PRICEWATERHOUSECOOPERS

**PricewaterhouseCoopers CEO Survey Executive Summary**

## Introduction

PricewaterhouseCoopers' 7th Annual Global CEO Survey, *Managing Risk: An Assessment of CEO Preparedness*, represents input from nearly 1,400 CEOs from across the globe about the current business climate and "Enterprise Risk Management." Enterprise Risk Management (ERM) is the name for an emerging set of practices that provide a framework for management to deal with uncertainty and associated risks and opportunities, thereby enhancing management's ability to build value. What risks do CEOs perceive in the current climate and within their companies? How do CEOs go about mitigating these business risks while seizing opportunities? Are there CEOs and companies today that demonstrate exceptional skill and achieve clear benefits in managing risk? How do they do it?

*Managing Risk: An Assessment of CEO Preparedness* reveals thought-provoking regional and industry-sector differences regarding risk appetite and attitudes towards risk management. In comparison to European CEOs, for example, CEOs from the United States appear to view enterprise risk management through a narrow aperture, more as a method to help ensure regulatory compliance than as a broad-based discipline capable of yielding an array of benefits. How does one account for European and American understandings of ERM in light of recent corporate scandals and regulatory change in the United States or in light of Europe's momentous and complicated advancement towards union?

The Global CEO Survey also contains data on CEO predictions of enterprise performance in coming years and assessments of potential threats to that performance. While CEOs worldwide are optimistic about their companies' growth potential, with more than 80 percent reporting confidence in revenue growth over the next twelve months, they nevertheless perceive a range of threats and risks.

CEOS' greatest concern is increased competition, with 63 percent of the survey pool considering it a threat. Global terrorism is viewed a threat by 40 percent of the participating CEOs. At the same time, however, 59 percent of global CEOs view over-regulation as at least a significant threat. How is one to understand the relationship between risk management, value creation, open competition and government regulation?

*Managing Risk: An Assessment of CEO Preparedness* concludes with an examination of the best ERM practitioners. While 60 to 73 percent of CEOs report that the six basic processes of entry-level ERM are already well embedded in their organisations, two groups of CEOs and companies, each just 15 percent of the total sample, prove to be advanced practitioners of ERM, generating dramatically greater benefits from their ERM programs than their peers. For example, 74 percent of the advanced practitioners cite increased ability to take appropriate risks in order to create value as a benefit of ERM. This is nearly double the 39 percent of all other CEOs that cite increased risk-taking ability as a result of ERM practices. A formal ERM program is an integral component of sound management in uncertain times.

## Management Strategies and Performance Forecasts

To better understand CEO comments on risk management, some understanding of general management issues and concerns is required. What are CEO expectations for revenue growth and profitability? What management strategies are CEOs using to respond to global economic conditions?

CEOs are more confident now than one year ago in their companies' prospects for revenue growth over the next 12 months: 31 percent are very confident and 53 percent are somewhat confident versus 2002 numbers of 26 percent and 46 percent, respectively. CEOs in the United States (36 percent) and Asia-Pacific (37 percent) are most confident in their prospects for revenue growth in 2004, while European participants are least confident (22 percent).

Three-year revenue growth projections track closely with the one-year projections. 39 percent of CEOs in the United States, Asia-Pacific and South America report that they are very confident of three-year revenue growth, while in Europe the percentage is significantly lower, at 26 percent. The cautiousness of the European CEOs is worth noting in light of the changes underway in the European Union.

Among various possible methods for dealing with the challenges presented by global economic conditions, CEOs in aggregate are more likely than ever to outsource core business functions—56 percent in 2003, up from 46 percent in 2001—and 73 percent of the CEOs surveyed reported that they view the move towards outsourcing as a long-term change in their business strategy. Workforce reductions or lay-offs, while unchanged on a year-to-year basis, were considerably higher this year in Europe (60 percent) than in the United States (42 percent). Globally, 52 percent of CEOs resorted to workforce reductions in the past year, almost unchanged from 50 percent in 2001.

## Business Climate and Risk Appetite

CEOs are not alarmist—only 10 percent view global terrorism as a very substantial threat. At the same time, seventeen percent of CEOs described increased competition as a very substantial threat and another 46 percent view it as significant. A related issue, loss of key talent, looms as one of the biggest threats for 11 percent of global CEOs and as a significant threat for an additional 34 percent of global CEOs.

By industry sector, loss of talent is of particular concern to CEOs in the financial services sector, 16 percent of whom consider it a major threat and 33 percent of whom consider it significant. Financial services CEOs were also more fearful of increased competition than technology, media and product CEOs, and are clearly under intense pressure to deploy winning strategies and retain top talent in order to stay ahead.

Currency fluctuations also trump global terrorism as a significant or major threat with 15 percent and 33 percent of global CEOs considering it to be a major or significant threat, respectively. Not surprisingly, 62 percent of South American CEOs have their eyes on the threat of currency fluctuation.

The threat of over-regulation has been in the news in recent years: how much is too much? Although one might expect US CEOs to be most exercised about the threat of over-regulation, just fewer than half (49 percent) consider over-regulation a significant or major threat versus 72 percent of South American CEOs and 61 percent of European CEOs.

All of the above views—in very nearly the same percentages—prevail among the CEOs of middle-market companies. Even on such issues as the cost of capital, where size matters, they are only slightly more concerned than their larger peers. The congruence between middle-market and larger-company CEOs' views on many issues suggests that the challenges and management methods common to CEOs leading companies of all sizes far outweigh the differences.

Despite various threats, nearly fifty percent (48 percent) of global CEOs report that they are more aggressive risk takers than one year ago. In the technology and media sector, 15 percent of CEOs report that they are significantly more aggressive than one-year ago and another 43 percent report that they are somewhat more aggressive, considerably more than in other sectors.

## Enterprise Risk Management: Processes, Commitment, Barriers, Benefits

### 1. ERM Processes

The exploration of ERM in *Managing Risk: An Assessment of CEO Preparedness* is based on the conviction that an important new management practice has emerged, now more thoroughly understood and structured than in past years. Previously, there had been very little information available concerning the degree to which ERM has been integrated into current management practice and still less information about regional and industry-sector variations in its implementation. This survey creates what amounts to a profile of global CEO commitment to ERM and depth of penetration of ERM practices. It offers an overview of the most important concepts, capabilities, barriers, and benefits while offering a hierarchy of ERM functions: Which elements are most important? What constitutes full implementation? According to today's global CEOS, what ERM practice or technique generates the greatest benefit?

Three-fifths to three-quarters of CEOs affirm that **the six basic processes of ERM** are in place and functioning in their companies. These include formal enterprise-wide risk identification, risk assessment, agreed-upon patterns of response, risk control activities, risk monitoring activities and regulatory compliance processes.

US CEOs are strong with respect to compliance processes—second only to South American CEOs—but less involved with the other basic processes. For example, 42 percent of US CEOs report that their companies have formal enterprise-wide risk identification in place, as contrasted with 80 percent in Europe and 64 and 65 percent, respectively, in South America and the Asia-Pacific region.

On an industry basis, it's no surprise that the highly regulated financial services sector has the most developed basic processes for risk management, ranging from 89 percent of financial services CEOs reporting the presence of formal enterprise-wide risk monitoring to 78 percent reporting that risk response mechanisms are in place. Product companies consistently lag behind the other industry sectors across all six basic processes.

The survey indicates a considerable gap between the adoption of the basic processes of ERM and full implementation. **Full implementation of ERM** is in place when:

- The CEO has the information needed to manage risk at the enterprise level.
- A common terminology or set of standards exists for managing risk.
- ERM is fully integrated within the strategic planning process.
- Risk management data are quantified to the greatest possible extent.
- Risk management is fully integrated across all functions and business units.
- All in the organisation understand their level of personal accountability within the enterprise risk management framework.
- The costs of regulatory compliance are closely tracked.
- Compliance with regulatory requirements is closely managed and monitored to eliminate the risk of noncompliance.

Somewhat less than a third of participating CEOs are confident that their companies have achieved full implementation. Only 20 percent of US CEOs strongly agree that they have the information they need to manage enterprise-wide risk, and only 12 percent strongly agree that a common terminology and set of standards exists across the enterprise. Only 7 percent of US CEOs strongly agree that ERM is fully integrated across all functions and business units, while 22 percent of Europeans take that view.

In terms of industry sector, financial services CEOs are more confident than others (35 percent in strong agreement) that they have the information they need to manage risk, while 22 percent of technology and media CEOs say they have the information they need and only 20 percent of product CEOs strongly agree that they have common set of terminology and standards.

Middle-market companies tend to be somewhat less advanced in their ERM implementation than larger companies.

## 2. ERM Commitment

More than a third (39 percent) of participating CEOs strongly agree that ERM is a priority, and more than a third (38 percent) agree that it is a board priority. As will become clear later, the companies of those CEOs strongly committed to ERM and the companies in which ERM is strongly integrated into strategic planning processes experience a much greater ability to create value by appropriately managing risk and opportunity.

When fully implemented, ERM creates a more fact-based analysis of the current risk portfolio and of potential future scenarios. Effective ERM is dependent upon the availability and timeliness of information reaching decision makers. In companies that have mastered the skills of ERM, there often occurs a process of reducing the volume of data that enters the system because management has identified the key data elements that are required to make the strong, value-enhancing decisions.

3. **ERM Barriers**

Among the **barriers to effective ERM**, it is no surprise that CEOs single out the timeliness of information, the availability of information, and what the survey calls "people"—namely the training and capability of personnel necessary to carry out an ERM framework across the enterprise—as the top three barriers to implementation.

Sixty-three percent of CEOs see people as a key challenge to managing risk, and 20 percent regard people as the most difficult challenge. 59 percent of CEOs point to the availability of information as a key challenge that restricts them from identifying risk, and 17 percent regard availability as the most difficult challenge. Timeliness is cited by 62 percent as a key challenge and by 13 percent as the most difficult challenge.

4. **ERM Benefits**

It's important to remember that the ultimate goal of risk management is long-term stability and value creation. ERM is a set of practices designed to allow management to seize opportunities amid uncertainty, knowing as fully and rigorously as possible the risks of any venture. The survey identifies 11 primary benefits of ERM – admittedly a large number, but each is important to form a well-rounded view.

Forty-four percent of participating CEOs strongly agree that ERM will enhance their ability to take appropriate risks that create value. Nearly a third of CEOs strongly share the view that it will enhance their ability to think entrepreneurially and along innovative lines. Similarly, nearly a third strongly agree that it adds clarity to organisation-wide decision-making and the chain of command.

By region, it is the South American CEOs, with 64 percent in strong agreement, who shift the percentage upward. US. CEOs are most skeptical. For example, only 30 percent strongly agree that ERM will enhance their ability to take appropriate risks. Only 17 percent of US CEOs strongly agree that ERM will aid clarity in decision-making and chain of command—well behind the Europeans, for example, among whom 28 percent strongly agree that the organisation is strengthened in this respect.

As mentioned previously, US CEOs are more reserved than others regarding the value of ERM. The reason for this must also be consistent – probably the preoccupation of US CEOs with meeting new regulatory requirements and ensuring the integrity of corporate governance and corporate reporting under new rules.

Forty-four percent of CEOs share the view that ERM has a very positive effect on their confidence in the way the business is operating. The strongest endorsements of this premise are to be found in South America (62 percent) and in Europe (41 percent) and, by industry sector, among financial services CEOs (52 percent).

Thirty-eight percent of CEOs believe that ERM has a very positive effect on reputation, and here it is the South American CEOs (52 percent) and Asia-Pacific CEOs (40 percent) who pull the percentage up, while US CEOs (26 percent) are less fully persuaded.

**The Evidence and Benefits of Excellence in Risk Management**

Enterprise Risk Management is still an evolving discipline, and its adoption in depth by businesses is by no means complete. Some 38 percent of CEOs consider that they already have effective and efficient ERM in place. Another 46 percent view its implementation as a one to three year project. As the results of the survey came in, it became clear that **certain CEOs and their companies are dramatically ahead of their peers in terms of implementing and benefiting from ERM.**

*Managing Risk: An Assessment of CEO Preparedness* highlights the opinions expressed by those CEOs whose companies have already implemented ERM into their strategic processes. The opinions of these CEOs stand out from those of their peers in recognizing the benefits of ERM.

The survey reveals two groups of companies, each following one of two routes to ERM excellence: 1) through the CEOs personal commitment and 2) through the incorporation of ERM into enterprise-wide strategic planning. The benefits of ERM are substantially greater in companies that have a committed CEO, and greater still in companies that have integrated ERM into the strategic planning process.

The percentage of CEOs committed to ERM who strongly agree that they have the enterprise-wide information they need is nearly double the percentage of all other CEOs (53 percent to 34 percent). The same holds true for CEOs who strongly agree that their enterprise works with a common terminology and set of standards (56 percent of CEOs committed to ERM versus 33 percent of all other CEOs). Fully 62 percent of committed CEOs strongly agree that ERM helps their ability to take appropriate risks to create value—again nearly twice the percentage of other CEOs.

Companies with ERM integrated into their strategic planning mechanisms also evidence significant benefits. When ERM is integrated, 55 percent of CEOs say they have access to enterprise-wide information, more than three times the number of all other CEOs (15 percent). The same holds true for common terminology and set of standards (53 percent to 12 percent).

This group can be further narrowed. Access by the CEO to enterprise-level information and the use of a common terminology and set of standards are two critical components of full implementation of ERM. Achieving either of these aspects of full implementation contributes considerably to not only other aspects of full implementation, but also to the achievement of significant benefits. Even in companies in which the CEO regards ERM as a high priority or in which it has been integrated into strategic planning, much greater improvements and benefits flow from having in place either enterprise-level information available to the CEO or a common terminology. Achieving these goals is a prosaic and demanding task, involving countless details and robust technology, yet the survey findings show the importance of this work.

## Survey Participants and Methods

The 2004 edition of the Global CEO Survey, seventh in a series, casts a wider net than any previous edition. Nearly 1,400 interviews with CEOs were conducted on a worldwide basis in fourth-quarter 2003 (the precise number is 1,394), the great majority of them by means of telephone interviews, with regional exceptions in Japan, where a postal survey was conducted, and in China, Kenya, and Nigeria, where face-to-face interviews were conducted. The entire research effort was coordinated by the PricewaterhouseCoopers International Survey Unit, based in Belfast, Northern Ireland, in close cooperation with a New York–based team of project managers and a global advisory board of PricewaterhouseCoopers partners.

By region, there were 454 interviews in Europe, 182 in the United States (plus, in North America, 95 in Canada and 36 in Mexico), 258 in South America, 319 in the Asia-Pacific region, and 50 in Africa. By broad industry grouping, there were 244 interviews in financial services, 173 in technology and media, and 974 among consumer and industrial products manufacturers, distributors, and retailers (referred to hereafter as the product sector), in addition to 3 companies that did not provide an industry designation. Company size is also a critical measure: 37 percent of the companies represented have more than 5,000 employees; 32 percent have 1,000–5,000 employees; 13 percent have 500–999 in their workforce; 16 percent have a workforce of fewer than 500; and the small remaining percentage offered no information about workforce size.

Thirty-three percent of the respondents' companies earn annual revenue in excess of $1 billion; 14 percent earn $500 million–$1 billion; 45 percent earn less than $500 million; and 8 percent offered no information. The regional distribution, in revenue terms, shows the highest concentration of $1 billion–plus companies in Europe (45 percent), followed by Asia-Pacific (39 percent) and North America (21 percent). New to the survey this year is an exploration of the findings for the 536 participating middle-market companies, defined as having less than $500 million in revenue.