Riding the risk and reward seesaw

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- Culture plays a significant role in bringing the risk appetite to life across the organisation.
- Boards are still grappling with how to strike the right balance between risk taking and avoidance and to define the sandpit for this test and learn environment.
- Monitoring of cultural indicators and being alert to red flags allows for the early detection of subtle changes which may create or increase specific risks.

Balancing risk and reward is a topic at the front of mind for directors, executives and governance professionals everywhere.

Too much risk and the organisation could suffer financial, regulatory or reputational issues. Not enough and the consequences can be sizable including missed business opportunities or perhaps inadequate or untimely responses to changing market dynamics. With ongoing disruption across multiple industries and global political uncertainty, boards are discussing how to mobilise their organisations to take advantage of innovative business opportunities. At the same time, they fear the fallout from getting it wrong, particularly in this day of instant news where the financial and reputational impact of decisions can be felt instantaneously.

The culture of an organisation will shape how risk frameworks, including the risk appetite, translate into daily work practices. This includes how staff interact with customers and each other and how they apply and use organisational policy, processes and tools. A healthy culture is more than a line of defence against risk events occurring. It provides a competitive advantage in facilitating informed risk taking. The fundamental attributes of a healthy culture — sound leadership, well defined accountabilities, consistent communication, constructive challenge, appropriate rewards and consequences — create an environment in which risks are assessed, planned for, managed and mitigated. The culture of the organisation fosters good governance and risk management, acting as the 'guard rails' for decision making and judgment. It reduces the reliance on risk appetite and policy frameworks to anticipate and provide for every set of circumstances confronting employees and the leadership team. It is the culture of the organisation that needs to guide employees to do the right thing.

Five panels were held across the country as part of Governance Institute's Corporate Governance Forums and insights were shared from current directors, chief executives, chief risk officers, heads of governance and consulting professionals. The themes and highlights from the sessions are outlined below.

Considerations for risk appetite

A well-articulated risk appetite which is aligned to strategy is an important first step. It should be a living and breathing document which guides the organisational response to taking, avoiding and managing risk. Clear measures of appetite, financial and beyond, are important to ensure all leaders can align behind the organisation's direction (as opposed to setting a direction of their own). For example, it should include statements about events and activities for which there is a zero tolerance (harm to employees as an example). A risk appetite with positive statements can also help an organisation help steer what risks to take. The risk appetite

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and its associated measures need to be discussed, monitored and refined on a regular basis.

Culture plays a weighty role in bringing the risk appetite to life across the organisation from the boardroom to the frontline of the business. Leadership, communication, challenge, reward and consequence all influence how the risk appetite statement transforms into work practices to achieve the desired outcome. For example, the risk appetite needs to be translated into simple messages aligned to the work an employee is responsible for. It is easy for staff to 'tune out' when using complicated risk language. Basic ethical principles such as what is good for the customers and employees and the 'newspaper' sniff test are easily understood and applied by all.

The dynamic of how a culture of innovation can be encouraged as part of a positive risk appetite was also a key discussion point. It is important that employees test and learn and fail fast in a protected way. The open sharing of mistakes and lessons learned enables a culture to thrive and be creative. Staff look to the leadership and the board to support a climate of openness and learning. Boards are still grappling with how to strike the right balance between risk taking and avoidance and to define the sandpit for this test and learn environment. Organisations need to find efficient ways of decision-making to enable faster growth, deal with disruption and drive innovation without losing the level of oversight required.

The importance of leadership

Leaders, from the board and executive through to direct supervisors, play a fundamental role in how risks are managed within organisations. Leaders set the tone, direct, coach, give feedback, reward and reprimand staff. The actions and decisions of leaders are under continuous observation both consciously or unconsciously. They need to walk the talk including ensuring consistent application of consequences for good and bad behaviour.

Middle managers were a topic of discussion at the panel sessions and they were identified as key influencer of culture. It was viewed that developing their leadership capability will correlate to an improvement in the organisation's culture. Specific training on both culture and ethics has been a focus for senior and middle managers across many organisations.

A true picture of culture and how to use it

It is not always easy to see the difference between the desired culture and actual culture — what is written in a value statement compared to what is happening as part of the 'norm'. Culture is hard to measure and it is more than a feeling or intuition. It requires quantitative data and qualitative narrative gathered from employees and other stakeholders. Regulators, shareholders and stakeholders expect boards to have a current view on their culture and to consider it as they make key strategic and operational decisions.

It was acknowledged that quantitative metrics already reported can highlight specific issues when viewed through a 'culture lens'. They are often contained in board reports but to bring them together can help paint a more complete picture. Metrics could include the time to close customer complaints, overdue audit and regulatory issues, social media themes, diversity and retention statistics just to name a few.

However, it is not enough to use only quantitative metrics. Ultimately, does the board feel as though they have the true picture of what is going on in the organisation? In the measurement of culture, boards and leaders takes great comfort in annual engagement survey outcomes. The point was well made that engagement surveys are different to cultural health surveys and the results need to be carefully considered in terms of high engagement versus the attributes of a healthy culture. Other methods that will add colour and depth to the cultural narrative can include workshops, interviews and customer feedback.

A periodic independent perspective on culture is important as complacency around the current state can set in and cultural shifts may not be noticed. In addition, the real narrative may be hard to obtain if workshops and improvement programs are always run internally as staff may not be honest due to fear of repercussions.

The role of the risk function and policy

The risk team needs to play an active role in monitoring risk taking but they should not be viewed as the 'police officers'. They need to be part of management responsibility to monitor limits. Partnering with the business can be challenging, as can presenting an independent perspective as part of the broader strategy and decision making. Nevertheless, these are key elements of the risk team's role. The willingness of the business to come to the risk team to ask questions was considered a benchmark sign of strength from a cultural perspective. It shows people in the business are thinking about risk and engaging their risk teams in the dialogue early in the process.

On the question of policy, it was acknowledged that the regulatory burden and complexity around risk management has become an issue for organisations. It can drive a culture around the 'letter' as opposed to the 'spirit'. This in turn can lead to employees finding ways around policies or identifying gaps to get desired outcomes. There is a move toward simplification and the reduction of policy to a focus on basic principles which are centred around ethics and 'doing the right thing'. It was recognised policies provide detailed guidance that cannot be substituted by culture alone. That said, culture and policies can and should co-exist as policy cannot (and should not) cover every scenario and it is human nature to push the boundaries.

In conclusion

Culture is dynamic, responding to factors in the external environment (regulatory priorities, labour market changes, economic factors for example) and to key influencers in the internal environment (remuneration and reward, leadership behaviours, consequences, constructive challenge). A change in either may be designed to have a specific impact but may lead to other unintended consequences. Unpredicted events and influences can catch the board and leaders off guard, leading to hasty decisions which in turn create more risk. Monitoring of cultural indicators and being alert to red flags allows for the early detection of subtle changes which may create or increase specific risks. A robust partnership between business leaders and the risk function provides a forum for informed analysis, discussion and management of risks. Where the board sets the tone for open dialogue about managing and taking risk and employees practice risk management in their daily roles, organisations can build resilience into their culture to the benefit of customers, employees and stakeholders.

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