SPEECH BY THE HON. DOUGLAS ORANE TO THE GLOBAL ASSOCIATION OF RISK PROFESSONALS (GARP) – CARIBBEAN CHAPTER MEETING, AT 6.00PM, JUNE 12, 2012
At the Jamaica Pegasus Hotel,
81 Knutsford Boulevard, Kingston 5, Jamaica
"Managing risk in a conglomerate – the GraceKennedy experience".

I am very happy to be here speaking to the members of the Global Association of Risk Professionals. I am fully aware that, in your vocation, the concept of risk is something you live with and embrace, but for many people in our society, risk is scary and best dealt with by putting it out of their minds, in fact, a form of denial.

My chosen topic this evening is "Managing risk in a conglomerate – the GraceKennedy experience".

Firstly, I would like to carry you through my personal journey as a business person from early in my career to the present, sharing how my perspective of risk has changed over time, and what I have learnt. Secondly, I'd like to share how GraceKennedy has evolved in managing risk, and what direction we are moving in to be more effective.

When I joined GraceKennedy in the early 1980s as a young man in my early 30s, I can't recall us ever using the word risk in its current context. We saw ourselves as business people who were there to run a company to the best of our ability. However, what we today consider risk management was self evident to me, in hindsight - it was generally intuitive, in the sense that successful business people have always practised risk management, and called it applied common sense. It is clear to me that risk management was very much in place since the founding of the company in 1922 by Dr John Grace and Fred W Kennedy, together with the first accountant, James Moss-Solomon Sr. There are very specific examples of this, and I will share with you a few.

Firstly, the company has always had a policy of being entrepreneurially aggressive in terms of entering new businesses, and developing innovations in products and services in existing ones. Financially, however, we have been, and continue to be, very conservative. A cardinal rule in our 90 year history, has been to never run the risk of disappearing because of financial insolvency, by taking any risk so large that it could detrimentally affect the operations of the entire group.

Secondly, we have invested in many types of businesses in different industries over the decades, but we were always careful to recognize a potential failure and move out of those areas very quickly.

A third example is that GraceKennedy has always had an obsession about producing timely accounts, a fundamental underpinning to internal controls and risk management. The company was founded in February 1922 with a staff of 15 persons. The first financial year ended on 31st December 1922 and the audited accounts were completed by the 31st January 1923. I ask you to consider how many small businesses you know that have finished their annual accounts and had them signed off by the external auditor in one month. This obsession with timeliness and accuracy in order to manage the business runs very deep in the DNA of GraceKennedy.

It is clear that our risk management strategy has worked, exemplified by the following anecdote. Our late Chairman, Carlton Alexander, used to share with us young people in rap sessions in the 80s, a long list of companies that he would reel off, and he would ask "Do you recognize the names of any of them? " and we would reply in the main, "No". He would then explain "When I started at GraceKennedy in the 1930s they were all bigger than GraceKennedy, and they no longer exist". Therefore whatever our predecessors did has worked, from a practical point of view.

There is an important issue underlying this story. The founding fathers established a set of values that have been practiced and that remain unchanged – embodied in the phrase – honesty, integrity and trust. Our respect for people is manifested through our motto "we choose to care". In today's modern world, these are essential ingredients in what is now commonly known as corporate governance. This approach has been embedded within the company from its inception and has been integral to the effectiveness of managing risk, whatever it may have been called in the past. Later I will come back to the essential contribution good governance has made to our risk infrastructure.

Now that I have retired, as at the end of June last year, I have more time to reflect on the course of our business history in Jamaica. There are four trends over the last thirty years that are relevant to risk management that I'd like to highlight. Two are global, one is internal to GraceKennedy, and one is cultural to us here in Jamaica.

The first is the fact that globalization has swept through virtually all countries, and created huge opportunities for those who have prepared themselves for these transformational changes. Simultaneously, the risks involved in this new environment have increased exponentially, even for those not directly involved in the globalization process.

Second, the digitalization of the world, best exemplified by the spread of the internet and telecommunications, opens up transformational opportunities for running our businesses as well as for living our personal lives. However, we are becoming more aware each day of the risks involved in functioning in such a very different world. For the older ones among us, we are analogue immigrants into a digital world into which our children were born and grew up.

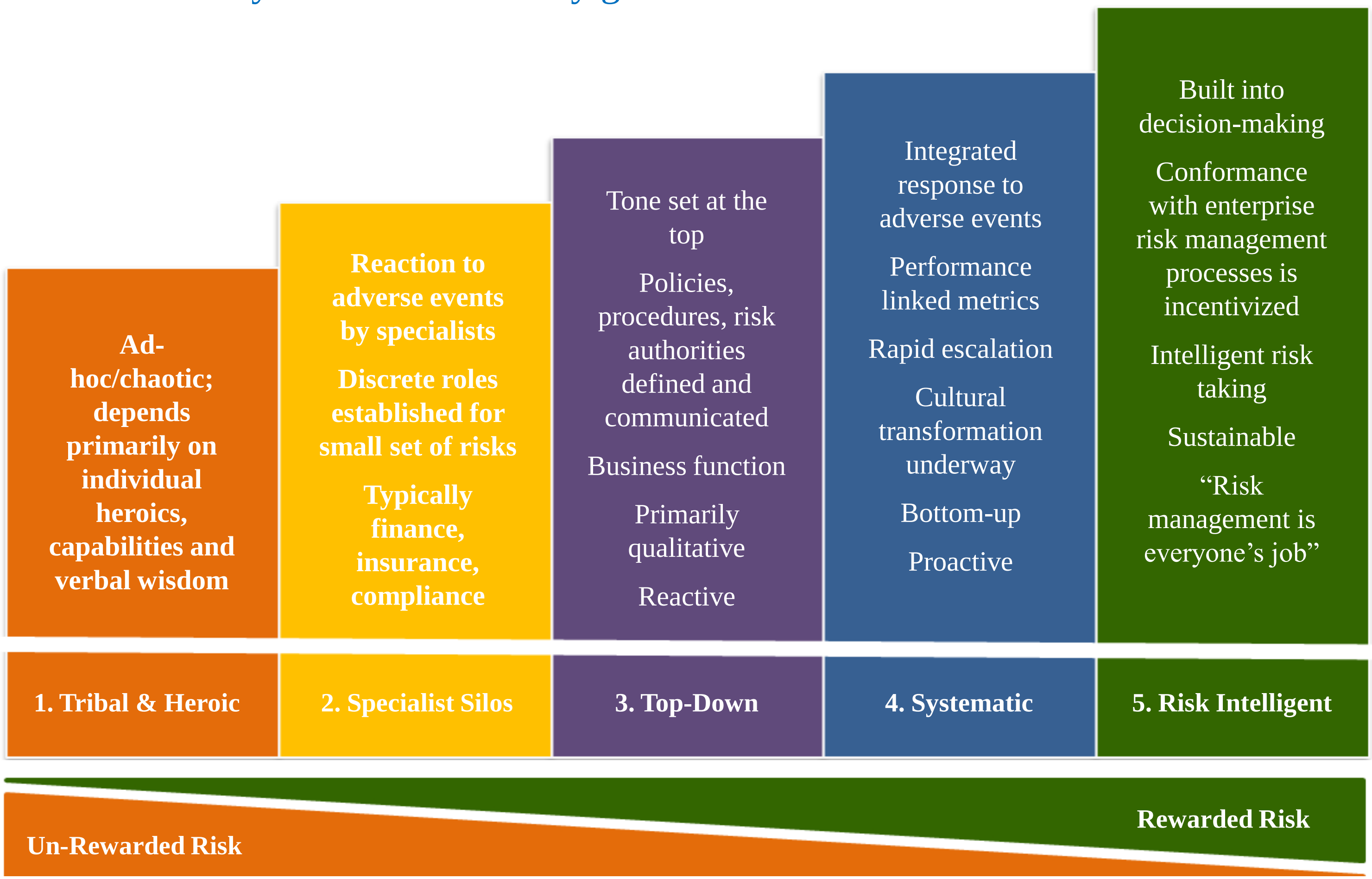
Third, as GraceKennedy has executed on applying our entrepreneurial spirit, we have continued to grow faster than the Jamaican economy, by expanding in areas in Jamaica where we have spotted unmet needs, and by expanding abroad, primarily to meet the needs of our diaspora. One effect has been that since my joining the company in the early 80s, the percentage of our profits earned from financial services has increased from a relatively small percentage, to currently about 70%. Note that we have always been involved in financial services from our founding in 1922, with an insurance agency being part of the operations. We have historically functioned for decades on a decentralized basis for our business units. This has been epitomized in delegating authority to the senior management of each business unit to operate with significant autonomy, so as to enhance competitive initiatives in the marketplace. This has worked well in creating entrepreneurial and innovative behavior. However, combined with the first two trends of globalization and digitalization, and the majority of earnings now coming from financial services, the group has evolved to have a profile of qualitatively different risks that are also quantitatively larger.

The fourth factor is very different from the first three. On my joining GraceKennedy, there existed a well entrenched code of business behavior – however it was an oral tradition. Nevertheless, there was an implicit sense that it was shared as a common belief system by all of us employees. Over the last three decades, Jamaican cultural standards have diverged into a variety of subcultures with very different, and sometimes conflicting belief systems. We may not be unique in the world in this regard, but certainly as practicing managers in this environment, we now have to cope with individuals who share our own values such as "If I see someone else doing something wrong, it's my duty to report it" through to a large percentage who feel "It's none of my business – I'll just remain silent" and to a few who believe "Informer fi dead – man haffi eat a food".

This cultural phenomemon has added another overlay to risk management for us to address. We do know this fact - you can't build a world class organization unless we all share and practice the same high standard of values. Therefore, we in GraceKennedy have become very explicit in codifying our ethics and guidelines for business practices, ensuring to the best of our ability that new employees accept these standards as their own, and regularly reinforcing the application and understanding of these values.

The Risk Intelligent Enterprise Maturity Model

How capable is your company today? How capable does it need to be?
Every industry, company and division is probably at a different stage of development.
Where should they be and how do they get there?



Source: Deloitte

Deloitte recently published an article entitled "The risk intelligent enterprise – ERM done right". In it is a chart that shows five different stages of risk maturity from 1-5 (1 being the most basic and 5 being the ideal). (POWER POINT SLIDE UP ON SCREEN). I would say GraceKennedy today is generally at a 3 but in fact there are entities within the group that are further advanced than a 3.

I would say our regulated entities, for example, the First Global group are at a 4. It is a practical framework to use. I recognize that when I joined the company 30 years ago, many of the characteristics of a 1 and a 2 were present, and what we have done is to move ourselves forward along this curve. We recognize that this is a work in progress and we are learning as we move forward. We started by institutionalizing and formalizing many of the things that were being done informally by the organization.

Early in my tenure as Group CEO, from 1995 onwards, I came to realize how critical risk management was, and over time, enterprise risk management, particularly because we are a conglomerate and have such a wide diversity of businesses.

As a young CEO in 1995, one of the things I recognized was that risk has two sides to it. One is not only about managing risk to prevent the downside effects, but also to capitalize on the opportunities offered by the upside. The challenge was how to embed that in an organization that was becoming more international. We also had to address the fact that we were engaged in a wider range of activities, particularly in financial services.

I chose to start with ensuring that we had the fundamental basics effectively in place first, namely effective internal controls. I embarked on a programme of encouraging a change in behavior by carrying the message across the group that "controls are everybody's business". But one of the things I had to grapple with was that the absorption of it throughout the organization wasn't going at the pace desired.

What I found was that, while the top management and many elements of the middle management accepted the concept, it was exceedingly difficult to have this philosophy accepted throughout the entire organization. In fact this continues to be one of the biggest challenges that we face today. I strongly believe that everyone throughout the Group, from the customer service representative to the production worker in the factory to the Chairman and the CEO should have the same view of risk and controls. What we have done to ensure the process of making controls everybody's business is to incorporate an internal control objective as a part of the annual performance appraisal process for all employees. This seeks to measure each employee's knowledge of the subsidiary's internal control environment and is seen as an enabler for all employees to understand and embrace this philosophy.

I believe we have made progress in spreading the word. It's almost like religion. It goes beyond just being paid to do this work. This is something we believe in because it is good for us.

What have we done to shift us in the direction that the entire organisation moves to a 5 on the risk maturity model? There have been many actions taken, and in the interest of time, I'll just point to a few. We now have a full time Chief Risk Officer in place for the group, and a risk organizational structure covering Corporate and our two Divisions, food and financial services. A group risk appetite statement has been developed and approved by the parent company board. Our group strategic plan has enterprise risk management embedded as an integral component, and progress is measured using the balanced scorecard.

Five areas have been identified where paradigm shifts are required to deliver on the ERM strategy. I will itemize and give examples.

1. NEW -"Risk management embedded in business processes"

   OLD – "Risk management viewed as a project"

   In 2009 we embarked on a major groupwide assessment of our internal controls, risk management at the subsidiary level, enterprise risk management and corporate governance at the group level, using overseas based consultants. There has been great improvement in these areas, and the task now at hand is to make this an ongoing process of improvement with reinforcement of gains.

2. NEW -"Risk Management viewed as an enabler"

   OLD – "Risk management viewed as a hindrance"

   A classic example of how GraceKennedy used risk management as an enabler goes back to the 1970s when the group was a net user of foreign exchange and was chronically short of FX to pay foreign suppliers for imported raw materials and finished goods. Instead of tolerating this risk, the group embarked on a concerted series of initiatives to treat the risk. These included starting or expanding foreign exchange earning businesses, such as the Halse Hall farm in Clarendon to export fresh vegetables, creating Grace Foods International out of the former Export Department to export more processed foods, and seeking ways to help Jamaicans overseas send money home safely to their relatives. Some initiatives failed and others thrived. Our prior research on remittances meant that we were well prepared when Western Union came looking for an agent in 1989, and from that one of our most successful businesses was spawned. GraceKennedy has consequently been in surplus in FX flows since the mid 1990s. This is an example of us acting to mitigate a strategic risk long before the current terminology became common.

3. NEW–"Controls in place to support protection and business continuity"

OLD – "Controls in place due to mistrust and blame"

In 2009, First Global Bank discovered losses arising from unauthorized and undisclosed trading activities of a senior employee. Disciplinary action was taken and changes were made to strengthen the management structure. The bank took action to ensure that risks surrounding these activities were eliminated, and implemented additional measures necessary to ensure that there would be no recurrence. The bank was immediately recapitalized by its parent, so that it comfortably exceeded the capital base to total assets ratio required by the regulations.

This experience highlighted the critical importance of controls to protect the business, and led the group to reassess all control, risk and governance activities across the group, followed by implementation of major improvements. In addition, the group's long espoused policy of financial conservatism through our approach to corporate governance, facilitated the immediate recapitaliastion, and the subsequent expansion of FGB to become one of the most profitable and robustly run subsidiaries within the group.

There is another factor emanating from our governance approach. We were completely open and transparent with the public about the event and our subsequent actions. We believe this was the best policy, and it actually created confidence in the minds of the public, as our openness reinforced their trust in us. We have learnt this over decades in the food sector, where we have always handled product recalls in the most timely and transparent manner. We have heard consumers remark that they actually trust our brands more after such recalls, because they know that we are doing what's right for them.

4.NEW – "Managing Risk Mindset"

OLD – "Avoiding Risk Mindset"

Please permit me to use a personal anecdote from my own life to demonstrate this paradigm shift. The 2010 earthquake in Haiti got me thinking afresh about catastrophic risk. I have heard people say …"Well, will it happen in Kingston? Most times, the answer I hear is " I don't think so because it is a 250 year event so it won't happen any time now – the last one was 1907". But, as you and I know, a 250 year event could happen in the next 10 minutes!

So one of the things our family has done … and I must say I owe the original idea to Leachim Semaj… is that we have developed a risk strategy for the Orane family, in case of an earthquake similar to Haiti's. Each of us now has an earthquake survival kit in the back of our cars. The kit is a backpack containing a pair of running shoes, a day's supply of water and food, a hunting knife (not for hunting but for cutting ones way out of debris) and a first aid kit. You might question the reason for this plan. There were two thoughts that determined how we would proceed.

First, when we thought about the possibility of a major earthquake, if you are a lady dressed in high heels and the roads are all blocked how would you get home? The only way to do so is to walk! Imagine walking in high heels from downtown Kingston to Constant Spring through rubble filled streets!

The second one is if you have a family with large numbers, where would you all congregate to vouch that everyone is safe? We have decided on a location for that also.

I quote this example because, when I raised it with my family, many of them didn't want to think about such a possibility, but now they have embraced it. Also, by thinking it through, they have taken action to prepare and, in addition to that, they now have a greater sense of self confidence in terms of facing the future. These are really the simple principles one ought to be using in the management of risk in our personal and business activities.

5.NEW – "Proactive, Risk Management Focused"
OLD – "Reactive, Internal Audit Focused"

This is a work in progress for us. We are each learning to look at the world differently. One example is assigning higher levels of importance to low probabaility, but very high impact events – the so called black swan events – and working through various scenarios.

Another example is that we are building in quality while we work, as compared to discovering errors by inspection after the fact. In our factories, our HACCP programs and quality management systems have moved the "do it right the first time" responsibility to the frontline persons. The operators of the processes and controls are responsible for them, not audit.

Another improvement across the group is the move to "self audit" by process and control owners. This gives full ownership of controls to those who actually operate the processes and controls. It produces an early warning system to catch problems earlier and fix them faster.

This also an exciting time to be in internal audit, as the function is changing steadily to include more risk based activities.

One of the issues that faces all organizations, moreso conglomerates, is how to aggregate risk and the actions associated with managing those risks, across the enterprise. Doing it manually has proven to be very complex and time consuming. The ideal solution would be electronic, but up to now we have not been able to find the software that could do it, and even if we could, it would probably be extraordinarily expensive.

What we have done in the interim is to develop a template internally, through the innovation of one of our risk units at First Global. We have shared that electronic template for risk management across the group. In other words, what we are really doing is to tailor-make our own proprietary GraceKennedy methodology. It is, in fact, a work in progress.

In closing, what I have I learned along the way? The only thing that separates opportunity from success is execution and risk. Both can be managed.

We, as leaders, need to find a way to bring risk management to life for individuals - to make it personal to their lives. I leave you with these thoughts and I now open up for question and answers. Thank you very much.