Why Managing Risk is a different ball game…

The best example of unforeseen risk is what happened at the end of March 2020 when places were suddenly locked down with just a few days' notice. What started out as for a couple of days got extended and extended for well over 4 to 5 months hitting personal and business life in a total unexpected way.

While it was almost impossible to predict and plan for such an unforeseen risk, different organizations and industries reacted differently with different results.

So, is there a way to plan for the different risks and have clear plans in place which will alert us in advance in case the risks are building up?

Organizations are made up of the best talents from the best management and engineering colleges. Many of these people have never experienced a failure in their academic life or in the initial years of their work life.

Our culture which always promotes success, and the successful people makes it very difficult for the people who had grown up in this culture to speak about failure and then plan for risks of failure which need to be factored in into any plan for managing risks.

What has been our normal procedure to mitigate risks? Build in rules and procedures for everything and anything that we do. Am sure everyone who reads this has experienced some of their suggestions and out of the box thoughts being met with what will the auditor say if we do this?

So, if we do not question the status quo how can we even think of failures and then about the associated risks?

Some of our other practices which makes managing risks difficult are as below:

- Multiple studies have found that people overestimate their ability to influence events. We tend to be overconfident about the accuracy of our forecasts
- We anchor our estimates on readily available evidence despite the known danger of making linear extrapolations from present data to an unknown future.
- We operate under confirmation bias which makes us to favor data that supports our point of view
- When situations go wrong or not the way that we have planned we very often increase commitment irrationally directing more money to our failed course of action.

In troubled situations most groups follow what we call the group think where once a course of action has received acceptance within the group most people tend to suppress their objections and fall in line even when their objections are very valid and probably pointing towards the right direction.

Because of the way we are structured with rules and procedures for everything we very often ignore the small deviations observed and hence miss out on the early warning signs that become visible to the imminent high risk

Organizations also make the mistake of departmentalizing risks...So you will have IT risk, Financial risk, Market risk, Operational risk etc.. Such compartmentalization disperses both responsibility and information for effective risk management.

Let’s understand the different types of risks so that we also know how to manage them

1. **Preventable Risks**

These are internal risks arising from within the organization that are controllable and ought to be eliminated or avoided. This risk category is best managed by what we all do best. Creating processes and systems which are then continuously monitored to eliminate these risks.

2. **Strategy risks**

Strategy risks are very different from preventable risks because they are not totally undesirable. To grow its business and generate returns organizations must take on significant risks. How effectively organizations can manage these strategy risks is what differentiates between companies.

Strategy risks cannot be managed by rule-based systems but by risk management systems which reduce the probability of such risks materializing and even if it does materialize how the same can be contained. There are three distinct methods which are usually adopted to managing strategy risks.

a. Independent experts

This is more effective in highly specialized fields where external experts challenge the project team to ensure that all risks are covered. This also keeps the project team on their toes. These are most effective in specialized fields where the project is probably being done for the first time and hence the team doesn’t have any precedence to fall back upon.

b. Facilitators

This is generally used in stable industries which have stable technological and market environments and predictable consumer demand. In such situations risks stem from seemingly unrelated operational choices. These choices lead to gradual accumulation of risks which can also remain and not be noticed for a long time., The facilitators enable a regular and open discussion with all concerned operational staff making them aware of the risks involved in each of their day-to-day decisions and the also develop matrixes to track and identify them.

c. Embedded experts

This is applicable in industries where there is a risk involved in everyday day to day operations. Let’s consider the example of investment banking where the banks risk profile can change dramatically with a single deal or a major market movement. In such organizations risk management experts work side by side with the line managers continuously monitoring and influencing day to day decisions.

d. Using Strategy Management tools like Balanced Scorecards, Risk event cards, Risk report cards, Heat maps etc.

3. **Managing the Uncontrollable Risks**

These risks occur external to the company and there is not much that companies can do in advance to prevent them. What companies can do is focus on identifying them, assessing their potential impact and figuring out how best to mitigate their effects should they occur.

Some of the analytic approaches that are used to manage external risk are as below

a. Risk Stress tests

These help companies assess major changes in one or two specific variables whose effects would be major and immediate although the exact timing is not forecastable...

b. Scenario Planning

This tool which is used for long term planning examines the effects of key drivers like political, economic, technological, social, regulatory and environmental etc. Usually, the top four contributing factors from the among list which effects the particular industry is considered for the analysis.

c. War gaming

This tool helps companies to assess a firm's vulnerability to disruptive technologies or changes in competitor strategies...

Managing risk is very different from management all other functions within an organization because risk management focuses on the negatives, the threats and failures rather than the opportunities and success that all other departments within the organization focuses on.

Risk Management is nonintuitive. Rules and compliance can mitigate some of the risks but not all of them as we have all seen in the last year and a half...

Active and cost effective risk management requires managers to think systematically about the multiple categories of risk that they face. They will then have to build in processes which help them to neutralize their managerial bias of seeing the world as they would like it to be rather than as it actually is or could possibly become…

This crisis has also taught us to see risk as an opportunity and use it to leverage new business models to grow in any new normal…

Only then will an organization be truly resilient to any risk foreseen or unforeseen.

Until next time…