



■ Risk Management

Changing the way you look at risk

By Mark Q. Smith and Craig Mindrum

Most corporate risk managers are more concerned about potential catastrophes and financial risk than about operational risks like fraud and mismanagement. As recent events have shown, such inattention can be fatal. Is it time to change your company's risk management culture?



The title of a recent Accenture study, “Business in a Fragile World,” seems to capture the current mood of uncertainty perfectly. War and terrorism, economic gloom, corporate mismanagement and failure, plummeting markets: If companies weren’t focusing adequately on risk management before, they clearly are now.

But as the world has changed, has the concept and practice of risk management changed along with it?

It’s human nature to use the tools and approaches we know best and that have been effective in the past. But are they still the right tools for the right job? Maybe not. It’s a little like the New Yorker who lost his wallet on 54th Street but was looking for it on 42nd. Why? Because the light was better.

So where is the risk management light the strongest these days? In the area of high-level financial, strategic and hazard risk. For example, the CFOs of most companies, especially in the financial services industry, have at their disposal advanced thinking and increasingly sophisticated computer-based tools to monitor and manage financial risk. Resources companies and insurance companies can do complex calculations about potential hazards and catastrophes.

The light doesn’t shine quite as brightly, however, for the day-to-day management of operational risks, which can lead just as surely to business problems and failures. For the most part, corporate risk managers have not yet applied the same sophistication embedded in their financial and catastrophe risk management disciplines to the task of managing operational risks, which are generally those associated

with the daily interaction among people, processes and tools as an organization works toward a goal. In 2002, in an effort to encourage debate and help close the gap between theory and reality in the field, Accenture embarked on a research and cross-industry benchmarking study focusing on operational risk management.

Our research confirmed the premise that operational risk management is, for now, at a less mature stage than financial risk management. However, the companies that were our benchmarking partners in this study were able to offer a number of important principles, tools and approaches that can be used to manage operational risk more effectively.

Sense of urgency

More significant, perhaps, our benchmarking partners shared a general sense of urgency about this subject. They were concerned in particular about the potential threat that lower-level operational risks increasingly pose to a key corporate asset: the brand. Although hurricanes and earthquakes can damage bricks and mortar, and interest rate and foreign exchange fluctuations can wreak havoc with the balance sheet, they seldom threaten a company’s brand. But given the recent experience of a certain brash young energy trading company, inattention to the risk of fraud and mismanagement can be fatal to the brand.

Clearly, a company’s operational risk management must be designed with brand equity risk foremost in mind. All executives—indeed, all personnel—must understand exactly what the stakes are.

An effective approach to operational risk management is based on three

overarching principles. (For a more detailed look at the process of managing operational risk, see page 34.)

Develop the capability to anticipate risk

One of the obvious principles that informs the more mature fields of financial and hazard risk management is *anticipation*—preventing situations from happening, or at least establishing procedures ahead of time for dealing with them if they do happen. It's surprisingly easy to overlook this basic principle, however, when it comes to operational risk.

Indeed, managers at one company in our study came to the realization that, in practice, they often were not managing risks at all. Consider this example. A team is working on a project—a new product release, perhaps, or the creation of a new information system. Team members meet each Monday morning to discuss events of the previous week—challenges that came up, what was done to address them, and how they will affect the budget and delivery dates. Are they managing risks effectively? Not really: They are managing problems or issues, but not risks.

Most companies do, in fact, have well-defined procedures in place to identify and track risks at the operational level. Here's what they usually do:

- Identify possible risks against standard categories or with a checklist of known risks.
- Assign a numerical value to its likelihood and its severity.
- Assign responsibility for managing each risk to a function, a department or a person.

Sounds great, right? Too often, however, this approach doesn't work particularly well. Why not? In part because of the pressures of the day: People end up putting out fires instead of preventing them. But it's also because the anticipation of operational risks is actually a capability in its own right and, as with all capabilities, it must be developed in managers (see box, page 36).

Manage risk in the context of specific goals

If organizations need to focus on developing operational risk management as a capability, they must also help their people consider risk management in the context of a clear objective or goal. Here is where traditional risk classification systems may inadvertently put organizations on the wrong path.

Different goals entail different risks. And by thinking of risk first in terms of goals, companies can set up risk identification and mitigation procedures, or improve their existing ones, so that risks become more relevant and real. Consider the following three categories of goals. (The goals we describe here are not exclusive, and different companies may define their goals differently.)

- Execution goals: delivering a project or program; developing new products and services.
- Relationship goals: maintaining effective relationships with customers, clients and business partners.
- Opportunity goals: developing new business, opening new markets, expansion, new prospects with customers or clients.

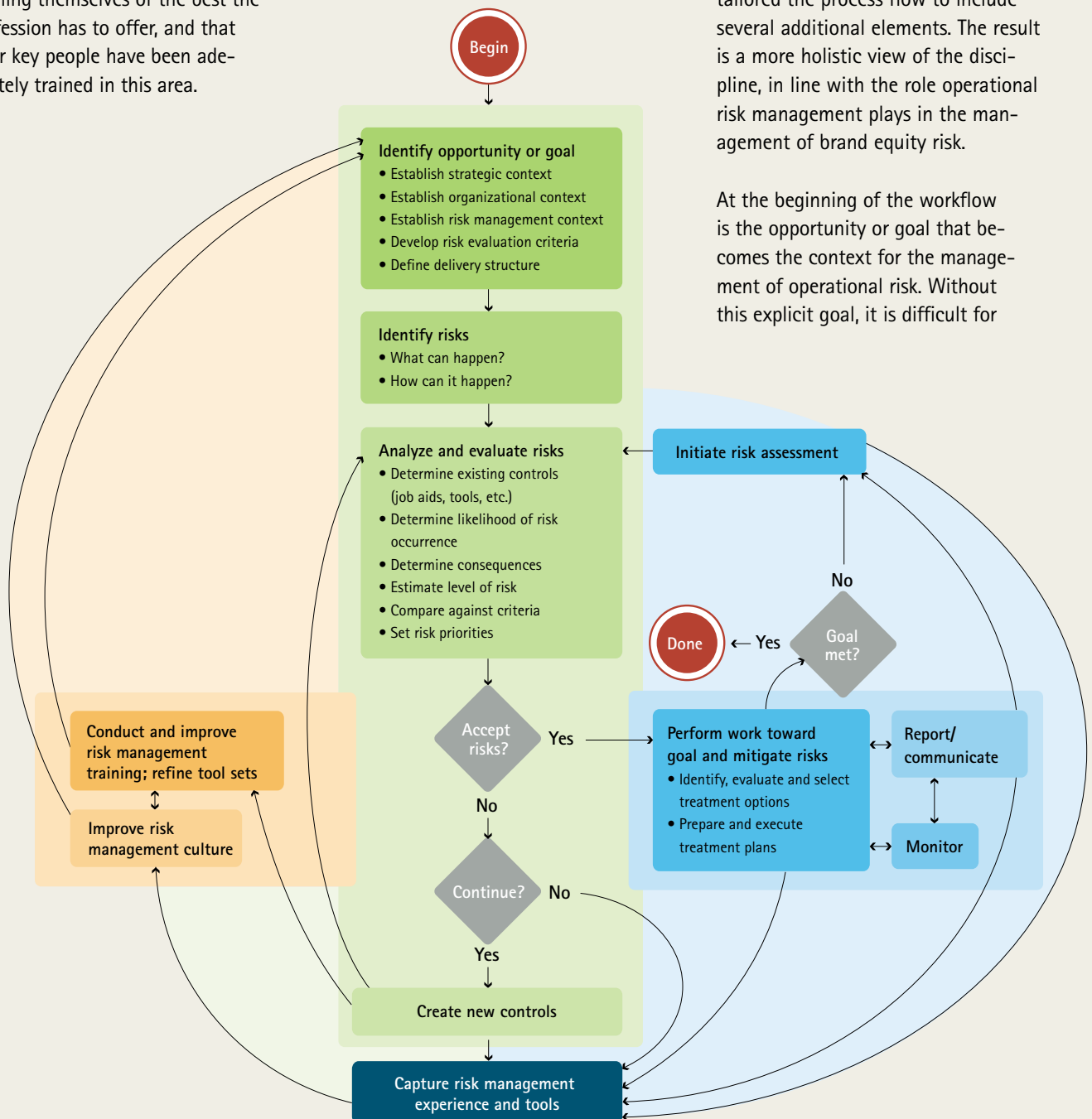
Managing risk: A holistic view

Although the discipline of operational risk management lags behind financial and hazard risk management (see story), there exists a great deal of sophisticated thinking about how to bring rigor to the practice. Companies would do well to ensure that they are availing themselves of the best the profession has to offer, and that their key people have been adequately trained in this area.

For example, consider the standard for risk management developed by two of the world's leading standards organizations, Standards Australia International and Standards New Zealand. A joint committee from the two organizations devised a systematic, cross-

industry approach to identify, analyze, evaluate, treat, monitor and review risk. As part of an Accenture benchmarking study of operational risk management, we began with the Australia/New Zealand standard and, based on interviews with our partners, tailored the process flow to include several additional elements. The result is a more holistic view of the discipline, in line with the role operational risk management plays in the management of brand equity risk.

At the beginning of the workflow is the opportunity or goal that becomes the context for the management of operational risk. Without this explicit goal, it is difficult for



an organizational culture to focus properly on the tasks necessary to manage risk effectively.

Once the goal is clearly identified, those involved most closely with the work identify, analyze and evaluate the associated risks. Then comes a big decision: Are the risks manageable enough so that work toward the goal can continue? Are risk mitigation plans in place, or do team members need to create or locate new ones? The implicit lesson: Leave yourself an out; don't be afraid to walk away.

As a team works toward its goal, it owns the management of risks from a project viewpoint. But in the interest of balance, the process should also include an element of integrated oversight. Project activity may trigger a regular external review by a quality team, for example. Reporting and communication take place both from the project team perspective and by the oversight review.

Finally, all experiences, reports, new techniques and communications are captured and fed back to the organization in the form of new training and explicit efforts to improve the risk management culture.

Why is this risk management process flow important? Its primary value is to give the entire organizational culture a set of concepts and a common vocabulary to deal with risk. In addition, the process flow makes it easier for companies to perform either a quick assessment or a more in-depth diagnostic about how efficiently they are dealing with various components within the workflow.

Our study showed that of these three types of goals, managing risks during project execution is the least mature. This somewhat surprising point was well made by one of our benchmarking partners, an investment bank. This company has, of course, highly sophisticated tools for tracking in real time certain financial risks (in equity trading, for example). Yet the factors that pose risks to project execution are not as tangible. They can range from the emotional well-being and morale of the project team to the effectiveness of the business vision behind the project to the ability to track the project's inner workings so that corrective actions can be taken. A number of tools on the market provide analysis and simulation of execution or project risk. However, these tools are often limited by the subjective input of information about risk volume, exposure and severity. So the subjectivity inherent in the risk tool can itself become a risk, if relied on too heavily.

Full participation

Achieving relationship-oriented goals often involves the early participation by all concerned parties in the identification and management of associated risks. One of the best practices identified in our study is one used by a major software company. For high-impact special projects, especially those involving a number of clients, company employees and vendors, the company will run a risk management workshop lasting several days. Although the explicit objective is simply to identify the areas that need the most attention by the extended project team, the unspoken goal is just as important: overcoming the initial distrust of parties that have, at the least, competing agendas and are, at worst, actual competitors.

In the field of risk management, opportunity is often talked about in terms of “upside risk.” That is, the risks associated with *not* seizing an opportunity to move into a new area or to make a new kind of deal. In this sense, opportunity is, in many respects, the great unknown.

A company may have a structure in place to support its people in their attempts to meet strategic goals. But does that structure also support their work in expanding those goals? In moving into new opportunities? It can be difficult to tell, because the structures that help companies succeed at one level may impede their ability to succeed at the next. In this light, one of the observations from a benchmarking partner in our study is instructive (and comforting): Effective operational risk management procedures, when implemented well, do not restrict a business or its growth; in fact, they make that growth possible.

Create a culture in which risk management is everyone's job

Another common problem cited by our benchmarking partners is that

people within an organization tend to conceal operational problems until they get out of hand. Call it the “hide-and-seek” syndrome. As one of our benchmarking partners put it, “If there is risk occurring, and my job is to find it and you think your job is to hide it, we’ve got a dysfunctional system on our hands.”

More often than not, however, this breakdown is the natural consequence of a system that has assigned risk management to specific individuals or teams. If the responsible person raises a concern, will this be perceived as an indication that he or she cannot solve this problem alone?

On the other hand, it doesn’t necessarily work when executive management takes a Big Brother approach. For example, one of our benchmarking partners uses the concept of project oversight lists to identify projects of particular importance to the organization. In practice, however, the leaders in charge of those projects do not want to be on those lists, because they perceive that “honor” as one that just means more work and hassle.

Anticipating operational risks: A simulation tool

How can companies increase their ability to anticipate issues and therefore manage risk better? Consider one simulation tool developed by Accenture and used for workshops and educational purposes.

Built according to the principles of system dynamics (that is, on the complex set of causes and effects that come into play, for example, in ecosystems), the tool allows a user to create a computer model of the social environment of a project (including “softer” factors like clarity of vision, employee burnout and morale, and team experience). Based on the model created by the user, the tool simulates the performance of the project against schedule and budget. Then the user can go back in and adjust the settings of the model to see what impact different leadership actions could have on the success of the project. The tool is not a predictor of success; its primary benefit is in teaching leaders to anticipate the sorts of complex factors that can derail a project team.



The lesson: Adequate reporting and oversight from leadership is not enough. Companies must also create a culture in which individuals have the capability and the responsibility for managing risk. The chief audit officer of one of the companies in our study put it quite well: “I see my ongoing responsibility as one of making myself less and less important.”

Striving for balance is key here. One recommendation we made to the company whose leaders were not eager to be on project oversight lists was to redefine those lists so that they didn’t mean more work, but rather that more resources and expertise would be made available because of the importance of their project. Instead of focusing exclusively on oversight, such an approach would signal that the company was there to support its people in their effort to take ownership of risk management.

To be sure, we don’t believe that such a change will transform the oversight list concept overnight. But it does underscore the importance of working with the culture to manage risk, rather than overseeing the work like a schoolteacher during final exams.

One thing that encourages broad ownership of risk oversight is the concept of “attentiveness.” Companies that are effective at managing operational risk have built rigor and watchfulness into their processes, structures and tools. For example, one interviewee stated that the reason his project had been so effective at managing risk was that “our supervisor simply demanded that our risk logs be on his desk first thing every Monday morning.” Sound obvious? Sure, but according to our study,

it’s a technique more honored in the breach than in the observance. Companies need structures and procedures that ensure that there is 1) less need to hide and 2) no place to hide.

The challenge then, as is so often the case, is primarily cultural. This, too, was affirmed by participants in the benchmarking study. A simple cultural diagnostic showed that, for those taking the survey, the primary gaps between current capabilities and where the company wanted to be with regard to operational risk management were in culture-influencing areas such as knowledge capture and sharing, learning and training, and continuous improvement.

Companies today must infuse the entire organization—every employee, every function, every level—with the responsibility to manage risk. And they must provide the right mix of leadership, processes and tools to support people as they perform their jobs and as they both enrich and protect the brand. ■

This article is based on the findings of an Accenture benchmarking study, completed in August 2002, on operational risk management practices. The authors served as project director and research director, respectively, for the study.

Mark Q. Smith is an associate partner in the Accenture Financial Services operating group, where he serves as global director of quality. In this role, he focuses on client satisfaction, operational risk management and business process improvement. Mr. Smith is also responsible for maintaining external quality certifications for the group. He is based in London.

mark.q.smith@accenture.com

Craig Mindrum teaches organizational change and ethics at DePaul University in Chicago. As a strategic management consultant, he works closely with Accenture in the areas of workforce performance, organizational change and the effects of technology on human performance. Dr. Mindrum has studied risk management best practices for large, complex development projects, and he also directed the creation of a simulation tool for Accenture to teach anticipatory skills in managing risk.

cmindrum@depaul.edu