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elton consulting

Managing Strategic Risk

Case study | four

Prepared for NSW Federation of Housing Associations and NSW Registrar of Community Housing

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www.elton.com.au
consulting@elton.com.au
Sydney | Canberra | Darwin
ABN 56 003 853 101

Contents

01 About the project

The NSW Registrar of Community Housing (the Registrar) and NSW Federation of Housing Associations (the Federation) engaged Elton Consulting to prepare a series of in-depth case studies of community housing organisations' experience with managing strategic risk. This report was commissioned under the NSW Community Housing Industry Development Strategy 2013/14-2015/16. The Strategy is a partnership between the NSW Federation of Housing Associations and the Department of Family and Community Services and aims to enhance the industry's ability to respond to the challenges and opportunities of the emerging environment. This project extends and complements the Managing Strategic Risk Stage 1 Report, also jointly commissioned by the Registrar and Federation in 2014. The Stage 1 Report documented the perceptions of providers and critical stakeholders regarding contemporary strategic risk practices in the sector.

About the case studies

The case studies explore key issues emerging from the Stage 1 Report, including:

- approaches to managing risk arising from changing government policy
- appreciation of the risk inherent in existing community housing business models
- approaches to managing risk to culture, purpose and values, for example, resulting from growth
- the Board's stewardship role in managing strategic risk
- experiences with managing financial risks
- approaches to decisions about organisational structure
- appreciation of the role of business diversification as a strategic risk, as well as a risk mitigation technique.

Participating case study organisations were selected on the basis of a recent history of growth and diversification, or a recent reshaping of the organisation in readiness for growth and diversification. Further information about each organisation and the reasons for their selection is contained in each case study. The case studies include overseas providers.

The case studies have been prepared using the current risk management strategy and reporting framework of participating organisations, as well as relevant documents including Board papers, Audit and Risk Committee papers, and strategic and financial plans.

CEOs of case study organisations were interviewed twice to canvass their experiences and perspectives on the key issues, and to explore matters arising from the review of their documents. The first interviews were approximately two hours in length and were in depth and discussion-style. The second interviews were shorter and more targeted, focusing on topics which benefitted from further exploration or confirmation.

All materials received from participating organisations have remained confidential, and case studies have been de-identified.

About strategic risk management

Risk refers to the effect of uncertainty on an organisation achieving its strategic objectives and maintaining its long-term viability and reputation. Risk management is an integral component of good organisational strategy. At an operational level, the purpose of risk management is to minimise the impacts of potential threats to achieving an organisation's objectives, and to enable it to take advantage of opportunities. At a strategic level, risk management is essential for sustaining the organisation's purpose and for creating value for shareholders and stakeholders.

To manage strategic risks effectively, organisations must first consciously take an approach to risk. They must anticipate risks and opportunities, understand the character of the risks, and determine their risk appetite. They must also appreciate that the drivers of risk tend to operate in an interconnected way, which means they must be monitored and managed in combination.

Risk management must be integrated into all levels of an organisation's processes. In particular, the management of strategic risks must be embedded in business and strategic planning, as it forms an integral component of decision making. A risk management framework should ideally be subject to iterative and continual monitoring and review. This aims to ensure that the risk management approach continues to remain relevant and is able to inform decision making as the organisation's operating environment changes.

The International Risk Management Standard AS/NZS ISO 31000, published in November 2009, provides the benchmark for good practice risk management. The standard outlines risk management architecture, comprising core principles and a related risk framework and process. While the risk framework and process are important for effectively identifying and managing operational risks, it is the 11 principles which most directly address the question of strategic risks. As articulated in the ISO 31000 principles, risk management:

- creates value
- integral part of organisational processes
- part of decision making
- explicitly addresses uncertainty
- systematic, structured and timely
- based on the best available information
- tailored
- takes human and cultural factors into account
- transparent and inclusive
- dynamic, iterative and responsive to change
- facilitates continual improvement and enhancement of the organisation.

These principles assist organisations to navigate their operating environments, with all their inherent and ever-changing uncertainties and potential opportunities. Linking strategic risk management to the aim of creating and protecting value allows an organisation to get the most out of its business strategy and to understand closely both its business model and its stakeholders. In order to understand the risks to an organisation's business strategy, the organisation must first understand and be able to articulate the key elements of that strategy. Strategic risk management helps organisations to make strong decisions at the executive and governance level, by making explicit the level of risk the organisation is prepared to take in executing its business strategy. Equally, strategic risk management makes explicit the level of risk which is actually being taken, and allows this to be evaluated.

The principles draw attention to uncertainty: to probabilities and consequences which cannot be known; on events which are outside the organisation's control and estimation; on the potential for catastrophic risks which may pose a threat to the ongoing existence of an organisation or an entire industry. Strategic risk management does not require that all unknowns are made known, only that the uncertainty inherent in the operating environment is identified as much as possible, and so that it can become an explicit part of decision making. One way for an organisation to address uncertainty is to identify the assumptions it is making, and to subject those assumptions to stress testing and/or scenario analysis. The latter involves modelling the impact on the organisation of an adverse event such as a development partner bankruptcy or more dramatically a second global financial crisis.

All risk management approaches need to be able to adapt to changing circumstances. This is even more critical at the level of strategic risk management, which aims to support business decisions in dynamic and complex environments.

This project applies the principles of ISO 31000 to inform the desired approach to strategic risk management in the community housing context.

02 About the organisation

This case study focuses on a provider which has a strong reputation for innovation in service provision and business diversification. It operates in a largely non metropolitan area, although close to a bigger city.

The organisation has long identified three key areas of strategic risk, linked to its three largest cost areas: staffing, housing development and property maintenance. It has a range of practices in place to manage risk associated with staffing. In recent years, the organisation has therefore focused on managing risk related to property development and property maintenance.

Key facts

Number of properties	1,300
Staffing numbers	80
Operations in multiple locations	No
Core social housing activities	» Managing tenancies » Managing properties » Maintaining own properties » Supporting tenants
Other activities	» Developing properties » Maintaining other properties

03 About the organisation's management of strategic risk

Forging partnerships

The organisation has established a key partnership as its selected method of managing the strategic risks associated with property development. For many years, the organisation had its own in-house property development program. Some ten years ago, the organisation moved to a partnership model. The organisation now identifies and acquires sites and sources development funding, with its partner managing the planning, design and construction process.

This partnership initially emerged at a challenging time in the history of the organisation. The organisation had been formed to provide tenancy and property management services in a specific local area. It also undertook a small development pipeline. While it was meeting its mandate to serve its local community, the organisation appeared to have reached the end of its likely growth trajectory.

The Board was therefore considering a range of options for the immediate future, including a potential merger. On the advice of consultants, the Board reached the stage of seeking expressions of interest from the industry. One of the submissions was from a not-for-profit organisation with a very large property development program. The organisation was in some ways offered a choice between merging with another provider or retaining its autonomy by working with a development partner.

The Board chose to remain independent. It entered into a strategic partnership with another local social housing provider, which also gave it access to the large not-for-profit development partner. The creation of the partnership, including due diligence processes, took approximately one year. While there was some initial concern from staff and some stakeholders that the partnership represented the first stage of a takeover, these fears have not been realised.

The partnership provides the organisation with a very large development capacity at a significantly reduced risk. The organisation is able to rapidly change its housing development strategy in response to changes in the operating environment. It also benefits from the considerable expertise of its development partner. More generally the organisation benefits from the partnering approach. Rather than making a permanent decision to merge, the organisation reserves the capacity to maintain the partnership while ever it suits both parties.

Unlike many of its peers, the organisation does not need to maintain a development pipeline in order to retain experienced staff. Instead, its partner maintains significant in-house resourcing and development capabilities.

This means that the organisation is able to rapidly reduce or cease development activities during adverse market or funding conditions. Similarly, it is able to increase its development activity as soon as conditions improve, without the lag time associated with the recruitment of experienced staff.

In significantly reducing its development risk, the partnership also allows the organisation to focus on other areas of growth and diversification.

Diversifying the business

Business diversification increases the risk profile of an organisation. It can also, however, be a risk management strategy, as it helps protect the organisation from the impact of changes in the operating environment.

With strategies in place to manage risks associated with staffing and property development, the organisation identified the failure of its property maintenance contract as its biggest area of residual strategic risk.

This was the most important of several drivers which led the organisation to establish a subsidiary focusing on providing property maintenance and repair services for its own properties, as well as those of other providers.

The business strategy driving the establishment of the subsidiary rests on three pillars. The first and most important of these pillars is to control the costs and reliability of maintenance services – that is, to reduce the risk associated with property maintenance. The other two pillars are to improve the quality of services for tenants and to create a profit for the parent organisation.

The order of these pillars is seen by the organisation as critical, with making a profit the third and lowest priority driver of the subsidiary. Maintaining focus on the pillars and their prioritisation is one of ways in which the parent organisation manages the challenge of being a hybrid organisation.

As a relatively small and locally focused provider, the organisation understood that, to be successful, the maintenance subsidiary needed a larger pipeline of work than it would be able to provide alone.

The organisation established the maintenance subsidiary on the basis of service agreements with two 'founding partners'. The partners agreed to receive services from the subsidiary, as well as a share of the profits provided that the terms of a Memorandum of Understanding were met. The process took approximately two years from the initial concept to the first day of trading. This included a comprehensive due diligence process. For example, the organisation had sought advice from a top tier legal firm on the structure of the subsidiary.

Over time, the contracts with the founding partners have ended and the subsidiary has tendered for and won other maintenance contracts with a large number of social housing providers. More recently, it has begun to provide services to the private market.

Aligning with strategic direction

A key aspect of the organisation's management of strategic risk is the use of clear and succinct vision statements – both for the main organisation and for the subsidiary. The vision statements provide direction not only on the kinds of activities the organisations should pursue, but also the outcomes expected.

This is particularly important for the subsidiary, with its more commercial focus. Interestingly, the subsidiary's name and vision statement was developed by a graphic design and marketing agency. When the organisation put out a tender for the branding of the subsidiary, a small local firm provided a persuasive response. It included a three word strap line which provided a catchy and compelling summary of the subsidiary's focus of operations.

That strap line became the subsidiary's vision statement, which features on the organisation's website and other branding material. It is supplemented by a similarly concise three word mission statement, which is a key tool to guide organisational decision making. As discussed previously, the mission statement is based on the three pillars of the subsidiary: controlling costs and reliability of maintenance services, improving quality of services for tenants and creating a profit for the parent organisation.

Until relatively recently, the main organisation had a more traditional approach to documenting and communicating its vision. It had a long mission statement supported by a similarly lengthy set of principles. About four years ago, in part inspired by the success of the subsidiary's more concise approach to conceptualising and communicating its vision, the main organisation changed its approach.

The process for developing the new vision statement was similar to that used in many other organisations. It was developed over a consolidated two day period by the management group, led by a consultant.

The result was another three word vision statement which is written in plain English and able to be easily understood by Board members, staff, residents and stakeholders alike. The vision statement is catchy and easily remembered. Most importantly, it is couched as an outcome statement, which acts as a guide for organisational decision making. If an activity does not align with the vision statement, the organisation knows it should question why it is doing that activity at all.

Setting risk appetite

The organisation has established clearly differentiated risk appetites for the parent organisation and its subsidiary.

The parent organisation has a very low risk appetite. It focuses its activities on the traditional social housing activities of managing tenancies and properties. As discussed previously, it also works in partnership to initiate a low risk development pipeline.

One of the other critical factors which reduces the parent organisation's strategic risk is its decision to operate only within one local government area. Its tenancy and property management activities, as well as its development activities, are all contained within this area. The organisation works in close partnership with the local council and has a deep understanding of its local community.

In contrast, the subsidiary is described as having a medium risk appetite. As noted earlier, in addition to maintaining the parent company's own properties, it bids for management contracts with other organisations in a competitive market.

In addition, the subsidiary operates within a much wider geographic area. Its area of operations takes in several neighbouring local government areas, including a large urban area. This broader geographic range is necessary to provide the quantity of work to make the subsidiary viable, but also increases its risk profile.

While not formally documented as part of the organisation's risk management framework, this setting or risk appetite is a conscious decision, which is deeply embedded within the strategic plans and operational decision making of the two organisations.

Implementing internal controls

The organisation has a cascading series of committees and groups with defined responsibilities for identifying, assessing and managing the organisation's risk. This includes the Board, risk management committee, corporate risk panel and organisational risk groups.

The corporate risk panel plays a critical role in this hierarchy of risk management. It oversees the management of corporate risks for both the main organisation and the subsidiary. Unusually, the membership of the panel includes of the senior management team and at least two Board members.

With up to 15 members, the Board of the main organisation is relatively large. The role of the Chair in strategic risk management is therefore particularly important. The Chair is typically one of the two Board members on the corporate risk panel. The Chair therefore engages in regular, structured and sustained discussions about organisational risks, including but not limited to strategic risks.

The panel is responsible for assessing each corporate risk, preparing appropriate risk maps, and reporting their findings to the committee. As part of this assessment and mapping process, the panel is expected to ensure that appropriate controls are put in place. The panel uses specialised risk mapping software to capture the identified risks, proposed controls, and any other actions. Selection of the risk software to streamline the panel's processes has been important in implementing robust internal controls.

In addition to having integrated risk management processes, a single risk management strategy covers both the main organisation and the subsidiary. The CEO identifies the organisation's nuanced approach to risk mapping as one of the key contributors to its successful management of strategic risk. While many organisations use a three to five point risk rating scale, this organisation has a ten point risk rating scale.

Each risk is given a risk score based on the probability of an event occurring (between zero and ten) multiplied by the impact such an event would have (between zero and ten), resulting in each risk receiving a score out of 100. Risk are then categorised and mapped, to give a visual assessment of each risk.

Importantly, the use of a more gradated risk mapping approach leads to the organisation's risk structures, and particularly the corporate risk panel, as having longer and more nuanced conversations when setting scores. The use of more gradated scores also leads to more active involvement is the prioritisation of risk management tasks by the panel. The meetings are scheduled on the same day as Board meetings, to reduce the likelihood that they will be deferred or cancelled due to lack of quorum.

Containing financial risk

To contain financial and legal risk, the organisation has set up its property maintenance business as a subsidiary. This is an approach increasingly being used, particularly by larger providers, to quarantine higher risk business activities from their core tenancy and property management activities. It also meets legislative requirements relating to the commercial activities of charities.

To provide appropriate oversight and manage strategic risk, the organisation has established separate Boards for the main organisation and the subsidiary. Half of the members of the subsidiary Board are sourced from the Board of the parent organisation, with the remainder being independent appointments.

Cultivating readiness

With a typical turnaround of three to four weeks, the timeline for the subsidiary to respond to new business opportunities does not usually enable the involvement of the Board.

To enable the subsidiary to take advantage of emerging opportunities while managing risk, the subsidiary therefore assembles bids based on an agreed schedule of rates and within set parameters. The CEO can approve subsidiary bids, but not accept contracts.

If the subsidiary is successful in its bid, the subsidiary Board must approve the contract and associated variation to the entity's budget.

Declining an opportunity

In the early years of managing its subsidiary, the organisation experienced some difficulties associated with faster than expected growth. As part of its commercial focus, the subsidiary initially attempted to take up all opportunities and tendered for a number of large contracts.

The organisation encountered greater than expected success in winning these contracts – but found that its systems and structures were not always able to cope. In particular, its systems did not enable timely invoicing of works, resulting in the organisation encountering large holding costs and cashflow issues.

The subsidiary now targets its bids for property maintenance contracts more carefully. In assessing potential opportunities, it considers factors including organisational alignment and systems capacity. In some cases, this means passing up on potential opportunities.

This more considered approach is standing the subsidiary in good stead as it further expands its services.

Structuring the organisation

The organisation uses its structure as an important tool to manage the risk associated with its subsidiary.

The main organisation has a three-directorate structure, with all directors reporting to the CEO. The Director of Asset Management has an important, dual role.

This Director manages the Asset Manager in the main organisation. The Director also oversees the manager of the subsidiary. This structuring of roles and responsibilities create a 'purchaser/provider' or 'client/contractor' split.

The Asset Manager has sole responsibility to the main organisation. His or her role is to scope the maintenance contract, including the level of service requested, and prepare the relevant documentation.

The Subsidiary Manager has sole responsibility to the subsidiary organisation and ultimately reports to the Board of that organisation. His or her role is to respond to the request for maintenance services with a competitive price and service proposition. The Director of Asset Management, however, has primary responsibility to the group.

It there are disagreements between the Asset Manager and the Subsidiary Manager, the two roles are encouraged in the first instance to resolve the issue themselves. If the issue cannot be resolved, it is escalated to the Director. This role must act in the interests of the entire group, taking into account the objectives of both the main organisation and the subsidiary.

This organisational structure is somewhat unusual. In many small to medium organisations, responsibility for considering the interests of the group rests with the CEO and Board. However, the structure of this organisation has been operating successfully since the establishment of the subsidiary six years ago.

The organisational structure helps to ensure the subsidiary is subject to the same rigorous procurement standards and service agreements as any other maintenance service provider. Conversely, it also means that the subsidiary is not required to provide services to the main organisation on unviable terms

Staffing new initiatives

Given the importance of the role, recruiting a suitably experienced candidate to the Director of Asset Management position was seen as one of the highest priorities in setting up the subsidiary.

As the role required someone with unusual expertise for a social housing provider, the organisation directly approached a senior manager with the appropriate skills and experience, rather than advertising for the role. This is an example of a more strategic and deliberate use of recruitment practices to meet organisational objectives, which is increasingly being seen among providers.

More generally, the organisation has a succession plan in place for key roles within the organisation. It identifies roles which are critical to the success of the organisation and reviews these roles on a yearly basis at its strategic planning day. There are fast track processes in place for the recruitment of these roles if necessary, with pre-prepared advertisements ready to be placed at short notice. The organisation also has a contingency budget for temporary staffing of key roles to ensure business continuity and reduce operational and strategic risk.

4

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