Risk Leaders' Roundtable:

Balancing risk – the fine line that can make or break an organisation

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Risk management has evolved beyond drafting risk appetite statements and achieving regulatory compliance. Today it's a holistic question of culture and conduct which reaches from a business' frontline all the way up to the boardroom.

When businesses make headlines for all the wrong reasons, questions are asked as to whether poor business conduct can be blamed on a few 'bad apples' or whether the people at the top can actually set the tone and culture of the entire organisation. Every level of a business plays a role in shaping its corporate culture and approach to risk, but the influence of the board and its CEO are critical, says Sally Freeman – National Partner in Charge of Risk Consulting at KPMG Australia.

"One of the clients I spend a lot of time working with always reinforces the values it wants to implement, such as boldness and integrity."

"It's an interesting way of managing culture – they seek to manage people and talent for success, rather than micro-managing businesses and structures."

Corporate culture can be difficult to define but it boils down to the values of the organisation, its beliefs and principles. Just as importantly, it's about how they're embedded within the organisation and put into practice.

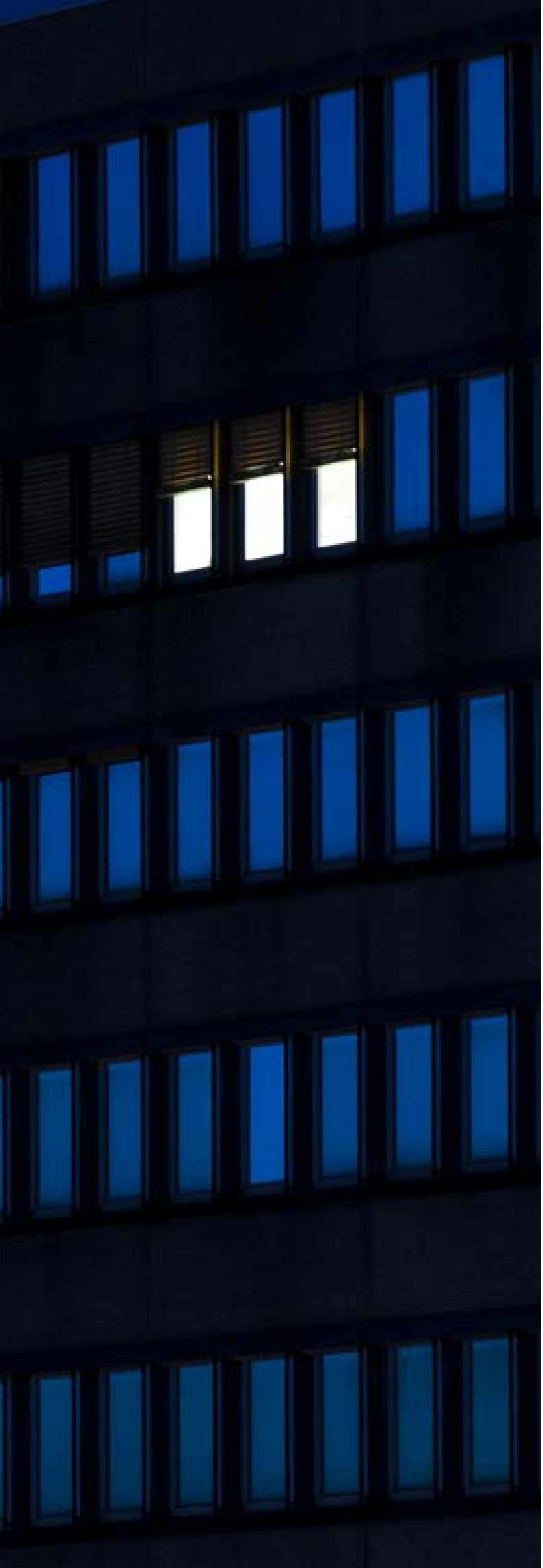
"Managing corporate culture requires a holistic approach; it goes much deeper than looking at one product you're selling or blaming a few rogue employees," says Gary Gill – Partner in Charge, Forensic Sydney at KPMG Australia.

"The mindset at the top rolls through the business and it's been said that the worst conduct which your leadership will condone can define your culture." It's also important to realise that we are most influenced by the behaviour of our immediate manager, so conduct flows from the board all the way through to front line staff.

The importance of corporate culture in risk management was long overlooked, Gill says. For a long time risk management was only focused on the content required for businesses to make risk-related decisions and the processes in place to drive those decisions through the organisation. Business culture is the critical third factor which helps balance the risk management equation in the pursuit for sustainable performance.

"Culture is the way that we actually embed our risk management in the business. Even with all the right content and process, if you don't have the right culture you are not going to have great long-term performance," Gill says.

"The notion of culture is not new but now we're more consciously aware of its importance and that we can shape it. The corporate regulators are also aware of the importance of culture and they're expecting businesses to do more and take on the responsibility of rectifying problems with corporate culture and conduct risk."



Managing conduct risk

Australian regulators are clear on that fact that they can't regulate culture, only conduct – or more explicitly, the results and outcomes of poor conduct.

The Australian Securities and Investments Commission defines conduct risk as a risk of inappropriate, unethical or unlawful behaviour by management or employees. This behaviour can be deliberate or inadvertent, perhaps caused by inadequacies in policies, procedures and training.

There's no simple checklist to tick off to ensure your business culture is conduct risk compliant. The process of combating conduct risk with good corporate culture requires an organisation to completely evaluate the way it does business, Freeman says.

"There a few key questions to start you on the journey towards good corporate culture, and to mitigate that risk of misconduct," Gill says.

"Have you defined your business culture, values and purpose? What communication of that culture at the top has filtered throughout the organisation? How are you ensuring that the desired culture and behaviours are reflected in your decision making?"

With a background in forensics, Gill says concern over conduct risk is not a passing fad; it doesn't only affect the financial services sector and it's not just relevant to sales staff. He estimates between $4 billion to $6 billion are lost each year due to misconduct, but the damage extends beyond unrecovered losses to impact on a business' reputation, employee morale and integrity of the markets.

Looking overseas, the UK Financial Services Authority has been renamed the Financial Conduct Authority and is bringing the integrity of financial markets to the forefront. Closer to home, ASIC and the Australian Prudential Regulation Authority are publicly targeting companies with bad corporate cultures.

"ASIC has recently said that they are really trying to signal to the industry more broadly that customers want to engage with corporates who have a culture that they can truly believe in," Gill says.

"It's also saying that the number of instances of misconduct indicate that it might be more than just a few bad apples but actually the tree itself, and I would maybe even extend that to say perhaps the trouble is the entire forest."

There is a key opportunity for business to become proactive to avoid further regulation. In the UK, regulation has become far more heavy handed – and not just with respect to financial services sector. The energy sector is facing far heavier regulatory burdens. With a more forward thinking approach, business may be able to avoid the more constricting approach taken by regulators.

Creating a great culture

Good business practices which help tackle conduct risk include rewarding good conduct as well as balanced performance targets, providing secure communication channels for whistle-blowers and ensuring that the board is accountable – taking responsibility for misconduct and investigating incidents in order to remediate them going forward.

Nurturing a positive business culture to combat conduct risk requires corporate self-reflection, drilling deep into the organisation to gain a clearer understanding of its culture – both in theory and in practice. It also requires mechanisms which drive that culture and processes which help people understand what behaviour is appropriate. Organisations need to understand what 'good culture' looks like – this can be difficult to describe and measure – especially using traditional KPIs. So taking time to really understand the culture paradigm you're after is key.

Defining, assessing and reshaping business culture to address conduct risk is not a simple one-off compliance exercise, it requires ongoing tracking, says Mike Ritchie – Partner in Financial Risk Management at KPMG Australia.

Tools for assessing corporate culture can include conducting internal surveys and interviews as well as workshops. You might start by looking at the corporate culture propagated by the board, but it's important to objectively measure whether the organisation is actually meeting its articulated cultural objectives and to determine what success looks like in the different facets of the business.

"If you decide that putting the customer first is your primary cultural objective, what sort of things would you expect to see when you look at customer-facing activities? What about when you look at your training material, or look at the models defining the way your people are rewarded?" Ritchie says.

"You then need to marry this up with what is actually happening within the organisation, such as at the coalface in the sales area, how are your policies being executed and how are people actually behaving?"

While managing corporate culture requires a holistic approach, in large and diverse organisations it can help to start by focusing on areas where cultural change could have the most significant impact. It can help to approach this from a value stream perspective, Ritchie says, drilling down into different value stream flows to look for the key points influenced by corporate culture.

Achieving balance

Managing risk within an organisation also involves balancing the needs of stakeholders, in order to keep the business aligned with the corporate culture it aspires to maintain. Achieving this balance often requires holding conflicting views simultaneously and finding a way to reconcile them in the boardroom, says Karen Orvad – Partner, Internal Audit Risk & Compliance at KPMG Australia.

"There's a risk when the value of one stakeholder's view is given preference over another, which is where competing interest dilemma reconciliation can help resolve issues and develop a healthy risk culture," Orvad says.

"This can be quite challenging and anyone who has been through the process knows that to reach a really good outcome sometimes you need to sit in discomfort around the problem for quite some time – as chief risk officers and consultant advisors we often try to solve a problem quickly but sometimes to get the benefit you really need to tease it out."

There are classic dilemmas which apply to practically every business, such as whether to centralise or decentralise, where to trade short-term cash flow for long-term sustainability and how to balance customer needs against shareholder needs.

When these appear to be opposing goals it seems difficult to satisfy both. Rather than placing them at either end of a scale and simply attempting to strike a compromise somewhere in the middle, Orvad favours a concept called "cracking the line". Allocating conflicting goals to the X and Y axis of a graph, this technique allows greater flexibility to explore options beyond simply trading off one goal for the other.

"Traditionally most organisations resolve these dilemmas by deciding to do a bit of both and end up somewhere in the middle, even if that's not what they're trying to achieve," Orvad says.

"By cracking the line you can move into a space that hasn't been explored before, which is where corporate culture and your approach to risk management become important because they can help light the way."

Ultimately, building more sustainable and trusted businesses relies on having a culture that creates the right conduct. It's not easy but it's the only way to meet the sometimes competing demand of customers, employees, suppliers, regulators and shareholders.

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