"THE OBSESSION WITH CONTROLLING RISK – IS IT STIFLING OPPORTUNITY?" – "Dare to dream or continue to nightmare!!"

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Abstract: I'm a big believer in risk management strategies, but we need to focus on the management, and not so much on the risk itself. We can't let the presence of risks stop us from seizing opportunities, from innovating, and from serving our customers as best we can. We need to work out how we can minimize the effect of the downside of risks and we need to weigh the risks, their likelihood, and their manageability against the risks associated with not taking the 'risky' action. A failure to seize opportunities, a failure to be responsive, and a failure to be innovative within an organisation is a huge risk in itself.

What is needed in organisations is an approach which can integrate smoothly the management of risks and opportunities. In fact the terminology and methodologies we use often completely omits the assessment of positive opportunities and continues to perpetuate the emphasis on risk controls. This paper attempts to provide an opportunity based approach.

The willingness to take significant risk is a common factor among the people we consider heroes, great artists, traders, and entrepreneurs alike. Avoiding risks is a sure path to failure. Rather than avoid risk, which is impossible in the first place, we need to develop a deeper understanding of risks in order to convert potential pitfalls into opportunities, we need to consider and embed opportunity into our risk assessments, and we need to consider putting people into the risk assessment equation.

David will also utilise everyday situations facing organisations today to demonstrate that people are central to every kind of risk decision; from the cost and structure of labour to understanding the power of employee engagement – especially in turning risk into opportunity.

Keywords: Opportunity, Opportunity Risk, Risk Controls, Risk Management
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1. INTRODUCTION

"*Great deeds are usually wrought at great risks.*"

Herodotus (484 BC - 430 BC), the Histories of Herodotus

For the risk management profession to continue to be of value to our organizations we must encourage them to take more risks. Carefully assessed risks, for sure, but take them we must. The failure to seize opportunities is Risk Managements greatest risk.

If you are starting to feel uncomfortable already it is because the word "risk" is still very strongly associated with negative outcomes.

If you do a "google" search on "risk and opportunity management" you will find thousands of sites. Many of these are organizations that are espousing their risk strategies. However, when you look at these websites closely and their associated documentation you find that, despite the rhetoric, they are concentrating on the negative aspects of risk.

I don't know about you but I love to daydream. In fact because we live in rural Australia my wife and I will often daydream while travelling in the car about what we would do if we won the lottery. This has been a really positive process because I can quote several instances where we have realized "we can do this now we don't need the lottery". As risk managers we don't do this. In fact I have often been quoted as saying "although a lot of paranoid people work here I am the only one that is actually paid to be paranoid". Why do we do this? Why do risk managers "nightmare" instead of daydream?

In order to understand this we need to look at some of the weaknesses inherent in many of the approaches to risk management that organizations take.

2. THE WEAKNESS OF CONTROLS.

A favourite quote of mine is:

"The greatest risk to value is not what has gone wrong, but what could go wrong, you need a forward looking, risk-based approach to provide reliable assurance".

Although I agree with the sentiment the reason it is a favourite of mine is not because of what it says but from where it came from - Arthur Andersen's home page!

Before their demise Andersen's lead the way in 1991 when they moved away from the traditional audit risk model of the 1980's that concentrated on financial statements to what they called a "business audit model". Basically the model consisted of first gaining an understanding of the entity's business, the strategic risks facing the business, and the controls that are in place to manage those strategic risks. Secondly the key business processes are identified along with the risks associated with those processes and what controls management has in place to manage those controls and any emerging risks. Thirdly the audit evidence is collected and controls assessed [1].

The business audit model has continued through a number of iterations within the large audit firms until today, and with its introduction we had for the first time a systematic way of looking at the effectiveness of risk controls. In fact another eight years was to elapse before the first Australian Risk Management Standard was introduced.

Now, don't misunderstand me, I am not suggesting that risk controls should be ignored. In fact noted software expert Tom Gilb says "if you don't actively attack risks, they will attack you." [2]. However concentrating on unimportant controls at the expense of seizing opportunities is counter productive.

The problem with the business audit model is that it concentrates on the likelihood of a control failure and thus continues to reinforce the "nightmare approach" to risk management.

The business audit model as well as quality systems like ISO 9001 look at organisational procedures and processes. The danger is that it may concentrate on the operational level and not at the enterprise level. The reason it does this is because the negative side of risk is more important than the opportunity side at this level. In other words control is more important than opportunity at lower tiers within an organisation.[1]

What is needed in organisations is an approach which can integrate smoothly the management of risks and opportunities. In fact the terminology and methodologies we use often completely omit the assessment of positive opportunities and continue to perpetuate the emphasis on risk controls.

[1] I will discuss this aspect in more depth later on in the paper.

In figure 1 below we can see that we need to expand our focus when thinking about uncertainty management [3]. By focusing on negative uncertainty we concentrate on controls, policies and procedures. In doing so our concentration is internal. In order to encompass opportunity we need to expand our view so that it not only takes an internal focus but more importantly an external one.

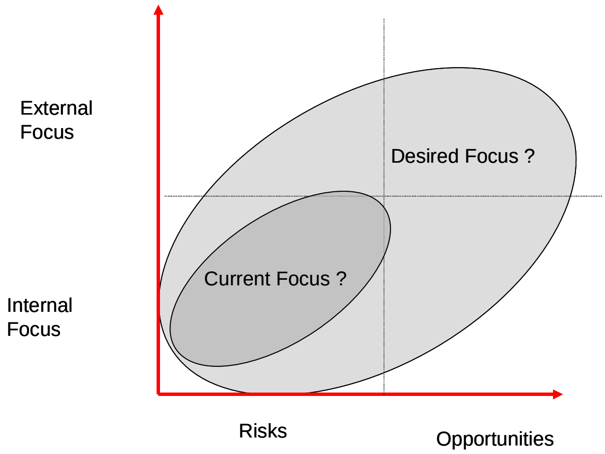

Figure 1: Organisational risk focus.

3. THE WEAKNESS OF THE MODELS WE USE.

Most Risk Managers utilise a probability/impact matrix for assessing levels of risk. In using such tools we need to understand their weaknesses.

Firstly they are subjective. It is true that they are generally based on an experienced professional opinion, however at the end of the day they are still subjective and open to the issues of risk perception. For an expanded discussion on risk perception I suggest that readers obtain a copy of my presentation from last years RMIA conference [4]. Secondly we need to understand that the results from such tables are non-linear. As an ordinal scale the results can be used to prioritise risk but not to measure their magnitude. Thirdly we are trying to predict uncertainty which is by its very nature "uncertain" – if our model can accurately predict uncertain future events then it isn't a risk, because it will surely happen (and can I please buy one!!).

Finally for many engineering and financial risks it is not uncommon to know the probabilities of failure to a high level of accuracy. However, I put it to you that the more you know about a risk, and the more you can measure its probability and impact, the less of a risk it actually becomes!!

Many organisations spend so much time understanding and measuring risks that they never actually get around to dealing with them.

4. THE IMPORTANCE OF OPPORTUNITY RISK.

Hillson [5] makes a convincing case that opportunities get "short shrift" in most organizations. "The standard risk process is limited to dealing only with uncertainties that might have negative impact (threats). This means that risk management as currently practiced is failing to address around half of the potential uncertainties – the ones with positive impact (opportunities)".

With both AS 4360 and the draft version of ISO 31000 talking about risk as the uncertainty around future events both "upside" and "downside" risk should be considered.

Hillson [Op.cit.] goes on to talk about an opportunity as the opposite of a threat and adopts the position that both concepts together constitute risk. Instead of opposites I prefer to see them as part of a continuum.

At one end of the continuum we have uncertain future events that have the potential to have a negative impact and need to be avoided. At the other end of the continuum we have uncertain future events that may have a positive impact. These are the opportunities that we need to seize.

In the middle are events which I have termed neutral (although this is not strictly the case). They may have either a positive or negative effect, but still need to be considered. I have often found this to be the group which receives undue audit attention. From an uncertainty management perspective the return on investment can be problematic in this area and requires due consideration. Where there is a risk of a control failing we need to consider the importance of the control, the effectiveness of other controls, and if the organization's risk appetite warrants further mitigation. On the positive side the rate of return versus other investments may not warrant its implementation.

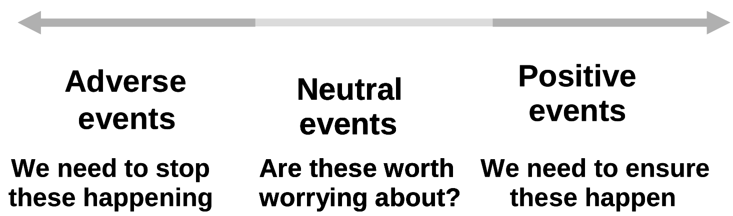

Figure 2: Uncertain future events

"Elimination of all risk is not practical, not necessary and, not even desirable……… my focus is always on achieving the requirements *in spite of* the risks". [6]

The reason organisations exist is to embrace opportunities not to minimize risk. As such the more you move away from the operational level and the more strategic your viewpoint the more important that opportunity risk becomes.

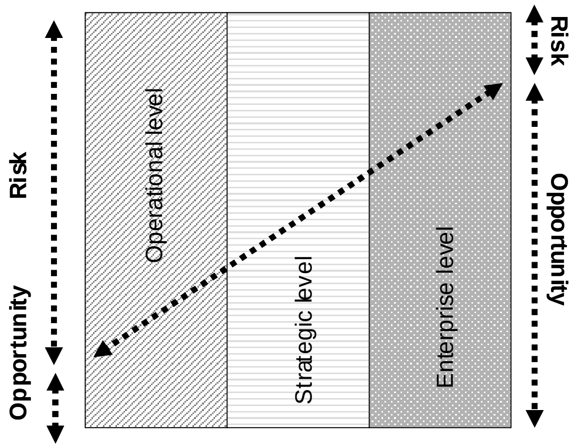

Figure 3: The relative importance of opportunity and risk [7]

5. TOOLS FOR INTRODUCING OPPORTUNITY RISK

How then can you introduce opportunity risk in a practical way in your organisation?

First you need to understand that just as organisations can be risk seeking or risk averse, organisations can be opportunity seeking or opportunity averse.

In figure 4 below we have a situation we can define risk as R = Lo (likelihood) X Io (impact). In an organisation with an averse risk/opportunity profile for any increase in Lo you see and lesser increase in Io, likewise for a risk/opportunity seeking profile, for any increase in Lo you see a greater increase in Io. It is possible and perhaps even desirable to have an adverse risk tolerance for negative uncertainty and a risk seeking tolerance for positive uncertainty (opportunity). What you need to do is to incorporate risk opportunity tolerance into your framework. If you don't then the dominant organisational culture will prevail and this may not be what you desire.

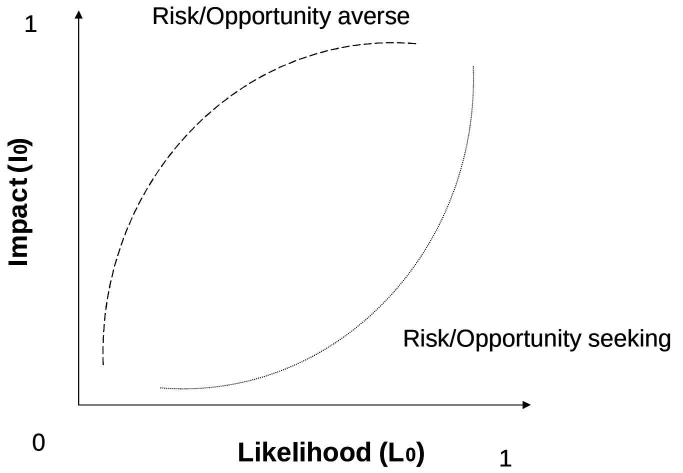

Figure 4: opportunity tolerance

Secondly when considering uncertainty you need to consider both negative and positive certainty in your analysis. As experienced risk managers you have the tools. The same process we use now as outlined in AS 4360:2004 can be used for both negative and positive uncertainty.

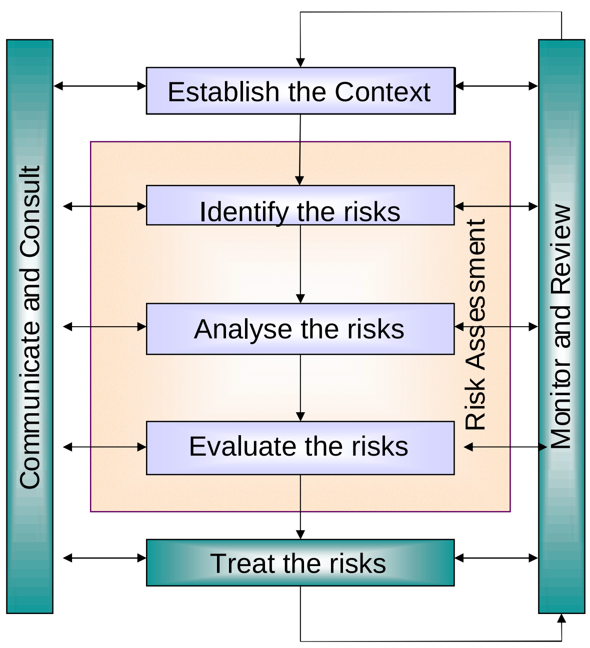

Figure 5: AS 4360:2004

Thirdly by developing a consequence/likelihood matrix that includes both risks and opportunities you are encouraging staff in your organisation to think about considering risk and opportunity as dual entities.

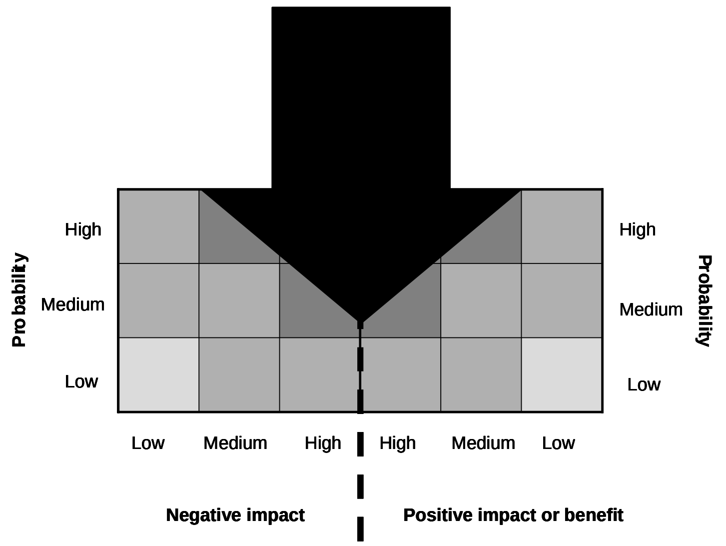

Figure 6: Risk & Opportunity matrix

The matrix you use should be yours, but by including a mirror image, opportunities will not be ignored. The attention arrow indicates the areas for benefit and dis-benefit where the most gain can be found.

6. THE WEAKNESS OF PEOPLE IN THE PROCESS

Those of you who know me well are aware that the engagement of people in the risk management process is a passion of mine and this will certainly not be new to you.

In order to move staff and organisations along this journey it is important to realise that you need to engage people's Head, Hands and Heart [8].

First you need to engage people at the head level by providing the justifications and structures to support the organisation. Then you need to build competencies and skills (hands) and finally people can really see the benefits and are fully engaged because they want to be (heart).

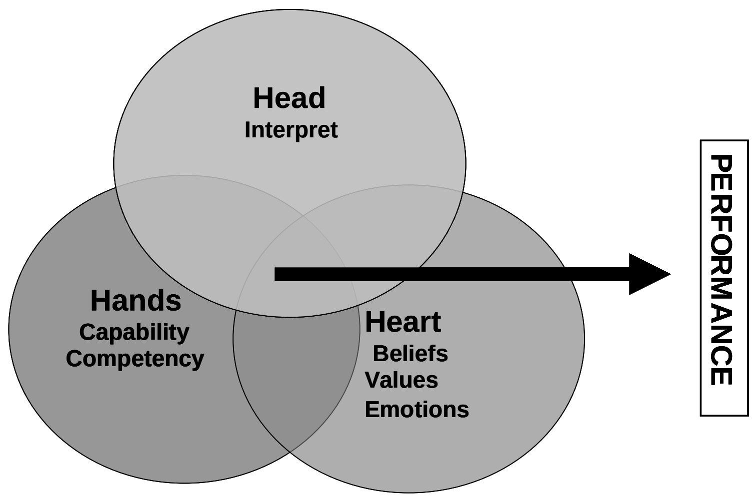

Figure 7: Linking risk concepts with performance

It is important to realise that to achieve the ultimate level of performance the head, hands and heart all need to be involved. Without the heart people will not have the will to perform, without hands they will not have the skills, and without the head they will not know what to do. All are integral and we need to engage people at all levels to achieve results.

7. CONCLUSION

As a risk manager, are you able to stand alongside Martin Luther King and shout at the top of you voice ***"I have a dream"?***

If you cannot then the likelihood is that you are leading yourself and your organisation down a nightmarish path. Certainly put strong robust controls in place that will mitigate negative uncertainly, but also ensure that you seize hold of the opportunities that uncertainty also brings. Above all ***dare to dream*** or you will surely continue to "nightmare".

References

[1] Jeppesen, K., *"Risk and Complexity in Social Systems: The Case of the "Business Risk Audit"*, in Torben Juul Andersen (eds.): Perspectives on Strategic Risk Management Chapter 5, CBS Press. (2006), Copenhagen.

[3] Developed from a presentation by Michael van Aanhout, presented in Vancouver 2004 which can be found at: http://stratos-sts.com/publications/Imagine_2010_Strategic_Approach_CS_Sept_2004.pdf

[2] Gilb, T., *Principles of Software Engineering Management*, Addison-Wesley Pub.Co., (1988), Boston.

[4] A copy of this paper *"Moving people from process to preference"* can be found on our website at http://www.riskmatters.com.au/5.html

[5] Hillson, D., *"Effective opportunity management for projects"*, Risk Doctor and Partners, (2004), New York.

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[7] White, B., *"Enterprise Opportunity Risk"*, INCOSE, (2006), New York.

[8] Adapted from a model in Henderson, M. & Thompson, D. '*Values at Work"*, Chapter12 ff, Harper Collins, (2003), Auckland.