

White Paper

RISK LEADERSHIP **Searching for Core Competencies**

When a storm approaches many build shelters, but some build windmills

The concept of risk leadership has arisen in the last few years to address a problem that has emerged from broader forces of change in the field of risk management.

To understand the overall nature of that change one must understand that most areas of management contain specialised or technical knowledge and practices, but also possess a more non-technical, integrative face. For example, financial management requires technical knowledge and consequently most organisations have specialists in financial management. However, it also is true that most all management positions are seen as having general financial management responsibilities. The same could be said of accounting/audit, marketing, operations, strategy, human resources management and so on. However, as risk management is a relatively new field, the 'general face' has only just begun to emerge. Put another way, risk management has existed almost exclusively as a technical function (really, as many technical functions), and heretofore has not been understood as an integrated aspect of general management.

But why has change occurred? To a significant degree it may be due to the simple maturation of the field. However, beginning in the mid-1990s, a number of developments occurred that sped up the process. These developments, if discussed individually, would make for a very long story, so suffice it to say here that an environment of external expectations began to emerge, first through the establishment of market standards; then expanded through the release of best practice and guidance statements; followed by influential legislation and court decisions in key countries; and most recently emanating from new policies in accrediting and rating agencies. **While all these developments have a degree of independence from one another a common thread has emerged, which is that key stakeholders expect organisations (both public and private) to practice risk management and that the nature of this risk management is broad, comprehensive, integrative and strategic.** As a practical matter, this has meant that while the technical aspects of risk management have retained their importance, attention has had to be paid to the general management face of risk management. Since, in a sense, all managers are now risk managers within the scope of their duties, what does risk management mean in that context?

The answer to the preceding question is not entirely clear at present. It seems evident that technical specialists will continue to pursue their responsibilities (buying insurance, managing financial risks, assessing operational risks, and health

and safety measures). For top managers, basic logic would seem to indicate two types of roles; 1) setting policy, and 2) assuring that the intended integration of technical risk practices is taking place in accordance with that policy. The addition of this dimension to the individual technical functions has earned various labels. For many reasons, the term Enterprise Risk Management (ERM) has captured the flag at present, so when discussions of comprehensive, policy-driven, integrated risk management occur, ERM is the short-hand term of reference.

The term 'ERM' has a number of limitations, especially when applied in settings that are not strictly business related. For example, use of the phrase seems less than useful in public sector contexts or when multiple organisations or, say, citizen groups are involved. In the interest of avoiding those limitations here, we use the term, Modern Risk Management to convey this broad and integrative conceptualisation of risk management practices.

Early study of emerging trends and practices has led to the view that the policy/governance dimension of the Modern Risk Management is best characterised as a matter of Risk Leadership, while the operational/performance issues are categorised as matters of Risk Practice. This statement is largely silent on the details of Risk Practice except insofar as they might bear on defining and structuring the concept of Risk Leadership. However, this White Paper does include a general statement on Modern Risk Management core competence (see Appendix).

Although there is much research to be done, we can briefly reflect on the question, 'What is risk leadership?'

What is risk leadership?

We begin with the picture of the manager, sitting alone in the office (or out in the field) and faced with the usual tasks of the day. One can argue that a significant part of that individual's activities are tied into goal-related activities and to process-related activities. What do I want to achieve and how will I achieve it? Broadly speaking, a third general activity area is present as well: activities that exist because risk and uncertainty are present.

In a world of certainty one would need to only set goals, marshal resources, and the intended outcome inevitably would occur. However, risk and uncertainty intrude at every turn: they influence our perceptions of the world and our tasks, they present us with possibilities, threats and opportunities that may arise, they confuse and obscure the competitive environment, and they introduce change to the underlying environment. Simply put, part of every manager's job has always been risk management. The distinction between the old and new worlds of management is that in the past, the risk management part of everyone's job has been informal, idiosyncratic, unsystematic or...most often...simply unexamined. Thus (and this is essential to remember), Modern Risk Management is not focused on giving non-

technical managers something else to do; it is focused in helping managers more effectively perform in areas of existing responsibility.

Carrying the image of the individual manager forward, one can easily imagine that part of his or her risk management activity is geared toward performance...that is, actually undertaking decisions and actions that assess and address risk (introducing a safety measure, purchasing a financial risk management software programme). There clearly is a need for non-technical managers to understand the tools and techniques of Risk Practice, but discussion of those tools and techniques is not relevant here as they are widely understood and readily connect with current technical practices. However, the act of joining up the various bodies of knowledge in Risk Practice is an issue with important relevance to Risk Leadership, and therefore will merit further discussion below.

Risk Leadership and Risk Governance

Recently, the concept of Risk Governance has emerged and has been used to define a field with similarities to Risk Leadership. The International Risk Governance Council produced a white paper entitled Risk Governance: Towards an Integrative Approach. In that document, Risk Governance was defined as:

Include(ing) the totality of actors, rules, conventions, processes, and mechanisms concerned with how relevant risk information is collected, analysed and communicated and management decisions are taken. Encompassing the combined risk-relevant decisions and actions of both governmental and private actors, risk governance is of particular importance in, but not restricted to, situations where there is no single authority to take a binding risk management decision but where instead the nature of the risk requires the collaboration and co-ordination between a range of different stakeholders. Risk governance, however, not only includes a multifaceted, multi-actor risk process but also calls for the consideration of contextual factors such as institutional arrangements (e.g. the regulatory and legal framework that determines the relationship, roles and responsibilities of the actors and co-ordination mechanisms such as markets, incentives, or self-imposed norms) and political culture including different perceptions of risk.

(General Governance is defined as 'at a national level, the structure and processes for collective decision making involving governmental and non-governmental actors. At the global level, governance embodies a horizontally organised structure of functional self-regulation encompassing state and non-state actors bringing about collectively binding decisions without superior authority.)

In many respects this seems virtually synonymous with Risk Leadership. However, the Risk Governance concept might better be seen as the application of Risk Leadership, inasmuch as it generally describes what Risk Leaders do and how they do it.

As a point of contrast, Risk Leadership might be defined as follows:

Risk Leadership is an attribute of leadership representing a conscious understanding of risk and its impact on decision-making. While its visible manifestation is seen in the activities that constitute risk governance, the reference here is on the individual capabilities and methods of a manager or groups of managers to understand the cultural, social and psychological foundations of their approach to decision making as well as their specific role in the implementation of their risk governance responsibilities.

To place it simply into a framework of understanding, Risk Leadership is an attribute of effective leadership and is therefore mainly a matter of individual or group characteristics and capabilities. That capability is implemented through the activities of risk governance.

What is contained within Risk Leadership that is not part of Risk Governance?

The demarcation line between the two concepts is not clear cut...and indeed...exploration of the precise characteristics of Risk Leadership is a task the European Institute for Risk Management intends to undertake. Such an investigation would, it seems, need to clarify the following:

1. How does knowledge of risk relate to and integrate with general knowledge of management?
2. How does a manager become usefully conscious of the influence of culture and psychology on his/her perceptions of risk...as well as on perceptions and the framing of risk generally?
3. What analytical methods allow the decision maker to effectively account for risk and uncertainty in analysis?
4. To what extent must the leader understand and guide the risk management process?
5. How can leaders develop an organised approach to understanding the limits of their knowledge and to know how to ask proper questions?
6. How does an understanding of risk communication inform their approach to communication?

These distinctions seem to be, in effect, pre-conditions for the effective practice of risk governance. Both issues are critical; one focuses on the decision maker, the other on the instrumentation of decision-making.

So, the essential feature of Risk Leadership is the challenge of making top managers better risk-informed decision makers and effective leaders in addressing critical risks. What must be done to address this challenge?

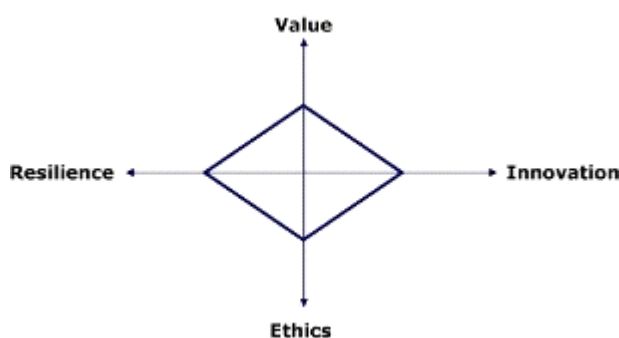
An Illustration: The Danish Framework

Recognising the importance of risk leadership, PRIMO-Denmark was formed in 2005. PRIMO-DK is a risk leadership association for chief executives in Danish public organisations. It exists to provide a forum for increasing awareness and knowledge of risk management among public leaders, and for leading projects geared toward better understanding what risk leadership means for Danish public organisations. As of 2009, PRIMO-DK has nearly 1000 members.

The Risk Leadership framework devised by PRIMO-DK follows.

Risk leadership and risk management are more or less two sides to one coin. Both activities deal with optimising the results of the local authority's organisation in relation to its goals. Risk leadership could be said to deal with defining, evaluating and deciding what could constitute critical risks to the organisation, whereas risk management to a larger extent deals with how these risks are handled in the best possible way.

The ultimate purpose of risk leadership is to contribute to ensuring that an organisation is able to handle its tasks and its responsibilities effectively and efficiently. PRIMO-DK has identified four different ways in which this takes place as shown in the VERI-model:



Value creation

Risk management has a clear economic purpose. Due to a systematic handling of risks, the organisation achieves a healthier financial position as a consequence of fewer outlays in connection with damage, accidents, mishaps and errors. Risk leadership also creates value because risk work generates confidence and innovation.

Ethics

The purpose of risk management is also to protect the welfare of people, values and the world. Systematic risk work is based on a healthy concern for our fellow human beings and for our common environment. Thus, risk leadership can be viewed as a concrete form of ethics, in the sense that it is an action-oriented realisation of value-based leadership.

Resilience

Through systematic identification, assessment and handling of risks, the organisation will reduce the likelihood that risks will come to constitute actual threats. Predictability and resilience in relation to changes in the external environment is thus a third purpose of risk

leadership. This is achieved through organisational learning, which is an integral part of good risk leadership.

Innovation

The starting point of innovation is limitation. Necessity is the mother of invention. Whenever something is not allowed or seems impossible, the drive and creativity to overcome what is forbidden or risky, is created. This is a situation that we recognise from our personal lives. But it is, not least, a lesson that is learned on a daily basis by innovative enterprises. Thus, good risk leadership also has as one of its aims to identify fields suitable for innovative solutions.

Nevertheless, it is also important to emphasise that risk leadership and risk management should be seen as correlated concepts. Strategic risk work should be closely connected with practical risk work.

The European Institute for Risk Management (EIRM) has set the subject of risk leadership at the centre of its risk agenda. Over the course of the next 1-2 years, EIRM intends to initiate a number of projects with the goal of better understanding the scope and depth of the risk leadership concept. Those interested in joining in the conversation or simply staying abreast of developments are encouraged to contact Dr. Peter Young at pcyo@eirm.com.