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Risk management moves to the front of the class

The financial meltdown has business schools scrambling to add classes on all things risk, but can they help execs dodge the next big disaster?

By Judith Crown

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As the saying goes, there is opportunity in every crisis. And the current financial meltdown is no different.

Case in point: Business schools are adding or expanding risk management programs aimed largely at chief risk officers, auditors, IT specialists, financial engineers, directors and other top executives. The courses typically combine quantitative approaches and qualitative discussions to ensure that execs ask all the right questions and key in on possible threats that can topple an enterprise.

For example, Northwestern University's Kellogg School of Management will begin offering a 20-week non-degree executive education program beginning in February—a partnership with the non-profit Professional Risk Managers' International Association (PRMIA). The association has similar partnerships with more than a dozen institutions worldwide and added five affiliations, including Northwestern, during the past year. The Minneapolis-based association has increased its own classroom courses by 58% for its fiscal year ended June 30, and says revenue from online courses more than doubled.

“Before, it was an academic discussion,” said Dan Dalton, director of the Institute for Corporate Governance at Indiana University, which isn't affiliated with PRMIA. “We hadn't seen a sector's near demise. Now we've seen it.” He said the institute's executive seminars have dedicated one-third to two-fifths of their time to risk management during the past 18 months; previously, the issue got little attention.

And yet even with a solid grounding in the tenets of risk management, there's no guarantee that future crises can be averted, because some threats aren't detected on businesses' radar screens in time. In addition, it's difficult for some managers to take an unpopular stand. For example, execs who benefited from the subprime gravy train were loath to closely examine the underlying fundamentals of the risky securities.

“There's no incentive to be a naysayer,” said Russell Walker, assistant director of the Zell Center for Risk Research at Kellogg. He does point out, however, that not all banks around the world participated in the reckless lending practices.

Risk management, of course, predates the subprime meltdown and credit crunch. But risk has historically been embraced mostly in the financial and energy sectors, which are subject to intense price volatility.

Meanwhile, much executive education during the past five years has focused on corporate governance and transparency in the wake of the corporate accounting scandals and the 2002 passage of Sarbanes-Oxley. The credit crunch, along with the Katrina disaster and the discovery of a $7 billion fraud at France's Société Générale earlier this year, presented a new urgency.

Yet many officers and directors lack the tools needed to quantify risk.

“It's hard to come by people who have good training,” said Prakash Shimpi, managing principal at Towers Perrin in New York, who specializes in Enterprise Risk Management (ERM).

That's likely to change as risk continues to shoot up the corporate to-do list at companies in all sectors.

Take John Schwitz, an operations risk manager at Unisys who evaluates risk in software infrastructure projects. While Mr. Schwitz said he was something of an “outlier” at a recent 20-week risk management program at George Washington University, because most students were from the financial sector, he expects the discipline to gain the same stature in non-financial businesses within the next five years. “But it's not there yet,” he said.

Mr. Schwitz already had considerable background in theoretical physics and quantitative finance, but the program at George Washington demonstrated how statistical models and other tools could be applied in a practical way. It also helped him understand their limitations.

He said the knowledge is useful in his current position but that he hopes to parlay it into a chief risk officer position down the road.

Execs with risk management skills are in increasing demand as companies as diverse as food producer Heinz and truck maker Navistar add chief risk officers to their senior management teams. Scott Simmons, vice president at executive search firm Crist Kolder, said the firm now conducts up to four searches for this position a year. “Before five years ago,” he said, “the position didn't exist.”

Although risk specialists increasingly earn more specialized degrees—such as a master's in financial engineering, or M.B.A.s that concentrate on risk management or actuarial science—many of the new crop of programs start at a more basic level. For example, many of the courses cover the foundations of measuring risk and emphasize the use of statistical models and probability, covering mean, variance, correlation and skew. Those models can be used to quantify the financial risks presented by any number of variable costs, such as energy and raw materials, shipping and labor. They can also be extended to assess credit risk or declining demand.

Many segments concentrate on financial markets and managing market risk, using tools such as bond pricing, options, swaps and other derivatives. Financial services firms have used risk management for decades to quantify credit, but the function is gaining in importance with market complexity, said Costis Maglaras, co-director of the risk management program at Columbia University. He noted that firms now use managers to assess the risk that is aggregated at different levels.

Columbia has been offering two 20-week programs that cater largely to the financial services crowd, either from large banks or smaller hedge funds and asset managers. A third course is scheduled to begin in January. Courses have been updated to encompass different categories beyond financial risk, such as operating, legal, environmental or regulatory risk. An evolving part of the curriculum involves developing corporate competency to report, monitor and intervene proactively on risk, Mr. Walker said.

There also is more emphasis on what Mr. Walker calls the “tails,” or the low-probability, high-impact events—applicable certainly to the recent financial industry meltdown. Another category that's hard to measure and anticipate is market risk—as in a competitive threat that could make a product and even a company obsolete overnight.

Too often executives at companies that are performing well can't fathom something going wrong. “If a senior executive can't even perceive a risk, then how can he assign a person or committee to manage and monitor it,” Mr. Shimpi said. “That's where the statistical analysis comes in: What is it you're trying to measure?”

None of this education comes cheap. A three-hour seminar typically costs $1,200, and tuition for the nine-week Northwestern program is nearly $10,000. Mr. Walker of Northwestern surely has a dog in this hunt, but he aptly pointed out that companies in the current downturn are shedding workers in any number of disciplines. “But they're not laying off in risk management,” he said.

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