Q&A

Dan Baldwin, staff vice president, risk management, Leggett & Platt, Inc.

SLEEPING BETTER WITH ERM

By Russ Banham

Dan Baldwin

RIMS

More than 125 years ago, Leggett & Platt took a risk on a bold, new sleep technology—introducing the first bedspring. Until then, mattresses were filled with everything from feathers to sawdust, and the idea of sleeping on springs took some urging. Ten years ago, the company took another risk of sorts—introducing ERM. The project was tasked originally to the company's director of continuous improvement, and shortly thereafter fell in the capable hands of its staff vice president and risk manager, Dan Baldwin, who started his career as a safety engineer at aerospace giant Boeing.

Baldwin sat down with RIMS to discuss the ERM program at publicly traded Leggett & Platt, Inc. ($3.7 billion in annual sales), which designs and produces a diverse array of products for homes, offices and vehicles, including furnishings, fixtures and industrial materials, to cite just a few.

RIMS: Your background is steeped in the culture of risk management, beginning with your work in systems safety at Boeing's Wichita production facility, which was recently shuttered. How did this experience inform your later work with Leggett & Platt?

Baldwin: Right from the start, the work I did was extremely safety-oriented. At Boeing, I worked on the Air Force One program for six years, addressing engineering initially and then safety and industrial hygiene. When I came to Carthage (Leggett & Platt's Missouri headquarters) 18 years ago, I served in a corporate safety function, reporting to the risk manager. My boss taught me the ropes, and I learned all about insurance. He retired a year and one-half later, and I inherited his responsibilities.

RIMS: When did you first learn about ERM?

Baldwin: It was in the mid-1990s at a course provided by RIMS. I was a little reluctant at the time to introduce the concept here, given the political issues around how it would look and work. I perceived the senior executives as the risk managers, since they handled risk every day. But, as I learned more about ERM, I became intrigued by its possibilities. And then one day the CFO in 2003 approached me about the subject. That got it going, and we formed a committee to launch the process and brainstorm our risks.

RIMS: I understand that the committee initially tried to do ERM "by the book," so to speak. What happened?

Baldwin: Well, we found out that there is no such thing as a "one size fits all" ERM program. You need to suit the program to your organization's particular culture and risk profile. We also learned that you don't simply flip a switch and the ERM program is done—it is a continuous improvement process that evolves slowly.

RIMS: Tell us a bit about the ERM committee—who sits on it, how meetings are structured and who directs it?

Baldwin: The functional heads at the corporate level are committee members, including the CFO, treasurer, vice president of IT and the vice presidents of tax, legal, audit and accounting. I lead the committee, although the CFO participates very strongly in the meetings. The process initially involved everyone identifying the risks that confront us strategically, operationally and financially. Once we identified these risks, we assessed them from a severity and frequency standpoint.

RIMS: Did you plot the risks on a matrix, which seems to be the process at most organizations?

Baldwin: Yes, we do this for probability and significance, which helps us prioritize which risks can have the direst impact or impacts. In some cases, these exposures can be mitigated and reduced—the case with reputational risk, for instance, even though this is one of the more difficult risks to get our hands around. It's outside risks like economic threats, which we have no control over, that give us pause. There is not a lot we can do about the decisions made by the Federal Reserve or actions taken by the European Community.

RIMS: Tell us about how risks are categorized and tracked.

Baldwin: Different committee members are entrusted with identifying and tracking different risks. For example, I carefully track health and safety exposures confronting our 18,000 employees—I own that risk. I've developed specific metrics, monitor them on a regular basis and report any changes to the committee at the monthly meeting. Each risk is entrusted to an expert in that area. I don't track tax risks because, quite honestly, this is not my area of expertise.

RIMS: What has been one of the more difficult assignments for the committee?

Baldwin: Hands down, we have the toughest time figuring out risk correlations. By this, I mean one risk that leads to or springs other risks. Take operating risk, for example. We've moved away from simply rating this risk on its own, and now identify the other exposures like reputational risk that it can trigger. The team does this with all risks. We'll identify political risks and then assess their correlation with other risks, plotting it all on the matrix. If the outlook changes, the point on the matrix where a risk is plotted moves.

RIMS: Sounds like the matrix also serves as a forecasting tool of sorts.

Baldwin: I would say so. For instance, the operational folks on the committee feel pretty good right now about the economy and its impact on our sales. They're fairly optimistic. This is reflected in our overall risk assessment. But, we don't rest on this assumption. We also look ahead to where we think the economy might go in future. We'll develop three or four factors that might lead to political instability in a particular country, and then forecast their impact on our business from a risk standpoint. Our credit risk would heighten, for instance. This is an area we're working hard on right now, and we're using a tool from Zurich (Insurance Group) to assess political risks by country.

RIMS: This does not sound like a job for the fainthearted.

Baldwin: By no means—we are composed of 20 business units, and operate in 130 facilities in 18 countries. But, I'm not alone here in managing risk. Even though I lead the committee, my direct responsibility is the insurable risks. That's what falls to my department. We must report how we're mitigating identified risks, where we buy insurance to transfer them, and why these coverages and financial limits of protection are sufficient. Insurance is just one tool we have to reduce the significance of risk, but it does not alter the probability of risk.

RIMS: Are there any insurance products that the company has passed on previously that it is now considering as a result of your work on the ERM committee?

Baldwin: In fact, we are this minute examining the prudence of buying cyber risk for the first time. It now seems this is a growing and dangerous exposure, one that has passed a threshold.

RIMS: What do you mean?

Baldwin: Well, in my days at Boeing working on safety systems and subsystems, we would multiply probability and significance to produce a particular metric. When the number exceeded a certain limit, the Air Force required us either to increase safety via the design process, or create backup redundancy to get the number below the boiling point. I think we have now passed that point with cyber liability.

RIMS: Any parting words for our readers, Dan?

Baldwin: I'd like to say that risk is a big part of life and business. If you take no risks, you limit your potential for success. If you take too much risk, you may threaten your survival. This is why I believe ERM is as much art as it is science. You need to establish certain risks like health and safety that are absolutely unacceptable—hence our zero tolerance for accidents. Other risks that are more financial in nature are more acceptable to bear, but knowing where you verge into the unacceptable is what ERM is really good at. For this you need risk experts. Fortunately, they are at hand in most organizations.