Chapter 2.4: Risk Capability in the Extended Enterprise

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The Importance of Risk Capability

In this interconnected world, the capabilities (technical skills, knowledge and leadership competencies) of individuals and the collective group responsible for managing risk, plus the relationships within and outside organisations, can determine just how successful a company is. As a result, many organisations and individuals are now reflecting on the capabilities required for successful risk management, whether for the operation as a whole, or for the individuals responsible for ensuring companies manage risk effectively.

In this chapter we will look at the capabilities and competencies required to manage risk effectively within a company and, importantly, in the more complex world of the Extended Enterprise. We will also consider the other key roles that are significant in ensuring appropriate management of risk, and the capabilities each group should demonstrate.

Role, Responsibility and Relationship to Risk

Effective risk management is not achieved purely by the independent Risk Management function. However good they are, they need to work in collaboration with key stakeholders internally and externally to achieve the mature risk culture that companies are now striving to achieve. Each group of stakeholders have their own risk responsibilities, but also their own risk perspective, knowledge and perceptions.

THE BOARD

The role of the Board is to advise and guide the Executive team in their development and execution of strategy. As well as the financial stability of the organisation, they must now consider the risk that the business is subject to, from not grasping commercial opportunities (see ‘Risk and Innovation’ chapter) and as a consequence losing market share, to the extension of relationships that could bring the organisation into disrepute. At the same time they should not overstep the boundaries of their advisory remit and interfere in the day to day operational running of the business.
As business complexity has increased and, with it, greater expectations of appropriate governance, the need for a balanced Board with individuals demonstrating the right competencies, or characteristics, is now regarded as a necessity for effective risk management. A recent report published by the Korn/Ferry Institute which asked “What Makes an Exceptional Independent Non Executive Director?” reviewed and updated research on the same topic carried out seven years previously. Along with confirmation that the core characteristics identified in the original report remained, the updated study noted three new essential skills; an understanding of risk, finance and technology. To quote directly from the report, “mastering the complexity of risk is now considered elementary for Boards operating in the post-crisis era”.

The core non-executive director characteristics identified in the Korn/Ferry Institute’s paper were:

- Independence, courage and integrity.
- Challenging and supportive.
- Thoughtful communication.
- Breadth of experience.

THE EXECUTIVE LEADERSHIP TEAM

In a mature risk culture, everyone is responsible for the risk management of the business. This means doing the right thing and not putting the business at risk in the broadest sense. It is the role of the Executive Leadership to ensure this culture is maintained and that all understand their collective and individual obligations. They empower their Risk Management team to partner the business to ensure the right risk/reward balance is struck but they hold ultimate risk responsibility.

In a mature risk culture, each individual within the business understands their contribution including their risk management responsibilities. Collectively, the organisation is able to think long-term and strategically about the business challenges in the future and to put in place plans to mitigate longer term risk issues through strategic redirection. This is in addition to the risk management processes which ensure day to day risk mitigation.

To achieve this, the Executive Leadership needs to think beyond the quarterly financial reports that drive much of the corporate environment. As individual leaders they may demonstrate some of the behaviours, values and competencies detailed in Developing Organisational Capability in Risk Management (diagram 2) designed for the partners in Risk Management. However, there are additional considerations for leadership in the complex environment created by the 21st century company:

- Evaluating long term value over short term financial gain.
- Ensuring equal value (role/power/money) is placed on commercial risk management and revenue drivers.
- The ability to empower all direct reports to operate in a mature risk environment.
- The willingness to hear and act on challenges.
THE SENIOR RISK LEADER AND HIS/HER TEAM

For the purposes of this chapter we will assume that the Senior Risk Leader is responsible for Enterprise Risk Management as a CRO, Head of Enterprise Risk Management or as a Head of Risk. There are companies where a number of senior individuals collectively take the executive responsibility for independent risk management but an increasing number are appointing one individual to be responsible across the entire organisation or business division. Success requires a desire for understanding and risk maturity on behalf of the Board and the business leaders, and of course, an individual capable of the Head of Enterprise Risk/CRO role. This is a significant and increasingly complex role requiring technical breadth, worldly wisdom, stature and the ability to influence as well as communicate succinctly and with clarity.

The Risk Team forms the back-bone of effective risk management, working in partnership across the extended enterprise. Organisations require both “high potentials” to succeed bosses when they move on, and well as “high professionals” who constantly ensure the organisation is kept safe.

REGULATORS OR EXTERNAL STAKEHOLDERS

The external stakeholders have their role to play in ensuring risk is managed appropriately and not necessarily only from their own perspective; balance is key. There are now a myriad of stakeholders that a company can and does engage with, and they in turn engage with a host of others, including regulators, customers, suppliers and shareholders.

All can have a profound impact, positively or less so. Where companies are over-regulated, they may seek routes to keep costs down because they have a duty to other stakeholders (shareholders, customers) to maintain costs at a certain level. The outsourcing of processes has been extremely popular but does not always bring the cost savings over the longer term and can certainly increase risks if not managed correctly. Customers can demand increasing cost savings; responding to this and the competitive landscape, companies may choose to adopt a cost-driven supply chain strategy. The results are short-lived but the reputational damage is much harder to fix.

Risk Management Capabilities within the Organisation

The Risk Leader needs to blend technical depth and, increasingly, breadth with the interpersonal and leadership skills to manage the Risk team as well as the relationship with internal and external stakeholders. The Risk Leader relies on the broader team in the delivery of this objective, and they are collectively supported in this by technical skills and knowledge, behaviours and competencies.

Diagram 2 below explores the capabilities required within an independent Risk Management team. The core blocks of technical skills and relevant knowledge for the industry and of the company, are shared across the Risk function, but some individuals will be deeper experts than others. In developing a mature Risk team, a Risk Leader should look to develop “utility players” i.e. those individuals who have the potential and are capable of moving from one technical area to another. At the same time, the importance of technical specialist should not be under-estimated. They are the guardians of risk management who
ensure that frameworks, policy and process remain at the forefront of industry standards and are fitting to the business in all of its operations.

Diagram 2: Developing Organisational Capability in Risk Management.

Behaviours and values are the personal traits that should be shared across the function; they operate as the code of practice for risk management and some may have greater emphasis at different times depending on the sophistication of risk management.

The competencies that are required change. As an individual advances through their career and their level of experience grows, other competencies are learnt and developed which enable further progression. As an individual takes on another position, different role responsibilities need different competencies and previous competencies become lessons learnt rather than currently required. The above diagram illustrates competencies most relevant when working as an individual Risk Manager (Managing Self), when managing a team (Managing Others) and as the Risk Leader (Managing Enterprise).

Additional Capabilities for the Extended Enterprise
Diagram 3 below considers the factors to take in account and the competencies and values most needed to manage risks in the Extended Enterprise. Each individual has a role to play, as each will touch the Extended Enterprise.
When approaching the extended enterprise relationships, what should you consider?

1. Identify and develop a shared sense of ethics and values? Do you have the same approach to risk management and risk culture?
2. A realistic understanding and appreciation of who holds the power? Your company may not have the upper hand, but understanding this dynamic and the impact on your ability to influence is essential.
3. Who gets what out of the relationship? A contract might bind you and dictate the financial terms, but the relationship and consequences of poor decisions have the potential to go far beyond – reputational, operational etc.
4. Interconnectivity dynamics. Partners’ industry and economic factors that impact, jurisdictions that they work in (and associated laws), regulators who impact.

To understand, manage and mitigate the above, requires process, contracts and governance. But it also requires an understanding of the human factors that bring contracts to life – behaviours, values and competencies.

To get the best out of any partnership and to maximise open and honest communication, each participant must approach it collaboratively. This is important, and requires a maturity not always present. Approaching stakeholders as a partner will provide the foundation for a productive relationship. Any new partner with a defensive approach will usually ring alarm bells. In all relationships, as a Risk Manager, we need open and clear communication as well as the courage to challenge appropriately. This is true too of the Extended Enterprise and goes hand in glove with a collaborative partnership style if done correctly and with balance. Whilst partnership is key, a Risk Manager needs to maintain their perspective in order to provide sound judgment on any situation or the success/challenges of any extended relationships.

Finding a partner that shares your company ethics and values is an excellent starting point, assuming you have the rigour to see past slick marketing. Entering a partnership with a level of distrust or not sharing the same values will likely be a short-term one, ending in
dissatisfaction on both sides. A core element of any Risk Manager, whatever their level, is being continuously inquisitive, not settling for the first answer but quietly persisting until they are satisfied that they have reached the “heart of the matter”. In all endeavours, all Risk Managers must take stakeholder engagement seriously, maintaining and developing relationships, being responsive and collaborative, but also seeking to influence and shape thinking.

Depending on the level and role responsibility, each will have different competencies which could make a material difference to how well risk is managed. We might assume that an individual Risk Manager could have limited influence and impact. Rather, they are at the coal-face, and through networking will understand what best-in-class looks like and whether the partner shares the same values. They are the foundation of problem solving and decision making; with such information and interaction, they may be the first to see problem risks arising. Whether they are influencing through the relationship they build, the integrity they show, or through their constructive challenge, each individual can mitigate risk within and beyond their enterprise.

As a manager of a team, new skills and competencies are developed. It is the period in a career where the Risk Manager must become more comfortable with ambiguity as they are now leading a team and a step removed from the day to day detail. As such, they hone their skills in negotiation via developing excellent organisational agility. They must also become adept at conflict management. In the Extended Enterprise, these four are the most important competencies to develop for the mid-career level. All of these competencies sit within the broader banner of influencing, a key skill for the Extended Enterprise.

As a Risk Leader, partnership and the ability to influence become paramount, but so are a number of other core competencies. Dealing with the Paradox, i.e. comfortably dealing with competing ideas and possessing the clarity of thought and communication to navigate between, will help the Head of Risk deal with competing needs of partners and his/her business. Strategic agility coupled with future scanning are also essential to spot present and future landmines.

Conclusion
In conclusion the Board and Risk Practitioner should be comfortable they can answer the following:

1. Are the required risk roles across the Extend Enterprise identified and resourced correctly?

2. Are the Risk Leaders and team capabilities understood and aligned to the challenges of managing risk across the Extended Enterprise?

3. Does the Board understand and periodically review the risk capabilities of its organisation?