RISKINSIGHT

Q&A on risk management and decision-making

Interviewer: Gareth Byatt – Principal Consultant, Risk Insight Consulting
Interviewee: Anette Mikes – Professor at HEC, University of Lausanne

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Anette,

Thank you for taking the time to talk with me about your research into how people, and, by extension, organisations take and manage risk. There is lots to discuss in this field, and I am a keen follower of your research.

Gareth: You have been involved in award-winning research into risk management for several years. I'd like to start by discussing the research you co-developed with Professor Robert S Kaplan at Harvard which was published in the HBR June 2012 edition and titled ***Managing Risks: A New Framework***. Like many people around the world, I enjoyed reading it. It was very useful for me when I was a Group Risk Manager back in 2012, working on a Risk Framework for a global organisation.

To summarise the article in a very broad way, you suggest categorising (if that is the right term) risks as preventable, strategic and external, and you focus quite a bit on the challenges we face in trying to manage risk – many of them being behavioural and cognitive challenges.

Looking back, how has this research that you conducted influenced the work that you continue to undertake into risk management, and since publishing this research have you seen some examples of how people have applied it to good effect?

Anette: *This article was the first in a series of studies in which Bob Kaplan and I argued that in the world of risk management one size does not fit all. We should be wary of those who recommend "universal solutions" that should be applied in all circumstances. We proposed that risk management would be most effective when it matches the inherent nature and controllability of the different types of risk the organisation faces. Our conclusion was that effective risk management "depends"; it is contingent on the organisation's context and circumstances. Over the years we have offered several ideas about what risk management likely depends on, thereby hopefully helping practitioners to design and tailor their own risk management processes and tools.*

My recent focus has been to look more closely at a phenomenon I call the "Ethical Turn" in risk management. It has its own design and behavioural challenges, so my previous work informs this research greatly. But there is a new dynamic set in motion too, which we have not seen before.

For example, in the wake of the 2007–2009 financial crisis and in subsequent rate-rigging, money-laundering and other corporate risk management scandals, there has been a growing recognition that what had gone wrong can neither be understood nor prevented without considering what had gone ethically wrong. Accordingly, there are also normative calls for risk management to provide a systematic analysis of the ethicality of individuals and/or organisations.

Risk managers will have to ask questions they had never asked before: for example, are the demonstrated company priorities and values in line with the espoused values? Investors are also taking much more notice of corporate responsibility claims, so for example if a company highlights sustainability in its press releases, annual statements, and marketing campaigns, investors (and customers) actually will want to know if those companies walk the talk and correctly measure and monitor it.

Amoral management is no longer welcome, which makes hypocrisy an enterprise risk. Consider the pushback on amoral risk management that was part of the media outrage after Australian oil and gas company Santos had admitted that its business plans were based on a climate change scenario of a 4°C rise in global temperatures—that is, twice the level considered safe by scientists. In 2015, Shell was also called out for pursuing a business strategy based on 4°C warming. Accusations like this—coming not from muckrakers but from investors or shareholders—are a new development in governance. An Ethical Turn in risk management looms, focusing the attention of boards and executive teams on a plurality of ValueS at Risk, rather than a single or composite—and primarily financial—Value at Risk.
Is this Ethical Turn for real? It is. Some practices of risk management, particularly those that supposedly operationalize "risk appetite" and influence "risk culture", can no longer sidestep ethics.

Gareth: How people view and perceive risk is interwoven into this HBR article. As an example, you talk about how people often over-estimate their ability to influence events, and that we also tend to be over-confident about the accuracy of our forecasts and our risk assessments – that, in fact, these assessments are often too narrow with the range of outcomes that are considered.

Has your research uncovered things we can do to improve our ability to see risks for what they really are, how to guard against over-confidence and how to improve our forecasts and our ability to estimate a true "range of uncertainty" to the risks we face?

Anette: *Let me return to the pressing example of the climate risk, which, as a result of the work of the TCFD will be more and more prominent in risk management. The issue is a major blind spot for many carbon-intensive companies – and I think it is to a large extent a behavioural challenge to truly confront climate risk and all that it entails. In the examples I mentioned, it was not clear from Santos' or Shell's response whether they were even aware of the ethical dimension of betting on—and helping to bring about—a more carbon-intensive future. Similarly, there are behavioural biases at play when a firm is acting on a scenario that is most favourable to itself (a self-serving focus bias), but it neglects the possibility that such an action may have an ethical dimension and downstream consequences on other stakeholder (selection bias). Thus, a way of seeing risks becomes a way of not seeing, which can, in turn, cause the ethical dimension to fade or disappear from the risk discussion or even never to appear in the first place.*
My research focuses on new tools and processes to frame risk discussions in ways that allow a plurality of stakeholders and values at risk to be considered.

Gareth: I was interested to read your ACA award speech for winning the ACA prize in Financial Governance 2017 "Values at Risk: The Need for an Ethical Turn in Risk Management**"** published in November 2017 on ResearchGate. Congratulations on winning that prize, by the way!

You mentioned in your speech a dichotomy you see – that many organisations have run into problems resulting from reckless risk-taking, yet innovation requires risk-taking, so taking the right risks while staying in control is an important challenge of managerial life. Coupled with this, your work with risk managers has covered how they need to be "contributing members of the organisational tribe" without "going native." This includes the need to sometimes "call things out", whilst being integrated into operational activities.

Have you seen any repeatable behaviours and actions that risk managers can adopt and apply to find the right balance to achieve this? What role does organisational culture play in this?

Anette: Thank you.
I often have to remind people that risk management is not just about stopping folks taking bad risks but also about enabling them to take good risks. That requires better knowledge of the risk itself, including any hidden risks and unwanted downstream consequences (cultural, environmental, political, and the moral dimension, of

course). M&A activities are a good example: we shouldn't just focus on the added value and savings possible but take account of the difficulties involved in merging two different corporate cultures, the reaction of clients and suppliers, the likely upset internally in each company, and generally, so that the difficulties of "integration" are not assumed away but confronted with courage. If we do those things well, then the chances of success are far greater.

Gareth: In 2016 you published a paper titled "Risk management: Towards a behavioral perspective".

In this paper you discuss Enterprise Risk Management and the value that it brings, or not as the case may be (with good and bad examples cited). You argue a point in this paper that is particularly interesting to me: that risk management studies could – and should – address a key behavioural concern: *can risk management counter the individual and organisational biases that can inhibit constructive thinking about risks?*

I'd love to hear your views on how we can combat the individual and collective biases that lead to so many organisations overlooking or misreading ambiguous risks (I think this has a few linkages to the question we just discussed).
In this paper you discuss, for example, how budget and time pressures create an environment where people can become inured to risks and accept deviances and near misses as false alarms or the "new normal", and that people may double down on previous decisions and actions, "throwing good money after bad." In groups, *groupthink* all too often arises when individuals suppress their own objections and fall silently into line with the prevailing opinion.

Anette: *Ignoring errant behaviour, irregularities and anomalies pervades modern organisations. By pressuring employees to "buy into" particular ways of seeing and doing things, managers might reap some rewards in terms of increased focus and efficiencies – but only in the short term. In the long run the result is, at best, an illusion of control, or, at worst, a kind of "organisational stupidity" that leads to disaster.*

Only when employees start thinking again, only when they reflect and ask questions about the purpose and means of their work, can they fend off organisational stupidity.

There is another related point. People are tribal beings. Most of us want our "tribe" to be successful and act according to the priorities they perceive to be important in our tribe. In an organisation this means that subcultures can emerge with their own value systems that may not be aligned with the espoused priorities set by the board but with the ones they see their colleagues adopting and getting rewarded for in everyday behaviour.

When "lived priorities" are out of kilter with espoused values, risks quietly and inevitably incubate. The only way to avoid such value confusion is to anticipate it and pay attention to what actually goes on: actions speak louder than words. There are now tools and processes that allow managers to detect and visualise gaps between espoused and lived values.

Gareth: You are working on a project called “Risk Talk” at the moment – which I think is strongly linked to the points we have just discussed. In your LinkedIn article “RiskTalk: Can a better conversation fend off disaster?” you talk about how an excessive and uncritical use of certain kinds of risk management vocabulary and technology could invite risk rather than prevent or manage it. If I understand correctly, the essence of Risk Talk is to have a constant organisational discourse about risk issues in a practical and inconspicuous way.

Could you explain a little more about the Risk Talk initiative and how it can add value to organisations and individuals?

Anette: *Much research shows that risk incubation eventually leads to disasters – and that man-made disasters are caused not so much by strategy or external risks, but by preventable risks. When I recognised this, and read studies arguing that the extent of man-made disasters is increasing exponentially, it became clear to me that we are not nearly as good at managing preventable risks than we would like to believe. How are we supposed to get to grips with the purportedly even more challenging strategy and external risks if we are not good at dealing with risks that are preventable?! It is very frustrating, but we need a “back to the drawing board” approach if we are to beat risk incubation.*

Talking about preventable risks, my research shows the importance of “risk talk” — an organisational discourse about risk issues, which could be so practical and so inconspicuous, that participants do not even realise that they are engaging in risk management.

Bringing about risk talk is not easy. People need to see the sense in it. Technology can help – but requires careful design. A common problem plagues formal reporting systems: risk managers can get inundated by a tsunami of un-prioritised issues or risks – or else, when employees are asked to carry out “risk assessments”, reporting proclivity plummets, given that most people find risk assessments too abstract and difficult to do.
Applying this insight, we developed a simple reporting application, backed by a powerful control (back office) tool, called RiskTalk.

It is a “vox populi” tool: an application which allows employees to speak up - anonymously or not – when they encounter an anomaly. The new things we ask them is to link the reported issue to the relevant value(s) or priorities of the firm that are affected. It takes less than a minute to log, photograph, and submit an issue/risk by an employee’s on their phone and channel it directly for action. The back office team prioritises it, allocates it to the right department, confirms this back to the reporter and monitors follows up.
For the organisation, core values are re-enforced, data analysis is facilitated, and communications are improved. Training is minimal (typically under 1 hour) and no extra staff is required. As we say (echoing a current safety campaign on the London Underground) ‘See it – Say it – Sorted’.
For Swissgrid 300 reports were logged and resolved in the first year, some with life threatening potential. As the CRO says: ‘RiskTalk helps me sleep at night’.

For non-safety critical companies, the benefits are more about giving employees a voice and living the company's espoused values.

Gareth: Lastly, I'd like to finish this interview by asking if you are following any particular thought leaders on risk management at the moment, whose work people reading this interview may find of interest.

Anette: *I am not so much a follower, but a reader… I can talk about two books that have influenced my thinking recently:*

First, the provocatively titled "The Stupidity Paradox" (2016), in which Mats Alvesson and Andre Spicer warn that a dangerous degree of unintended stupidity is sweeping into organisations. The dynamics they describe and explanations they offer are not new to me – they are the very phenomena that I encourage risk managers to push back on! But I love the book's courage to call a spade a spade, and its implication that risk management is ultimately about "anti-stupidity management". If you are a feisty risk manager, this book is a rallying cry.

My current favourite book is Robert Sapolsky's magnum opus Behave (2017). It's gloriously ambitious in asking the ultimate question every risk manager should seek to understand: why do humans behave the way they do? What makes us tick? The answer is complex, but Sapolsky tackles that complexity the way you peel an onion: layer by layer. This book is a great companion to every thoughtful risk manager who wants to be truly reflective and treat their job as an intellectual adventure.

Thank you very much for your time, Anette.