RISK MANAGEMENT ANTE PORTAS

Ulrich Hommel and **Anna Pastwa** present the results of the EFMD Risk Management survey and argue that most business schools have just begun to look at this issue more seriously

The issue of risk is receiving increased attention in business schools. They have increasingly to rely on entrepreneurially generated funds to finance growth, to compensate for reduced government appropriations and to support cross-subsidisation schemes in wider university structures. These revenue streams are exposed to various forms of market risk.

Oversight bodies such as the British HEFCE and the Australian TEQSA have begun to look at risk more seriously and have amended their audit frameworks to include the risk-based regulation of higher education institutions, which has a trickle-down effect on business schools.

EFMD's accreditation service EQUIS has recognised the growing relevance of risk taking and has amended its standards to ensure that the quality review captures any issues threatening the economic and reputational viability of applicant institutions.

These changes were designed as an encouragement for business schools to think about managing their risk exposures more explicitly. Yet very little is known about the actual state of risk management in business schools. To answer this, EFMD has conducted a survey of business school deans to gauge the degree of organisational formalisation of the risk management function in terms of governance, management and mitigation policies. The feedback provides a snapshot of achievements and remaining actions needed.

The questionnaire-based survey was carried out in the last quarter of 2012, coupled with the annual Deans Barometer survey. A total of 708 deans from the EFMD business schools network were invited to participate.

More than 200 responses have been received with 103 questionnaires being sufficiently complete to qualify for further analysis (a response rate of 14.3%).

Most of the schools taking part in the survey were based in Europe (57%), 12% in the Middle East and North Africa (MENA), 12% North America, 7% Central and South America, 13% Asia and 5% Australia and Oceania. This allocation matches the geographical distribution of the EFMD membership.

Two-thirds of the deans participating in the survey lead university-based business schools. A quarter of the reporting schools operate independently. The remainder represents other institutional forms. Although the vast majority of schools operate in a not-for profit setting, 5% of the respondents represent for-profit organisations. Three-quarters of the respondents indicated that their school had been granted at least one international accreditation label.

The survey results provide valuable insights into the attention currently devoted to the management of risk. For good reason, the organisational response differs greatly within the sector.

Business schools differ greatly with respect to the risk exposures they face. The general business model (a focus on post-experience versus pre-experience education), funding constraints or the degree of internationalisation all have a profound impact on the volatility of net surpluses.

Business schools are also constituted in different ways with the spectrum ranging from private stand-alone business schools with no major endowment (high risk) to traditional faculties of management embedded in public universities and with far-reaching funding commitments by the government (low risk). But even the latter type needs to worry about implications of risk taking though this is mostly focused on reputational matters (for example, unethical behaviour of faculty).

The survey results send a strong signal that risk has been identified as a relevant issue by business schools but that it is still receiving limited management attention.

This is not surprising. The rising prominence of risk is a fairly recent phenomenon closely linked to the economic turmoil of the financial crisis and its aftermath. The likelihood of funding gaps has also increased as a result of

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75%

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73%

Nearly three-quarters (73%) of schools surveyed have begun to define their risk appetite and include this aspect in their communication with key stakeholders

47%

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government policy, be it in the form of visa policies constraining the inflow of foreign students or general cutbacks as part of fiscal austerity programmes.

Nearly three-quarters (73%) of schools surveyed have begun to define their risk appetite and include this aspect in their communication with key stakeholders (with 25% of the sample firms being satisfied with their approach in dealing with this issue). Seventy-five per cent of respondents argue that the tolerance for risk has become part of their school's decision-making culture, with 30% feeling comfortable with the current state of affairs.

Nearly the same feedback has been received on the question whether risk tolerance guides operational and strategic decisions.

For 47% of the responding schools, the responsibility of exercising risk control rests with the school board, while 8% have assigned this task to a sub-committee of the board. University parents (such as the chancellor or vice-chancellor, CFO or president) control 37% of the cases directly.

The distribution of answers reflects the aforementioned sample diversity but may also point to a one-sided focus on managing the financial dimension of risk. If the board is involved in the governance of a school's risk function, then basic management principles have generally been adopted and laid down in a guideline document. This is in line with current corporate practice.

However, the lack of prioritisation of risk management is reflected by the fact that 28% of respondents link risk assessments to annual reporting. Twenty per cent of sample schools assess their risk situation on a quarterly basis (10% monthly) while 32% of respondents indicated that risk assessments are carried out as needed.

As a matter of principle, a fixed school-wide rhythm of risk assessment is inappropriate since each risk factor has its own time line. For one thing, risk-related information arrives in variable frequencies. Adjustability of performance levers and the general ability to mitigate particular risks play a role as well.

The allocation of risk management responsibilities further supports the view that risk management is still a fairly immature activity in business schools.

Twenty-two per cent of schools surveyed follow corporate practice and assign the responsibility to the executive board (senior management team). It ensures that the strategic and operational dimensions of risk management are properly accounted for and that the school's management skills and market knowledge are utilised more broadly in the evaluation of risk exposures. Two schools have gone so far as to appoint a risk manager, which can be a necessary complementary step for large, financially complex organisations.

While 61% entrust the dean with the task of managing risk, deans are likely to be overburdened with other tasks, which can easily translate into systemic risk ignorance. In this context, it also not surprising that 74% of schools do not have a special budgetary allocation to support risk management activities. Only a minority of schools (11%) have not yet assigned risk management responsibilities.

When asked what tools are employed to assess risks, 58 respondents mentioned SWOT analysis, possibly in combination with other techniques (multiple responses possible). This is, at best, a first-cut analysis to identify general problem areas on a strategic level.

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35%
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Fifty schools use risk checklists. They represent so-called laundry lists of relevant risk factors and may also include links to performance levers and the assignment of operational responsibilities for managing these risks. Twenty-four schools compile risk matrices/maps, which rank risk factors in two-dimensional space according to "likelihood of occurrence" and "severity of impact" (for example, high, medium, or low).

Twenty-two schools attempt to measure the impact on performance with sensitivity analysis, while seven engage in full-fledged simulation analysis. The former technique studies how school performance co-varies with fluctuations of individual risk factors, while the latter considers the combined influence of all risk factors and therefore also accounts for the correlation of risk factors.

Overall, the majority of schools focus on the identification of risk factors and it is unclear how they actually measure the risks and their impact. It is noteworthy in this context, however, that 35% of schools are considering the adoption of a more formal risk management framework in the near future.

Most schools are selective risk takers – only 24 claimed that they have designed operations to avoid major risks altogether. The majority of schools (66) focus on the reduction of key risks, which is, first of all, in line with the way risks appear to be assessed and, second, takes into account diminishing returns from adding additional risk factors into the risk management framework.

Only 34 schools have adopted a state-of-the-art approach, where exposures are managed on the aggregate level to limit the likelihood of a risk-related performance shortfall (which follows the cash-flow-at-risk philosophy).

When asked how to respond to an expected decline in business volume, respondents showed considerable reluctance to touch the core of their operations. This for instance includes reducing the size of the core faculty (and increasing the reliance on adjunct faculty) as well as staff size overall, increasing teaching loads, mothballing infrastructure upgrades or reducing core administrative budgets such as marketing and communications. They would much rather seek to scale up activities less affected by the downturn (and possibly even to diversify into new activity areas) or to increase the admission yield.

Business schools may easily find themselves between a rock and a hard place where the preferred crisis measures prove themselves ineffective. The ultimate purpose of risk management is to avoid such a dilemma

Finally, schools were asked how they would be coping with an unexpected performance shortfall. The answers underscore the rising importance of implementing a well-functioning risk management system as part of regular business school operations.

Schools seem to be relying on a combination of two counter-measures: intensifying fundraising efforts and generating short-term revenue increases. If budget cuts are deemed to be necessary, then schools have a slight preference for reducing the non-academic budget. Liquidity reserves are available for some schools, but the overall sample is positioned neutrally via this option.

Obtaining emergency funding from the parent organisation is not considered a viable option by most sample schools, but may nevertheless be available if really needed.

Recent history has shown that such shortfalls are often triggered by a macroeconomic downturn and, hence, discretionary funding from donors and sponsors or opportunities for scaling up existing activities may simply not be available. Business schools may therefore easily find themselves between a rock and a hard place where the preferred crisis measures prove themselves ineffective. The ultimate purpose of risk management is to avoid such a dilemma.

The results of the survey signal that risk management is noticeably moving up the priority list of deans. For most business schools, however, there is still some road to travel before this activity will have been established with a sufficient degree of professionalism.

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ABOUT THE AUTHORS

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