The business of running state government operations

2019 business of running state government operations survey—
insights on risk management

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NASCA

McKinsey & Company

About NASCA

Founded in 1976, the National Association of State Chief Administrators (NASCA), is a nonprofit, 501(c)3 association representing chief administrative officers (CAOs)—public officials in charge of departments that provide support services to other state agencies. NASCA provides a forum for CAOs to exchange information and learn new ideas from each other and private partners. NASCA's mission is to help state CAOs and their teams strategically transform state government operations through the power of shared knowledge and thought leadership.

About McKinsey & Company

McKinsey & Company is the world's leading strategic management consulting firm, deeply committed to helping institutions in the public, private, and social sectors achieve lasting success. For almost a century, McKinsey has served as the most trusted external adviser to governments and private sector companies in the United States and across the globe, helping them solve their most pressing problems, and enabling them to achieve distinctive, substantial, and lasting improvements in their performance. McKinsey's governance as a private worldwide partnership ensures its independence and objectivity.

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Dear NASCA members,

State chief administrative officers (CAOs) are uniquely positioned to play a significant role in transforming the way state governments provide services. Together with our corporate partner, McKinsey & Company, NASCA conducted its second annual *Business of Running State Government Operations* survey of CAOs to identify and prioritize key issues, determine trends, and understand the perspectives of these state leaders.

NASCA conducts research with the following goals:

- **recognize the role CAOs have in driving state government**
- **operational excellence**
- **curate and disseminate best practices, success stories, and case studies in state government operations**
- **assist CAOs with the strategies and resources necessary to modernize state government operations**

The study proposal, question development, and peer communications were led by NASCA's Programs Committee, which comprises state CAOs and corporate partner volunteers. We appreciate the leadership and guidance of the Programs Committee. In addition, we thank our state members for the significant time they invested and insightful comments they provided in this survey. Finally, we are grateful for the extraordinary support and resources McKinsey & Company provided in helping us design the survey, analyze the results, and prepare this publication.

Thank you,

Dan Kim
NASCA Programs Chair
Director of the Department of Administrative Services, State of California

Executive summary

The priorities of a state's chief administrative officer (CAO) are numerous and varied—managing critical state functions; providing services and support to other agencies; driving innovation and change; managing budget constraints; and continuously improving administrative strategies, initiatives, and processes. To help CAOs achieve their missions, the National Association of State Chief Administrators (NASCA) and McKinsey & Company partnered for a second year to produce the *Business of Running State Government Operations* survey on key issues affecting CAOs today. Survey results are published in three separate papers, which focus on real estate, digital government, and risk. Unless otherwise cited, the survey is the analytical base for all exhibits in the paper.

Based on a limited set of questions by design, this paper provides an overview of how state governments approach risk management. While almost all CAOs are responsible for risk management in some regard, the survey determined there is wide variation in how states delegate and manage those responsibilities. When analyzing the most prevalent risk management practices, four archetypes emerged from the data: risk owners, risk collaborators, risk responders, and risk prone. For each archetype, building an overall strategy and more structured oversight is critical for addressing risk exposure, as well as preparing for and mitigating potential crises. In subsequent surveys, it will be possible to look for causal links between risk management archetypes and states' risk exposure, as well as more deeply assess states' capabilities and processes.

About the survey

The *Business of Running State Government Operations* survey was conducted with NASCA state members and focused on their priorities and challenges in real estate and facilities management, digital government, and risk management. The purpose of the survey is to provide government leaders with a robust set of data and insights they can use to compare state practices and inform forward-looking strategic decisions.

Methodology

The survey questions drew from subject-matter experts on risk management, as well as NASCA state members' experiences. NASCA convened a working group of members who are chief administrative officers (CAOs) to vet the questions to ensure CAOs' responses could yield relevant and actionable insights for NASCA state members.

The respondents

Thirty-three (33) NASCA-member CAOs participated in the survey, though not all respondents answered each question (Exhibit 1). While CAOs were the primary participants, some deputies and other officers also participated. This paper refers to all respondents as CAOs.

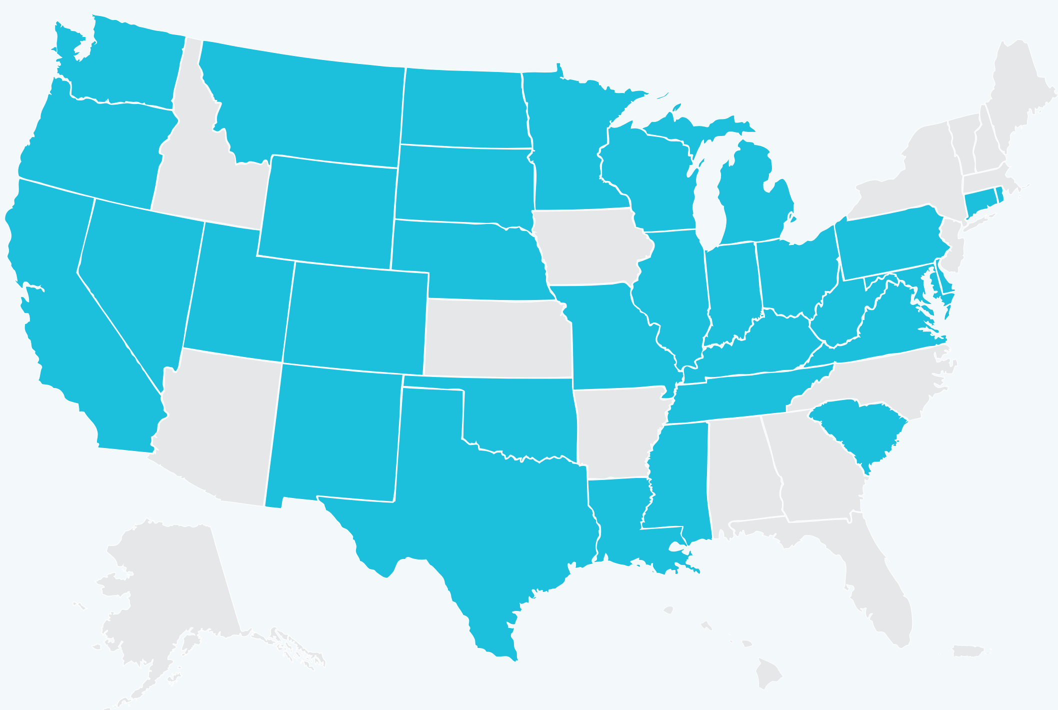
Anonymity

To preserve the anonymity of survey respondents, answers are not attributed to specific individuals or states.

Exhibit 1

Thirty-three NASCA-member CAOs participated in the survey.

States represented in the survey



Overview: How CAOs approach risk management

Risk management is more important than ever before, as fast-moving technologies and external forces create new and more powerful threats for state governments to identify, prepare for, and mitigate. Although 76 percent of CAOs are responsible for risk management, how that responsibility is defined and carried out varies widely.[1] Overall, risk management strategies and processes are relatively unstructured across states.

Among the states that have a well-established enterprise risk management strategy, there is wide variation in risk management processes, including how states delegate risk ownership and manage risk evaluation. For example, about 50 percent of respondents have a chief risk officer in the office of the CAO, 10 percent of respondents have a chief risk officer who reports to someone other than the CAO, and 40 percent of respondents do not have a chief risk officer. In addition, only about 50 percent of CAOs have a well-established risk strategy with a formal process for regular evaluation (Exhibit 2).

Among the states that have a well-established enterprise risk management strategy, there is wide variation in risk management processes, including how states delegate risk ownership and manage risk evaluation.

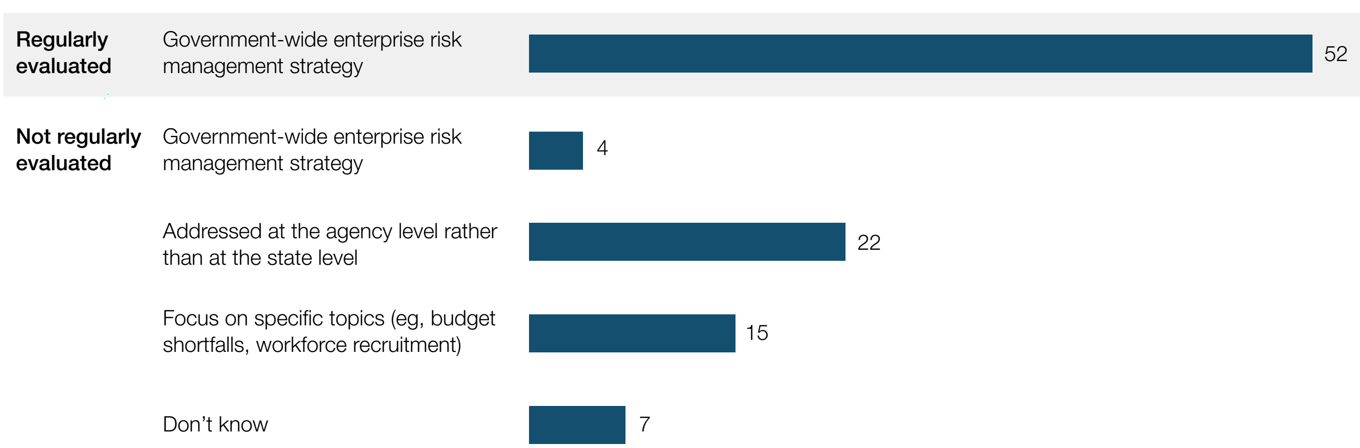
CAOs are responsible for managing a wide range of risks. Some of the top concerns cited include employee safety and security, cybersecurity, financial security, and facility security.

There is also a correlation between the number of risks that CAOs are most likely to directly oversee and their approach to risk

Exhibit 2

Only half of the states surveyed have a regularly evaluated enterprise risk management strategy.

% of respondents, n = 27



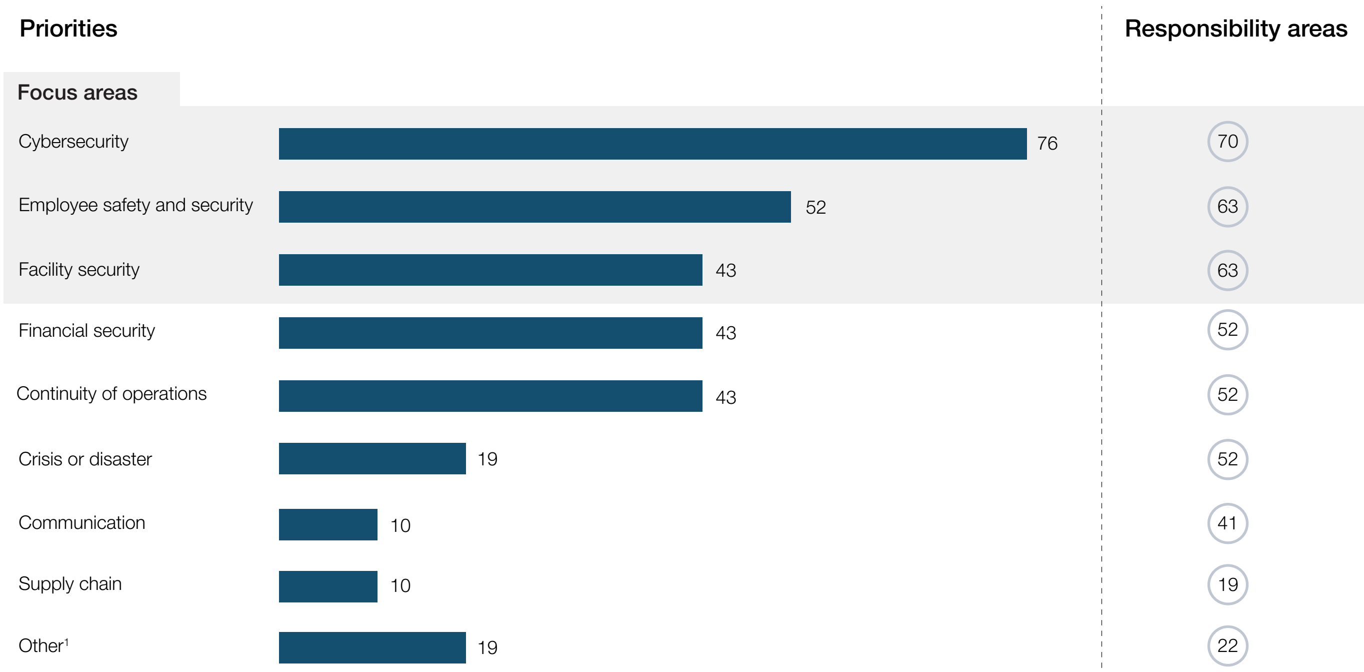
[1] NASCA member survey on areas of responsibility, July 2019.

management. CAOs who have broader risk management responsibilities tend to think about the whole taxonomy of potential risks. By contrast, CAOs who do not have accountability for risk management across a broad range of functions are more likely to concentrate solely on those topics for which they are otherwise responsible, such as facility security. **The result is that many governments lack necessary awareness and centralized oversight of all risks faced by the state (Exhibit 3).**

Exhibit 3

Cybersecurity, employee safety, and facility security are CAOs' top priorities for risk management as well as the most common areas of responsibility.

% of respondents, n = 27



[1] Human resource and civil rights complaints, insurance contracts and claims, workers' compensation, etc.

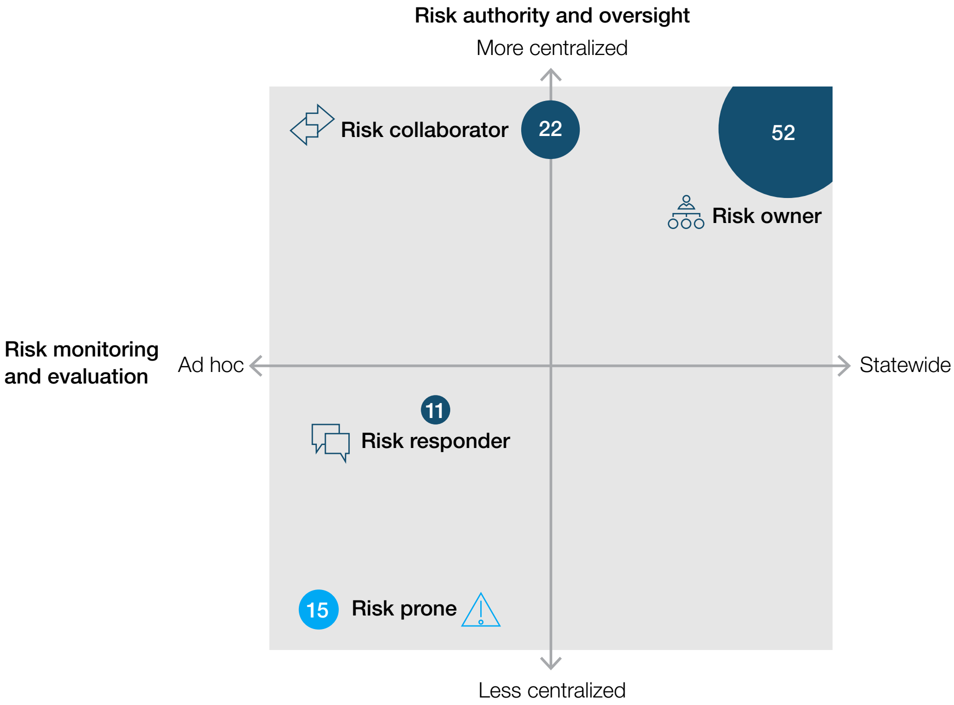
Four archetypes illustrate CAOs' approaches to risk management

The survey revealed a wide range of approaches to risk management that can be sorted into four archetypes: risk owner, risk collaborator, risk responder, and risk prone. These archetypes are based on two dimensions of risk management: 1) how risk management and oversight is assigned and carried out across the state government, and 2) the frequency and structure of risk monitoring and evaluation (Exhibit 4).

Exhibit 4

Four risk archetypes emerged from the survey data.

Size of circle represents % in each archetype



The characteristics of each archetype are described in more detail below:

Risk owner

Fifty-two percent of states follow the risk owner archetype. These states have a centralized risk management authority and regularly evaluate and update their statewide enterprise risk management strategy.

Leadership

The CAO has primary responsibility for statewide risk management in 86 percent of risk owner states, while the remaining 14 percent designate another senior official. In addition to a CAO, states in this archetype are most likely to have a chief risk officer.

Risk responsibilities

States that follow the risk owner archetype are most likely to include a wide variety of risks in their risk management plans rather than focusing on a few discrete topics.

Risk collaborator

Twenty-two percent of states follow the risk collaborator archetype. These states have a centralized risk management function, often in the CAO's organization. While they believe that managing risk is essential, risk collaborators prefer to evaluate it at the agency level rather than at the state level.

Leadership

The CAO has primary responsibility for statewide risk management in 66 percent of risk collaborator states, while the remaining 34 percent designate another senior official.

Risk responsibilities

CAOs whose states follow the risk collaborator archetype are more likely to have a relatively narrow risk portfolio, with other senior officials taking responsibility for additional risks.

Risk responder

Eleven percent of states follow the risk responder archetype, in which there is no centralized risk management function. Instead, each agency is responsible for its own risk management. Risk evaluation is addressed on a topic-by-topic basis, rather than with a regular, comprehensive review of the state's or agency's risks.

Leadership

States in this archetype are unlikely to have a chief risk officer, either in the CAO's organization or in another department or agency.

Risk responsibilities

While many CAOs in these states retain some risk management responsibilities, they generally prioritize a few areas of risk, such as procurement or insurance, rather than overseeing a large portfolio of risks.

Risk prone

Fifteen percent of states follow the risk prone archetype. These states do not have an enterprise risk management strategy, nor do they have a centralized risk management authority. While CAOs in these states may have some risk responsibilities in specific topic areas, they typically assess and deal with risks on an ad hoc basis. These states are highly unlikely to be supported by a chief risk officer.

Takeaways from the risk archetypes

There is no one-size-fits-all risk management approach for states; indeed, the best risk-management approach for each state is highly dependent on structural factors related to an individual state's context. For example, states may have different risk appetites, leading to varying levels of financial, environmental, or other regulations. They also have different levels of exposure to natural disasters, variable budgets, and economic downturns, among other factors.

Even with these structural differences, best practices dictate that there should be an overarching strategy and clear ownership approach, as there is with the risk owners, risk collaborators, and risk responders.

Even with these structural differences, best practices dictate that there should be an overarching strategy and clear ownership approach, as there is with the risk owners, risk collaborators, and risk responders. Public sector best practices also demonstrate that the most effective strategies are collaborative and enterprise-wide, backed by risk management plans and procedures that align with the state's risk appetite.[2] Once a state determines its risk management strategy, it should assign clear, primary responsibility to an individual or group for this function. Failing to designate one point of contact as the primary responsible party has proven to leave certain risks unaddressed, while assigning responsibility to multiple groups can result in ambiguity and duplication of resources, undermining the overall approach.

Polar satellites: A model for cross-agency risk management[1]

The National Oceanic and Atmospheric Administration (NOAA) and NASA collaborate to manage risk in the Joint Polar Satellite System program that collects and reports on environmental and weather data. While a joint program director is responsible for overall risk management and oversight, each agency has specific risk responsibilities outlined in a formal memorandum of understanding. In this instance, NOAA is responsible for monitoring cost and schedule risks, and NASA is responsible for systems and engineering risks. This approach ensures that together the agencies can control for a wide spectrum of risks, without creating redundant or conflicting systems.

[1] *Enterprise risk management*.

[2] *Enterprise risk management: Selected agencies' experience illustrate good practices in managing risk*, United States Government Accountability Office, December 2016, gao.gov.

Looking ahead, more than half of the CAOs currently in the risk prone archetype are actively developing more robust risk management strategies, signifying that they recognize and are addressing current gaps. Overall, nearly 17 percent of CAOs plan to develop a new risk strategy in the next 12 to 24 months. These CAOs, and others looking to develop or refresh their risk management strategies, could consider the range of risk management approaches used by public sector entities across the country and determine which would be most effective in their states.

Conclusion

Governance, decision-making structures, and risk exposure vary significantly by state, as do risk management approaches, but there are some additional lessons to be drawn from the available data, validated by private and public sector experiences, that are instructive for CAOs developing a risk management strategy in the near term.

The most effective risk management step an organization can take is to ensure that senior leaders are accurately identifying the state's full set of risks and areas of potential weakness. Risk management should be led by a CAO, chief risk officer, or another leader with statewide authority appointed by the governor. In addition to this designated risk manager, a committee of senior, interagency leaders should be responsible for regularly reviewing and evaluating risk. This committee should also be responsible for coordinating across all parties with risk responsibilities and ensuring that every employee upholds the responsibility of managing risk and adhering to the state's risk culture.

Case examples demonstrate approaches to risk management transformations

A large US city articulated guiding principles for its enterprise risk management function, drawing on best practices across risk management and crisis management, and mapped options for its risk management structure, including key roles and responsibilities.

A US federal agency overhauled its risk operating processes by refining its risk models, establishing risk governance protocols to ensure transparent decision making, and developing an approach to systematically assessing risk.

Risk management leaders should work together to adopt an overarching strategy. The best strategies will not only have a clear owner but also have the following characteristics:[4]

- be comprehensive and proactive
- include regular evaluation of risk assessments and resource allocations
- be broad in scope, including assessments of a wide variety of risks, risk management processes, governance and accountability structures for those processes, and playbooks for crisis response

By ensuring clear ownership over all the risks a state faces and adopting an overarching strategy, states can significantly advance their risk awareness and oversight capabilities. ■

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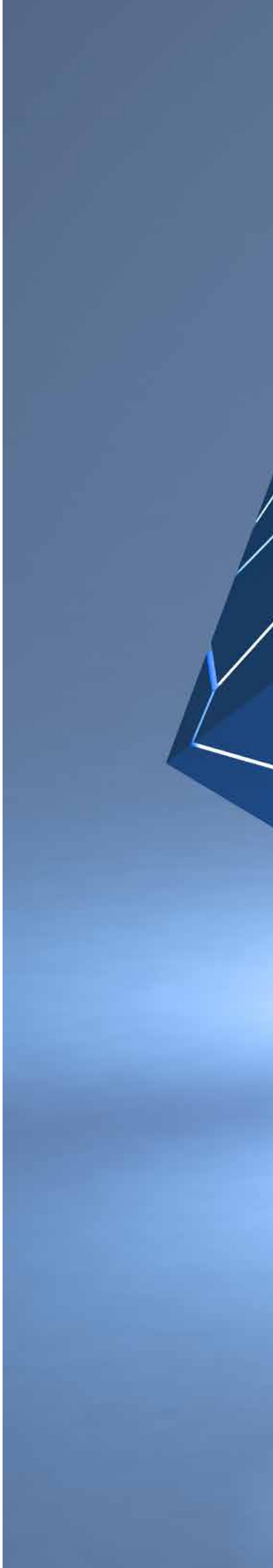
[4] Daniela Gius, Jean-Christophe Mieszala, Ernestos Panayiotou, and Thomas Poppensieker, "Value and resilience through better risk management," October 2018, McKinsey.com.



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