Science of Culture

Can risk culture be taught? There is no lack of advice, methodologies, frameworks and tools for corporations seeking to instill risk-aware values and better governance.

By Katherine Heires

The News Corp. phone hacking scandal that flared this summer, and that caused founder and CEO Rupert Murdoch to be summoned before the British Parliament, brought the term “corporate culture” into the media mainstream, along with commentaries about apparent breakdowns in governance, risk management and other safeguards against costly or wrongful behavior. Similar lapses have been exposed in the aftermath of headline-making disasters such as those of the Fukushima nuclear plant in Japan, the Deep Horizon oil rig in the Gulf of Mexico and the Massey Energy mining accident in West Virginia.

That same type of criticism hit home in the aftermath of the financial crisis. The Institute of International Finance, among many others, cited cultural failures, and specifically those of risk culture, as a leading cause of the credit and liquidity crisis of 2008. Switzerland-based UBS, in an October 2010 accounting to shareholders of its crisis-period losses, admitted to “organizational shortcomings and the lack of adequate controls inside the bank.” As a result, many provisions in post-crisis legislation and regulation were intended to tighten governance and risk management principles and standards.

Now management science is having its day. Corporate consultants have sought to analyze, assess and gain a better understanding of culture and its essential elements. They are delving into how organizations can best build and embed effective “corporate risk cultures” or “risk management cultures” that discourage negative, harmful or illegal behaviors while also having a positive effect on the business.

Such efforts to define and systematize risk culture have been undertaken despite the fact that many companies do not even use the term when addressing operational and behavioral problems. Risk management experts, however, believe that risk culture, in the sense of how well organizations are equipped to deal with problems, competition and business pressures on a day-to-day basis, is ripe for further study and analysis.

New York-based governance research firm Governance Metrics International (GMI), for example, has more than 100 corporate clients interested in its ESG – environmental, social and corporate governance – performance ratings, which to some degree take risk culture into account, says CEO Jack Zwingli.

“There is a growing belief among institutional investors that they need to look past financial results and examine corporate governance practices, including the risk management practices of the board and whether or not they encourage inappropriate risk taking,” says Zwingli. GMI’s analysis is designed to determine what corporations may have the riskiest cultures and, thus, the greatest probability of facing litigation or public embarrassment a la News Corp.

Characteristics of Culture

“It is rare that clients come to us and say they need or want to change their risk culture,” notes Chris Thompson, North American lead for risk management consulting services at Accenture in New York. “It is more common for people to ask for assistance in how to be better at taking risks or how to be better able to take on even more risks.” The term “risk culture,” Thompson says, is more common in the context of mergers and acquisitions that require two cultures be melded. For those needs, Accenture offers a cultural assessment tool kit for companies coming to grips with their risk appetite and risk culture.
When we talk about risk culture, we are talking about firms that knew how to take the right amount of risk so that while they are avoiding bad things happening, they are also driving innovation," says Thompson. “Firms with effective risk cultures are taking the right amount of risk,” and in a balanced way.

In advising clients, Accenture defines risk culture in terms of six key attributes. Among them are: the degree to which accountability for risk management is clearly defined, the clarity of risk management tasks, and the level of understanding of compliance with regulations and procedures; and the degree to which risk management is integrated into all activities, including resource allocation, planning, budgeting and measurements as well as documentation, procedures and processes.

Third is the degree to which leadership for risk management is clear or visible: Are leadership skills cultivated? Is there openness and communication about risk management issues? The fourth attribute is the degree to which risk management is learning-driven, including whether or not learning about risk issues is facilitated and a questioning attitude encouraged.

Accenture’s fifth attribute is the degree to which there is a clear process for effective risk management: Does the whole firm have risk awareness? Is there a fear of reprisals that might have a chilling effect on employees? The sixth is whether or not incentives are geared toward the best interests of the enterprise: Is compensation aligned with the risk strategy? Does risk management have a role in approving risk-adjusted compensation measures? Do incentives promote long-term, risk-conscious behavior?

Thompson concludes by saying, “At all times in your business, you want to take the right level of risk and make sure that when you are taking risks you are doing so in an area of your core competencies. That is what we see companies have gotten wrong of late and hope to redress.”

Flexible and Customized
Carrel believes in firms-wide risk cultures that are flexible, customized and reflective of their respective risk appetites. This entails disseminating risk exposures and sensitivity to all groups and in a way that ensures that managers fully comprehend the activities, including resource allocation, planning, budgeting and measurements as well as documentation, procedures and processes, and the degree to which risk management is integrated into all activities, including resource allocation, planning, budgeting and measurements as well as documentation, procedures and processes.

Post-Crisis Response
As executive vice president of governance, risk management and compliance advisory services at Thomson Reuters, Philippe Carrel has spent the last three years meeting a great many CIOs and CROs in a variety of fields and advising a broad range of companies on how to improve their risk management efforts post-crisis. The questions he is asked are diverse, but, to Carrel, the road to improvement converges inevitably on risk culture. His book on the subject, “The Handbook of Risk Management: Implementing a Post-Crisis Corporate Culture,” was published in 2010 by Wiley Finance.

To inculcate an effective risk culture, “you need to do what we call to take the right amount of risk so that while they are avoiding bad things happening, they are also driving innovation,” says Thompson. “Firms with effective risk cultures are taking the right amount of risk,” and in a balanced way.

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It has to be designed to overcome the different and sometimes inconsistent processing methods serving various silos of information; it has to be able to compute the sensitivity of exposure from all sources under a single scenario; and when risk policies are translated into quantified risk targets for the various business units, the technology must be capable of sending triggers and alerts to the relevant unit managers, allowing them to react in real time to any unwanted or excessive exposures.

Where do risk managers fit in this picture? According to Carrel, when each business manager becomes a risk manager—not only in front-line settings, but also in the back office, senior management, legal and administration departments, production units and IT—the traditional mission of the risk management department evolves into fostering the culture of risk management, providing coaching and education on how transactions are processed, how business is negotiated and relationships are handled; how employees are trained and rewarded for their work; how risk exposures and sensitivities do not merely rest on amounts and figures. Risk is a changing geometry, an adaptive complex system. In turn, the process of mitigating and controlling exposures does not leave us with a static, defined formula; it is a changing process. What is right now can come back and appear different tomorrow, and risk exposures and sensitivities do not merely rest on amounts and figures. Risk is a changing geometry, an adaptive complex system. In turn, the process of mitigating and controlling exposures does not leave us with a static, defined formula; it is a changing process. What is right now can come back and appear different tomorrow, and when risk policies are translated into quantified risk targets for the various business units, the technology must be capable of sending triggers and alerts to the relevant unit managers, allowing them to react in real time to any unwanted or excessive exposures.

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