RISK MANAGERS AND THE MANAGEMENT OF RISK

Why Risk Culture Building should be the most important item on the Board Agenda

The Boards of Directors of organisations continue to face increasing accountability for ensuring their organisations are effectively managing risk. Yet, despite improvements in risk identification, reporting, and strategic risk management initiatives, regulators, rating agencies and shareholders still question whether they are truly engaging in the right ways on the top risks that could bring down an individual organisation or have a broader systemic impact.

Successful organisations rely on trust; and while it takes years to establish that with the public, it can be lost in a moment through failures caused by break-downs in ethics, values, and bad behaviours. Poor cultural fundamentals and significant people risk failures were major drivers of the financial crisis, and continue to be factors in the scandals since then, aggravated by staff with questionable conduct and values.

Organisations continue to feel the pressure: increased regulatory attention, a sharper focus of shareholder value and better customer service expectations. Add to this, an ever more competitive and closely scrutinized market place where those who are not good at risk management are being
exploited by those who are better in a race for much needed transformational change and often a rush for profits.

Consultants and business strategists responded by coaching us into centralisation. Then came outsourcing, the process where we moved work away to get it done cheaper and we never built effective risk management structures to manage decision-making that is now even further removed from where business is done.

Yet business is done where the customers are and that is where the management of risk must be done. People risk is the biggest risk, because all problems go back to people in the end.

All of these changes also drove the mindset that risk management is all about “defense” instead of optimisation—taking more risk for more reward.

In many organisations, the centralised risk management function developed into a factory with the sole purpose of collecting historic data and turning that into risk dashboards and risk reports, most of which are too old and useless by the time they reach those who need to make decisions based on that information.

These factories also operate in silos, even within the financial and non-financial aspects of risk management in the same organisation and are mostly seen as cost centres, places not required to add any commercial value to the bottom-line.

Let us look at Risk Identification: we tried in many ways to identify all the risks—until a volcano sneezed and we realized that we have not; and can never, identify all the risks. Let us accept that and move on. The size of your risk register is not related to, nor is it an indication of the effectiveness of your risk management process.

Next, we get to Risk Assessment and Analysis: Those who thought they were good at risk identification moved on to quantification. Sadly, many are still stuck there, thinking that models can control and mitigate risk.

Risk reporting, control and treatment: How wrong did we get red, amber, green! Now everybody wants every risk to be green, because green is good. Green on a risk report is perceived to mean “do nothing”, but that is the quickest way for those risks to shoot to red. Then we get to amber, what a nice place to be- all risks are under control and we choose to overlook the fact that those controls might not be efficient or can be completely ineffective.

DANGER ZONE - those risks in the red zone, the bad zone. The red zone is where you make the most money, but it is also the place that requires the most effort in risk control. For as long as red is perceived as bad we will be stuck with average risk management effort (amber) or no risk management effort (green). So, the red zone is the best zone with the biggest returns—if you are prepared to put in the effort to manage and optimise risk.

We already know that the effectiveness of your risk management process is not linked to the size of your risk register. Similarly, it is also not linked to the thickness of your executive risk report. People Risk is the most vital component of modern day risk management and those organisations that are not good at this; or ignoring it, stand to be exploited by those who are. How much time and effort will we spend to attempt to predict human behaviour and human error in risk-taking situations? The results will remain distorted views of the situations, behind every loss there is a person, even if he/she was just not performing a routine check. Risky stars with hero status are taking many companies to zero status.

Trying to set standards and benchmarks in people risk is just subjective juggling- it cannot be done. People risk is incalculable and in this wide open psychological mind space it is best to start by working on the mitigation of people
risk. This is where the value lies, do not focus on efforts to quantify the level of people risk in your organisation, accept that it is too high and move on to build an effective mitigation strategy and an effective risk culture.

The Human Factor is the weakest link in the management of risk and as organisations continue to push through their own cultural change programs aimed at instilling better behaviours, something that many risk practitioners attribute to the failings that led to the financial crisis, the role of risk in helping to embed the right approaches within the business seems to be gaining traction.

There will always be people risk and some bad outcomes, but it’s got to be controlled and managed to within a risk appetite level that you’re comfortable with; and that is consistent with the performance and reputation that the bank would like to achieve.

Risk Management does not operate in isolation but rather is an enabler of the management process. Over the past decade, risk management became more about quantitative models and less about behavioural models. Unfortunately, as we discovered during the global financial crisis, even the best quantitative models cannot predict the result of misguided behaviour.

We know that any firm’s risk culture evolves over a long period. You can’t just flick a switch to make it go from one culture to another. “Carrots and sticks” also have limited success and often any of these just add to a bad situation of mistrust and frustration. Risk managers should avoid “one-size-fits-all” thinking and solutions and use their experience and foresight to exercise judgement as to which areas they should be focusing their attention.

All employees should learn basic risk management skills and the relevant risk competencies must be built into the organisation’s competency framework. Skills gaps must be identified and structured training programs implemented to upskill staff.

Building an effective Risk Culture; making every employee a risk manager, will support executives to deal effectively with uncertainty and associated risk and opportunity to achieve sustainable competitive advantage.