>5.1</td>
</tr>
<tr>
<td>Not yet but we’re implementing it</td>
<td>5.0</td>
<td>2.5</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

2. **Has a RM/ CRO been designated in charge for enterprise-wide risk management?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9.75</td>
<td>4.9</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

3. **Has an ERM policy been defined?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9.43</td>
<td>4.8</td>
</tr>
<tr>
<td>Not yet, but we’re defining it</td>
<td>4.29</td>
<td>2.2</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

4. **Is the ERM integrated with strategic and business plans?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>10</td>
<td>5.1</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

5. **Who is the prime sponsor of ERM in the organization?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOARD</td>
<td>9.67</td>
<td>4.9</td>
</tr>
<tr>
<td>CFO</td>
<td>6.88</td>
<td>3.5</td>
</tr>
<tr>
<td>CEO</td>
<td>9.43</td>
<td>4.8</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>1</td>
<td>0.5</td>
</tr>
</tbody>
</table>

6. **Does a dedicated ERM function exist in the organization?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9.75</td>
<td>4.9</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

7. **Is it clearly specified who is accountable for every identified risk as well as who is responsible for controls to treat the risk?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9.44</td>
<td>4.8</td>
</tr>
<tr>
<td>In part</td>
<td>5.71</td>
<td>2.9</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

8. **Does it exist a formal and well defined process to identify or review potentially significant risks?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8.50</td>
<td>4.3</td>
</tr>
<tr>
<td>Not yet but we’re defining it</td>
<td>5.85</td>
<td>3</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

9. **Has a formalized process been defined to evaluate risk appetite in accordance with shareholders?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>6.14</td>
<td>3.1</td>
</tr>
<tr>
<td>No</td>
<td>0.33</td>
<td>0.2</td>
</tr>
</tbody>
</table>

10. **Are company objectives, policies and tolerances for risks clearly communicated through the organization?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>8.45</td>
<td>4.3</td>
</tr>
<tr>
<td>Only in part</td>
<td>6.14</td>
<td>3.1</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

11. **To whom does the Risk Manager/CRO (or other equivalent position) report to?**

<table>
<thead>
<tr>
<th></th>
<th>Score</th>
<th>Normal Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board</td>
<td>10</td>
<td>5.1</td>
</tr>
<tr>
<td>CEO</td>
<td>8.38</td>
<td>4.2</td>
</tr>
<tr>
<td>CFO</td>
<td>2.33</td>
<td>1.2</td>
</tr>
<tr>
<td>Controller</td>
<td>0.75</td>
<td>0.4</td>
</tr>
<tr>
<td>Question</td>
<td>Score</td>
<td>Normal Score</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>-------</td>
<td>--------------</td>
</tr>
<tr>
<td>12. Do interdisciplinary risk management teams exist to support the CRO (so that each functional area can understand where it fits into the entire company strategy and how it affects other areas)?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>9</td>
<td>4.6</td>
</tr>
<tr>
<td>No</td>
<td>0.89</td>
<td>0.5</td>
</tr>
<tr>
<td>13. Are roles and responsibilities of everyone involved in the management of risks clearly documented and communicated?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>9.5</td>
<td>4.8</td>
</tr>
<tr>
<td>Only in part</td>
<td>5.43</td>
<td>2.7</td>
</tr>
<tr>
<td>No</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>14. Are risks integrated within scorecard or corporate performance measurement criteria?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>9.5</td>
<td>4.8</td>
</tr>
<tr>
<td>No</td>
<td>0.5</td>
<td>0.3</td>
</tr>
<tr>
<td>15. Is risk tolerance threshold, defined by considering the risk appetite, applied to each organizational objective?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes, it is applied to each organizational objective</td>
<td>9</td>
<td>4.5</td>
</tr>
<tr>
<td>No, it is only applied to the most important organizational objectives</td>
<td>7</td>
<td>3.5</td>
</tr>
<tr>
<td>No, it isn't applied to any organizational objective</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>16. Is the incentive system for management linked to risk adjusted profitability measures?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>8.71</td>
<td>4.4</td>
</tr>
<tr>
<td>No</td>
<td>0.25</td>
<td>0.1</td>
</tr>
<tr>
<td>17. Is risk management fully integrated across all functions and business units?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>No</td>
<td>0.33</td>
<td>0.2</td>
</tr>
<tr>
<td>18. If a formal and well defined process to quantify risks exists: are quantitative or qualitative methods primarily used?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quantitative methods</td>
<td>7.57</td>
<td>3.8</td>
</tr>
<tr>
<td>Qualitative methods</td>
<td>7.22</td>
<td>3.7</td>
</tr>
<tr>
<td>Both qualitative and quantitative methods</td>
<td>9.43</td>
<td>4.8</td>
</tr>
<tr>
<td>19. Does a periodic risk reporting system exist?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>9.75</td>
<td>4.9</td>
</tr>
<tr>
<td>No</td>
<td>0.33</td>
<td>0.2</td>
</tr>
<tr>
<td>20. Does it exist a register containing the list of identified risks and the potential responses?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>7.90</td>
<td>4</td>
</tr>
<tr>
<td>No</td>
<td>0.75</td>
<td>0.4</td>
</tr>
<tr>
<td>21. Does the organization train employees on ERM?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>8.71</td>
<td>4.4</td>
</tr>
<tr>
<td>No</td>
<td>0.43</td>
<td>0.2</td>
</tr>
<tr>
<td>22. Has a specific ERM standard been adopted?</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>9</td>
<td>4.5</td>
</tr>
<tr>
<td>No</td>
<td>0.17</td>
<td>0.1</td>
</tr>
</tbody>
</table>

Table 1 - ERM index (full questionnaire and scores)
5. ROBUSTNESS ANALYSIS

The design of the index is based on the personal judgment of a limited number of experts, therefore it is important to check the robustness of the index: a small set of firms are invited to complete the survey, ERMi is calculated for each firm and an ordered list (ranking) is obtained. Order list robustness to small changes in the ERMi parameters scales and weights is verified with a sensitivity analysis. Each score composing the ERMi is modelled as a stochastic variable normally distributed, with average equal to the score given by the panel of experts. Robustness is checked with 0.5 and 1.0 standard deviation. One thousand different combinations of changes in the scores are obtained using random values for each score; for each combination, the ERMi is re-calculated for each firm and order list is checked. The number of permutations is a measure of the robustness of the model.

The analysis run on the answers to the questionnaire obtained from 12 companies shows that for changes to the score within 0.5 standard deviation there are no permutation in the ranking, while for larger changes up to 1.0 standard deviation in 105 over 1000 cases there is 1 permutation.

6. CONCLUSIONS

This paper illustrates the development of the ERM Index (ERMi), a model to assess the maturity of the ERM implementations in non-financial firms. The ERMi is the first ERM maturity model available in literature which is built in a rigorous and scientific way.

To compensate for the lack of quantitative measures for the many qualitative best ERM practices and recommendation available in literature, after a thorough literature review, experts opinion is solicited and group consensus obtained through a Delphi procedure. One of the advantages of the research method chosen is that the ERMi, as an output of a Delphi procedure, is an instrument already approved by the group of ERM leading experts who participated in the panel.

In particular, the Delphi procedure has engaged for four months the 16 experts, out of the initial selection of 60, who agreed to participated and competed the procedure. The panel was composed by 5 Academics, 3 Consultants and 8 Practitioners, thus representing the opinions of different types of parties with an interest in ERM practices and creating a fruitful debate. In fact, the panel experts showed active interest and provided a number of different comments and justifications of their choices which were circulated (in anonymous form) among all the participants, thus creating an enriching exchange of ideas.
The ERMi is a tool that can be used both by academics in their empirical research, thus contributing to advance the academic knowledge in the ERM field, and by practitioners and consultants as evaluation tools. In particulars, firms may use the ERMi to self-evaluate the adherence of their ERM system to the best practices and eventually to spot any area that should be improved to align ERM performance with its objective and contributing to the ultimate goal of any firm: increasing value.

It should be considered, anyway, that ERMi is not a comprehensive evaluation tool, but the number of parameters to be included was deliberately limited keeping in mind the use of the tool in large numbers empirical researches using survey instruments, which require a trade-off between completeness and ease and speed of data collection.

The best practice indicators identified in literature listed in the second chapter but excluded from the ERMi could still be used in a self-evaluation exercise by firms in a qualitative way, to complement the quantitative exercise of the ERMi.

A drawback of the present research is the low number (16) of experts who completed the procedure compared with the number of experts (60) initially identified and invited. Considering that the ERMi is based on the personal opinion of 16 experts, a robustness check has been applied to verify if and how the evaluation of the firms through the ERMi changes for small variations in the scores of the answers and weights of the questions. In particular, a test has been run with real data from 12 firms obtained through a survey. In a test based on 1000 different sequences of scores within 0.5 and 1 standard deviation, the firms ranking did not undergo significant variation, therefore ERMi proved to be robust.

The ERMi is therefore an easy-to-use and a robust model which makes a starting point for future empirical works on ERM, contributing to advance knowledge on the topic.
REFERENCES

ERM references


Economist Intelligence Unit (2005). *The evolving role of the CRO*. ACE, Cisco Systems, Deutsche Bank and IBM.

Ernst & Young (2010). *Risk Appetite - The strategic Balancing Act*. Ernst & Young.


Delphi method References


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We would also like to thank the firms which accepted to participate in the survey, allowing to test the ERMi and check its robustness.

Finally, we thank Sara Galliazzo for her precious research assistance.