



Creating a Lean ERM Process

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In today's unpredictable business environment, organizations turn to enterprise risk management (ERM) as a strategic approach to manage risks. Developing an ERM process is most often discussed in the context of a large multinational corporation, including large construction companies, where operational and people risks can span a range of product lines and geographies.

So, it's natural that many small to mid-sized general contractors may have overlooked this strategic approach because it appears too complex and unwieldy for their needs. Many may assume that the process will be too time-consuming to implement or don't know how to take the first step.

However, this thinking appears to be a case of the proverbial "throwing the baby out with the bathwater." That's because the basic concept of an ERM framework — the discipline of identifying, organizing and creating an action plan for managing opportunities and risks — is an approach that can benefit general contractors of all sizes. In fact, the argument can be made that smaller and mid-sized general contractors need ERM more than larger ones, since even a single risk that results in financial or reputational damage can be more difficult and even impossible to overcome.

ERM Manages Construction's Growth Opportunities

Over the last several years, the construction industry has benefitted from strong growth, outpacing any other industries and the economy overall. The 2016 Dodge Construction Outlook predicted that US construction starts this year would rise 6 percent to \$712 billion, following gains of 9 percent in 2014 and an estimated 13 percent in 2015.

However, a strong business environment can bring more risks. While projects may now be easier to get for general contractors, this is also the time when oversights in labor, contracts, materials, and backlog can turn a profitable situation into a bottom line loss. An established ERM framework can assist general contractors in determining the associated risks that come with an increase in project volume

in 2016 and future years. It should be designed to help the organization evolve with changing market conditions, leverage emerging opportunities, anticipate surprises and recover from any disruptions.



Creating a "Lean" ERM

As previously discussed, many small and mid-sized general contractors do not need the robust ERM process that large national or multinational firms may need, as they are typically more locally or regionally based. A more streamlined or "lean" ERM framework can provide general contractors with the benefit of a consistent and ongoing assessment of their risks which is focused more tightly on where these risks are most likely to occur. It is important to note that owners and top managers should be at the table together when identifying and prioritizing risks, and determining who will have the responsibility for controlling them throughout the organization.

As one of the largest insurance providers in the construction industry, Zurich has worked with various sizes of construction companies in cre-

ating an ERM framework. For a basic starting point, Zurich uses this 4-step ERM framework with our construction clients:

Step 1: Identify and Prioritize Risks

Identify the external and internal risks and prioritize risks by levels (high, medium, low is a common ranking).

Step 2: Create An Action Plan

High-risk areas should be given top priority, and plans should address how to control for weaknesses and to mitigate losses. Assign personnel responsibilities and a completion date for each risk.

Step 3: Outcomes

Determine the appropriate reporting timeline on each of the priority risks, whether it is weekly, monthly, or quarterly.

Step 4: Management Reporting and Continuous Feedback

Report outcomes to owners and key managers. ERM is not a one-time exercise, but a dynamic and continuous process for organization-wide improvement.

A full-up ERM framework for larger construction firms typically assesses four main risk areas – strategic, operations/people, financial, and market. For small to mid-sized contractors, Zurich recommends a lean ERM that focuses on operations/people which is the area with the most frequency of risks: subcontractor pre-qualification and management, quality management, materials, contracts, labor and backlog.

Risk Areas to Examine in a Lean ERM

Any successful ERM process starts by thoroughly identifying and prioritizing risks as outlined in Step 1 above. A focus on the operations/people area of the business should,

among other areas, include a deep dive into: *Subcontractor pre-qualification and management process*

- Does the subcontractor have the financial capacity and technical ability to complete the work on time and on budget?
- What is the quality and consistency of their workmanship?
- Is the subcontractor experienced in the type of work and in the geographical area?
- Do the subcontractors have the proper certifications and licenses?
- What type of safety programs do they have in place?

Quality management

- Are the high-level project members accountable for quality?
- Is there a formal QA/QC manual?
- Do they have documented quality inspections?
- Are there formal record retention protocols with photo documentation?
- Is there initial training on quality implementation?

Materials

- Are the right materials being sourced?
- Are vendors available?
- Are quality control/assurance procedures in place for vendors?

Contracts

- Are owners asking you to take on liabilities

such as onerous terms or conditions?

- Are you asking subcontractors to take on additional risks?
- Has the contract been signed and formalized before work is begun?
- Has an annual contract review process been established?
- Does your contract language indicate that safety programs are being met or exceeded?

Labor

- Do you have enough personnel to take on the backlog?
- Are there special skills required to take on the work?

Backlog

- Are you at risk for taking on more work than you can handle?
- Do you have the ability to expand or contract operations as needed?
- Will your staff be overburdened or have too much inexperienced project management?

Clarity for the Future

An effective and focused ERM framework can provide a general contractor with a clear picture of its overall risk exposures, and can improve firm-wide understanding of its ability to control the risks. A "lean" ERM framework can result in a more efficient use of people and financial resources, and can help a general contractor

avoid having to manage the same risks again in the coming years and with future projects.

Note: This article was originally published in the March/April 2016 issue of California Constructor.

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Beginning in 1988 as an underwriter trainee with Kemper, John spent the next 20 years advancing his career in underwriting management, territory management and product management roles. Since joining Zurich Construction in 2000, John has held underwriting management positions within the field and home office organizations and has developed intimate knowledge of virtually every product offering of Zurich Construction.

John graduated from Charter Oak State College in 1992 with a Bachelor of Science in Business Administration. He holds both CPCU and AIM professional designations and is a member of the Association of General Contractors (AGC) and Construction Financial Managers Association (CFMA).

