Risk management and risk governance: why imperfection is better than perfection

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Risk as a major preoccupation

- Risk appears to be more prominent than ever

- Terms such as risk governance have arisen and associated ideas such as resilience have also developed

- "Risk governance in transformation"

A very brief (and recent) 'history' of risk

- Late 1980s and early 1990s
  - Value at Risk (VaR) and risk appetite

- Mid to late 1990s
  - ERM and operational risk

- Early 2000s
  - Risk governance

- Post 2007-8
  - Risk culture

Risk management

RISK MANAGEMENT SYSTEM

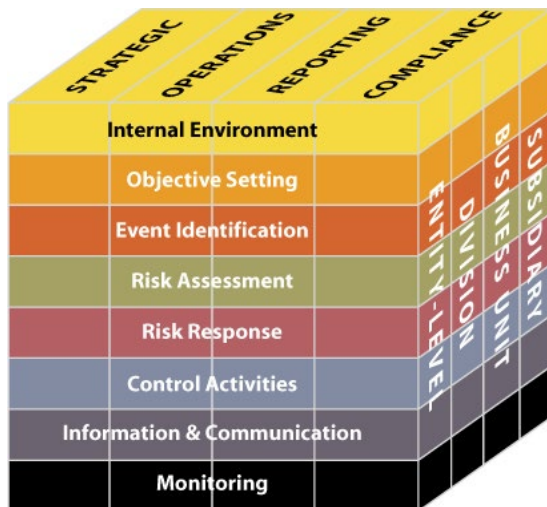Identify any risks that can affect the company

⬇

Decide which risks are important

⬇

Manage these important risks

⬇

Keep checking for new risks

COSO Enterprise Risk Management (ERM) Integrated Framework

Risk culture

Provoked by the financial crisis but still of great concern (PPI mis-selling, LIBOR manipulation). In UK Banking Standards Board (BSB) created 2013, renamed the Financial Services Culture Board (FSCB) in 2021.

Best practice guidance on risk management and internal control for boards of directors states an "organisation's culture is essential to the way in which risk is considered and addressed" (FRC, 2014, p. 1)

Reports recommend banks develop a *strong* or *sound* risk culture (for example, G30 2015, 2018; FSB, 2014)

Directors should develop a single, unified risk culture

For example: "The Board: … sets the tone from the top and seeks to effectively inculcate an appropriate risk culture throughout the firm" (FSB, 2013, p.30).

People think differently to one another

For example –poverty debates

Fatalist (Isolate)
> Whatever you try to do there will always be poor people

Hierarchy
> We need a structured approach to understanding the causes of poverty

Individualist
> Individuals have to take responsibility for their own lives

Egalitarian (Enclave)
> Poverty has happened because governments and business do not care enough

Anthropology and Risk

- Social relations matter (maintaining stability)
- We have selective attention to risk

Isolate ordering	Hierarchical ordering
Isolates feel excluded from society but also feel imposed upon by others. They can feel frustrated by life and that they have no control what risks might arise. They are just getting by.	Tradition and authority are important, and experts should be trusted. Rules and regulations keep order and should be respected.
Individualistic ordering Individuals need to take responsibility for themselves and not rely on others. Failure is your personal responsibility Self-regulation is preferred over imposed regulation.	**Enclaved ordering** Belonging to the group is important and the world outside the group may be viewed as 'dangerous' or 'risky' . Being disloyal is seen as dreadful. Justice, fairness, and acting ethically are considered important.

The four solidarities

Each solidarity has a different thought style

For example, hierarchists think risk can be managed over the long-term and prefer using a structured approach to risk management – ERM.

All four solidarities are present in any organisation or society or group

One of the four may be dominant but all are present

Change can, and does, occur

The dominant solidarity might change and be replaced

People think differently to one another

For example –poverty debates

People think differently to one another

For example – COVID debates

Fatalist
(Isolate)

Wearing masks may or may not help; having a vaccine may or may not help – and who can know?

Hierarchy

Wear a mask as this is what the scientists and government tell us is best to do.

Individualist

Individuals should take responsibility for their own lives and decide for themselves if they want to wear a mask.

Egalitarian
(Enclave)

Society caused COVID. The guidelines should be followed as we have a duty to protect our fellow citizens.

Four perspectives on risk management

FATALIST	**HIERARCHY**
Look to keep options open and adapt strategy as uncertainties arise	Careful balancing of risk and reward
All risk management systems will eventually be found to be inadequate	Preference for comprehensive (ERM) risk management system
INDIVIDUALIST	**EGALITARIAN**
Comprehensive risk management systems impede innovation and risk-taking	Look to avoid losses
Accept losses may arise but over time profits will more than match losses	Based on judging the world as a very uncertain place

See Underwood and Ingram (2010)

Because all 4 solidarities are present this implies:

A single risk culture is not possible to achieve

Acceptance of an ERM system by all members of an organisation is not possible

But accepting imperfection is positive

- Multiple risk cultures

  - Can halt the dominant risk culture becoming a caricature of itself

  - If the 4 are combined risk might be managed better as they see different risks partially but differently

  - messiness and reassurance

Imperfection again

Each solidarity has advantages and disadvantages

Therefore, if you want the 'best' solution they should work together

But if you want any solution to a problem to be accepted then it needs to appeal to (at least partly) to each solidarity

QUESTION

How to fashion such a solution?