

## Outside Influence on the Form of a Risk Management System at Public Universities

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**Abstract:** *Purpose* – Identifying risks and factors differentiating corporate banking from public universities, which influence the correct functioning of a risk management system (RMS). This is done, so that the RMS fits the organisation in the best way possible.

*Design/Methodology/approach* – This article contains my experience gathered while searching for the most adequate RMS for a public university as well as experience gathered while implementing an RMS. It is also based on a survey conducted among auditors from 30 public universities in Poland. A comparison between the conditions in corporate banking and public universities is made.

*Findings* – The main result is the identification of factors, which should be taken into account in order for the RMS to be an effective part of university management.

*Originality/value* – The collision of two different environments where RMS operates is a new way of looking at the topic, especially useful for the public sector, which in my opinion, will be implementing solutions used in the banking sector for over a decade.

**Keywords:** Risk management, Higher education management, University

### Introduction

“Models are to be used, not believed” (Theil 1971), “all models are wrong, but some are useful” (Box, Draper 1987) – these citations can be an inspiration for those working with models to build a model of a risk management system (RMS) that fits the culture of a certain organisation as much as possible. As a result, we can obtain a model that is useful and effective, able to solve various issues in the organisation, a model which will minimise the risk and at the same time help to take advantage of emerging opportunities. The most important thing is for the RSM to become an integral part of organisational management. In my opinion, the best model for public universities at their current developmental stage is a model that looks at the organisation and its processes horizontally from the managerial point of view and from a risk perspective on the characteristics of the Delphi method defined by Helmer and Dalkey (1963). The Delphi method is based on independent opinions, communication and multistage actions. Elements of a probability theory and statistics can be used in databases with a large storage capacity. The elements that should be taken into account when

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modelling are described in Section 1. The conditions that need to be met for the system to function properly are discussed in Section 2.

As Churchill used to say, “attitude is a little thing that makes a big difference”<sup>1</sup>. Applied solutions should be the most effective ones. In my view, they can differ from the theoretical schema of strategy → aims → tasks → risks as long as they are effective in the environment of public universities. Universities where the strategy has been identified (single cases) do not normally put it into practice because of the lack of cohesion between the undertakings and the financing. At almost all universities, there are certain processes that can form the basis for risk management, but “effective risk management requires the integration with existing processes” (PricewaterhouseCoopers 2005).

We need to remember that models where the Delphi method is applied to assess risk are limited, as they rely on expert knowledge. In comparison to mathematical models that are relatively objective, it lacks consistency. The assessment of the same situation at the same time by different people can differ. This is mainly a result of a dynamically changing environment, a different level of experience or access to information and a difficult to define number of factors affecting the final risk level. Therefore, in order to eliminate subjectivity, we can use a multistage process, which utilises the knowledge and expertise of the risk owner and the risk specialist – the Risk Manager. Also “an important feature of this system is the ability of gathering comprehensive information in a certain field and the possibility of perpetually updating it” (Matuszyk 2004), which will make the RMS more flexible and fit not only for the organisation but also for the dynamically changing situation.

The contribution of this paper is three-fold. Firstly, we identify the best model for public universities at their current level of development. Secondly, we point out the areas of greatest differences between the public and the private sector and describe how they influence the risk management model. Thirdly, we present findings on the conditions that need to be met for the RMS model to function properly and become a fundamental part of university management.

The remainder of the article is organised as follows. In Section 1 we describe the factors that differentiate corporate banking and higher public education, and their impact on the RMS. We also review the literature and emphasise the similarities and differences between studies and the terminology used. In Section 2 we comment on the results of a survey conducted among 30 public universities and the experience gathered over a 15 month implementation of an RMS at a public university. We also identify what elements are worth taking into account when modeling the RMS for it to function properly. Finally, we summarise the results in the Conclusion.

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<sup>1</sup> <http://cytatybaza.pl/autorzy/winston-churchill.html> (11.01.2014).

## **1. Differences between the private and the public sector**

Risk management systems were introduced in the Polish corporate sector at the beginning of the 21<sup>st</sup> century, initially in corporate banking. At first, they only covered credit risk, but both operational and market risk followed. These systems were mostly introduced by the initiative of foreign stakeholders in Polish banks. Banks such as Citigroup (Citi Handlowy SA), ING Group (ING Bank Śląski SA), AIB (Bank Zachodni SA), Uniredit (Pekao SA) or Commerzbank (mBank SA) in the majority of cases they tried to share their own experience and applied solutions relating to risk management. In 2004 I was actively involved in the creation and implementation of the system that would identify corporate credit risk in ING and I remember the challenges around implementing new solutions. There were serious issues with employees' mindset and the fact that the bank and its subsidiary were in different stages of development, both bearing the same ING landmark.

When building a risk management model in a public university, one needs to realise the differences that exist between those two very different organisational environments: corporate banking and the public sector. "A number of authors (Behn 2001) point to unavoidable friction between efficient management and public accountability" (Knedler, Mazurek 2010). Public university management tends to view risk only as a threat rather than a lost opportunity. In my opinion, a lot depends on a management's mindset and it is very likely that public organisations will adopt solutions that have been used and tested in the past decade within corporate banking. However, I do not think this will be a simple replication without adjusting to the specificity of the sector. The differences in the developmental stages, employees' mindset and most importantly the management's awareness are so significant that the knowledge transfer should be reviewed bearing in mind the differences in these environments.

### **Senior Executives**

The first factor that should be taken into consideration is the Management. Large corporations tend to employ top managers for their top management positions. These managers are not only very well educated, having graduated from the best universities but also have a wealth of experience having managed a number of companies. They are very skilled in what they do and very successful. Almost every company adopts succession planning, which selects the best candidate from its employee pool for a particular position. The person aspiring to the position of Chairman has been a manager for years. Once appointed, they receive a significant pay increase. However, this does not mean they can do no wrong. Even a single wrong decision or lack of desired results can lead to the Chief Executive being called by the Board to step down. Top management at public universities typically do not have good managerial backgrounds, neither theoretical nor practical. The choice of who to promote is determined by the same principles that work in politics (a faculty with more and more influential connections in the university's social network has a higher chance of having their candidate selected for the position of Rector). A newly appointed Rector very often

continues his academic duties, gives lectures and conducts research, treating the position of Rector as an additional role, done within certain working hours and not necessarily substantially contributing to their financial gratification. Furthermore, quite often they become a “hostage” of those who elected them and will not act in a way that could make them unpopular and jeopardise their re-election. Taking the above cultural differences into account is of prime importance for the created model to be effective.

### **Employees**

Another factor is the employees. A multi stage annual performance review in private companies and the selection process for each position eliminate employees with the lowest potential, inadequately prepared for the job or not productive enough. At universities performance ratings are not commonly used as yet, especially among administration staff, neither are selection criteria for new employees. This results in the differences in the quality of employees, which is a significant factor in the successful implementation and administering of an RMS. However, I have observed in the last couple of months that the situation has slowly started to change.

### **Regulatory limitations**

Regulatory limitations with regards to public university operations, resulting from the imperfect Public Procurement Law (Ustawa z dnia 29 stycznia 2004 r.), Public Finance Act (Ustawa z dnia 27 sierpnia 2009 r.) or Higher Education Law (Ustawa z dnia 27 lipca 2005 r.), are a very significant factor. Especially the requirements of the Public Procurement Law generate a lot of problems when an unreliable construction company is chosen. It is impossible to exclude such companies from the tender process and as a result millions of zlotys are wasted when unreliable contractors abandon the construction site or declare bankruptcy. On the other hand, the corporate environment is not as limited by public control, imprecise interpretations of legal regulations and, more importantly, interpretations that change in time destabilising the law and, at the same time, the safety and comfort of conducting business. This is important because both private firms and public universities exist in a real market and have to fight for the client for their services. In addition, universities have internal competition between the same courses in different faculties of the same university.

### **Sector regulations**

Another vital issue for the risk management system is the support of the outside sector regulations in the area of risk management. Very precise regulations regarding every possible risk have existed in banking since 1997 thanks to the National Bank of Poland (General Inspectorate of Banking Supervision). These regulations devote up to ten odd pages on a single risk type and are updated when new risks are identified. The Public sector managed to get a few sentences on risk in the Minister of Finance Announcement No. 23 from 16 December 2009 (Komunikat nr 23 Ministra Finansów z dnia 16 grudnia 2009 r.), which related to the whole public sector and referred to risk in general without specifying any actions taken by individuals. Another communiqué on this subject, which was a little

more precise, was Announcement No. 6 from December 2012 (Komunikat nr 6 Ministra Finansów z dnia 6 grudnia 2012 r.). There are still no detailed regulations regarding risk at universities. We need to add that there are more universities than banks and the number of mergers and declared bankruptcies in higher education institutions is comparable to those in the banking industry.

### **Information transfer**

Another factor which strongly differentiates these two environments is the speed with which information, knowledge and data are transferred. Public universities have not yet developed electronic communication as their primary form of communication. Generating documentation in its traditional form significantly delays the transfer of information and generates additional unnecessary costs.

### **Purpose**

Another difference is the primary objective. Corporate firms have a very measurable result of its operations, which is their profit. In the case of public universities, the objective is to fulfil their mission statement, which is more challenging to quantify than profit. It is also not easy to compare it against other public universities.

### **Financing**

Another difference is the way they are financed. A university is, in this case, in a better position as it receives public funding. Private firms do not get this benefit. Financial resources come from shareholders (counting on dividends and an increase in the market value of a company) or from loans (e.g. bonds), which have to be paid off with interest. Therefore, the public sector lacks the concept of time value of money. As such a concept exists in private firms, they have to carefully account for the results of their decisions and actions. Public universities hardly ever account for their decisions. Generally, time in the public sector flows slower, decision making takes weeks rather than hours or days. Financial statements are not generated every quarter, a few days after the end of the financial period but only once a year with a close to 6 month delay. This does not allow for a comparison of results with the competition throughout the year and is an impediment in the management of the whole organisation. There is also a huge difference when it comes to the products and services offered. Private firms undertake major market research before they introduce a new product. They test customer expectations and adjust their current or future services accordingly. It is difficult to observe the same attention to a customer (a student) in public universities. An indirect effect of such an attitude is seen in the recruitment process – not enough candidates to start a course that is being offered. Lack of effective monitoring of students' careers or the quality of teaching worsens the situation. The same applies to projects, which are not always financed by a university or in line with its strategy. This leads to a misuse of university's resources, a situation that most likely would never happen in the private sector, where practically every decision is assessed for its benefits before it is made.

**Approach**

Every difference described above seems to resemble an academic approach to problem solving, unlimited ideas and the autonomy of individual departments. Although an academic approach is desirable when looking for a solution to emerging problems, having this attitude when actioning tasks – either questioning the task or lack of action – is destructive. Corporate firms resemble an army, where orders are carried out immediately and without question. Therefore, implementing new and more complex organisational solutions runs quickly and smoothly without much complication. Introducing any change in public universities is a long process, in which a change proponent needs to show great determination and commitment, a process that can be stopped at any time without giving a reason.

**Positioning of risk owners**

Finally, there are differences in the positioning and the resources dedicated to managing risk (in organisations employing c. 5,000 FTE). In the private sector, there are whole departments employing dozens of staff, which make executive decisions on the corporation's operations. In the public sector, however, there is often one person undertaking tasks related to risk management as an addition to their regular academic or administrative role.

**2. Conditions required for proper system operations**

In the period of September 2012–March 2013, I conducted a survey among auditors from 30 public universities in Poland. One of the open questions asked was to identify “what conditions need to be met for the RMS to operate properly in a public university and what needs to be changed and in what order, so that risk management can support the management of the university?” The respondents mentioned the change in the management's mentality (14 cases), the need for training of the management, complying with the procedures and responsibilities (7), raising scientists' awareness and necessity to introduce a risk management policy (4), full engagement from Senior Executives, mainly the Rector (3), and tailoring the system to the organisation (2). Respondents also mentioned comprehensive succession planning for all levels, introduction of clear competencies and responsibilities (2) as well as assigning the responsibility to risk owners (2) and implementing a university management system (1). A similar observation with regards to a successful implementation of an RMS was included in URMIA's White Paper: “a cookbook recipe for implementing Risk Management is not feasible, because so much depends on the culture of the organization and the change agents who lead the effort. The most important is obtaining strong, visible support from senior management” (URMIA, 2007).

From my experience in implementing a risk management system, it seems vital for risk owners to accept the RMS being implemented. Risk owners who do not identify themselves with their risk areas are unable to accurately assess the risk. It needs to be noted that there is a possibility of overlapping responsibilities across a number of risk owners in a certain

area. There is also a risk of misusing the RMS for employees' own benefit by manipulating the assessments. Generally, people do not like changes and reject what is new. Therefore, it is necessary to organise training as part of the implementation process. In my view, all the above elements are important, not only for the system to function but to function properly and fulfil its purpose as an early warning system. For the system to flag risks early enough, so that there is still time to mitigate them, it is important that employees are aware of what the main purpose of the system is and what role it plays. Risk owners should never go by the rule "if we do not show the risk, it does not exist", as it will lead to the failure of the whole project.

## Conclusions

The conditions discussed above, relating to the construction of an RMS model for public universities, indicate that risks occur in many areas. They concern employees, the management, the legal environment in which the institution operates, organisational solutions, ways of financing the sector as well as users' attitude to risk management. The task is made even more difficult by the fact that some of the conditions cannot be influenced even by the management of a university. On the one hand, public universities are forced to operate in a dynamically changing, competitive market and take advantage of the opportunities that arise from being part of the EU. On the other hand, they need to fulfil a certain mission, look after its intellectual resources and substantial wealth. A properly functioning RMS should focus the management's attention on the most important issues, selecting only the information that relate to the most probable risks for the organisation. The following fact was made clear by the conducted survey – there is little correlation between risk management and the way that universities are managed. This may be a vital reason for the decline of public universities' financial results and the fact that the number of universities incurring losses doubles every year.

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### **WPLYW ŚRODOWISKA NA MODEL SYSTEMU ZARZĄDZANIA RYZYKIEM W UCZELNI PUBLICZNEJ**

**Streszczenie:** *Cel* – Wskazanie zagrożeń oraz czynników różnicujących bankowość korporacyjną oraz sektor publicznych uczelni wyższych, które mają wpływ na funkcjonalność systemu zarządzania ryzykiem aby powstające systemy zarządzania ryzykiem były jak najbardziej dostosowane do uwarunkowań i wymagań organizacji.

*Metodologia badania* – W artykule ujęto doświadczenia autora zebrane w trakcie realizacji prac nad poszukiwaniem modelu systemu zarządzania ryzykiem najbardziej adekwatnym do zastosowania w publicznej uczelni wyższej. Wykorzystano również doświadczenia uzyskane w trakcie wdrażania przedmiotowego systemu w uczelni. Autor posiłkował się także przeprowadzonymi badaniami ankietowymi wśród audytorów reprezentujących 30 publicznych uczelni wyższych. Porównano uwarunkowania panujące w bankach korporacyjnych oraz w sektorze publicznych uczelni wyższych.

*Wynik* – Efektem tego porównania jest określenie czynników, które należy uwzględnić aby model systemu zarządzania ryzykiem był skutecznym elementem zarządzania uczelnią.

*Oryginalność/wartość* – Zderzenie dwóch różnych środowisk funkcjonowania zarządzania ryzykiem jest nowym ujęciem tego tematu, cennym zwłaszcza dla sektora publicznego, który w opinii autora będzie wdrażał rozwiązania wypracowane ponad dekadę temu przez sektor bankowy.

**Słowa kluczowe:** Zarządzanie ryzykiem, Zarządzanie uczelnią, Uniwersytet

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