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How to Manage All Levels of Risk Management in a Project-driven Organisation: from Enterprise Risk Management to Project Risk Management

We are often requested to link project risk management with the wider enterprise risk management process. The latter is often mandated by regulations for public companies. In this White Paper, which is a summary extract from new content in the Second Edition of our Industrial Project Risk Handbook for Project Managers, we describe how this process should be setup.

The Different Levels of Opportunity & Risk Management Analysis

Enterprise Risk Management

Enterprise-level risk management is the highest level of opportunity & risk management in an organisation. It is driven by the organisation's executive management and board. Its objective is to protect and enhance the realisation of the organisation's strategic objectives. It involves the consideration of a systemic view of the organisation, taking into account a large number of macroscopic business risks. For example, risks considered will include risks related to debt such as interest rates or other debt covenants, general availability of manpower and capital, legal and regulatory risks, effective usage of capital, general market and reputation risks, general economic situation of relevant geographies, etc.

Through the enterprise risk management process, the risk appetence of the organisation will also be determined and generally made explicit. This appetence will align with the organisation's strategy.

While project and project portfolio-level processes are different and operate at a different scale, by different people, some level of consistency remains essential in terms of strategic alignment.

Depending on the organisation and its business model, capital project-related risks will have a different weight in the overall organisation perspective. It will be very significant for fully project-driven contractors or service providers with a limited asset base, and much less significant for owners having a very significant operational component involving a large asset base.

Portfolio-level Opportunity & Risk Management

Organisations generally spend their capital expenditures as a portfolio of projects of various sizes, durations and progress, possibly spread over several locations. Some projects may be interrelated in larger programmes within the overall portfolio. All projects in the portfolio will at least share the capital expenditure capability of the organisation, and they may also share resources.

Portfolio-level is a very relevant level for opportunity and risk analysis. For owners, prioritisation of the effective usage of available capital expenditure is performed at this level based on a cost, risk and benefit analysis. It is also at this level that risks related to sharing of scarce resources should be identified and managed. . Such analysis may be performed on the entire project portfolio or on relevant subsets, driven by the entity in charge of projects.

Single Project Opportunity & Risk Management

Project-level opportunity & risk management is relevant for the project manager, the project team and the particular project governance to analyse and take action, with the aim of protecting and improving the performance of this particular project.

Managing the Consistency Between the Various Levels of Opportunity & Risk Analysis

Feeding Project and Portfolio Risk Data within the Enterprise Risk Management

The relevance of project-level and portfolio-level opportunities and risks at enterprise level will obviously depend on the magnitude of the projects with respect to the entire organisation, and the magnitude of the opportunity & risk related to the projects. Depending on the actual opportunity or risk, it may be more relevant to address it at project level if project specific, or portfolio level if common to several projects. In any case, the general rule should be followed that risks and opportunities are better managed at the level with the most leverage on those particular issues.

In general, only a few chosen project-level or portfolio-level opportunities and risks will make their way into the enterprise risk management framework. We do recommend, however, to try to aggregate those opportunities and risks as much as possible, and in any case, to have at least one line reflecting the projects of note as a couple of line items in the enterprise-level risk register. In addition, we find that it is also worthwhile to mention the following opportunity and risk areas in the enterprise risk register:

- project and portfolio governance,
- rare or major / critical resources shared between various projects across the portfolio,
- Very low probability – very high impact risks

Accounting for Enterprise-Level Business Risks and Risk Transfers in Project Opportunity & Risk Management

Conversely, it is important to reflect enterprise-level opportunities and risks at the portfolio or project level, if that is relevant. Relevance should be directly related to the capability to take useful action at portfolio or project level.

In many organisations, this top-down loop is often absent because the higher-level analysis is deemed confidential. This may lead to missing essential issues at the more operational level. Enterprise risk managers should be encouraged to flow down relevant opportunities and risks.

The potential impact of capital project risks on organisations is often underestimated, in particular in owner organisations

How to manage practically those interrelationships

We generally find that exchange of information with enterprise risk management will be performed on a punctual basis, driven by enterprise risk update frequency. Project and portfolio updates will generally be more frequent. Rituals should be defined to ensure a proper quality of information exchange between these processes.

Aligning Organisation Strategy with Project Portfolio

One of the bigger issues in organisations is to have a capital projects portfolio that is not aligned with the organisation strategy. Of course, due to the duration of capital projects, it may well be that projects in execution cannot be stopped without hurting the organisation even if they are not any more fully in line with a new strategic orientation. Therefore, some misalignment related to the consequences of previous decisions must be accepted. However, it remains quite essential to frequently review the capital project portfolio for potential misalignment. In case of significant misalignment, it is often possible to sell projects, or a portfolio of projects to an interested third party with substantial benefits for the owner. This can even be done in the middle of the project development and execution phases, or at a convenient project milestone where the projects can be more easily valued.
Strategic portfolio management has become a discipline brand name by itself and should certainly be implemented in a systematic manner. The fact that capital projects involve substantial amounts of capital and sunk costs accounted for as an asset in the balance sheets, may delay or prevent effective decision making. Further cost expenditure and greater negative impact on the accounts may result from delayed decisions to cancel of divest a project. The portfolio optimisation process will thus require a strong leadership at the highest level of the organisation.

Summary

Enterprise risk management is a very useful process that is deployed in many organisations. While project and project portfolio-level processes are different and operate at a different scale, by different people, some level of consistency remains essential in terms of strategic alignment. The potential impact of capital project risks on organisations is often underestimated, in particular in owner organisations. Thus, a positive conversation should be organised between the enterprise level and the project/portfolio level to ensure that the opportunities and risks facing the organisation are effectively addressed in the most comprehensive manner possible.