When Risk Maps become Risk Traps

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Let us step back and consider the process of collecting risk information for the purpose of communicating to senior management and the Board about the most important threats to their organization (that they may or may not be currently aware of) with sufficient credibility to cause them to sponsor further action.

Probably the most important thing to note is that this process is not “in the business”. Like finance and human resources, explicit risk management is an undeniable component of modern management. And as much as we strive to keep risk processes in “the business”, for many organizations it will feel sufficiently distinct from “the business” that we should recognize and account for that. This article suggests a solution.

“By failing to prepare, you are preparing to fail”, Benjamin Franklin

Finding opportunity in risk

The conundrum is that as we design our risk reporting process, we readily identify with the “threat” side of risk and rarely apply similar effort on the “opportunity” side of risk. Few risk teams have focused risk reporting on recommending actions to management that indicates how these actions can be expected to enhance performance in measurable terms.

In many organizations, executives and boards are presented with reporting based on what the risk management team has decided to do based on whatever qualifications they may have. Their focus is threat oriented and the approach inevitably becomes protection centric.

This focus comes with two immediate challenges:

- Management and boards are naturally focused on driving performance – as they should be. Hence discussing risks separately is interesting but leaves a gap between how management thinks and the risk picture. It can be viewed as a compliance effort rather than value adding.
- The focus on threats (i.e., bad things that may happen, like a fire or a new competitor) means that levers (good things that may happen, like a favorable market trend or a new technology) and even uncertainties (things which will affect performance, but with a range of plausible outcomes, like a currency rate or inflation) are ignored.
- The focus on individual risks means that management and boards are not provided with any level of consolidated impact and often lack insights into the perfect storm of A, B <u>and</u> C when they are given information of A, B <u>or</u> C. It’s also quite possible that one or more of A,B and C fall below the reportable threshold and are not discussed at all.

All the above drives the process to become a separate add-on, somewhat arbitrary and bureaucratic process which appears to be driven for its own sake. It’s perceived as not adding a lot of value to the company, and hence many companies tend to scale down risk management efforts and –reporting to whatever minimum they believe they can get away with. It does not need to be.

From threat-centric to performance optimization

What if your “risk” process became a fundamental component of how the business plans and executes? What if when a business got it’s stretch goals, the first thing the division leader said was “Let’s get the risk guys in here with the operations team to help us identify areas we need to dig into”.

For even a shade of this to happen, the output needs to be compelling to senior management. It must come from a process that supports asking the right questions, has a framework to receive the full richness of the answers and one that can objectively compile and synthesize all this information into clear and conscience messages—messages about opportunities as well as threats.

“You cannot improve what you do not measure”, Lord Kelvin

There is more about this at the end of this article, but we recommend risk teams look for existing decision processes and build a supporting process that creates performance value by leveraging the insights collected on risks— triggers, uncertainties, impacts, interconnections.

Begin with that end in mind

It doesn’t matter if you are following a well exercised process or if you are building a new one, you will start with the end in mind and work backwards. Your goal is to fill a repository with risk information that can be processed into the output. This is where risk maps become risk traps.

The fundamental methodology of a risk map is to synthesize the information collected into a handful of sentences and attach a version of frequency and severity. This determines its location on a Cartesian plane and other formatting such a color and size of the bubble can be used to addition information, sufficiency of controls for example.

Because the risk process is an important one, it will be given the license to collect information across the enterprise. In organizing those meetings (or surveys or other collection methodologies) it will be necessary to communicate the form of the information being collected. While there are a myriad of nuances and techniques, fundamentally the process will be generating a list of risks and their associated frequency and severity.

The participants will want to understand how the information they are providing is going to be used so that they can provide the best information that they can—and if the process is simplistic enough, to hide what they don’t want to disclose.

“If everything is under control, you are moving to slow”, Mario Andretti

The advantage of a simulation-oriented approach is that it has a much richer repository for collecting the risk information and thus supports a much richer dialogue about risks.

- *How does the risk change the flow or efficiency of operations?*
- *What are the triggers?*
- *Where does the volatility come from?*

- *What drives the volatility?*
- *What activates or disables a trigger or dampens the volatility?*
- *Are there natural offsets within the business?*
- *How are the triggers and volatility drivers interconnected?*

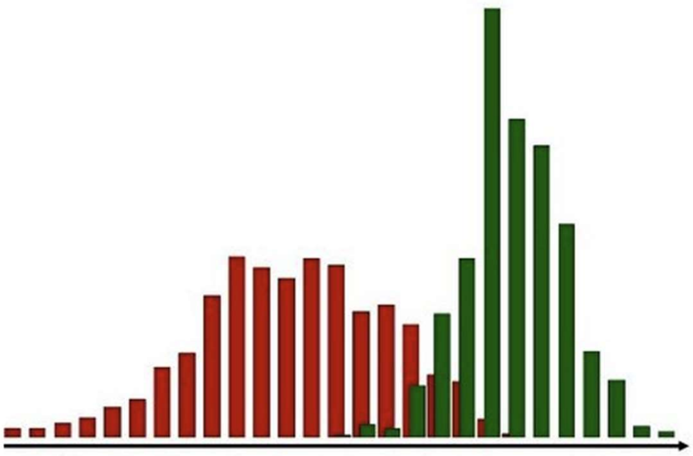
This sort of framework captures the interaction and variability in how a risk manifests as impacts. The act of asking these questions and then attempting to connect them together via influence diagrams, butterfly diagrams and ultimately mathematical formula results in a more expansive understanding of the risk even amongst those in operations. It can tease out how the risk works. This approach enables the participants in one group to recognize that they are impacted by a trigger that comes the actions of other teams not in the room. One might wonder if that other team is aware of that.

Your goal is to build a reasonably detailed picture that shows the pathway to an impact. The business needs to recognizes the impact pathway as one that sufficiently describes how the risk works. Looking at an impact pathway naturally leads to asking questions like:

- *How can suppress that trigger?*
- *How do we shift the volatility to more positive outcomes?*
- *What if we did things a little differently and bypassed that trigger?*
- *Are there natural offsets within the business?*

The questions are not only about lessening the downside, but pushing the upside, tightening that range of outcomes around a higher mean point.

More carrot, less stick



This chart shows performance. More right and higher is good. Every business would want the green chart vs the reds ones. The green business leads to recognition, promotion, and higher compensation. You want to be part of a process that practically and credibly charts a path towards the green.

Risk maps won't capture the imagination of operations because it can't begin to tease out the "how". And if risk management isn't helping with the "how" it's not really helping at all.

As the globally acknowledged standard ISO 31.000 states numerous times, risk management must affect decision making. It is a principle of ISO 31.000 standard that risk management should be tailored and integrated.

Doing it differently

Our recommended approach to this is to refrain from focusing on risk management and risk reporting as a separate process, but rather look closely at the decision processes and performance reporting already in place in the company – be it strategic, investment planning, sales, operations or budgeting and work to integrate a dynamic, interactive risk perspective.

"We make money by taking risks, and we lose money when we do not manage the risks we are taking", Countless companies globally.

For each process define:

- What are targets/performance criteria?
- How are risks, levers and uncertainties currently addressed?
- Leveraging the insights of the risk team, how can this be improved based on data/facts?
- How to upgrade the decision process to effectively take risks etc. Into account when making decisions?
- How can we support management by e.g., reporting on the likelihood of meeting defined targets, and what are key issues to address if we wish to enhance this?

The objective is to understand, for example, where and why of

- "bold" strategies are not so bold,
- "safe "projects are not so safe and
- where rules-of-thumb are no more helpful than sucking one's thumb. (Although you'll want to more tactful when discussing it)

Not because they are easy but valuable enough to justify the effort

There is no question that building impact pathways and then coding them into a model is a much larger task compared to risk maps. It requires statistical skills, modelling skills, advanced facilitation skills and the ability to communicate concepts without making them seem complex. There is also bias against modelling – analysis paralysis, garbage-in-garbage-out, models are always wrong, and "I can't trust a black box".

Some suggestions on getting started from an organizational perspective:

1. Think about timing: When is the right time of year to run the project, when do you seed ideas into the budget cycle, plant seeds this year or advocate for a pilot – take the time to think about the "who" and the "how" to get your organization to take a step forward.
2. Identify the business leaders that can sponsor a pilot initiative who will commit the required resources.
3. Be clear about the kind of people you want the business to contribute to the team. Have specific people in mind if possible. You might not get them, but business leaders will understand better what you are looking for.
4. Look across the various business units to identify a business where a pilot project would be interesting and valuable to them. Use messaging that is less about how "risk

management is going to improve performance" and more about how "this process is going to unlock the knowledge in the business has to create new and credible ideas and perspectives to improve performance". You want to answer the business leaders. question: "what's in it for me"
5. Draft the objectives and socialize the objectives – what success looks like, both for the pilot and for the process.
6. Before you start socializing, put it all together using a pitch deck template. They are a good way to tell your story because it forces you to answer the key questions in the right order. You might also find that you need to change your ideas and do more research to be ready.

Some suggestions on getting started form a process perspective:

1. Start with pictures and draw the risk impact pathways, triggers on the left, moving to impacts on the right.
2. Think broadly about impacts. In addition to direct costs, impacts can also be a) shifts in operational parameters, c) additional triggers in other risk pathways, d) activation of dormant risk pathways.
3. Ask about data for the various triggers, you might find that it is operationally captured or somebody in the business as a very good idea about its pattern of activation because it's observable with some regularity.
4. Get the operations to agree with the risk pathways and the data that can be collected to parameterize the triggers. It's not your pathway and data, it's theirs. Your role is to facilitate capturing that in a format that supports building a model.
5. Build out the formulas on paper before you start building the model, get the operations to agree to that.

At this point you've got operations to agree that you've captured how the risk works and how to calculate the impact in dollar terms.

Now comes the fun part, the part that the business will appreciate – start a conversation about improving the performance of the business. If you shift your scope, focus, language, and objective from managing risk for the purpose of protection to managing risk for the purpose of creating or optimizing value the business will pull you in.

" Risk management transcends mere threat mitigation; it is the untapped reservoir for driving business performance. When we reframe risks as levers for advancement rather than obstacles for containment, we shift from being compliance officers to strategic enablers.", ChatGPT in response to this article.

Leveraging this may very well earn the risk manager the position of being a favorite "go-to" person when decisions are turned into projects and initiatives to ensure these perform successfully.