Q&A

Q&A: John Hach, Risk Manager, The Lincoln Electric Company

ERM BUY-IN AT THE TOP

By Russ Banham

John Hach

RIMS

Since the company's founding in 1895, Lincoln Electric has always been a top-down driven company. John C. Lincoln launched the business with a mere capital investment of $200. At the time, the focus was the manufacture of electric motors of Lincoln's own design.

As the years progressed, Lincoln and his younger brother James expanded the product line to seize market opportunities. Battery charges were added for electric automobiles, for instance. Then, in 1911, the brothers hit upon the product that would define its future—the first variable voltage, single operator, portable welding machine in the world.

Today, Euclid, Ohio-based Lincoln Electric is a Fortune 1000 company that manufactures welding products, arc welding equipment, welding consumables, and robotic welding systems, among other products. That $200 original investment has paid off big time—sales in 2012 were a record $2.9 billion.

When the company's risk manager, John Hach, perceived opportunity by migrating Lincoln Electric to an ERM platform, he knew who to turn to first—the top of the company to champion the project. RIMS sat down with Hach to discuss how these plans have progressed.

RIMS: We understand that the ERM project was your inspiration. Tell us how the process launched.

Hach: We've been doing ERM since late-2007, right before the financial crisis hit. This was a good thing, as we had some of this in place before the crisis took hold here. The way to get things done here, and I suspect most places, is to have it driven from the top—if you don't have board or top management buy-in the effort is not worth pursuing. It would be a waste of time—an exercise in theory and therefore ineffective. Fortunately, the directors had already heard about ERM from the other boards they sit on, from their own companies in some cases, or from articles they had read.

RIMS: Was there any pushback at all?

Hach: Interestingly, prior to 2007 and before we discussed this at the board level, I had solicited input from the CFO at the time, who was not in favor of the idea. Otherwise, we would have started earlier. The current CFO is a strong proponent of ERM. I would add that the CEO didn't buy into ERM immediately, but after a few months he thought it was a good idea. One of the major obstacles, though, was management. Since ERM assigns people responsibility for risks and holds these individuals accountable for the management of these risks, they're not exactly supportive of the idea. Having top managements support of ERM was instrumental in us rolling out ERM across the world.

RIMS: Would you give us an idea of the ERM process today?

Hach: We initially executed a risk map that identified 70 different risks, which we then narrowed down to a dozen to focus on. The determinants were frequency, severity and velocity—how fast these risks were moving. We put together a dashboard that defined these risks and listed the various metrics we would use to monitor them. It's a typical dashboard with red, yellow and green `traffic lights.' The dashboard is a key component of our approach to ERM, which we review, to varying degrees, at every board meeting. We also send the board a substantive, written ERM update prior to the meeting, with a commentary letter covering the key issues.

RIMS: Are strategic risks captured on the dashboard?

Hach: No, the dashboard is mainly for the execution risks we have—the top of it, for instance, says 'Operational Risks.' Things like business continuity and supply chain risks are also on the dashboard. We do examine strategic risks, but we don't necessarily document them on the dashboard. They're discussed at the board meetings, however. At these meetings, we have five different segments globally, and each respective leader gives a presentation regarding how they have embedded risk discussions in their business plans and what they're reporting on. Having the dashboard ever present and risk discussion embedded in management presentations incorporates ERM within the company's normal, on-going management and governance processes, not treating it as a separate compliance exercise.

RIMS: Please provide an example for the reader.

Hach: Sure, a key operational or execution risk is new product development. We divide this into four areas—intellectual property development, time to market, relative investment in R&D—how much we are spending—and then innovation effectiveness. These are the four headings of what is viewed on the dashboard. If we're doing these things right, we essentially have good new product development.

RIMS: What tells you good from not so good?

Hach: In each of those four categories, we have different metrics, like the `percentage of US patents issued in the last five years' under `intellectual property.' That tells us if we have products that are going to be unique. We also have a metric indicating where our welding products are ranked number one or two, and another indicating where our patents are cited. The latter may mean someone is trying to copy us, which tells us we have a good product that will be in demand.

RIMS: Fascinating. Using the same example, how do the `traffic lights' alert you to a risk?

Hach: A green light indicates that the percentage of our total US patents issued in the last five years is greater than 30 percent. Yellow is 20 to 30 percent, and red is less than 20. We also have a benchmark column that shows what third parties like a rating agency or a composite of our competitors would consider as `good.' The dashboard is a great way to communicate with the board and shareholders what your risks are. It helps us decide which operational risks we want to avoid, which operational risks we want to chase, and what we're doing about it. A separate benchmark we use for the program – aside from the dashboard - is the RIMS Risk Maturity Model.

RIMS: Aside from the five segment leaders reporting on their respective owned risks to the board, who also makes a presentation?

Hach: Every significant risk owner makes a presentation, such as the head of R&D, the VP of HR talking about compliance training, and so on.

RIMS: Are you in charge of the ERM process?

Hach: No, my role is to facilitate the ERM process. ERM is an executive, management committee level responsibility. The CFO is the owner of ERM along with the VP of Strategy & Business Development, who reports to the CFO.

RIMS: Any parting words for the reader?

Hach: Risk is unavoidable in every organization, so why not plan and manage it across the business? That's what ERM tries to do, with varying degrees of success. It helps answer the questions I mentioned earlier—which risks to avoid, chase and do something about. Through an organized risk assessment, you can establish a risk appetite—what risks are going to be tolerable or intolerable. ERM tells you what this is and isn't. One more thing: The risk awareness gained through ERM is the biggest value gained for an organization practicing ERM. I wish I could say there is a definite ROI from ERM—that our overall performance improved because of it—but I can't. The problem is we can't know what our performance would have been without it. … But, I would have to say that my gut feeling and common sense tell me that if you improve risk awareness across management, if people are more cognizant of risk and their risk responsibilities are clarified, you're moving in the right direction and improving the probability of successful achievement of the organizations goals.