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## Managing Risks: A New Framework

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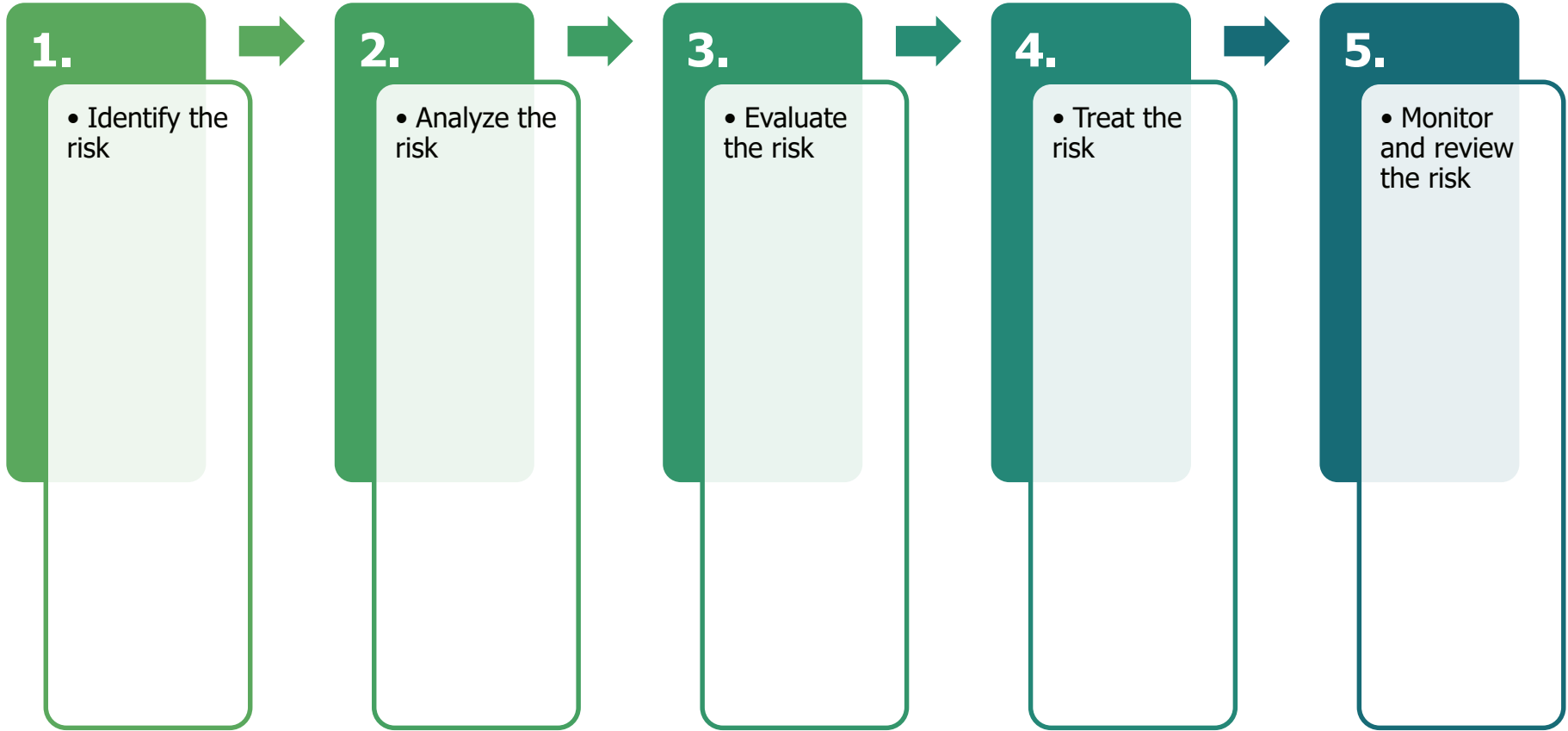
# Agenda

- Introduction
- Organizational risk management process
- Traditional risk categories
- A new framework
- Managing risk: rules or dialogue
  - Category I: preventable risks
  - Category II: strategy risks
  - Category III: external risks
- Why risk is hard to talk about
- The leadership challenge
- Questions



# 01 | Introduction to risk management

# Organizational risk management process



# Traditional risk categories



# Challenges with the traditional approach

- Treated as a compliance issue
- Insufficient executive dialogue
- Overly reliant on complex rules
- Qualitative elements not sufficiently integrated into the mix



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A new framework by  
Robert S. Kaplan and Anette Mikes  
from Harvard Business Review – June 2012

# Managing risk: rules or dialogue

- First step – “understanding the qualitative distinctions among the types of risks that organizations face...”
  - Preventable
  - Strategic
  - External
  
- Engaging the organization in dialogue provides foundation for action:





# Preventable risks - internal controllable risks from within the organization

Identifying and manage preventable risks - provide guidelines and clarify company goals and values

- **The mission**

- A well-crafted mission statement serves as a “true north”
- Mission statements should be communicated and understood

- **The values**

- Articulate values
- Reinforce behaviors

- **The boundaries**

- A strong corporate culture clarifies what is not allowed
- Strong internal control systems, such as the segregation of duties are critical
- Align boundaries with culture

# Strategy risks – a key to superior returns

Company voluntarily accepts some risk to drive strategy

- Strategy risks cannot be managed through a rules-based control model
- Employ a risk-management system:
  - Designed to reduce the probability that the assumed risks will occur
  - Identify key elements of risk events
  - Improve the company's ability to minimize impact of risk events that occur
- Risk management system enables companies to take on higher-risk, higher-reward ventures



# External risks - risks from events outside the company beyond its control

External risks require an alternative approach - focus on identification and mitigation

- Understand operating environment
- Identify key risk
  - Tail-risk stress tests
  - Scenario planning
  - War-gaming
- Develop mitigation strategy
  - Identify cost effective mitigation strategies
  - Seek alternative approaches



# Why risk is hard to talk about

- Overconfidence about the accuracy of our forecasts
- Anchor our estimates to readily available evidence despite the known danger of making linear extrapolations
- Teams facing uncertain conditions often engage in groupthink



# The leadership challenge



- Managing risk is very different from managing strategy
- Risk management focuses on the negative—threats and failures rather than opportunities and successes
- It runs exactly counter to the “can do” culture of most leadership teams
- Leadership teams are reluctant to spend time and money now to avoid an uncertain future problem
- What to do?
  - Create a separate function to handle strategy and external-risk management
  - Risk function’s size will vary – but must report to the top
  - Avoid the tendency to relegate risk management to a compliance function



Questions?

# Contact information



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