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Operational risk associated with the strategy implementation

1. Introduction

The development of the strategic management theory covered many aspects associated with the functioning of organizations. They included the resource-based view (Wernerfelt 1984), the issue of knowledge management (Grant 1996), building a competitive advantage (Peteraf 1993) and ensuring its continuity (G. Szulanski 1996), as well as using the strategic resources for this purpose (Amit, Schoemaker 1993).

Despite the fact that new problems are raised in studies on strategic management, the main determinants of the course of this process remain unchanged. First of all, the necessity of developing a strategy and implementing it in all organizations is emphasized even now, despite the rapid changes, often difficult to predict, which take place in the environment of a company and inside it. (Bourgeois, Jay 1980, pp. 25-39).

Strategic management is a set of decisions and actions relating to a strategy, so it concerns planning and implementation of the company development concept, taking into account both predictable changes and those difficult, if not impossible to predict. The strategic management process includes

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establishing the long-term goals, as well as making the decisions and taking the actions that aim at the implementation of the priority direction of development. In addition, organizations earn the “active” status (Johnson, Scholes 2002, p. 18). Moreover, the process of formulating and implementing the strategy is subject to a continuous, regular evaluation that aims at determining whether this is the way toward the development which brings the success close or whether a correction is required. It is also necessary to analyse and implement the current and future activities and processes as well as coordinate them in a systematic manner, which will allow implementing the strategy despite the variability of the environment and the organization (Keil, Reibstein, Wittink 2001, pp. 67-81).

Each of these aspects is accompanied by various types of risk, including operational risk. Therefore, the aim of this article is to examine the impact of its individual components on the effectiveness of the strategy implementation.

2. The stage of strategy implementation in the strategic management procedure

Three constant and concurrently running processes can be distinguished within the strategic management procedure: analysis, decision making, and actions. Thus, the process of formulating the strategy is not only creative, but also characterized by a high degree of complexity. (Gołębiowski 2001, p. 395). For this reason, individual stages of this process are burdened with various types of risk, while the decision makers and managers often pass over this aspect in the course of the strategic management process. Considering the importance of strategic management, the person responsible for the strategy must have adequate knowledge, information and analytical skills that help to make right decisions.

The traditional, sequential approach to the strategic management procedure is challenged by researchers as insufficient in the turbulent environment. On the one hand there are undeniable benefits resulting from the creation of far-reaching visions and plans, but on the other hand the necessity to abandon the universal principles of strategic management seems to be inevitable, while the time horizon of the strategies created is shortened. (Box 2011, p. 115).

It is worth emphasizing that the strategy development and implementation process may be an effect of systematic and carefully thought-out actions or may result from decisions of operational nature, which not always seem to be linked with each other. (Bowman, Faulkner 1996, p.4) An insufficient level

of theoretical knowledge causes that most companies have problems with an effective implementation of the strategy. As indicated by results of many studies, the strategy implementation is much more difficult than formulating it and at the same time a significant number of managers devote less attention to it (Hanley 2007). That's because the conceptual stage is often supported by various tools and expert opinions, while the execution process requires combining many, sometimes inconsistent elements and eliminating the influence of internal and external factors. The development of the strategy consists in the selection of optimal development options, whereas its implementation should ensure that they are properly and effectively put in place. This is an important issue, because organizations are unable to evolve without effective implementation of the strategy (Kathuria 2012).

It is therefore necessary to integrate all the elements as well as to derive continuous inspiration from the processes occurring in the environment and in the organization in order to move smoothly from the conventionally divided stages and integrate them with each other (Wu, Wu 2003). It is worth emphasizing that such an approach undoubtedly contributes to an increase in the flexibility of the strategies created, but also generates various types of associated risk.

3. The necessity to consider the risk aspect

As the risk may constitute an unpredictable threat to the survival of the organization, it is necessary to take actions mitigating the impact of many types of risk on the development of the organization and to use the risk to generate benefits. Collecting and analysing the information concerning the risks and taking it into account in the decision-making process allows identifying such risks and preparing for changes. In turn, if there is no risk analysis and the risk is not taken into account when making choices, it may cause wrong decisions, which are unfavourable for the organisation, improper execution of decisions in practice, or a lack of response to the changes occurring in the environment and in the organization. The second aspect associated with the risk results from the fact that a proper analysis and calculation of the risk should maximize the organization's chances of achieving a success. Risk exposes to the danger of potential losses, but it also may generate opportunities for development (Studies Research Paper WP07/00, Cambridge, United Kingdom).

One of the risk definitions says that it is a degree of the existing uncertainty concerning the occurrence of potentially significant and disappointing outcomes of decisions (Sitkin, Pablo 1992, p. 10). If decisions are of strategic character,

then it determines the ability of the organization to operate and implement the development concept adopted. In strategic management, risk is inseparably associated with the concept of variability or turbulence of the environment, which is largely responsible for its occurrence. (Kotler, Caslione 2009, p. 22). However, a clear distinction between the risk and uncertainty should be made. The latter can be divided into four levels of different complexity – from a clear future (which is however quite considerable simplification of the existing operating conditions), through fulfilment of the development scenarios planned and the determination of the range of possible events in the future, to the total uncertainty that does not even allow defining the variables that affect the potential future and thus preparing any more accurate forecasts. (Courtney, Kirkland, Viguerie 2004, pp. 111-114).

What's important, risk is also a resultant of forces acting inside the organization and it should be considered also from this perspective. That's because the fact that it is associated, inter alia, with the effectiveness of the incentive system as one of the determinants of the implementation of the strategy and the effects it brings (Knight, Durham, Locke 2001, p. 336). Therefore, the need for a system integration of risk aspects under a risk management model is more emphasized (Buehler, Freeman, Hulme 2008, pp. 104 – 109).

There are some factors that contribute to the growing importance of the necessity to take account of risk in the strategic management:

- changes in the environment that should be taken into account when developing and implementing strategies or business models,
- incorrect strategic choices that result from a lack of understanding of the environment, which in turn causes that wrong decisions are taken,
- negligent implementation of strategic decisions resulting from a failure to provide the employees with basic information on the strategy, which causes that the operations of the company are undefined and incomprehensible.

4. Operational risk associated with the strategy implementation

The following definition of risk will be adopted for the needs of this study: a combination of factors, actions or activities causing that an objective is not achieved (Kaczmarek 2006, pp. 52-53).

The operational risk, which refers to the ability of an organisation to implement its strategy, has a special nature. It is associated with the occurrence of threats to the implementation of strategic objectives or even to the survivability and development of the organization.

It can be stated that the operational risk takes two perspectives:

- internal perspective - related to the course of the strategic management process in the context of its individual stages,
- external perspective - covering the aspects associated with the strategy implementation and therefore determined also by the environment and the turbulences occurring in it.

Therefore, the definition saying that operational risk can be defined as the possibility of incurring losses as a result of unadjusted or unreliable internal processes, people and systems or as a result of external events seems to be correct (Polish Financial Supervision Authority, Recommendation M, 2004).

Operational risk management is therefore a process involving identification, assessment and management of both internal and external events and threats that could hinder the implementation of the strategy and achievement of strategic objectives (Frigo 2009). This requires a strategic vision of the risk and the ability to assess which external and internal events or scenarios may affect the capability to achieve the organization's objectives. It is worth emphasizing that this is a continuous process (Frigo, Anderson 2011, p. 22). Moreover, the key issue is not the aversion to the strategic risk, but to be aware of its existence and to take such actions that will allow achieving a competitive advantage, growth and creation of the organization's value (Frigo, Læssøe 2012, p. 35).

The studies on the risk occurring in strategic management have been conducted for a relatively short period of time, while the research issues focus on the managerial approach to emerging categories of problems (Światowiec-Szczepańska 2012, p. 117). Thus they largely concern rather an external perspective and the threats associated with sources of long-term growth of the organization. Researchers draw attention to the difficulty of measuring the operational risk occurring at different stages of the strategic management process and the measures used for this purpose (Ruefli, Collins, Lacugna 1999, pp. 167-194). M. Bratnicki and M. Kulikowska-Pawlak (2013, pp. 20-31) write about aspects of the risk management understood as taking account of the impact of development challenges translating into the effectiveness of an organisation, while the risk associated with strategic choices made by companies is examined by E. Urbanowska-Sojkin (2013). However, it would be worth complementing the existing research results with the issues related to the operational risk occurring at the stage of strategy implementation, which is considered to be a critical stage of the strategic management process (Hrebiniak 2005).

An insufficient level of theoretical knowledge causes that most companies have problems with an effective implementation of the strategy. The studies indicate

that even 60%-80% of companies do not obtain the benefits they expected from new strategies (Kaplan, Norton 2008, pp. 114). It can be presumed that taking account of the operational risk arising at the strategy implementation stage will contribute to its optimization, and thereby will increase the effectiveness of the actions taken. This is consistent with the ERM (Enterprise Risk Management) concept, that is creating integrated models for risk management at all stages of implementation of the adopted strategies (Paladino 2008, pp. 27-33).

The scientific areas of strategic management and risk are developing separately, despite a high synergy potential for their integration. If these problems are linked and examined under a strategy implementation process, this should result in obtaining a comprehensive approach to the strategic management and the risk management. The examination of the realization of the development process concept in terms of the risk analysis and assessment should provide a basis for a synthesis of these two areas. There are important reasons for that, because the risk is an integral and inseparable part of the organization's strategy, especially when implementing the strategy. Such an approach is based on the assumption that the strategic management also applies to the operational risk management when making key decisions and monitoring the implementation of the strategic plans.

In risk-related studies, problems of financial risk management are discussed most often (Powers 2010, Jorion 2007, Kuhnen, Knutson 2005). The risk associated with the implementation of the strategic management process is definitely a rarer subject of studies. In addition, individual stages of the strategic management process are not treated equally when analysing and assessing various types of risk. The risk identification, analysis and assessment predominate during the work associated with the development of a strategy, but the interest in the risk drops at the stage of the strategy implementation. Particularly significant is the fact that the speed and intensity of the impact of changes may cause a domino effect, so the need to consider different categories of risk seems to be gaining in importance.

In turn, an analysis of the operational risk occurring in the strategy implementation process will allow organizing the implementation process in a knowing manner and limiting the adverse impact of this risk on the results of the process. Kaplan and Mikes (2013, pp. 95-107) indicate the need for a system approach to the problem of managing the operational risk associated with the strategic decisions taken in companies and the changes in their environment that accompany the strategy implementation process.

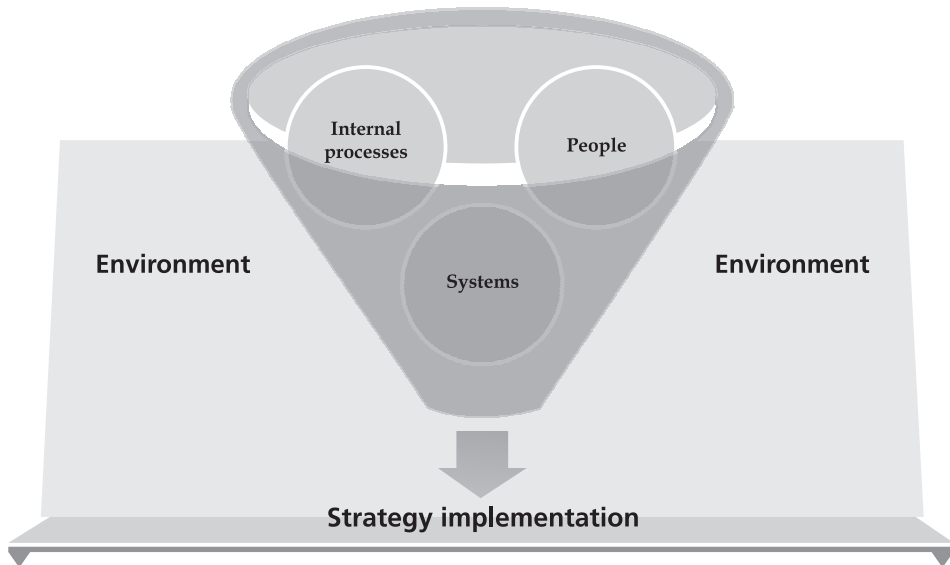


Figure 1. Elements of the operational risk affecting the implementation of the strategy

Source: own study

The current approach to the risk associated with implementation of the strategic management process is a prerequisite for starting the studies aimed at the extension of the existing frameworks and tools used for a comprehensive management of the operational risk when implementing the strategy. The strategic management procedure, which has been used so far for developing and, first of all, implementing the strategy, should be extended by inclusion of the risk. Thus it is important to understand how the operational risk affects the realization of the vision and the key strategic intentions. The strategy implementation should be supported by the discipline when trying to understand the potential impact of the operational risk on the final stage of the strategic management process and defining the priorities for the operational risk management. This is presented in the figure below.

5. Research results

The group of respondents included managers of 200 companies that have been operating for at least 5 years and are listed among the 500 largest Polish companies in the ranking of the "Polityka" weekly magazine (101 entities) and in the "Forbes Diamonds 2013" ranking (99 companies). The first ranking takes account of the revenues on sales, the total revenues of the companies, the gross and net profit, as well as the employment level. On the other hand, the "Diamonds" list included the companies with the fastest increase in their value. The group of respondents included 68 small businesses (up to 49 employees), 63 medium-sized companies (50-249 employees) and 69 large enterprises (employing over 250 people). The results described below are a part of broader surveys on the implementation of the strategy in enterprises.¹ In order to ensure the highest possible representativeness, the sample was selected using the stratified random sampling method and the data were collected in an open (overt) and standardized way. The following research hypothesis was adopted:

H: Elements of the operational risk affect the effectiveness of the strategy implementation.

Elements of the operational risk were determined by analysing the following questions:

- Environment - rapidly changing environment forces frequent modification of the strategy implemented - **negative impact**,
- People - the resistance of employees to changes associated with the strategy implementation - **negative impact**,
- Internal processes - regular measurement of progress in the implementation work - **positive impact**,
- Systems - appointment of a person or a special team responsible for supervising and coordinating the strategy implementation process (supervision system) - **positive impact**.

The results of the studies are presented below. Since the questions had the character of ordinal variables, the Kendall's tau-b correlation was calculated - the relationship between the aforementioned elements of the operational risk and the effectiveness of the strategy implementation was examined.

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Table 1. Research results

Area	Correlation coefficient	p	n
Environment	-0,224*	0,026	64
People	-0,257*	0,040	44
Internal processes	0,264**	0,000	132
Supervision system	0,262**	0,001	114

* Significant correlation at the level of 0.05 (two-sided)

** Significant correlation at the level of 0.01 (two-sided)

Source: own study

As indicated by the research results, the assumed relationships between the operational risk elements and the effectiveness of the strategy implementation were confirmed. All the correlations are statistically significant. Although they differ slightly, they indicate the existence of an average relationship. With respect to the environment and people, this relationship is negative, which means that the effectiveness of the strategy implementation decreases along with an increase in the employee resistance and the speed of changes in the environment forcing frequent modification of the strategy implemented. In turn, a positive relationship was observed in the case of internal processes and the supervision system. Thus the introduction of the processes for regular measurements of the progress in the implementation work and building an adequate supervision system by appointing a person or a group responsible for coordinating the strategy implementation process result in an increased effectiveness of the strategy implementation and a reduced level of the accompanying risk. Thus, this hypothesis can be accepted.

The basic limitation of the described studies is the subjectivity of answers. The author tried to minimize it through the selection of the sample - the respondents were chosen among managers responsible for developing and implementing the strategy. It is therefore considered that their knowledge and experience can be an important source of information about operational risk.

6. Conclusion

The theory of strategic management is currently in a pivotal point of development, mainly due to the fact that many failures occurred in effective

implementation of the strategies created. This state of knowledge is caused by a lack of theoretical models offering universal solutions that would contribute to increasing the importance of strategic management as an applied science. It is characterized by a low degree of formalization. There are neither rules nor procedures that would increase the likelihood of a successful implementation of the strategy.

Focusing on different aspects of the relationships between the strategy implementation and the operational risk should allow understanding:

- the methods for identifying, analysing, assessing and monitoring the operational risk in relation to the strategy implementation,
- the reciprocal influence of the risk, environment, organization, and strategy,
- the risks associated with a failure to include the operational risk at the stage of the strategy implementation,
- the methods for managing the operational risk when making decisions concerning the implementation.

The concept of risk management in the strategy implementation process has not appeared so far in the literature of the subject. Most existing publications discuss the problems of risk management, concerning in particular the financial or strategic risks. It is therefore worth examining how the aspects associated with the identification, assessment and optimization of the operational risk should be incorporated into the final stage of the strategic management procedure. Bearing in mind the need to develop a universal concept, it is worth considering also other factors that can affect the course of this process, not only the main guidelines related to the integration of these areas. In particular, attention should be paid to the aspects associated with making strategic decisions and implementing various strategies by organizations. Key operational risk factors associated with the strategy implementation constitute another subject worth examining. Since companies are facing the challenge of reconciling sustainable elements of the strategy with the need of continuous changes, another important aspect is to examine the subject of the strategy implementation model in the context of continuous, incessant changes that shape the types, level and impact of the operational risk.

Summary

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The paper discusses the subject of the strategy implementation and the operational risk that accompanies this stage of the strategic management process. The studies confirmed the

existence of a relationship between the effectiveness of the strategy implementation and the operational risk aspects (including internal processes, systems, people and the environment). This indicates the role of risk aspects when implementing development concepts. Therefore it seems necessary to take these elements into account in the course of the strategic management process in order to achieve a greater effectiveness of the implementation work..

Keywords: *risk, strategy implementation, strategic management process.*

Streszczenie

Ryzyko operacyjne towarzyszące implementacji strategii

Artykuł opisuje tematykę wdrażania strategii oraz ryzyka operacyjnego, które towarzyszy temu etapowi procedury zarządzania strategicznego. Przeprowadzone badania potwierdzają istnienie zależności pomiędzy skutecznością implementacji strategii a aspektami ryzyka operacyjnego na które składają się procesy wewnętrzne, systemy, ludzie oraz otoczenie. Wskazuje to tym samym na rolę jaką odgrywa opisywany aspekt ryzyka w realizacji wyznaczonych koncepcji rozwojowych. Niezbędne wydaje się zatem uwzględnianie tych elementów w przebiegu procesu zarządzania strategicznego w celu osiągnięcia większej skuteczności prowadzonych prac implementacyjnych.

Słowa

kluczowe: *ryzyko, wdrażanie strategii, proces zarządzania strategicznego.*

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