risky business

Risk management and oversight are the buzz words du jour, heard more and more frequently around New Zealand's boardroom tables and as part of governance discussions.

As a relatively new organisational capability, it is perhaps not surprising that there is no clear understanding or definition (in every day terms), of what risk management is. Many resort to a definition in an ISO standard; in this case 'coordinated activities to direct and control an organisation with regard to risk'. To make matters a little more obscure, the ISO definition of risk is 'effect of uncertainty on objectives'.

Do these relatively simple definitions help directors and management engage with staff on why they should contribute to the risk management efforts or what value such efforts bring? Very unlikely! In our experience, any reference to an ISO standard tends to be a major turn-off.

This uncertainty about what risk management is, and what value it can add, only confirms the confusion that seems to exist about why we should be practising risk management.

Some risk taking is essential if an organisation is to achieve its objectives. Airlines, for example, wouldn't fly if they didn't want to take risks. Many companies that have been successful understand that, historically, they have been managing risk well. They would not have been successful otherwise. So why do anything different now? Many company decisions involve a risk reward trade-off so, implicitly or explicitly, risk is considered in their strategic and tactical decisions. In all likelihood though, across any one company, different people will approach the risk reward trade-off quite differently; a risk worth pursuing for one person may not be attractive for another. With those inconsistencies can the company be confident that, in each case, objectives are being pursued without putting the company's financial position or reputation at more risk than the owners/shareholders would accept?

In attempts to strengthen risk management and corporate governance, companies may establish audit and risk committees, maintain risk registers or appoint risk managers. For some companies, CFOs or financial controllers who are tasked with procuring insurance are unofficially (and unwittingly) assuming a critical part of a risk management function. Is effective risk management being established and embedded through the organisation with these steps?

Our experience suggests perhaps not.

A risk register is not evidence that risk management is adding value to an organisation. More often than not, it is evidence that someone is meeting a compliance requirement. It is probably even more concerning if the risk register is produced by one person (eg CFO, legal counsel), once or twice a year, and can create an illusion within the board that robust risk processes are in place.

SOME OF THE CHARACTERISTICS OF GOOD RISK MANAGEMENT ARE:

- It is forward looking; it helps to identify and systematically consider things or events that can impact a company's performance.
- It helps prioritise where focus should be; considering the consequence of a possible event in relation to a company's objectives and ties the event to what is important. Considering the likelihood of an event with that consequence helps ensure time and management resource is not wasted on remote possibilities. eg technology risk should perhaps be

Jennifer Calder

Rob Frost

"Risk comes from not knowing what you are doing" – Warren Buffett

higher on the agenda than environmental risk for some companies.

- It improves the quality of decisions. A degree of uncertainty is present in most decisions; risk disciplines provide a context that allows the uncertainty to be considered systematically within a decision; it increases the likelihood that the risk reward trade off being made is more than the toss of a coin or based on the personal biases of the decision maker.
- It supports accountability and performance management; prudent responses to identified threats to a company's performance can be assigned to the appropriate person and monitored.
- It supports growth, innovation and pursuit of competitive advantage; decisions to grasp an opportunity are taken when they may not have been without the use of risk disciplines. For example, Air New Zealand's decision to introduce night flights into Queenstown is likely the consequence of a thorough assessment of the risks as well as the commercial benefits. The risk modelling and assessment were presumably a powerful factor that delivered additional insight to all stakeholders.
- It supports a consistent consideration of risk across an organisation; at the risk of dangerous stereotyping, accounting and engineering teams may well make different decisions on the same matter than the marketing or development teams. How does management encourage risk taking that is broadly aligned across the company?

The value that flows from using risk disciplines is not achieved if one person in a company is in charge of risk management.

In a recent Conference Board article (by Praveen Gupta and Tim Leech), the authors' challenge to directors was reflected in the article title: *The Next Frontier for Boards: Oversight of Risk Culture*. It reflected that superior company performance flows from having everyone in an organisation holding some level of ownership for a company's risks and an understanding of how their decisions impact on the overall performance.

Those organisations that are more risk aware appreciate that actively managing not only potential problems (threats) but also potential opportunities, provides them with a competitive advantage. Taking and managing risk is the very essence of business survival and growth.

Some of the more high profile corporate issues in recent times often are the consequence of inadequate or no risk assessment made as part of a number of smaller decisions. Serious loss or disaster (i.e. risks manifested) is typically not attributable to one isolated factor. Rather, it is the culmination of a series of steps and decisions which have exposed a vulnerability of processes, which permitted the loss or disaster. Risk exposure can reflect interrelated event. Each on their own may not pose a major threat, but in combination with other events occurring, significant financial or reputational consequences are felt.

Organisations today face an unprecedented level of reputational risk. Social media options ensure bad news spreads fast. To simply pay lip service to management and related governance is to unwittingly expose the organisation to serious loss or disaster or potentially, not seize strategic opportunities that should be pursued. Effective risk management should not be a top-down directive but does require appropriate leadership from the top. It cannot deliver value to the organisation however without all staff assuming an element of responsibility for risk and having the discussions around risk just as we expect staff to take some individual ownership for health and safety. At its core, risk management is about asking and answering five questions:

- What are we trying to achieve?
- What are the events or circumstances that could affect the achievement of our objectives?
- What are the consequences?
- How likely are these events?
- What can we do to manage these outcomes and maximise opportunities so that we are not managing the business with more risk than we are willing to accept?

How a culture of risk management is created, applied consistently and sustained in an organisation with various silos of operations will be a challenge. But such a programme could be the difference between failure or success in today's increasingly competitive and rapidly changing economy.

Jennifer Calder, Client Advisor – FINPRO, New Zealand, Marsh jennifer.calder@marsh.com

Rob Frost, Head of Business Risk, Marsh rob.frost@marsh.com