5

The end game

Beyond resilience

In my early days of preaching the risk management message to boards and executive teams I would talk of the 'risk management journey'. Now some risk practitioners are well and truly over that term, though I still use it for those organisations that are on the first half of the journey.

Before I explained the risk management journey I would facilitate a discussion on the journey of a business from small to big. As a great example, I usually turn to the Microsoft Corporation. The journey started with Bill Gates and Paul Allen working in Gates' garage in Albuquerque, New Mexico.[11] Their success meant they quickly outgrew the garage, and Albuquerque, and moved their operation to Bellevue, Washington. As the years flowed by they grew and grew. Occasionally they would hit a bump in the road, such as the anti-trust action by the US Department of Justice or a product flop like Windows Vista. Mostly, though, they found new ways to grow — from MS-DOS to Windows, Xbox to Surface. No matter the challenge, they took stock of the situation, consolidated and grew some more, consolidated and grew some more . . . repeat.

Once I had painted this picture, I moved on to the risk management journey (figure 5.1). I described the purpose of risk management to executives and boards as being to develop triple bottom line success by moving through four phases of growth. I would define triple bottom line success quite loosely, as it differs from industry to industry. In general, though, I would speak of $$$ and sustainability where sustainability could mean safety, the environment or a social licence to operate.

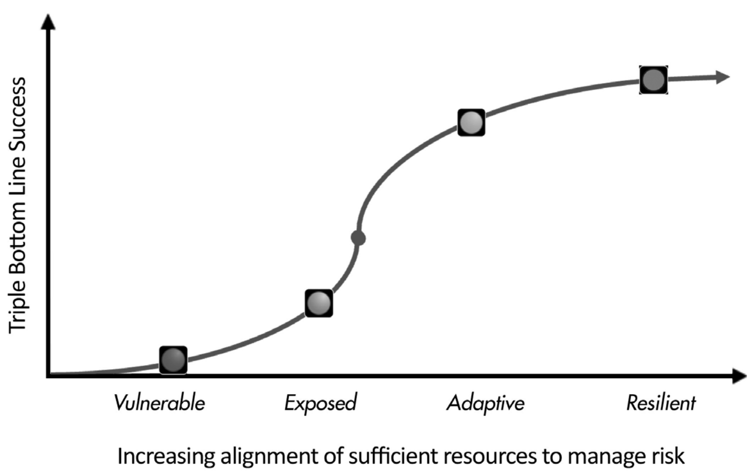

Figure 5.1: The risk management journey (four phases)

I would then describe the four phases:

- **Vulnerable** — Not even aware of the risks being taken
- **Exposed** — Some discussion about risk has taken place. Maybe they bought some risk software and ran some workshops or asked staff to think of some risks and fed them through the software. They then found they had a lot more risk than they'd known about.
- **Adaptative** — Now the organisation is managing risk, and it is using the insights gained to plan for the shifting sands ahead.
- **Resilient —** The organisation has developed a strong capacity for risk. They have a strong balance sheet or, if in government, access to funds. Their staff have developed a capability both to manage the key risks identified and to identify and manage new risks.

And there you would have it. I used to say that the end game of risk management was to become resilient. This approach served me well for quite a few years. People got it. And because they were not feeling so resilient at that stage, they would buy into the idea of becoming more resilient.

As time went by, more and more organisations 'did risk'. Either they gave someone the responsibility or they brought someone in. Some used consultants, others didn't. Either way, they moved up the curve. What I was seeing, though, was that risk management as a discipline was increasingly based on compliance. Resilience meant the regulators, the audit and risk committee and a few other interested stakeholders were feeling comfortable about the risk level in the organisation, so now they could get on and manage the business. The message to the risk fraternity was, 'Keep on doing what you're doing and keep them happy.'

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My view on risk had always been that risk management was about helping organisations to be successful. 'Do enough to be successful — not too much, not too little', was always my advice. So when risk devolved to the role of placating others, I wasn't happy. Soon I asked myself a question: 'What makes a small business resilient?' If risk management is about seeking resilience and small businesses manage risk to survive, how do they do it without the big balance sheets? The answer, I realised, was 'agility', the ability to move faster than the giant sloth with stellar balance sheets.

Now when I present to boards and executive teams I tell them I used to stop at resilient. I ask them what makes a small business resilient, and with little or no prompting they fall upon 'agility'. Then I explain that the purpose of your risk management program should be to help you rediscover the agility that made you great in the first place. Good, fast decision making at all levels of the organisation. That's how risk adds the most value to an organisation.

I have no problem giving my audience a relevant example where agility is key to managing risk. Take the health sector, for example. For a public hospital, an aged-care provider or a pharmaceutical company, agility is essential. A public hospital must do more with less as new and often expensive technologies become available and public demand for them is created. Doing more with less is risky, so it is about achieving the same outcome faster and/or in a better way.

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Aged and agility don't often go hand-in-hand; the industry is growing fast, however, with all kinds of stakeholder expectations and opportunities. As I mentioned before, as I write this a Royal Commission into Aged Care is taking place in Australia. Change is coming to the industry, and the ability to shift quickly will be essential for competitive advantage. Australia's largest provider of aged care, Bupa, has hit the headlines with stories of atrocious standards of care, 45 of its 72 homes failing to meet safety standards, 22 of those homes putting patients at 'serious risk' and 13 of them sanctioned, meaning they have lost government funding and are unable to take new patients.[12]

Then there are the pharmaceutical companies that must continue their quest for a portfolio of products providing sustainable cash flow, new growth and the occasional star. They must be agile in pursuing new opportunities quickly, and failing them just as fast.

The risk management journey has five phases with the fifth being agility. I use the graph in figure 5.2 to illustrate this.

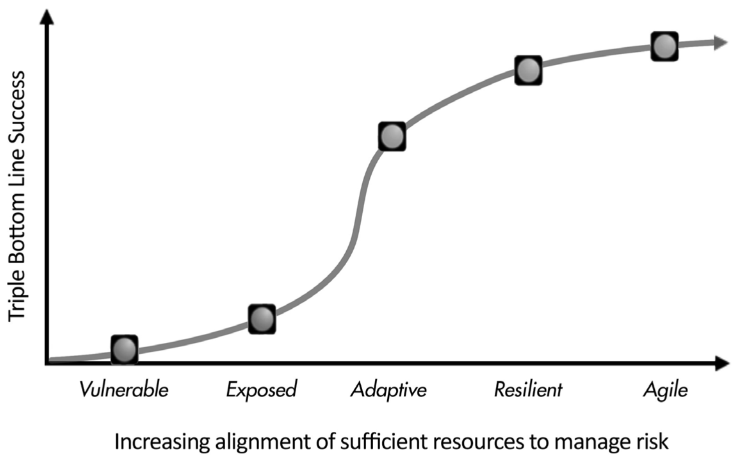

Figure 5.2: The risk management journey (five phases)

Organisational decision making

It's one thing for me to articulate the need for faster, smarter decision making and to declare that the risk management function is going to deliver it. It's another for boards and executives to fully appreciate how this can happen.

In order to answer that question, let me remind you what an organisation is. As you read earlier, Herbert A. Simon, in his book *Administrative Behaviour*, describes an organisation as a group of people who come together to fulfil a purpose. From there, management's role is to influence decision making to ensure the most appropriate decisions are made by those within the organisation to fulfil the purpose. In essence it requires that staff have the best information available for decision making so they can decide to act or not act, to hire or fire, to invest or divest, to run a project harder or abandon it. So what is the best available information, how does it get to where it's most needed and how is it moulded along the way?

I often pose this question to boards and executive teams. Before they answer I tell them about a time in 2010 when I was at a UNSW Business School seminar where David Thodey, then CEO of Telstra, was interviewed by Narelle Hooper, then Editor of *AFR BOSS* magazine, in front of about 400 people. Thodey was asked a question along these lines: 'What is the greatest challenge in running an organisation the size of Telstra?' (which then had over 45,000 employees). Thodey answered (in my words):

> *Getting information I need to know about from the extremities of the organisation to me, past all the information people are trying to tell me about that I don't need to know, in time for me to do something about it!*

I tell my audience that getting the most important information to the right people for faster, better decision making is the most important role of the risk management function. I then guide them through the following question-and-answer:

I tell my audience that getting the most important information to the right people for faster, better decision making is the most important role of the risk management function.

> ‘How does information we need for decision making flow through the human body to the brain?’
>
> *The brain gets information from ‘the extremities of our organisation’ (our body) via our five senses: hearing, sight, touch, smell and taste.*
>
> ‘And how is this information channelled through the body?’
>
> *Via the central nervous system.*
>
> ‘Where is the main information superhighway for the central nervous system?’
>
> *The spine.*
>
> ‘How much do we value our spines as human beings?’
>
> *A lot!*
>
> ‘And how much do you value the “spine” of your organisation?’

I then ask them about recent good and bad surprises that have filtered through to them from the extremities of the organisation. The organisations that are in most need of help have many. Some have fewer, but all get my point and accept they can do better. And they are interested in hearing more. After all, who doesn’t want faster, better decision making by staff at all levels of the organisation? And what board or executive team would not like to reach their decisions faster and build a better track record?

To give my audience a better understanding of how they can have faster and better decision making, I look to provide them with a better understanding of how the risk management process can deliver it. By way of example, I ask them to pick one of their corporate objectives and then ask these three simple questions:

- 'What must go right to achieve this objective?'
- 'What could go wrong?'
- 'What are we already doing about these things?' (In risk-speak, these are controls.)

> To give my audience a better understanding of how they can have faster and better decision making, I look to provide them with a better understanding of how the risk management process can deliver it.

I suggest that many processes or activities in their organisations likely address these questions; however, none but the application of the risk management process will determine a risk level. And you and I know that risk level is important to know. While there are many reasons to calculate or estimate risk level, including the insights the process brings to the understanding of key drivers of risk, these are the three most critical reasons:

1. Because not everyone has the same appetite for risk!
2. To prioritise limited resources.
3. To understand the importance of some controls and whether the cost of these controls are appropriate for the risks being taken.

I will now expand on each of these. In subsequent sections I will delve deeper into the intricacies of risk management frameworks and the risk management process.

People see the world differently when it comes to risk

Before we relied on the much-used, and more recently much-maligned, risk matrix (which I will go into later), if someone in a board or executive meeting said the risk was too high and someone else disagreed, all too often the discussion would degenerate into the kind of exchange you might expect between two kids in a schoolyard.

> 'Yes it is!'
>
> 'No it's not.'
>
> 'Is!'
>
> 'Not.'
>
> 'Yes it IS!!!'
>
> 'No it's NOT!!!'

Of course, a more mature conversation would explore each person's reasoning for why they felt the risk was or wasn't too high, why one person thought that it was a reasonable risk to take and the other thought it too high.

When organisations and eventually standards organisations started documenting the risk management process, they were explicit about the need to determine what is and is not acceptable risk well in advance of a discussion about the risk of a decision, such as whether or not to proceed with a certain project.

Risk is our best-known tool for assigning resources

Whether you are the director of an opera company, a general in the army, or CEO of a large or small business, you always want to apply resources where they are most needed. In the opera company, if your chorus needs work, you will ensure they are given valuable stage time in rehearsal. If you think you can take your lead to another level to completely entrance the audience, you will ensure the right people work with them. As a general, if you feel vulnerable in certain areas, you will lend greater support to these areas. Where you think you can gain a performance advantage if you bolster a certain area, you will do so. And in business, if you think production needs to be more efficient, you will apply resources accordingly, and if you think the R&D department is close to a breakthrough, you will invest more resources with them.

Whether you are the director of an opera company, a general in the army, or CEO of a large or small business, you always want to apply resources where they are most needed.

The difference between choosing where to apply resources, with or without an understanding of the risk levels being faced, is simply the application of a thought process. One we do pretty well naturally but that can be enhanced.

Understanding the importance of controls helps you avoid 'I could have told you that!'

How often after something goes wrong do you hear something like 'In hindsight it was an accident waiting to happen. We had so many complaints about it'? As you know, to get to a realistic assessment of risk level, you need to understand the controls you rely on for the identified risks. And you need to assess their current state of effectiveness. Not all controls are created equal, of course. Some are more effective and reliable than others. Once you understand the controls you rely on, you can decide which ones are most important by considering what might happen if they fail. Then you can answer the questions 'How important are these controls?' and 'How much certainty do I want that they will work when I need them to work?'

How often after something goes wrong do you hear something like 'In hindsight it was an accident waiting to happen.'

And one more element. As we learned in chapter 4 from the CFO about the audit into credit card expenditure, controls need to be enough to protect and should not lead to an unnecessary burden. Even better, they should help accelerate business as leaders devolve responsibility because they know the controls are in place and are reliable.

More on these aspects of risk management in subsequent sections. Now back to faster, better decision making.

So risk management, done well, delivers a clearer understanding of the organisation's appetite for business and key priorities, and the key controls being relied on. This facilitates faster, better decision making through what I call *decision envelopes*.

> Risk management, done well, delivers a clearer understanding of the organisation's appetite for business and key priorities, and the key controls being relied on.

A decision envelope provides clear guidance to staff on the decisions that are within their realm of responsibility, how to prioritise when there are conflicting requirements to be met, and the triggers for when to seek guidance or to escalate a decision. Typically, organisations do much of this through policies, processes and systems by way of financial delegations, approved suppliers and the like. However, when risk is overlaid on these, staff have more information for managing the uncertainty surrounding them, such as when controls are compromised or jeopardised.

All this means faster decision making when uncertainties are managed effectively, and better decision making when things have gone or are about to go wrong. Good news and bad news travel faster and more clearly through the organisation. The result is a more agile organisation. That's what I offer boards and executive teams. Now, what are the practicalities of delivering on my promise?