

From Risk Management to Intelligent Risk Taking

Risk Day
1 February 2019

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AKTUS

Who is this guy, Hans Læssøe

- Danish, 63 and with four children and four grandchildren
- M.Sc. in Electrical Power Engineering
- 35 years of broad LEGO Group experience
 - 2 years in IT
 - 13 years in Supply Chain
 - 4 years in Product Development
 - 6 years in Finance
 - 10 years in Strategic Risk Management
- Started **AKTUS** risk consulting April 2017
 - AKTUS = “AKTiv USikkerhed” (i.e. Active Uncertainties)
 - Uncertainties are facts of life ...
you may as well learn to manage these to your benefit
 - In a volatile world, manoeuvrability is a competitive advantage



First .. I tell you, what I am going to tell you ...

- **Where are we ... and why change now**
 - Basics of risk management
 - Risk types
 - Risk capacity/tolerance/appetite
 - Risk reporting
 - Speed of change
 - Development of risk management
- **Decision focused risk management**
 - Differences and requirements
 - Frame of reference
 - How to implement
 - Through processes
 - Through leaders
 - Scenarios sessions for strategy
- **Closing**



At the core ... risk management is not that complicated

Three simple questions ...



What can happen



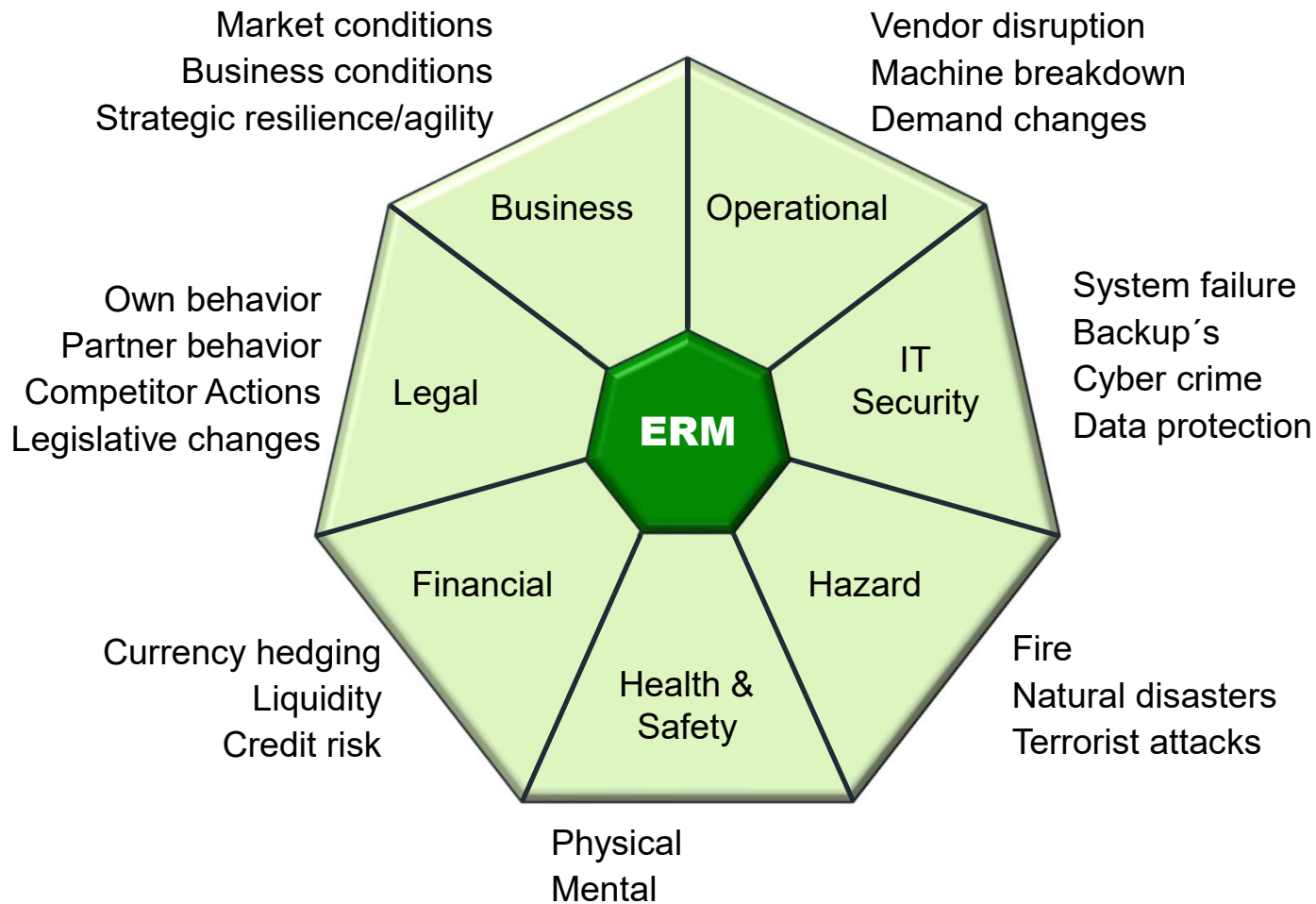
How important is it



What do you do about it

... which are potentially rather difficult to answer

Risk management covers a lot of different areas ... in different ways

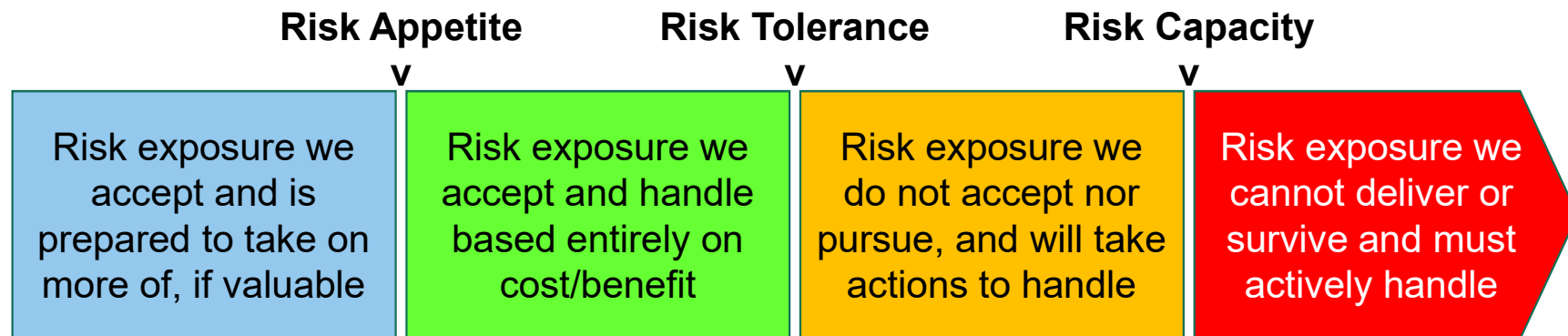


Alas, all of this ...

- Protect rather than add business value
 - Does not help making decisions
 - More “business hygiene than business leading”
- i.e.
- Is NOT a priority for executives

Risk tolerance and risk appetite ... both valuable guiding concepts

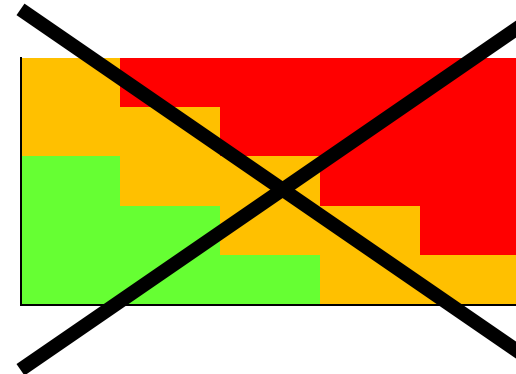
- Risk management is NOT about risk aversion



- The level of risk taking must be defined/confirmed/approved by top management and/or the Board of Directors
- There may/will be a plethora of risk tolerance statements all based on business targets
 - Profitability
 - Safety
 - Environmental
 - Reputational
 - ...

Effective reporting means “less is more”

- Quarterly reporting of the same dataset does not drive decisions ... only executive fatigue
- Reporting to executives must focus on what they care about
 - Likelihood of meeting defined targets
 - Based on executive risk tolerance
 - Key risks to meeting targets and status on mitigation
 - Key decisions recommended/needed to be taken
- Heat-maps are a total waste
 - Inconsistent with the outcome range of risks
 - No consolidated overview, no decision value
- Focus on “exception based” reporting
 - No news is good news
 - Annual status reporting can be shared between risk manager and relevant executive
 - Consolidate into simple and business focused graphics
- You may have legal reporting requirements ... fulfil these as “cheaply” as possible ... no-one cares anyway



Introducing ... Monte Carlo simulation

- Named after the Casino de Monte Carlo
- Based on using empirical analytics when formulas do not work
- First used by a British WWI prisoner, finding decimals of π
- Computers made this commonly available in the 1960's
- Many technical professions have used this regularly for decades ... apparently less so, the risk management profession
- Today a plethora of software packages can do this simple – often built as add-ons to Excel
 - @Risk
 - Crystal Ball
 - Vose ModelRisk (basic edition is downloadable for free)They all have great tutorial videos and examples
- Nothing magical ... just a modelling tool

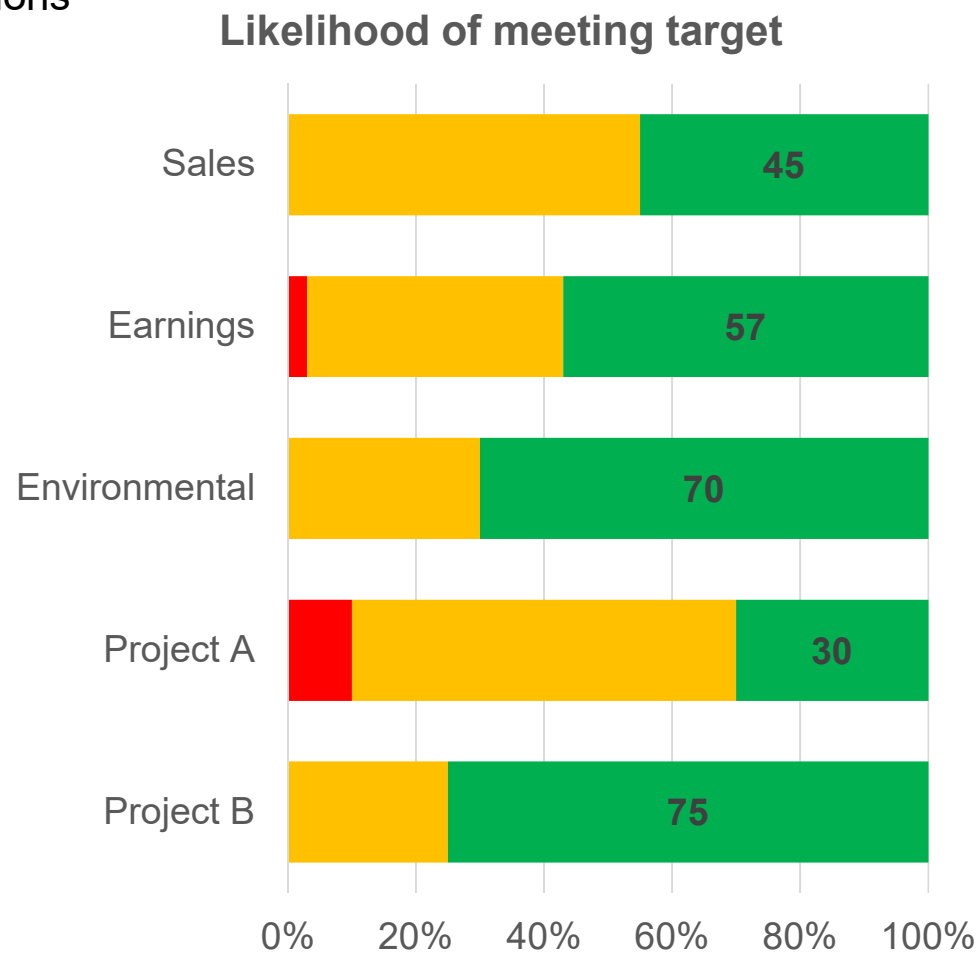
Show of hands ... who of you use Monte Carlo simulation?

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Simulation enables you to design business focused reporting

- Focus on what Management needs to take good decisions
- Show key outcome parameters
 - Data/charts are/can be auto generated by @Risk
 - Select (all) that apply ... but “less is more”
 - Show it in a way, Management understands
- List key uncertainty drivers
 - Limit to max 5
 - Potentially show tornado diagram
 - Describe what is being done
- Add recommendations as to new actions
 - What is recommended to focus at
 - What are action options and their impact



The world is changing at an ever increasing pace ...

The world has never changed as fast as it does today ...

... meaning, it will never, in foreseeable future, change this slowly again

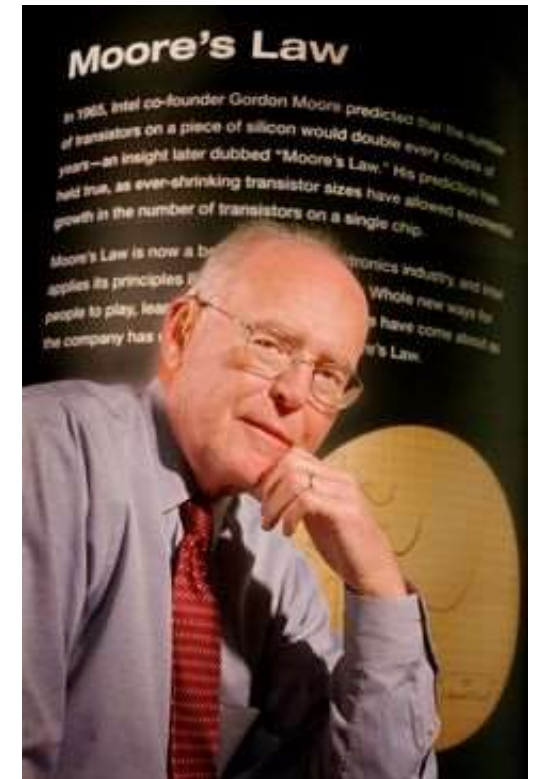
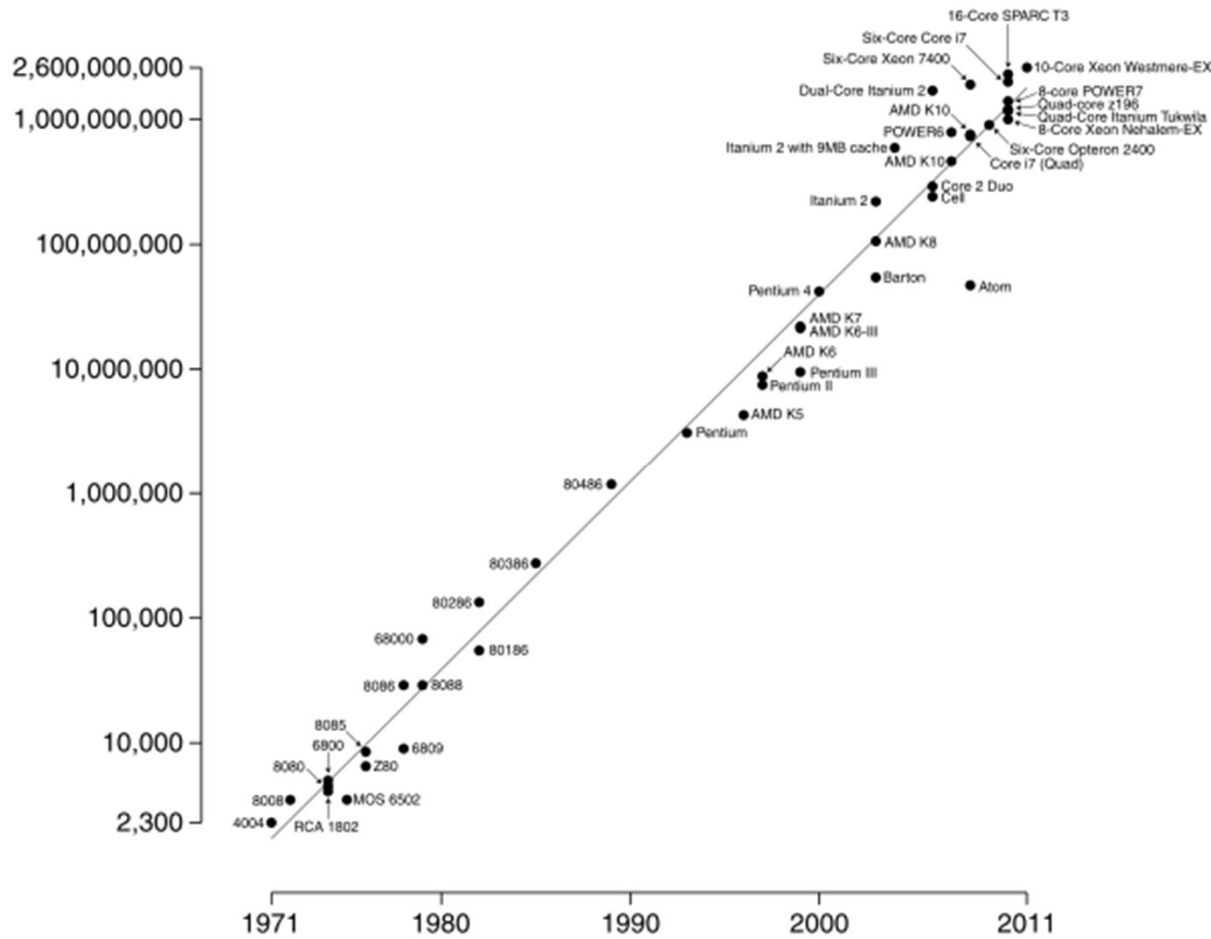
Teenager

Business Adult

Retiree

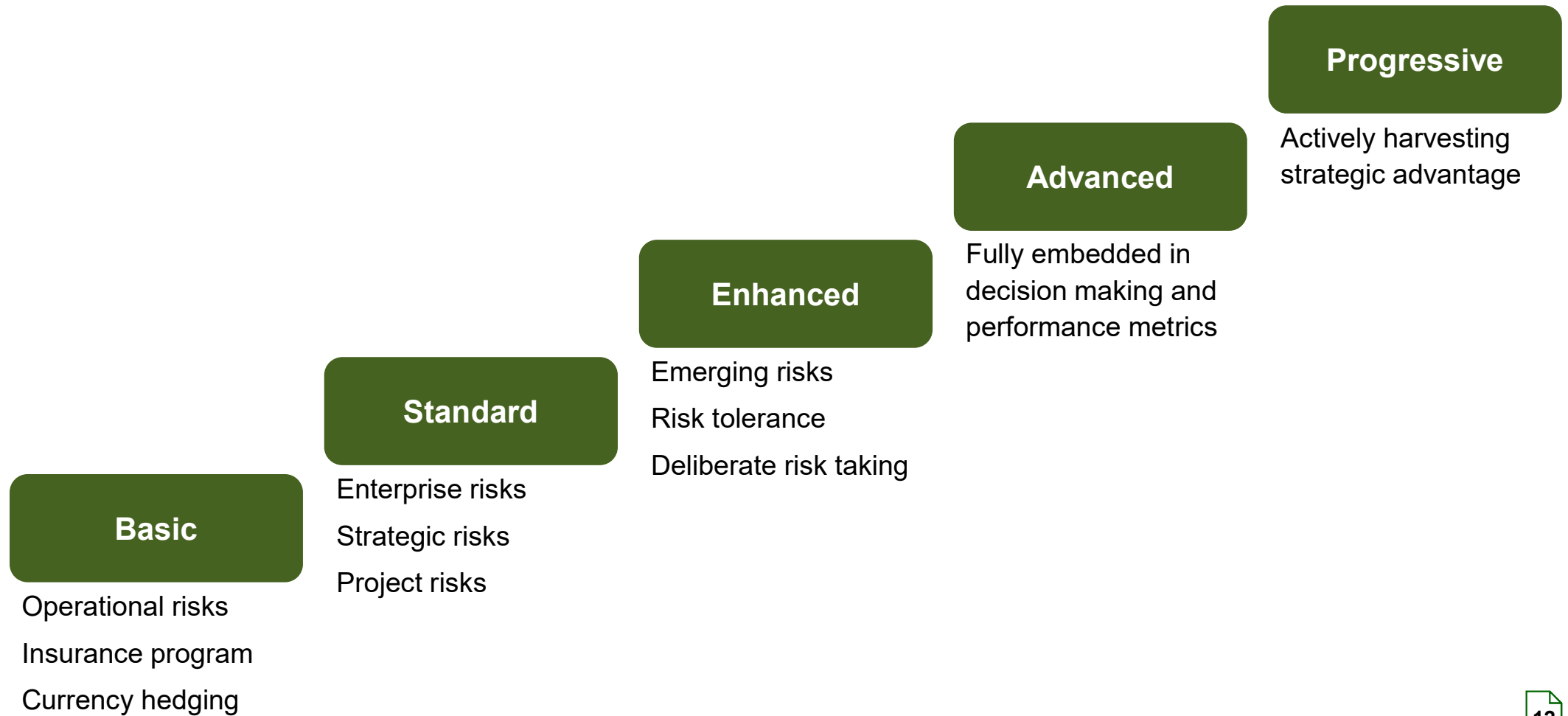
10% change per period

“Computing speed is doubling every second year” – valid for half a century



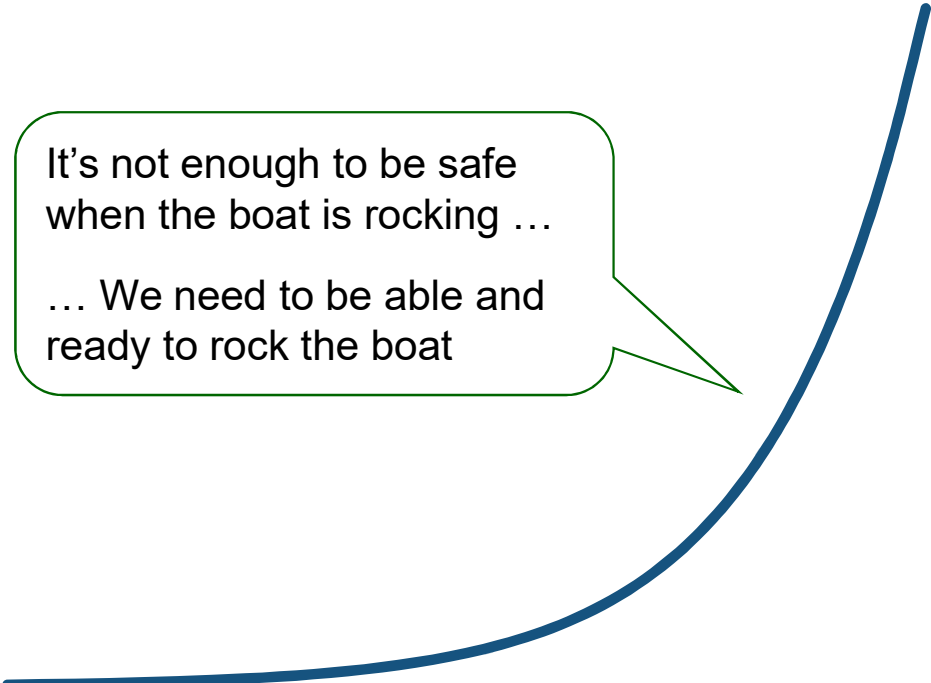
... and so the concept of risk management is changing

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Decision focused risk management is needed

- The world of the future changes faster than it ever did in the past ... and we need to deal with it
- Any decision made involves an element of risk taking ... and doing this heads-on creates value
- Trying to mitigate risks after these have been taken is “too little too late” and often ineffective
- “Dominate or die” has already been replaced by “disrupt or die” over and over again
- Risk managers have the skills to address uncertainties effectively ... leverage these
 - Processes
 - Tools
 - Technical capabilities
 - Business insight
 - Awareness of human biases



It's not enough to be safe
when the boat is rocking ...
... We need to be able and
ready to rock the boat

Execution focused and decision focused risk management differ

Execution focused ...

- Systematic ... same approach every time
- Transparent, technical and largely fact based
- Risk centric ... about minimising expected loss
- Driven by functional specialists
- Deep insight in tools and methodologies
- Supports decisions made by executives

Decision focused ...

- Ad hoc ... new approach every time
- Opaque and highly affected by human biases
- Business centric ... about optimising performance
- Driven by business leaders
- Deep business understanding
- Challenges decisions to be made by executives

Human biases are hard to handle ... and there are lots of them

Anchoring bias.

People are **over-reliant** on the first piece of information they hear. In a salary negotiation, whoever makes the first offer establishes a range of reasonable possibilities in each person's mind.



Confirmation bias.

We tend to listen only to information that confirms our **preconceptions** – one of the many reasons it's so hard to have an intelligent conversation about climate change.

Zero-risk bias.

Sociologists have found that **we love certainty** – even if it's counterproductive. Eliminating risk entirely means there is no chance of harm being caused.



Blind-spot bias.

Failing to recognize your own cognitive biases is a bias in itself. People notice cognitive and motivational biases much more in others than in themselves.



Overconfidence.

Some of us are **too confident about our abilities**, and this causes us to take greater risks in our daily lives. Experts are more prone to this bias than laypeople, since they are more convinced that they are right.



Assessments ... let's play a game

Question	Answer
1. Martin Luther Kings age at death	39
2. Diameter of the moon (km)	3.476 km
3. Number of books in the Old Testament	39
4. Weight of an empty Boeing 747-300 (metric tons)	178 tons
5. Age of worlds oldest tree (a spruce in Sweden)	9.550 years
6. Earnings of Mike Tyson before he was declared bankrupt	300 mUSD
7. Year in which Wolfgang Amadeus Mozart was born	1756
8. Size of largest soap bubble recorded (m ³)	96,3 m ³
9. Length of the river Nile (km)	6.853 km
10. Population of Greater Tokyo	37,8 mio people

What does decision focused risk management mean ...

- Being actively involved in the preparation of materials supporting/driving decision making
 - Strategies
 - Projects
 - Business initiatives
 - Standard decision processes
- Exploiting the risk tolerance of the company
 - Knowing the risk tolerance ... on multiple parameters
 - Knowing the current (already deployed) risk profile
- Drive and accept trade-offs
- Giving qualified advise
- Focus on business performance with risk in mind ... not risk management with business in mind



The optimal paradigm for decision risk management is ... Quality Assurance

Quality Assurance functions ...

- Have a can do mindset of “*what does it take to ... meet specifications*”
- Systematically analyse and address “input” and “process” issues/volatilities to ensure product quality
- Are end-to-end involved in “design for manufacture” / “design for quality”
- Drive actions to take, and results to monitor, to ensure ... success
- Verify results and adjust processes/methodologies as continuous improvement

... These same traits could be those of a valuable risk management (or Success Assurance) function

... and what does it take to deliver on decision focused risk management

- Speaking the language of business leaders
- Ask and listen before speaking
- Be proactive and forthcoming
- Understand business model and money making logic
- Understand, and work with, human biases and the decision making processes of the company
- Accept that “facts are facts, perception is reality”
- Network, network, network ... this is more about people than about technical skills



Two implementation approaches ... process or leader

Process focused

- Look at a current decision process
 - Sales & Operations Planning
 - Budgeting / Resource allocation
 - Project approval
- Invite yourself to listen in ... to learn
 - How are decisions made
 - What is the factual foundation
 - How are risks and opportunities embedded
 - What could you do to improve the process
- Approach process owner(s) and advocate your expertise
 - Which improvement do you offer
 - How to do these
 - What the result may look like

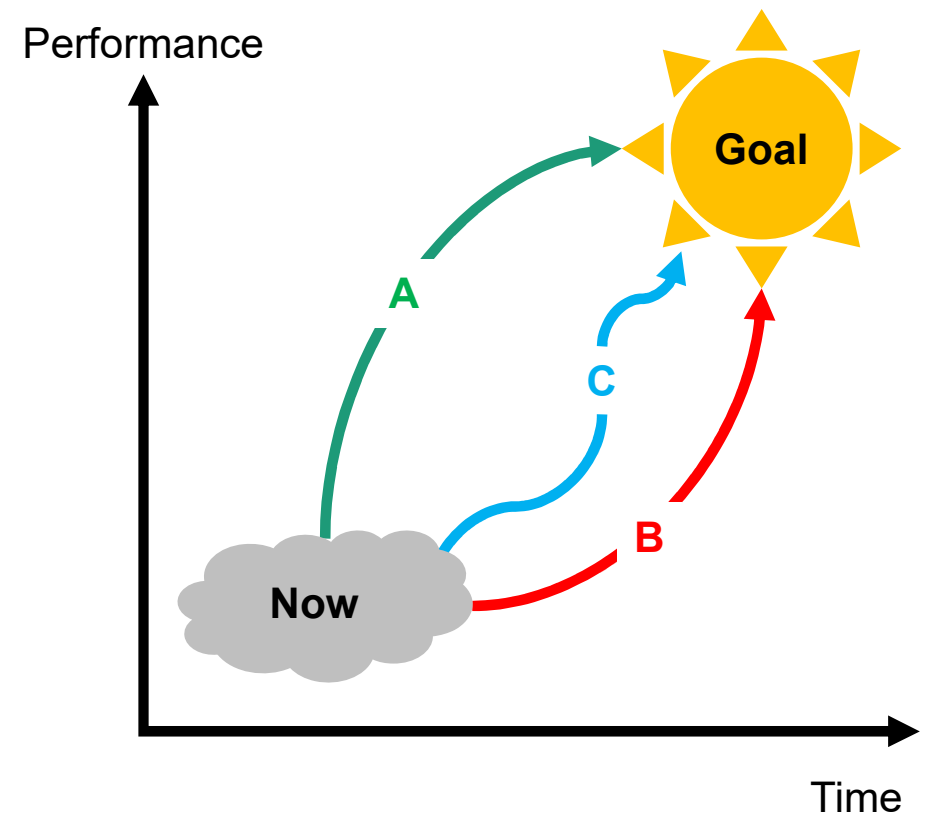
Leader focused

- Focus on a leader/an executive, who will buy in
 - Believes in the value of systematic processing
 - Is humble enough to want to learn
 - Finds *“there must be more to this risk thing...”*
- Look at, what decisions this leader makes
 - On what are these decisions founded
 - Are risks and levers catered for
 - How can we do that
- Offer your help – including “man-power” – for a pilot
- Don’t – **ever** – steal their thunder/success

**Start with one, then the next,
and the next and ...**

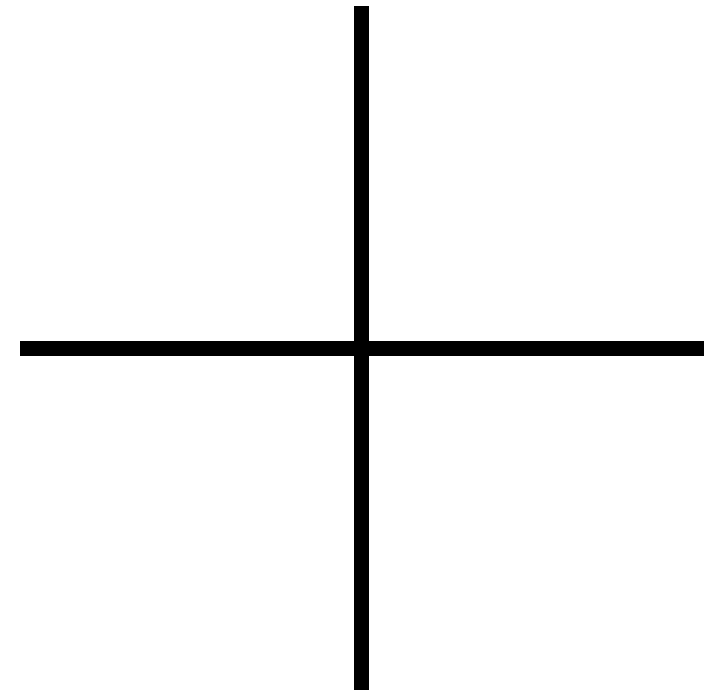
Strategic decisions are political choices

- There is no immediate problem to solve
- There is no immediate urgency
- Whatever we aim for, there are a plethora of options
- Attendees naturally have different backgrounds, approaches and biases ...
 - Viewpoints – what matters
 - Insights and facts
 - What is “better performance”
 - How can that be achieved
- Yet ... they must agree and act as an aligned team when addressing the organisation
- So ... **there is nothing “wrong” with politics** ... it is hard and difficult work



Step 1 – Uncertainty drivers

- The aim is to generate four scenarios which are
 - Relevant to the strategy
 - Deliberately diverse
 - All plausible ... although not equally likely
 - Somewhat extreme
- Scenarios are based on a simple 2X2 matrix
- The axes are defined by selected/defined drivers of uncertainty, which are
 - External
 - Related to the future
 - Important to strategic choices
 - Both “ends” are plausible
 - Mutually independent
- The tool is a deck of scenario cards with opposing statements on either end



Examples of uncertainty driver cards

<p>Value before Price When deciding, consumers look at value before price as driving the decision</p>	<p>Consumers</p>	<p>Price before Value Consumers first and foremost look at price and bargains, when deciding on a purch</p>
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<p>Free Trade World Trade is pivotal, and trade agreements are successful. Everyone can freely move goods from anywhere to anywhere</p>	<p>Political</p>	<p>1000 Restrictions Based on “protectionism”, all imaginable types of barriers and legislative restrictions emerge – hampering global trade</p>
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<p>Brick & Mortar Retailing The known “brick & mortar” type stores continue to be the base of our sales. On-line is there, but remains to be a smaller part.</p>	<p>Customers / Retailers</p>	<p>On-Line/Mobile Trading Products are easy to buy on-line and mobile/on-line trading is taking over as dominant buying channel for our consumers</p>
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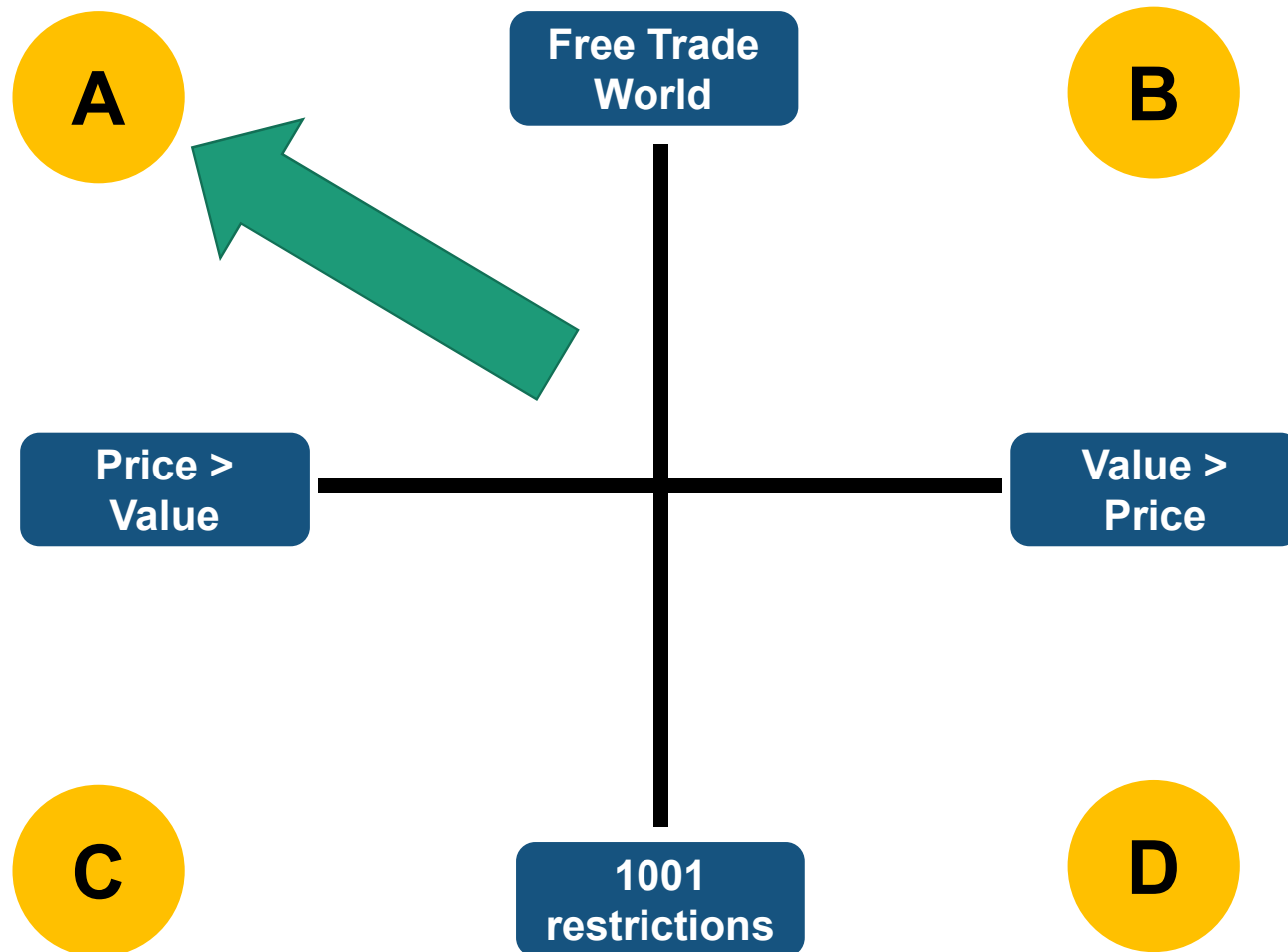
<p>Super-national Bureaucracy Legislation is predominately defined by super-national entities (EU, ASEAN, UN etc.) in a highly bureaucratic, slow and opaque</p>	<p>Political</p>	<p>Democratic Anarchy Legislation is effectively driven by NGO’s that drum up millions of members and “enforce” action/legislation – fast and unpredictably</p>
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<p>Quantum Leap Development The technological innovation is greater and create disruptive “quantum leap” developments and opportunities</p>	<p>Technology</p>	<p>Incremental Development The technological innovation may be fast, but provides mostly foreseeable and incremental opportunities</p>
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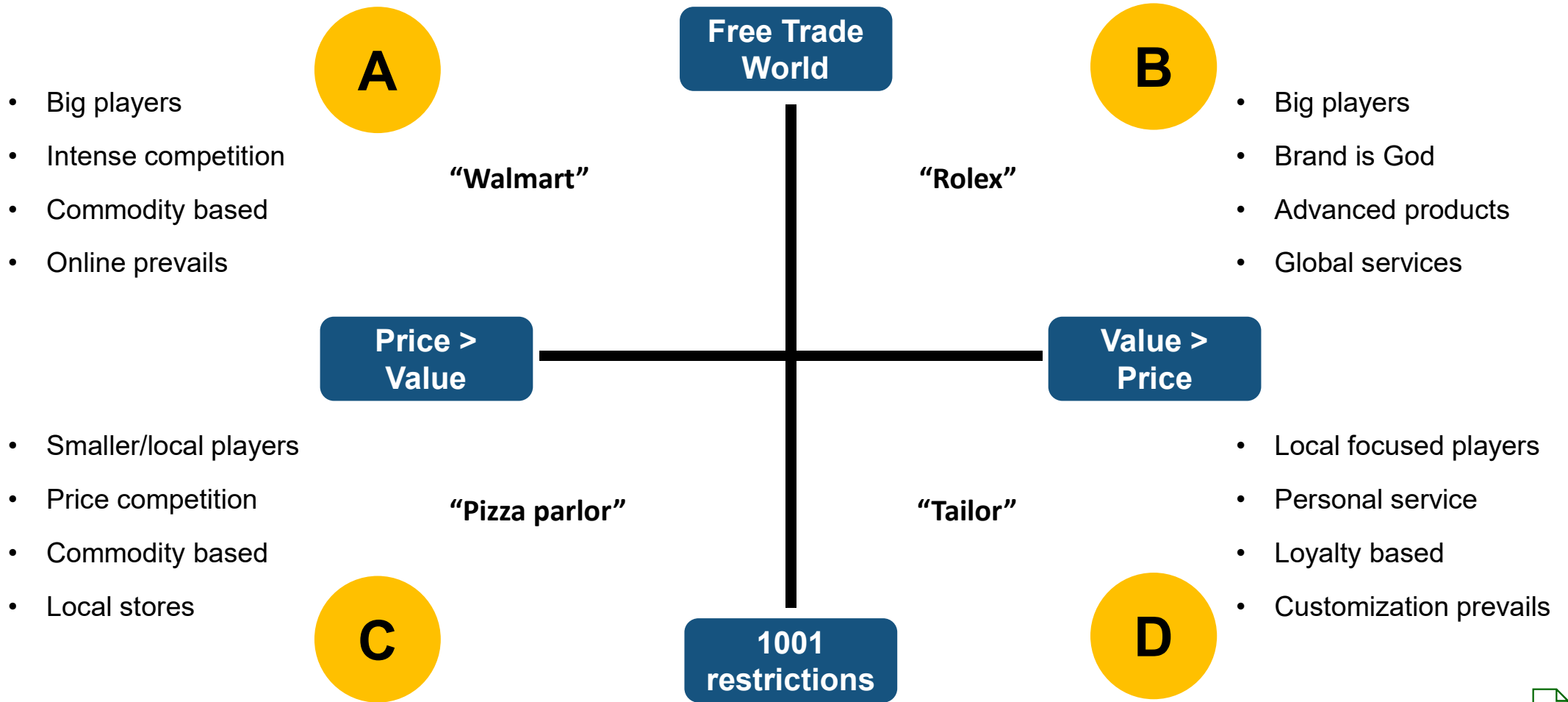
<p>Brand is God The value of a strong and recognized brand is paramount to drive and ensure consumer interest – even at a premium price</p>	<p>Branding</p>	<p>Products are a commodity The presence of a brand name does not drive value to the consumer and premium pricing is not possible</p>
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Step 2 Describe scenarios

- Assume the team has chosen these two drivers of uncertainty for their scenario planning
- Now, focusing on the topic at hand ... how may the world of Scenario A look
 - Push to be somewhat extreme
 - Get them out of their comfort zone
- Start with 10 minutes individually (post-its) to avoid group thinking ... then share
- Risk manager's role is to coach the session, but let the team work and discuss
- Ask the team to name the scenario
- Then scenario D
- Finally B and C

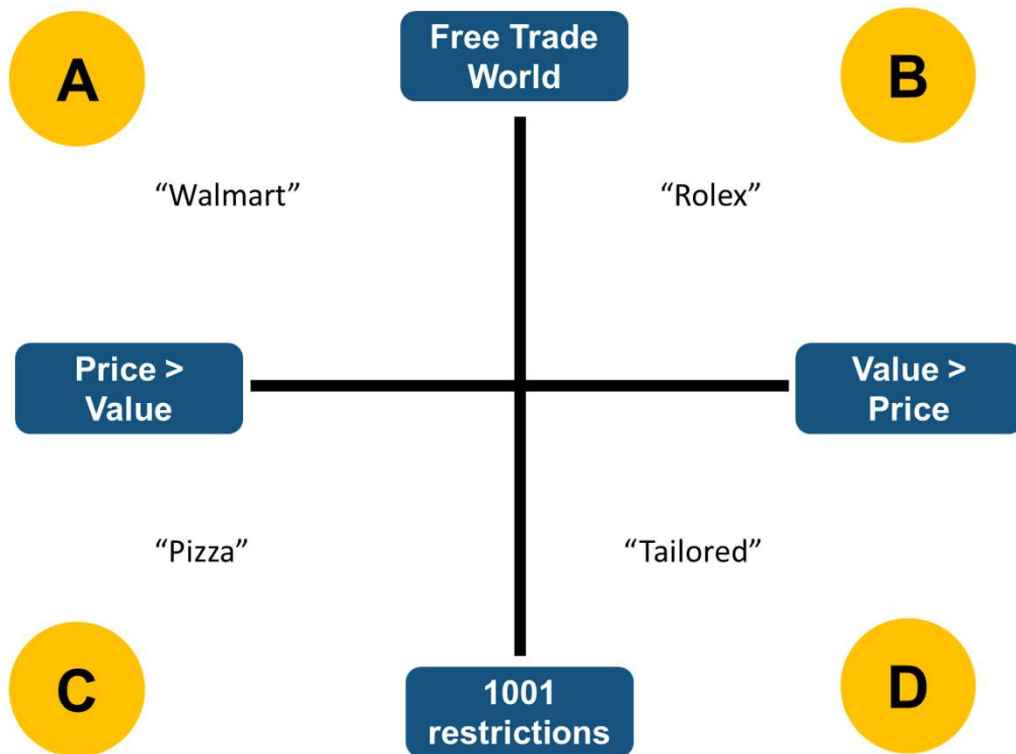


Example scenarios



Step 3 – Go from scenarios to issues

Scenarios ... the inspiration



Issues ... the "So What" notes

Each issue may be

- an opportunity
- a risk
- a problem

Depending on how we decide to handle it

In this step, issues are just identified ... not addressed by now

Solutions await prioritization

Issues may be linked to any one scenario, or two or all or none ... it doesn't matter

Use post-its and share – to avoid group thinking

Prioritization axes

Likelihood

FAST

If this materializes, we will be in trouble, if we are not prepared

IMPACT is inherently HIGH, so no added value in using this as a parameter

SLOW

Even if this materializes, we can address this effectively as it unfolds

Speed

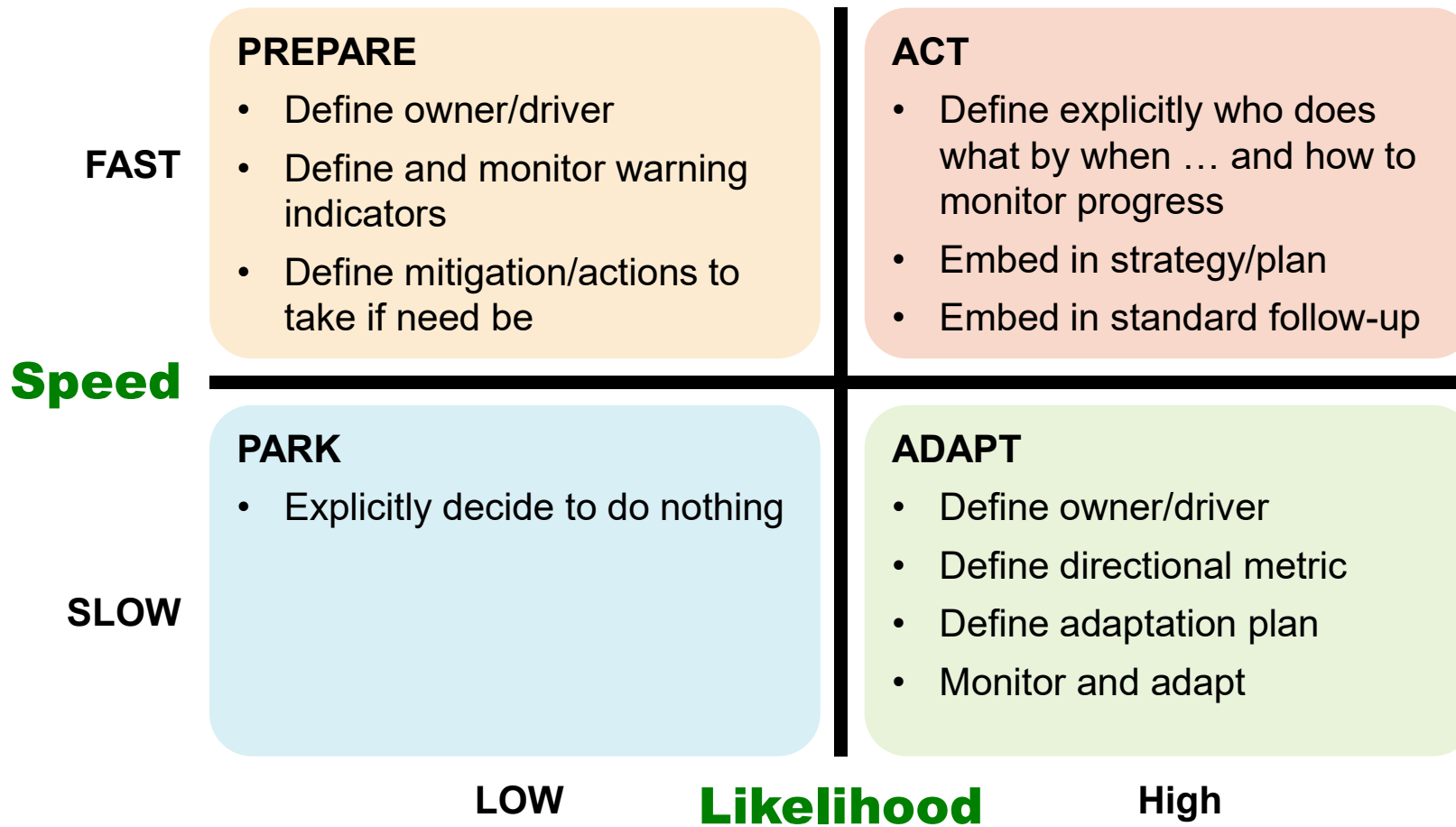
LOW

We **do not** expect/assume this will materialize within the strategic horizon

HIGH

We expect/assume this will materialize within the strategic horizon

PAPA prioritization model



I have done dozens of these sessions and ...

I have always had multiple and new ACT issues

Value is immediate

Step 4 – Prioritize issues ... and potentially define what to do about them

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Likelihood

PREPARE

- New environmental legislation
- Disruptive competitor enters business
 - New money making logic
 - New technology
 - Different consumer offering

FAST

ACT

- Digital/connective product technology
- Artificial Intelligence introduced
- Industrial 3D printing
- Shared economy impact

Speed

PARK

- Workforce based on freelancers
- Commodity prices double or half
- Consumer preferences change

SLOW

ADAPT

- Digitalization of processes
- Customer groups of one/customization
- Product life cycle reduction

LOW

HIGH

Closing off ... by telling you, what I have told you

- **Risk Management is changing**

- Risk management may be simple ... it is not easy
- From traditional / execution focused to decision focused
- From risk minimising to risk taking

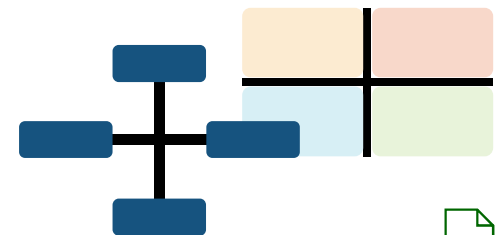
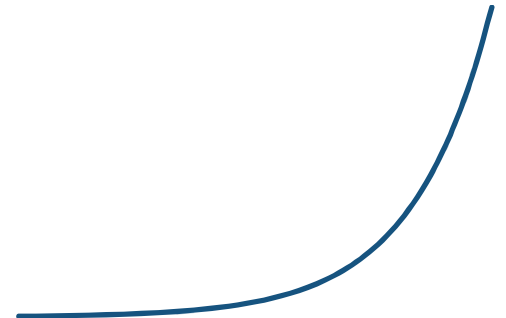
This is YOUR era of opportunity

- **Decision Focused risk management is very different from traditional**

- More ad hoc and less repetitive
- Heavily affected by human biases
- There is always trade-offs
- Focused on business performance and intelligent risk taking

- **Implement by combining two approaches**

- Via established decision processes
- Via selected leaders/executives
- Leverage scenario sessions to ensure strategies are resilient to future change





Thank you

I hope it inspired and helped



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