



Enterprise Risk Management at Pennsylvania State University (A)

Strategy Implementation in a Decentralized Organization

Case study
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This case was written by Assistant Professor Harvey B Lermack, Philadelphia University. It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. The case was made possible by the co-operation of Gary Langsdale, Pennsylvania State University.

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Harvey B. Lermack

Background

During the 2005-2006 academic year, The Pennsylvania State University (Penn State) undertook a rigorous University – wide initiative to identify the key risks to attainment of their mission, and related opportunities; to integrate processes into the academic and administrative departments to manage those risks on an ongoing basis; and to modify the organizational culture to ensure that risk-adjustment decision making occurred throughout the university.

The initiative was led by the University Risk Officer, Gary Langsdale; and was implemented by a cross-functional team that included members from across the University. The team organized the effort in congruence with the university's culture, organizational structure, and strategic objectives.

This case is intended to describe an example of strategic implementation in a decentralized, non-profit, academic organization. It is an example of an effective Enterprise Risk Management initiative team implementation.

Enterprise Risk Management

Enterprise Risk Management (ERM) is a process designed to identify, assess and prioritize, and prevent and manage the key risks that may have an impact on the ability of an enterprise to attain their long-term strategies and objectives. During the first decade of the 21st century, ERM has become identified as a best management practice for organizations of all types, including for-profit financial and non-financial organizations, non-profits, universities, and governmental organizations.

During 2004, Penn State determined that establishing an ERM process would help them to attain their long-term objectives.

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The case was compiled from publicly available information, and with support from the Penn State Enterprise Risk Management Initiative Team.

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The Pennsylvania State University

Penn State, founded in 1855 as an agricultural college, admitted its first class in 1859. The Pennsylvania legislature designated Penn State as the Commonwealth's sole land-grant institution in 1863, which eventually broadened the University's mission to include teaching, research, and public service in many academic disciplines.

Penn State has awarded more than a half-million degrees, and has been Pennsylvania's largest source of baccalaureate degrees at least since the 1930s. Although the Commonwealth privately chartered the University, it was from the outset considered an "instrumentality of the state," that is, it carries out many of the functions of a public institution and promotes the general welfare of the citizenry. The Governor and other representatives of the Commonwealth have held seats on Penn State's Board of Trustees since the University's founding, and the legislature has made regular appropriations in support of the University's mission since 1887.

Today, Penn State is one of four "state-related" universities (along with the University of Pittsburgh, Temple University, and Lincoln University), institutions that are not state-owned or state-operated, but that have the character of public universities and receive substantial state appropriations.

With its administrative and research hub at the University Park campus, Penn State has 23 additional locations across Pennsylvania. While some of these locations have specialized academic roles, such as the Penn State Milton S. Hershey Medical Center, they all adhere to a common overall mission and set of core values and strategic goals.¹

Penn State's Mission

Penn State's mission is as follows.

"Penn State is a multi-campus public land-grant university that improves the lives of the people of Pennsylvania, the nation, and the world through integrated, high-quality programs in teaching, research, and service.

Our instructional mission includes undergraduate, graduate, and continuing and distance education informed by scholarship and research. Our research, scholarship, and creative activities promote human and economic development through the expansion of knowledge and its applications in the natural and applied sciences, social sciences, arts, humanities, and the professions.

As a land-grant university, we also hold a unique responsibility for outreach and public service to support the citizens of Pennsylvania. We engage in collaborative activities with industrial, educational and agricultural partners here and abroad to disseminate and apply knowledge."²

Organizing for Enterprise Risk Management at Penn State

Background

During 2004, the Senior Vice President for Finance and Business identified ERM as one of six "2005-2008 Key Initiatives" for his area. He looked at ERM as a "best practice" for business management, and felt that the initiative could help enable Penn State to attain its long-term objectives. The initiative was outlined in the departmental objectives, as shown in Exhibit 1.

In 2006, the mandate for the initiative was expanded to the entire university. The 2006 Penn State Strategic Plan set forth the following Enterprise Risk Management strategic objective:

¹ Penn State's Mission and Public Character, <http://www.psu.edu/ur/about/character.html>

² Penn State's Mission, <http://www.psu.edu/ur/about/mission.html>

“Identify, quantify, and mitigate risks across the University within its systems of policies and procedures, finance, human resources, physical assets, and operations.”³

The University Risk Officer, Gary Langsdale, began to implement the University-wide ERM Initiative during 2004. Gary partnered with Dan Heist, the Director of Internal Audit, to design the implementation process.

Linkage with Strategic Management

In order to succeed, any ERM process must link closely with the organization’s strategic management processes. In fact, the measure of success of any ERM implementation is how much value it adds to the shareholders (for publicly held companies) and other stakeholders of the organization.

In the case of Penn State, the university’s key stakeholders include students, faculty and staff, consumers of research, members of the community, and the general public.

As with any successful strategic implementation, in order to link closely with the strategic management processes, and measure the value added by the process, implementers must understand the overall characteristics of the organization and the environment within which it competes, including:

- The organizational strategic, long term objectives;
- The industry within which the organization competes, its key competitors, and its stage of development (e.g. growth, maturity, decline);
- Its competitive landscape and scope of competition;
- The organizational culture; and
- The primary risks perceived by members of the organization⁴

Before deciding how to organize the project, Gary examined these characteristics in order to fashion an implementation organization and process that would have the maximum opportunity to succeed with the University.

Key Strategic Objectives

The university’s strategic objectives reflect excellence in three areas – teaching, research, and service; and address the needs of students, faculty and staff, and society – and are spelled out in the University’s Strategic Plan. Therefore, a successful ERM process must address the risks to attaining the long-term objectives in each of those areas. Penn State’s Strategic Objectives are reproduced from the 2006-2009 strategic plan in Exhibit 2.

Higher Education Industry and Competitive Landscape

The higher education industry is a mature but dynamic one. In the past, most competition came from other public and private, not-for-profit colleges and universities. However, the level of competition has increased even further over the past decades with the widespread emergence of for-profit universities, as well as the rapid development and proliferation of on-line programs. Further, technology has broadened the competitive scope beyond national to international in scope. Finally, the economy and other factors have reinforced the extensive growth of two-year and community colleges.

Organizational Culture

Like most universities, Penn State is a highly decentralized organization, divided into the Academic organization, directed by the University Provost; and the Finance and Business organization, directed by the Senior Vice President for Finance and Business. The Provost’s organization is responsible for academics, research, and information technology, while the

³ “Fulfilling the Promise: The Penn State Strategic Plan, 2006-07 through 2008-09”

⁴ For further discussion, see Lermack, Harvey B. “ERM in Action.” Risk Management Magazine, May 2008

Business organization includes finance and accounting, facilities, and other traditional business activities.

Further, unlike many other major universities, Penn State operates a main campus with about 43,000 undergraduate and graduate students; as well as 23 satellite activities (including 2-year, 4-year, and graduate campuses, a Medical Center, and a law school), located in various cities and towns across the state, with about 42,000 students. In other words, about 50% of the students are located at the main campus, and about 50% of the total enrollment is at other locations. A Chancellor or other senior official directs each of the satellite activities. He or she has broad general management authority and responsibility, under general policies established at the main campus.

At Penn State, it is clear that any successful strategic initiative must be designed to accommodate the views and requirements of a diverse variety of internal constituents – functionally as well as geographically. It must also accommodate the decentralized control and decision – making environment within the university.

Organizing for Success

Armed with this information, Gary set about to organize the initiative in order to maximize the likelihood for success.

He formed a cross-functional team with membership representing the broad range of the University's academic and administrative departments. The team was charged to individually represent their departments, and to collectively develop the project infrastructure within which the ERM process would be implemented. The team met about bi-monthly, with individual sub-teams assigned to research and develop each aspect of the process. Membership of the team is shown in Exhibit 3.

An outside facilitator was retained to guide the team through the initial implementation process, and to facilitate their meetings.

Voice of Constituents

During the first year, the team formed subgroups to examine the operations and related risks and costs; and to catalog the risk management – related initiatives already underway throughout the university. In addition, Gary and Dan interviewed Deans and senior administrators from across the university, including every satellite campus and facility. Working with the outside facilitator, the group then built an initial risk register that categorized the key risk – related issues facing the University, and prioritized them according to potential severity and probability. As part of that activity, they were careful to consider both the downside risk as well as the upside opportunity related to each, and to balance them in determining those with the greatest potential impact on the University's mission.

Framework

Several organizations have developed ERM frameworks, which are designed to provide guidance to organizations in their implementation efforts. The Penn State team decided to adopt the framework developed by the National Association of College and University Business Officers (NACUBO).⁵ In retrospect, the team later decided that adoption of a proven framework, appropriate to the mission and activities of the organization, was a key to the success of the implementation activities.

The framework identified eight "Key Elements" to the success of an ERM implementation. This case examines Penn State's approach toward each.

1. Acceptance of a Risk Management Framework – The NACUBO framework was adopted with minor alterations, and disseminated widely around the university.
2. Senior Management Commitment – Both the President and the Senior Vice President for Finance and Business signaled the importance of ERM, by including it in the university strategic plan and departmental strategic initiatives.

⁵ "Developing a Strategy to Manage Enterprisewide Risk in Higher Education." NACUBO and PriceWaterhouseCoopers, 2002.

3. Risk Management Owner – ERM leadership was assigned to Gary Langsdale, the University Risk Officer.
4. & 5. Communication and Training – The team identified communication and training as key to their success. Each member took responsibility to educate members of their own department. The team collectively, and through sub-teams, partnered with other university departments to integrate their educational efforts into already available internal training courses and communications.
6. Reinforcement through human resource mechanisms – The University publishes a set of measures to monitor success of the initiatives outlined in the strategic plan. The team identified as a future goal the establishment of measures of success for inclusion in that document.
7. Process – The team worked to develop implementation of a university – wide process within a period of five years, beginning with the Finance and Business Department, then into the Provost’s organization. The objective was:
 - *To integrate risk-adjusted decision making into the day-to-day operations of all employees, at all levels, in every department.*
8. Monitoring by Internal Audit – The Director of Internal Auditing, Dan Heist, was a team member, and was involved in all interviews and activities. He took responsibility to include ERM in the long-term operational audit plan.

ERM Mission, Vision, and Objectives

The team identified the following mission and vision statements to guide the ERM implementation process.

Enterprise Risk Management Vision

Create a risk-aware culture, permitting the University to identify and make plans to avoid material impact on finances and operations, while encouraging the acceptance of manageable risk.

Enterprise Risk Management Mission

Identify, quantify and mitigate risks across the University within its systems of policies and procedures, finance, human resources, physical assets, and operations.

Risk Categories

As a public institution of higher learning, Penn State is exposed to a variety of risks and opportunities to attainment of its mission. During the interview and data collection process, the ERM Team categorized the risks into the following categories.

Compliance Risks

Compliance risk is risk that affects compliance with externally imposed laws and regulations as well as with internally imposed policies and procedures. As a public institution of higher education with a wide variety of programs and facilities, the University must comply with the regulations of many state and federal agencies and governmental bodies. They must also abide by the regulations of the accrediting bodies of the institution and its programs.

Operational and Hazard Risks

Operational risk is risk that affects any ongoing management process. Like any large university, Penn State must focus on attaining teaching, research, service, and facility and hospitality objectives, each of which composes a separate value chain. Each value chain was examined to identify risks to attainment of those objectives.

Financial Risks

Financial risk is identified as risk that may result in a loss of assets. Typical sources of risk include credit, market, investment, liquidity, and control risks, as well as others depending on the goals and operations of the organization.

Strategic and Reputational Risks

Strategic and reputational risk is identified as risk that affects an organization's ability to achieve its long-term strategic objectives, including risk that affects an organization's reputation and brand. Most strategic risks arise externally from changes to the competitive situation, or to changes in the macro – environment, such as political, legal, economic, technology, or social and demographic changes.

Next Steps for the ERM Initiative

After the initial three years, Gary and the team reviewed their progress, and made plans for the future of the initiative.

During the initial three years, they had gathered the initial risk catalog and priorities, and developed plans to mitigate the most important risks.

They had partnered with other departments to expand the communication and educational activities, in order to integrate ERM into the entire organization.

Finally, the team determined their one, two and five year objectives, and prepared to continue the efforts going forward.

Exhibit 1.

Key Initiative 6: Enterprise Risk Management ⁶

Identify, quantify and mitigate risks across the University within its systems of policies and procedures, finance, human resources, physical assets, and operations

Gary Langsdale, University Risk Officer, Key Initiative Manager

In an attempt to identify and manage risks to the University before problems arise, Finance & Business is taking a proactive approach to Enterprise Risk Management. This new initiative focuses on ways to deal with risks proactively and recognize the ramifications about the risks within Finance & Business and across the University. Often, people only think of insurance and liability risks, but Finance & Business is working to broaden its definition of risk, including the financial and reputational risks to the University, with the goal of staying ahead of the curve and serving as the benchmark for all units at the University to follow when dealing with potential risks.

A manager for this initiative was named in 2004, and a team of individuals from units throughout Finance & Business and across the University will be put into place.

Vision:

Create a risk-aware culture that focuses on educating its members of risks within the University, permitting the University to identify and make plans to avoid material impact on finances and operations, while encouraging the acceptance of manageable risks.

Goals:

Goal 1. Review best practices both at other higher education operations and within private industry.

Goal 2. Build from ongoing efforts across the University to manage risks.

Goal 3. Identify key exposures that are not currently being adequately addressed.

Goal 4. Work with units to implement improved plans to deal with risks.

In addition to these specific goals, the University Risk Officer will consult with the Senior Vice President for Finance & Business/Treasurer, Provost, and Corporate Controller in matters of University-wide strategic issues and other top-level policy/procedures.

⁶ Reproduced from "Finance & Business 2005-2008 Strategic Plan," February 2005

Exhibit 2.
Penn State Strategic Goals
2006 through 2009

Goal 1: Enhance academic excellence through the support of high-quality teaching, research, and service.

Goal 2: Enrich the educational experience of all Penn State students by becoming a more student-centered University.

Goal 3: Create a more inclusive, civil, and diverse University learning community.

Goal 4: Align missions, programs, and services with available fiscal resources to better serve our students and their communities.

Goal 5: Serve society through teaching, research and creative activity, and service.

Goal 6: Develop new sources of non-tuition income and reduce costs through improved efficiencies.

Exhibit 3.
ERM Implementation Team Membership and Departments

Steve Abrams, Emergency Management Department

Phil Burlingame, Student Affairs Department

Maurine Claver, Health and Safety Department

Dan Heist, Internal Audit Department

John Keller, International Programs Department

Gary Langsdale, University Risk Officer

Ken Lehrman, Affirmative Action Department

Bill Mahon, University Relations Department

Bob Maney, Human Resources Department

John May, Milton S. Hershey Medical Center

Rich Pearce, Auxiliary and Business Services Department

Ron Rash, Administrative Information Systems Department

Herb Schmidt, Intercollegiate Athletics Department

Rachel Smith, Commonwealth Campuses

Candace Yekel, Office of Research Protection

Harvey Lermack, Outside Facilitator