Enterprise Risk Management at Safeway Inc.

Enterprise Risk Management (ERM) is a hot button in the boardroom. In the wake of the financial crisis, the Madoff arrest, the MF Global bankruptcy, and other shocking spectacles on Wall Street, regulatory oversight is intensifying, along with shareholder demands for managerial transparency. All this has led boards of directors at industrial companies, not just financial institutions, to ask their CEOs and CFOs to evolve their processes and capabilities that make up ERM. The goal is to identify, quantify, monitor, and manage potential events that could seriously disrupt strategic intent and result in serious penalty or dismemberment of the organization.

What's involved? How to do this? Identification and measurement of risks that truly qualify as enterprise risks are foundational steps, according Ward Ching, Vice President of Risk Management Operations at Safeway Inc., the second largest supermarket chain in North America. Ching, a respected leader in this field, describes ERM as "a structured analytical process that focuses on identifying and estimating the financial impact/volatility of a defined portfolio of risks. He explains that applying this framework helps his company to:

- highlight significant or 'material' risks using a structured and auditable process,
- identify risk interdependencies or clusters,
- establish baseline financial estimates of probable loss utilizing a variety of actuarial and financial modeling methods,
- assist in setting operational contingency plans to reduce the impact of catastrophic loss,
- establish a new and more comprehensive risk management discipline within the organization, and
- identify possible strategic competitive advantages.

By separating important financial and operational risks from "background noise," organizations can clearly view the material risks facing the enterprise as a whole. Senior executives are then properly equipped when facing shareholder questions about risks inherent in any business strategy.

Risk Is Capital

Ching views risk as a form of capital. Without risk, there is no possibility of reward. "When you think of risk as capital," says Ching, "there is both an upside and a downside to a risk-adjusted decision. When properly employed, ERM is about risk mitigation and advantage-exploitation. ERM develops and prosecutes a competitive advantage that is generated out of your risk management process and vision.

Safeway Inc. conceptualizes risk into different domains: hazard, market, operational, reputation, HR, etc. Calculating the combined risk volatility of these domains and then communicating the results to senior management and actuarial partners, Safeway Inc. is able to manage its entire risk portfolio as a whole.

Culture of Safety

Safeway Inc. was searching for a way to generate significant cost savings on the operational side in retail by reducing the number of workers' compensation claims and the capital reserves that a self-insured (in most states) company such as Safeway Inc. must set aside. Through simply looking at the costs to self-insure, Safeway Inc. identified the risk of worker injury as a driver of other forms of risk that could impact the company's reputation, ability to serve customers, and overall financial performance. This holistic view drove home the need to promote a strong culture of safety.

If there is no safety, there is no service. And in a service-centered industry, an injured retail employee cannot maintain Safeway Inc.'s promise to customers. Therefore, each individual has a responsibility to help colleagues work safely and stay healthy. To that end, Safeway Inc. nurtures an environment that is proactive about safety and accident prevention.

With Safeway Inc.'s emphasis on safety a key positive attribute of the organization's culture, Safeway Inc.'s "Culture of Safety" injury prevention program is a responsibility retail employees gladly undertake. Employees note that before the "Culture of Safety" program, Safeway Inc. did not offer enough opportunities or tools to maintain accountability for safety.

IMPLEMENTATION

Safeway Inc.'s "Culture of Safety" program includes specific procedures for handling safety issues and concerns in the stores that retail employees take responsibility for. In order to attract store managers to embrace the "Culture of Safety" strategy, the program increases costs for reluctant stores.

Safeway Inc.'s insurance premium incentive program is designed around clear performance expectations and key performance indicators (KPIs) that managers can control and influence on the store floor. The program monitors targets for the frequency and severity of safety issues and events. If a manager meets quarterly targets and adheres to Safeway Inc.'s risk awareness and prevention process, senior management awards a predetermined P&L benefit. If a manager falls short, then the financial return is withheld. Keep in mind, for many of Safeway Inc.'s divisions, this financial reward can mean the difference between profit and loss.

STRATEGIC BENEFITS

Over the course of two years, Safeway Inc. presented its injury prevention program to external actuaries, showing them the real financial returns generated by the framework the company was using. The actuaries validated Safeway Inc.'s data and analysis and assessed its risk profile, expected payout structure, and current and future capital reserves plan. Agreeing with the outlook, the actuaries gave Safeway Inc. credit ahead of schedule.

Believing that the way Safeway Inc. manages hazard risk is sustainable, actuaries appreciated how the company takes discrete risks (hazard, operational, market, reputational, HR, etc.) and analyzes these risks within the context of an ERM portfolio.

Safeway Inc.'s senior leadership recognizes the ERM approach to cost reduction as one of the most effective in the organization. The insurance premium incentive program showed a direct boost to profitability. Results were translated into metrics such as EVA, ROE, and ROI so that the CFO and other senior management found the efforts made meaningful.

Conclusion

The awareness of the value of ERM is no longer limited to the insurance or financial industries. Leading industrial companies utilize ERM to move from a single functional-silo view to a risk-adjusted, organization-wide planning strategy. Providing a holistic view, ERM compares the risk-adjusted value of one plan versus another.

ABOUT APQC

APQC is a member-based nonprofit and one of the leading proponents of benchmarking and best practice business research. Working with more than 500 organizations worldwide in all industries, APQC focuses on providing organizations with the information they need to work smarter, faster, and with confidence. Every day we uncover the processes and practices that push organizations from good to great. Visit us at www.apqc.org and learn how you can make best practices your practices.