Viewpoints

Bringing risk culture to the board room

By Dr Hamish Deery

Risk culture is a high priority for regulators and shareholders, but can be a tricky area for directors. Boards continue to grapple with important questions like how to define risk culture? Can it be measured or managed? What does success looks like? What is the role of the board in creating the right culture?

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The good news is, an organisation's risk culture can be measured and effectively managed as part of an integrated risk management framework. While some level of risk is necessary to drive growth, what constitutes an acceptable level of risk needs to be understood, and the 'human element', such as attitudes and behaviour that cause risk management failures, should not be left unmanaged.

What is risk culture?

So, what is risk culture? While there is no definitive answer, APRA describes it as "the way staff identify, understand, discuss and act upon the risks an organisation either confronts or takes"[1]. The Institute of Risk Management defines it as "the values, beliefs, knowledge, attitudes and understanding about risk shared by a group of people with a common purpose, in particular the employees of an organisation"[2].

As APRA points out, culture is influenced by both formal and informal aspects of how an organisation functions. Risk culture is part of the broader organisational culture. It reflects the way attitudes and beliefs are displayed when individuals in an organisation take or manage risks.

Risk culture is most effectively managed when it is seen as the responsibility of everyone in the organisation, from the directors through to employees at the 'front line' (those dealing with customers, contractors, suppliers or other stakeholders). It is important that the board understands, directs and governs the risk culture, even if day-to-day operations and monitoring of behaviours are the responsibility of management.

Culture within a broader risk management framework

Culture is one of a number of elements that make up a risk management framework. Others elements include:

- A governance structure that recognises the importance of different organisational roles for managing risk. It typically includes employees as critical owners of risk identification and management, and ensures both integrated and independent challenges can be managed.
- An agreed risk appetite, including how value and risk are assessed. This will include measures to evaluate risks against business goals, and a statement outlining the level of risk the company will seek, accept, avoid or eliminate. Limits and tolerances can then be developed to govern how risks will be measured and managed throughout the business.
- Policies and standards that document and support the risk management framework.

Tools and analytics are needed to support the implementation of the risk management framework. These are used to measure various types of risk (e.g. fraud, bullying and discrimination, workplace health and safety, cyber security and market risks, etc.). Processes then operationalise risk management, forming a control cycle that underpins effective risk-based decision-making. They typically include early identification of risks (before they become too expensive or difficult to address), horizon scanning to assess potential future risks, and stress and scenario testing the impact of possible future events.

When all of these elements are in place, directors and management can better anticipate and manage risk and risk culture.

Measuring risk culture

It is important for the board to set the tone for risk culture. Working with management, the board needs to be satisfied that reliable measures are in place to support the identification and management of risk attitudes, behaviours and experiences.

There are well-developed approaches to measure and report on risk culture, both qualitative and quantitative. These draw heavily on the fields of organisational behaviour, psychology and psychometrics. Directors should ask management if their organisation is using both qualitative and quantitative methods to be confident the results are representative of real issues and culture across the business. Combining methods also helps to pin-point segments of best practice and/or concern, to benchmark within or between organisations, and to track progress over time.

A qualitative approach can offer rich and deep insights on culture. It can include interviews, focus groups and case studies, and can be applied across an organisation or target particular areas. When these investigations are undertaken in a safe environment by skilled facilitators (often independent of those in the room), qualitative research can yield insights on key risk themes, identify potential issues, and surface useful examples to illustrate the current state.

Crucially, qualitative approaches can highlight issues in need of immediate attention, as well as more systemic issues requiring a longer term and more holistic approach to management. It is important to take into account the perspectives of the leadership team, middle management and employees on the frontline, as each group will likely have different information and experiences related to risk culture.

Many organisations are now using culture surveys to provide a quantitative measure of risk culture. Key questions related to risk attitudes and behaviour typically reflecting both organisational-wide and local team experiences, and include:

- **Knowledge:** Are employees aware of risks the business faces or risk challenges?
- **Process:** Is risk incorporated in policies and procedures, and is there personal responsibility for compliance?
- **Experience:** What are the shared employee experiences around risk (such as roles in decision making and the level of governance, how policies are implemented, and how specific risks are managed)?
- **Openness:** Is there an open sharing of views, and appropriate reporting of risks or issues, including where and how to raise concerns? And do employees believe that these concerns will be listened to and acted upon?
- **Behaviours:** Are employees comfortable and willing to raise concerns, speak-up, challenge colleagues and leaders when needed, mitigate risks or stop work operations when hazards are identified?

To get the most from a risk culture survey, there needs to be a quality benchmark – without that, boards and executive teams wrestle with the results. Simply, they have no context for what is normal or, indeed, what is possible. These benchmarks are typically available from providers of risk culture surveys who have sufficiently large and representative databases of culture among industry and national peers, or organisations that are best in class.

Say, for example, 85% of your employees report that they are willing to raise their concerns. How do you know if this is a good or bad result? What standard is sought (such as meeting an industry norm or best practice)? As a director, what do you think your organisation should aspire to? While aiming for 100% may be ideal, a benchmark can assist the organisation in deciding whether it is worth the time and effort needed to move the needle beyond a best practice standard. Measurement should primarily be about understanding where your organisation is, where it wants to be and how it will get there.

The board's responsibility for overseeing risk culture

Overseeing the management of risk culture should be seen as a core focus of the board. This should ideally be reflected in the organisation's constitution, board charter and embedded in organisational practices. The board's specific responsibilities may include:

- Ensuring clear accountabilities for culture, starting at the Executive Committee level. APRA has identified this as a problem in recent high profile culture failings – citing overly complex and collaborative decision-making processes that slow the detection of risk failings and defuse responsibility[3].
- Understanding the current culture. This should include asking for independent and timely information to be reported to the Board, and challenging this information to ensure any weaknesses are addressed in how issues are identified and escalated.
- Ensuring appropriate controls and monitoring systems are in place to manage the impact of risk management failings. It is important to avoid onerous decision making processes (e.g. decisions through a series of committees) that are slow or hide behaviour and operational risks.
- As APRA has identified, ensuring that the risk management framework works in practice (not just on paper).
- Ensuring the remuneration framework balances risk and return and does not promote inappropriate risk taking behaviours.

About Hamish

Dr Hamish Deery is the Managing Director of Willis Towers Watson's Talent & Rewards segment in Australia and Talent Line of Business across Asia Pacific. Hamish has 20 years' experience advising organisations on human capital strategies and programs, organisational culture, and working at the senior executive and Board level to help ensure alignment to business strategy and implement change. Hamish holds a Ph.D. in Psychology and a Bachelor of Behavioural Sciences (First Class Honors) from LaTrobe University.

Questions for directors

So, what types of questions should directors ask to satisfy themselves that the right approach to risk culture is being pursued within their organisation? Here are some examples:

- Is your organisation's risk appetite position clearly stated?
- What is the level of awareness of and approach to risks throughout your organisation?
- Is there an alignment between your board and executives on the current and desired risk culture?
- What are the most critical elements in the risk culture that support or inhibit management of risk behaviours and controls?
- Are there gaps in understanding, beliefs or behaviours part of risk culture that need to be prioritised and addressed?
- Who is responsible for closing any gaps and reporting on progress?

Ultimately, directors need a clear vision of what the organisation's risk culture should look like, and how the organisation can get there.

Sources:
[1] APRA 2016. Risk Culture
[2] Institute of Management Risk Culture
[3] APRA Executive Remuneration Press Release