Risk Management Made Simple

Welcome to the FREE Online Newsletter about **Systematic Risk Management**

for **executives** and **management professionals**

from ***Risk Wise Inc.*** and **Diana Del Bel Belluz**

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"Diana Del Bel Belluz is **an articulate thought-leader** in the field of risk management."

Edward Robertson
Manager, Enterprise Risk Management
Government of British Columbia

In this issue…

FEATURE ARTICLE: The Anticipation Advantage

By Diana Del Bel Belluz, M.A.Sc., P.Eng.

"Skate where the puck's going,
not where it's been." ***Walter Gretzky***

That's the advice hockey great Wayne Gretzky got from his dad. It encapsulates **a central objective of risk management — to anticipate your future circumstances** (both threats and opportunities) **so that you can position yourself advantageously**.

The importance of anticipation and positioning is even more dramatic in a sport like car racing which is a better sports metaphor for how organizations rather than individual players behave. **Think of your organization as a racecar**, with your CEO as the driver, the business units as the car's major components (e.g., engine, wheels, brakes), and the functional areas (human resources, finance, risk management) of the company as the pit crew that keep the car running smoothly. The car is a sophisticated machine, not an inanimate puck.

The driver and pit crew have an instrument panel with gauges that provide critical data on performance, e.g. the oil gauge, tachometer, thermometer. If the pit crew tracks the car's oil use, and analyzes it, they will know how much oil the engine is burning under various operating conditions and how far they can they can push the engine.

Tracking and analyzing the basic data enables the driver and the pit crew to anticipate the future and make informed decisions such as: how far they can push the engine, the optimal time to service it, and what modifications to it could improve overall performance.

The ability to anticipate enables you to compete. Christiane Bergevin, President, SNC-Lavalin Capital Inc. in an interview with The Globe and Mail explained it this way. **"If you can anticipate [trends] in the business world you are ahead of the crowd … you can have more time to think and you can innovate."**

To anticipate, you need to understand both:

1) **How internal factors influence the achievement of your objectives.** This means tracking the contributions that your key resources (people, business processes, and systems) make to your performance. For the racecar, this would include converting the data from the instrument panel into information to decide how best to operate the car.

2) **How factors in your business environment can affect your ability to achieve your objectives.** This means keeping a lookout for trends and disruptive events. In the racecar example, this would include looking at steady trends such as air and pavement temperature to determine optimal tire inflation. And it would require identifying and preparing for disruptive events, e.g., collisions.

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Here are 5 tips to build your anticipation capability.

1) LOOK AT TRENDS. Most organizations collect a great deal of basic data but **fail to transform it into information about trends**, and relegating it to what I call the 'data cemetery'.

If a trend shows that a key indicator is veering off track, you can dig deeper to understand why and know how best to address it. It's like the difference between knowing how much gas your car consumed last week versus knowing that your gas consumption has been steadily rising week over week. Different root causes will demand different solutions. For example, is your gas consumption going up because:

- you are doing more driving? If so, you may have to find money for the extra gas or reduce your mileage;
- you are doing more city than highway driving? If so, you may want to optimize your routing;
- your engine isn't operating efficiently? If so, you'll want to schedule a tune-up.

Start with the data you are already collecting on key performance drivers. (For example, in a health care facility wanting to reduce wait-times, performance drivers could include: number of qualified professionals; number of tests conducted in a timely; operating room capacity; etc.)

Track how changes in your indicators affect the achievement of your objectives. When you have observed the trends for a while, you will be able to:

- **Account for your ultimate outcomes** by linking them to the underlying performance drivers. When you know what exactly is driving performance, you'll know how best to address gaps and opportunities.
- **Establish trigger points**, i.e., the threshold at which you need to start planning an optimal action strategy. In the healthcare example, if it becomes difficult to attract new staff, it's time to develop a strategy to address the potential drop in qualified professionals before it affects wait times.

2) KEEP IT SIMPLE. Most people will tell you that their job, their business, their sector is already complicated. Choose analytical tools that are simple to understand and easy to apply, such as the trending approach described above, influence diagrams, environmental scans, etc. The tools you provide your people **must bring clarity to their decision-making and reporting processes**. If not, go back to the drawing board.

3) USE A MODULAR APPROACH. Start small and build the analytics piece by piece. Adapt and modify the pieces based on 'user' feedback and analysis of results.

Don't try to develop an analytical model that replicates your entire business. Trying to roll-out a comprehensive risk management analytic system right out of the gate is a recipe for failure. **Begin by focusing on a single key objective** and the most significant factors that contribute to it. Like wait-times in healthcare.

4) BEWARE OF ASSUMPTIONS. Whenever you make predictions about the future, **assumptions are a necessary evil**. This is particularly true when you are extrapolating trends of *past* data. Be careful that your assumptions are valid. Ask yourself questions such as:

- Do we have evidence showing that our past is a robust predictor of future performance?
- Is it reasonable to expect that the conditions that created our past performance will persist unchanged in the future?

For more on assumptions, see this month's Bonus Resource: ***The Achilles' Heel of Risk Management***.

5) WORK WITHIN YOUR CULTURE. If your organization's values are contrary to the principles of risk management, it will be impossible for risk analytics to gain traction. **Principals that form the foundation of a strong risk management culture include:**

- **a balanced approach to risk-taking** (versus gambling or risk aversion),
- **a proactive and disciplined approach to management** (versus ad hoc or reactive),
- **accountability** (versus buck-passing or blame),
- **evidence-based decision-making** (versus authoritarian or personality-driven).

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The *Risk Wise* bottom line…

To compete well, you need to anticipate. As a risk management professional, you are positioned to play a major role in building your organization's anticipation capabilities. With the right information and interpretation skills, decision makers across your organization will be able to consistently **'skate to where the puck is going'**. Think of what that could do for your organization in terms of improving your performance and reaching new heights of success!

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Tell me how you've built your people's analytical capabilities to help your organization to anticipate and compete. I appreciate receiving emails with your tips and success stories at Diana.Belluz@riskwise.ca

BONUS RESOURCE: The Achilles' Heel of Risk Management

By Diana Del Bel Belluz, M.A.Sc., P.Eng.

Would you agree that house prices can only go up? In the present credit crunch era, that seems like a whopper of an assumption. But in the months and years leading up to last August's sub-prime mortgage meltdown, it was a widely held assumption shared by homebuyers, lenders, investors, and regulators.

In a *New York Times* article titled *What Happens If We're Wrong?*, author **Peter L. Bernstein reminds us that forecasts are wrong from time to time**, particularly when the underlying assumptions are faulty. (Read the full article at **www.nytimes.com**).

Bernstein warns that **when managers ignore the true definition of risk, they lose all power to actually manage risk**. He shares a simple definition of risk by **Elroy Dimson of the London Business School**, i.e., "more things can happen than will happen". Bernstein explains that "**if more things can happen than will happen**, we can devise probabilities of possible outcomes, but — and this is a big "but" — **we will never know in advance the true range of outcomes we may face**".

Bernstein pillories the assumption that home prices can *only* go up. He states that in this assumption "the word 'only' is ridiculous ... More things can happen than will happen. Under those conditions, risk management should concentrate either on limiting the size of the bet or on finding ways to hedge the bet so you are not wiped out if you take the wrong side — if home prices do start to go down, or even stop rising."

He concludes with this advice, **"Effective Risk Management starts with the recognition that any forecast can be wrong, then weighs the consequences of being wrong. Only then can we decide whether to make a bet, whether to hedge that bet and how to execute the hedge if needed."**

In my view, **assumptions are the Achilles' Heel of risk management**. We cannot avoid making assumptions. They underlie every decision and action we take. Therefore, **if we want effective risk management, we need to learn how to handle assumptions properly**.

Here are three simple strategies to deal with them:

1) **Recognize your assumptions for what they are — assumptions, not facts.** We know now that 'house prices can only go up' is an assumption.
2) **Document your assumptions** to demonstrate due diligence.
3) **Test your assumptions —** both when you first make them, and then again from time to time. Validate your assumptions when conditions change.

I recently heard a hospital administrator share lessons learned from a minor fire that shut down a major health care facility for nearly a year. As a result of the fire, **they discovered that many of their pre-crisis assumptions were wrong and routinely went unchallenged.**

For example, they thought they'd be able to return to the building within hours of extinguishing the fire; but it was uninhabitable. Since the crisis, **members of the leadership team engage in frank discussions about the assumptions that underpin their decisions**.

Do decision-makers in your organization identify and test their assumptions? Or **is it just a matter of time until a crisis reveals your Achilles' Heel?**

Announcing the Risk Management 'Personal Trainer' program:

It solves a huge problem undermining virtually all risk management leaders.

The problem faced by the vast majority of people tasked with integrating risk management across their organizations is this: **they haven't implemented systematic risk management before.** Successful implementation of systematic risk management requires both solid knowledge of the risk discipline and the skill to shift organizational cultural. **Your *Risk Wise* 'Personal Trainer' bridges your experience gap.**

When you work with a *Risk Wise* 'Personal Trainer' you will:

- **Receive personalized on-going support** to systematize risk management and keep your program on track.
- **Develop actionable solutions that you can apply immediately** to the risk management issues you're grappling with today.
- **Learn to balance the strategic and the tactical** with an advisor who understands the challenges of implementing risk management in a complex business environment.
- **Gain access to a broad array of proven tools and techniques** for the assessment, management and communication of risk. **This includes powerful risk analytics that give your people the anticipation advantage!**
- **Benefit from the sounding board effect** created when you have the ear of a risk management expert who can help you develop your ideas into creative and feasible solutions.
- **Enjoy the convenience of having private, confidential sessions** over the phone at a time that fits your schedule.

You can begin working with a Risk Management 'Personal Trainer' immediately. There are **only 5 spots available this year.**

To find out how the *Risk Wise* 'Personal Trainer' program works and **how to qualify for the Earlybird Bonus (a $750 value) available only until July 31st, 2008, visit:**

https://www.riskwise.net/PersonalTrainer.html

About Us

Diana Del Bel Belluz
President
Risk Wise Inc.

Diana Del Bel Belluz, M.A.Sc., P.Eng., is a risk management advisor who **helps executives in large organizations to implement systematic and sustainable risk management practices**. Since 1990, Diana has been doing **leading-edge risk work** for companies in a wide range of industries and government organizations.

In addition, Diana **advances the field of risk management** by **teaching** university courses and management training seminars, **speaking** at conferences and **authoring** publications on a wide range of risk management topics.

To learn more about Risk Wise, contact Diana Del Bel Belluz directly at: Diana.Belluz@riskwise.ca

1 Yonge Street
Suite 1801
Toronto, Ontario
Canada M5E 1W7
T 416.214.7598
www.riskwise.ca