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Culture War: Embedding Corporate Risk-Intelligence

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The Ghana native worked his way up from a back-office accounting role at UBS to their vaunted Delta One derivatives trading desk. When Kweku Adoboli caused a $2.3 billion trading loss he was promptly labeled by the Swiss banking giant as a "rogue trader." However, in a September 2011 article, *The New York Time*s maintained that "at UBS, it's the culture that's rogue."[1]

Many examples of more benign risk culture deficiencies show honest efforts at implementing a true risk management framework. In some cases, approaches use concepts from COSO, ISO, or other respected frameworks. Risk practitioners have a large number of tools at their disposal and are increasingly backed by the necessary and often mentioned "tone at the top." Unfortunately, even in this seemingly ideal atmosphere, it is apparent that few companies have truly embedded a risk-reward view in its DNA.

The root causes are often some combination of a) lack of understanding of risk management's goals, b) fear of intellectual honesty, c) misaligned incentives, d) failure to operationalize risk appetite and limits, and e) neglect of risk analysis in key business decisions. An organization with a strong risk culture avoids each of these pitfalls.

A PATH OF LESS RESISTANCE

In their best-selling book *Switch*,[2] Chip and Dan Heath delve into the emotional and behavioral tendencies that commonly make significant changes difficult to achieve. Those who focus on corporate risk culture understand that implementing the desired behaviors represents a challenging change management situation.

The Heaths initially explain three *surprises about change*. They are:

1. What looks like a people problem is often a situation problem.
2. What looks like laziness may actually be a specific type of mental exhaustion.
3. What looks like resistance to change is often a lack of clarity.

CHANGE THE SITUATION, NOT MINDS

The New York Times best seller *Influencer*,[3] supports item 1, above, indicating that people's behavior can be altered through a change in environment. The authors describe a common situation in American restaurants in the late 1940s. When many of the soldiers returned home they often replaced women who had been serving as restaurant cooks during World War II. Many women viewed their new roles as waitresses as a step down and would often shout their orders at the cooks. The veterans were not at all pleased to be taking orders from these women and fights were commonplace. Both customers and employees were leaving restaurants in large numbers.

A University of Chicago professor named William Foote Whyte was asked to help with the problem. He simply changed the situation by introducing a metal spindle to which the servers would skewer their orders in written form. Training consisted of 10 minutes of instruction to the cooks and servers. Both groups preferred the new process and felt they were being treated better as a result. The minor tweak to the environment solved a problem that would have seemed almost insurmountable if one attempted to address the social views, notions, and intellects of the cooks and servers!

If a risk manager is attempting to improve identification of risks relating to achieving the financial plan or budget, it is not imperative that subject matter experts are persuaded of the value of such an endeavor. We may simply change the environment by adding a short section to the official "plan package" submitted to the finance department. It can be a page that asks for risks, challenges or factors that could lead to missing the plan or beating it. For each of those risks, the associated mitigations should be detailed. This tends to identify the higher likelihood and internal challenges most susceptible to early action or risk controls.

The above enables other concepts including: a) review of actual earnings versus plan and a comparison between root causes of the actual results and the before-the-fact list of risks to plan, b) quantitative modeling of the impact to next year's earnings for the risks to plan, assessment of associated mitigations, and a prioritized list for management or the board, and c) compensation tied to the quality, accuracy, or completeness of either of the previous ideas.

Another challenge in establishing risk culture is an employee's reluctance to suggest that a risk or mitigation under a superior's purview is problematic. This issue is often quickly solved by changing the environment; a risk manager might a) lead facilitated workshops with participants being decision makers from a

cross section of business lines or functional areas (without their "bosses"), or b) use anonymous surveys or voting.

THE ELEPHANT AND THE RIDER

The second surprise about change refers to exhaustion due to a struggle between two commonly opposed mental "factions." The Heaths describe two independent systems which are at work in our minds: the emotional side and the rational side. It is the emotional side which is instinctive, focused on short-term gratification, and feels pleasure and pain. The rational side is the more reflective and conscious aspect which deliberates and analyzes.

Social psychologist Jonathan Haidt likens the emotional side to an Elephant and the rational side as the Rider.[4] When there is a disagreement between the (much) larger Elephant and the Rider about which direction to go, the Elephant is going to win.

When a change management initiative causes the Elephant and Rider to disagree, the task at hand may seem arduous and stress-inducing. Asking people to change habits and provide new analysis or data for some eventual return requires cooperation from the Elephant. Our Rider may see the wisdom of the endeavor but this is exactly the type of situation that the Elephant will resist. It requires self-control and deliberate execution on the part of the Rider to control the Elephant intent on resistance. The critical point is that there is a limited supply of this self-control and it gets used up faster when the Elephant and Rider are at odds!

The agent of change should aim to harmonize the two potentially opposed forces. We must appeal to both the Elephant and the Rider.

The Heaths go on to say "if you reach the Riders of your team but not the Elephants, team members will have understanding without motivation. If you reach their Elephants but not their riders, they'll have passion without direction. In both cases the flaws can be paralyzing."[5]

1% LOW-FAT MILK HAS PERKS!

Two health researchers from West Virginia University were exploring ways to persuade people to follow a healthier diet. Past research suggested that vague instructions such as "eat healthier" did not typically lead to meaningful changes in behavior. The researchers often found themselves returning to the fact that milk was Americans' single largest source of saturated fat.

Rather than offering vague nutritional guidance they went for a simple message: switch to 1% milk. The marketing campaign was called "1% Low-Fat Milk Has Perks!"

The results showed a significant and persistent increase in the consumption of 1% milk. It was not that people were necessarily resistant to eating healthier; they simply needed concrete guidance. These events support the Heath's message that what looks like resistance may just be lack of clarity.

As a way to improve identification of risks to strategic execution and associated mitigations one may use a simple and fast survey to query business leaders on:

1. Critical business goals;
2. The necessary projects or sub-goals needed to achieve the goals in (1); and
3. Challenges, risks and factors that influence the execution of the projects and sub-goals in (2).

The above can be done anonymously if desired and the resulting information will point to key drivers of value and enable practical and intuitive steps toward risk appetite compliance and strategic risk management.

Clarity pairs well with brevity. Risk management expectations are best digested in small pieces. Consider a few one page company-wide communications. Keep things crystal-clear and streamlined.

BIG PROBLEMS SUCCUMB TO SMALL CHANGES

The post war restaurant problem described earlier is a striking example of how a minor change can solve a significant problem. Risk managers often cite ignorance or misunderstanding of risk management goals as a key problem. Anyone who has tried to implement a new risk process with someone who thinks of risk management as an extension of audit or feels the main goal is total elimination of risk will agree that education must play a part of the solution.

The problem is that leaders across a company's various business lines, functional areas, and geographies are not likely to ensure that their employees complete the training or retain its key messages.

One Fortune 500 company's risk management function requested a very small budget for a prize and then created a slide deck which was followed by a risk management quiz. The result was high participation rates, retained knowledge, and quick response times. The approved budget was just enough to cover the motivational prize of an iPad!

In some organizations, risk functions are asked to provide risk-based assessments of potential acquisition targets. Those involved in pitching the target company and forecasting of sales, expense synergies, profits, etc. can easily become emotionally

tied to the outcome. As the deal gets closer to final there is a tendency for them to view the deal through rose-colored glasses and a bidding war may result. Those in the line of business pushing for the deal may look very unfavorably on anyone suggesting potential downsides or that sales or synergy forecasts at optimistic at best.

In the above situation, a potential remedy is the designation of a "devil's advocate" among the group of internal experts. This person's role is to list key risks associated with the valuation, integration, and any other factors which may negatively affect the short- and long-term outcome of the proposed acquisition. The role can be made anonymous with the information provided directly to the risk management function.

Risk management departments are frequently striving for the Three Lines of Defense model. The main challenge to its implementation is that the frontline managers, subject matter experts and risk owners are the linchpin of the whole concept. In the case of risk identification and mitigation assessment, as part of an inventory or risk control self-assessment, it can be difficult to get quality updates of this information on a timely basis. This is a situation in which an investment in software and a one hour training session can solve the issue. Designate risk owners and describe the information to be determined, fields to be entered, and how to do it. Automatically generated email reminders should prod those who are late (and CC their superiors when needed!) and risk owners should have to proactively state when there is no change from last quarter's risk or mitigation assessment. It is important that the software also tracks changes, provides time stamps and lists the name of the person making the change.

Of course, money is often a driver of change. Some organizations attempt to measure the state or maturity of their risk culture and then link compensation to improvements in the various metrics. One might count the number of risks reported and updated in a timely and complete manner or track results of each operating division's scores on a risk management understanding assessment.

Finally, ego and competitiveness can work to your advantage. In *Influencer*, a story is told in which the agent of change proudly says, "We publish lots of graphs, charts, and tables. But none has been more influential than [*the race*] … we harness the natural competitive instincts of people by preparing a racetrack with the names of each country or even the faces of the [line of business] leaders on each runner."[7] When such a hypothetical race is shown to management and the board, line leaders ensure they are not embarrassed by their peers!

FINAL THOUGHTS

Any strategy for building a robust risk culture must reflect an organization's unique overall corporate culture, capabilities, resources, and risk profile. That being said, there are certain areas that must commonly be addressed to achieve success.

A McKinsey & Company whitepaper[8] describes four foundational elements for strong risk culture:

1. Transparency: ensure clear understanding and open communication of risk profile, risk appetite, and risk limits.
2. Acknowledgment: avoid overconfidence, challenge peer assumptions, be open to discussions about downsides, and learn from mistakes.
3. Responsibility: encourage proactive and timely response to risk manifestation or warning signs.
4. Respect: align incentives across individuals, departments, LOBs, and the enterprise to avoid attempts at "gaming" or "beating the system."

Armed with the weapons described in this article, a risk manager will have a fighting chance in the quest for robust risk culture. As risk management continues to gain acceptance as a value creator for organizations making decisions under uncertainty, the battle may well be easier for future culture warriors. ■

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ENDNOTES

1 http://www.nytimes.com/2011/09/24/business/global/at-ubs-its-the-culture-thats-rogue.html

2 Heath, Chip and Dan Heath. 2010. Switch. New York: Broadway Books.

3 Grenny, Joseph, Kerry Patterson, David Maxfield, Ron McMilan, and Al Switzler. 2013. Influencer. New York: McGraw-Hill Education.

4 Haidt, Jonathan. 2006. The Happiness Hypothesis: Finding Modern Truth in Ancient Wisdom. New York: Basic Books.

5 See *supra* note 2 at p. 8.

6 https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5175990/

7 See *supra* note 3 at p. 234.

8 http://www.mckinsey.com/business-functions/risk/our-insights/taking-control-of-organizational-risk-culture