Danger - smart executives at work: leadership and risk

Is it just banks where smart people make such poor decisions? Or can it happen anywhere?

As a wide range of experts, commentators and ordinary people have asked since the banking crash: how was it that smart executives made such remarkably poor decisions? There has been a rush of publications since the crash of 2008 on how why such dangerous risks were allowed in banks across the world. We looked through a range of material, over the last five years, to identify the consistent points of interest to any organisation.

What goes wrong?

Much has been written on what tends to go wrong – pointing at these ways that companies mismanage risk:

- *Relying on historical data*: data does not predict what next. Extrapolating from the past is dangerous
- *Focusing on narrow measures*: especially focusing on what is easier to monitor or measure
- *Overlooking knowable risks*: especially ignoring risks not normally associated with a particular activity
- *Overlooking concealed risks*: people responsible for incurring actual risks often do not report them
- *Failing to communicate*: those who monitor, or manage risks, do not tell leaders
- *Not managing in real time*: risks can change quickly and action is best taken quickly

The route to better risk management: moving from less external to more personal responsibility

There are three complementary approaches to risk management:

1. ***Formalisation:*** introducing rules, procedures and decision-processes to judge and manage risk.
2. ***Externalisation:*** using expertise and seals of approval from outside (auditors, regulators and others)
3. ***Personalisation:*** pushing responsibility for managing risk onto those managing the actual decisions.

Most commentators on the banking crisis suggest a need to focus less on externalisation and more on personalisation. They also agree that organisations should look for the answer to improving risk management within their organisation, more than looking for the next new external risk. The problem for banks was not sub-prime assets, it was the way they managed the risk of sub-prime.

In looking at the switch from 'externalisation' to 'personalisation', the literature suggests three requirements:

a. ***High-quality insight:*** ensuring high-quality, objective information, effective analytical tools and the ability and inclination to use them.
b. ***Personal accountability:*** an example from the UK police - when a routine incident escalates and becomes serious, an employee of any rank can trigger a 'critical incident' approach, call together a cross-force group to pull together all information available and make a decision about how to react
c. ***Supportive culture:*** those banks that survived the crisis better are known for more team-based decision-making processes where debate and open and productive challenge are the norm.

One survey showed that companies with 'better risk management *systems'* did less well at managing risk. Instead, an all-round common-sense view is required. If you live in Florida it is a waste of time working out the risk of hurricanes. You need to have a plan for what you do when they happen. This means businesses spending more time planning, becoming prepared and responsive and less time on risk measurement.