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CORPORATE RESEARCH FOREM

BRIEFING PAPER NO. 3

DISCUSSION PAPER:
"ORGANISATIONAL RISK"

Sponsored by: HIRERIGHT® KPMG

CONTENTS

COMMENTARY

HireRight is pleased to contribute a commentary to complement this discussion paper regarding organisational risk, the way risk is perceived and how best to manage it.

We partner with businesses around the world to help reduce the risk of new hires by applying our background screening services, but there is a lot more to managing risk in HR.

Here are some of the key questions the report raises and addresses:

Business Risks

How aware are your HR leaders and their team of your company's business risks? Different departments will have different risk concerns. Does your HR department work closely with the other teams in your business, such as legal, finance, marketing and IT, to ensure that you coordinate an appropriate business risk management strategy?

HR Risks

What are the key risks that your HR department faces and what are their underlying causes? Concerns about reputational damage, data security and leaks by internal staff could all be linked to the underlying risk of a bad hire, which can be mitigated by utilising pre-employment background screening.

Risk Culture

What is your company's attitude to risk? Is it appropriate for the business that you're in? Is it appropriate for the size of your business? Is it appropriate for the regulations that your industry has?

Risk Skill Sets

Does your company base its risk assessments on data? Do you think in terms of scenarios, considering different contexts and ways of looking at a situation?

However your company deals with risk, I am confident that this report will help you to develop your risk strategy for 2019 and beyond.

Steve Girdler
Managing Director of EMEA & APAC, HireRight

FOREWORD

KPMG is delighted to sponsor this important and fascinating Corporate Research Forum paper on the evolving links between HR and risk.

The paper is full of valuable, practical insights for HR Directors. In my view, two important themes stand out. The first is that people and risk are intrinsically linked; you can't have one without the other. The second is that risks, in themselves are not necessarily to be avoided at all costs. Rather, a sophisticated approach to risk taking considers the corresponding downsides as well as the upsides before making a decision. We touch on similar ideas in our Future of HR 2019 report, which identifies a divide between HR functions willing to embrace new approaches and models, and those suffering from inertia in the face of change.

Risk is human...

Of course, any HR Director knows that the two ideas I have highlighted are closely interconnected. On the first point, experience shows that every element of risk has a human aspect, and that every human activity carries an element of risk. An intelligent, holistic approach to HR understands that businesses can't divorce risk from people.

So it can't be eliminated

Furthermore – and this plays to my second point – it's a mistake for firms to try to eliminate every risk. After all, success in business is all about taking risks in an intelligent way. Instead, businesses need to develop an environment that encourages people to take measured risks, such as testing new products and new ways of working, without fear of failure.

Integration may hold the key

So what does this mean for HR functions? Personally, I expect HR and Risk functions to become much more closely integrated over the next few years. This will allow HR teams to apply a risk lens to all their activities, including recruitment, reward and training. And it will help risk teams to embed a better understanding of people into their processes. Today's firewalls and defined processes will give way to closer links, softer boundaries and more strategic thinking. A new, specialised discipline of People Risk is likely to emerge.

Thus rejuvenated, HR functions can play a vital role in achieving a healthy, mature attitude to risk throughout the business. The right risk culture – or risk 'personality' – will help empower all of a firm's people to understand, manage and embrace risk, instead of seeking to eliminate it.

Mark Williamson
Head of People Consulting, KPMG in the UK

01

ORGANISATIONAL RISK
SETTING THE STAGE

Almost every example of business misfortune can be reframed as a case of mishandled risk. Whether it is CEO misconduct, phones catching on fire, lack of innovation, or a cyber-security breech, all are risks that potentially could have been foreseen. How many of these foreseeable risks have a human element? We dare suggest that all of them do.

Risk is a far-reaching topic; let's begin this briefing by explaining how we think about risk.

WHAT'S COVERED

ORGANISATIONAL RISK

1.1 WHAT IS RISK?

For a senior leader, risk is a lens for viewing the business. Every decision or action can be seen through the lens of risk.

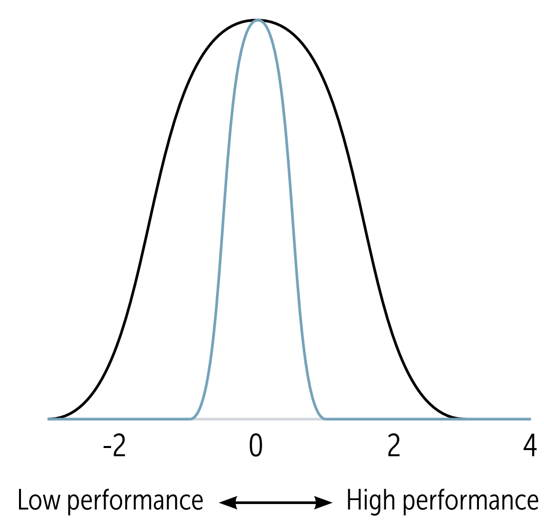
Compare the risk lens to our usual operational lens (Figure 1):

Figure 1: Operational Lens vs Risk Lens

Issue: A New Hire	
OPERATIONAL LENS	RISK LENS
'What are the competencies we need?'	'What's the damage if we make a bad hire?'
'What is the best way to bring them up to speed quickly?'	'What happens if they come up to speed slowly?'
'What's the median market pay?'	'If we stop hiring MBAs, how much cheaper will they be? Is it worth the risk?'
'How do we reduce the cost of hire?'	'What's the upside if this person is exceptional?'

A more formal view of risk is that it has to do with the range of *variability* in an outcome. If the best cashier is only a little bit better than the worst cashier, then there is not much variability and hence not much risk. To be a little more sophisticated about it, we might say if the business impact of the best cashier is not that different from that of the worst cashier, then it's low risk.

Figure 2: Risk as Variability



The Blue distribution is narrow which means that the best performers are not much better than average, and the worst not much below average. There is not a lot of risk in who we hire (assuming they meet minimum standards).

The Black distribution is wide which means the best performers are much better than average, and the worst much worse. There is a lot of risk when we hire for this kind of position.

This shows a normal distribution; there are many other kinds.

In this paper we will focus on how HRDs can apply the risk lens.

1.2
RISK MANAGERS VERSUS RISK TAKERS

It's common to see risk in terms of the bad things that could happen and to move from there to talk of 'risk management'. A better way to see a leader's role is that they are a *risk taker*, rather than a risk manager.

When we use the framing 'risk taker' it highlights certain points.

- **There is upside risk as well as downside risk.**
  Consider cyber risk in an insurance company. Yes, they could face an attack (downside risk); however, they could also see it as an opportunity to create new products for insuring against cyber-attacks.
- **Many risks are worth taking because of the upside.**
  Is it worthwhile spending money on summer interns who don't get much real work done? Perhaps, if it is a way to discover hidden gems.
- **Sometimes the cost of trying to mitigate downside risk exceeds the value of doing so.**
  How tightly do we need to control what hiring managers ask in interviews to ensure no one ever asks an inappropriate question?

POINTS TO PONDER

- It's easy to think of downside risks (e.g. the risk a new CEO won't work out, the risk of a strike).
- Can you think of risks HR is taking now because there is a big upside for the business?
- Can you think of cases where the cost the company is incurring in managing a downside risk exceeds the value of mitigating that risk?
- In this paper we will embrace the *risk taker* mindset. How does it feel if you see your role as being a *risk taker*?

1.3
RISK REGISTERS VERSUS STRATEGIC CURIOSITY

In large organisations, there is normally a visible stream of risk management activities that often centre around creating risk registers (Figure 3).

Figure 3: A Simplified Risk Register

DESCRIPTION	LIKELIHOOD	IMPACT	MITIGATING ACTIONS
Flooding of eastern Warehouse	Moderate	Moderate	Flood insurance. Create plans to service clients from other warehouses.
Strike at a key supplier	Small	High	Increase inventory of critical items. Source a second supplier.

There are also inevitably many reporting, auditing and compliance activities. Finally, there is often an entire department with specialised expertise for buying insurance against risks.

However, there is a rather different approach to risk management which we might call *strategic curiosity.* We compare the two elements of risk management in Figure 4.

Figure 4: Approaches to Risk Management

FORMAL APPROACHES	STRATEGIC CURIOSITY
Seeks to engage managers in risk processes.	Seeks to help managers see the world through a risk lens.
Concerned about management of risks that have been identified.	Concerned about bringing to light aspects of risk that have been overlooked.
Risk manager is likely to be in the office – gathering data, analysing information, managing processes, preparing reports.	Risk manager is likely to be out of the office – engaging in conversations to uncover risks and educate managers.

Both approaches are needed. In this report we'll focus on the strategic curiosity side of risk management.

POINTS TO PONDER

- Is the strategic conversation side of risk management visible in your organisation or is the focus largely on more standard and formal risk processes?

ORGANISATIONAL RISK

1.4 RISK ALL THE WAY DOWN

When one applies the risk lens it quickly becomes apparent that risk lives at every level of the organisation. Massive business risks can arise from any number of causes – a market crash, a geopolitical conflict, an extreme weather event. There are smaller risks around the hire of every worker. An HR clerk will make risk decisions about how thoroughly they will check that a form is filled correctly based on how serious the consequences will be if there is a mistake.

This means a strategy to enumerate all the risks will never work. Broadly speaking, we want a risk-savvy culture where people make good decisions about small risks on a day-to-day basis, as well as a more rigorous process for dealing with bigger risks.

POINTS TO PONDER

- Are your people reasonably savvy about day-to-day risk? Is so, how did they develop that skill?

02

ORGANISATIONAL RISK
BUSINESS RISKS

At the level of an HRD, a discussion of risk should always start with business risks. The extent to which the CEO involves HR in conversations about business risk is an interesting signal about what they expect HR to deliver.

We'll discuss three aspects of HR and business risk.

WHAT'S COVERED

ORGANISATIONAL RISK

2.1 IS HR AWARE OF BUSINESS RISKS?

A good starting point is to ask how aware HR is of business risk.

POINTS TO PONDER

- Is the HRD as well-informed about business risks as the CFO?
- Does the business involve the HRD in discussions about risk?
- To what extent are the HR leaders one level down from the HRD aware of business risk?

POINTS TO PONDER

- What are the top five risks the business faces? (Is your list the same as the CEO's?)
- What, if anything, should HR do differently in light of those risks? (Can you think of anything you should be doing that you've not done yet?)

2.2 CAN HR CONNECT BUSINESS RISKS TO HR ACTIVITIES?

HR professionals often struggle to make the connection from business risks to HR activities in anything but the most generic terms. If the business risk is from Brexit, HR may have a hard time identifying anything that they should be doing differently. Possible geopolitical risks, with uncertain consequences, are hard to connect to the day-to-day work of hiring, paying, and developing employees. Yet if we ask the question of what the fallout of Brexit might be, and extend our vision from the day-to-day to what might affect the firm a year from now, then we should be able to put our finger on some specific risks we should begin to manage.

If we start with a vague risk, such as 'unpredictable US president', are we able to tease out specific scenarios such as significant changes to labour regulations, and from there predict how those changes might affect the business and what HR should do?

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2.3
DOES HR SHINE A DIFFERENT LIGHT ON BUSINESS RISK?

Ideally different members of the leadership team will bring different perspectives to any discussion of business risks. Finance will be aware if a strategy exposes the firm to foreign exchange risk. Marketing will point out anything that risks undermining the brand. Legal will assess any legal risks.

What does HR bring to the table? If we think in terms of initiatives in your business, can you recall any times HR could see things other leaders didn't see? For example, HR might see how a proposed action could lead to bad ratings on Glassdoor, or HR might notice some subtle change in the culture that creates risk.

Note that HR often sees things in terms of activities ('If we are expanding production in China then we better invest in technology that will allow us to ramp up our hiring of workers') rather than in terms of risk ('If we don't succeed in hiring this many workers by this date then it will have this impact on production and hence this impact on the strategic plan').

POINTS TO PONDER

- Has HR ever provided fresh insights on business risk?
- Does HR refrain from jumping to a solution and instead simply articulate the risks for the leadership team to consider?

03

ORGANISATIONAL RISK
HR RISKS

While HRDs should be starting with business risks, there will come a time when the CEO asks HR about the biggest risks that fall squarely in HR's domain. Let's consider this topic.

WHAT'S COVERED

ORGANISATIONAL RISK

3.1 IDENTIFYING TOP HR-SPECIFIC RISKS

If you could only focus on three risks, what would they be? Here are some suggestions:

- Reputation
- Top leadership and leadership pipeline (critical due to their power)
- Top performers (critical due to their performance)
- Key technical roles (critical due to their knowledge)
- Hard to fill high-volume roles (critical because we simply need large numbers to keep the operation running but find it difficult to do so)
- Smart people doing bad things
- HR data security and privacy
- Leaks by internal staff
- Health and safety
- Code of conduct breaches
- Robotics and automation
- Other?

3.2 ASSESSING THESE RISKS

Once you've identified three HR risks, consider the following:

- **Are you clear about the time horizon?**
  One of the most important elements in strategically thinking about risk is time horizon. Global warming is a massive risk but it's unlikely to affect HR in the next year. It's worthwhile to estimate when it would begin to have an impact, and hence what kinds of decisions might be affected by this risk. For example, this risk does not affect how many staff you hire this year, but it will impact considerations about where to locate a plant that will be operation for 20 years.
- **Can you be highly specific about where the risk lies and the magnitude of the risk?**
  It's not much good to say that talent shortages are a risk or low engagement is a risk. Which talent shortages would have the greatest impact? How great would that impact be? Where would a change in engagement most severely hurt or help the bottom line? For the three risks you picked, can you be highly specific?
- **Do you have a range of mitigation options?**
  Have you thought of a range of things you might do to face these specific risks? Is there anything noticeably different from what you're doing now? If nothing is different, what does that say about your analysis?

3.3 BEING A RISK TAKER

What upside risks do you want to focus on? What would be big enough that it would be noticeable at the board level? For example, if you took a risk by investing a lot on the employer brand in the hope of increasing your reputation as a great employer, how big an upside would that have for the business?

POINTS TO PONDER

- Do any of these areas offer such big upside opportunity that it's worth taking a risk on them?
  - New organisation models
  - New technologies
  - Adding some extra kinds of talent
  - Trying out new HR processes
  - Experimenting with new working practices
- If not these, then is there any place where an HRD can be an aggressive risk taker in a way that opens up opportunities for the organisation?

04

ORGANISATIONAL RISK

RISK CULTURE

Culture is about values, beliefs and behaviours; *risk culture* refers to how values, beliefs and behaviours relate to risk.

WHAT'S COVERED

ORGANISATIONAL RISK

4.1 IS YOUR COMPANY'S RISK CULTURE APPROPRIATE?

A company's risk culture could fall short on a number of dimensions:

- **Too risk averse.** Always seeks to avoid risk to the point that it slows the organisation down, misses upside opportunity and spends too much minimising (rather than optimising) risk.
- **Too lax about some big risks.** Even if the company's risk culture is not bad on the whole, if it is cavalier about certain categories of big risks then that needs to be addressed.
- **Insufficiently sophisticated about risk.** Some companies haven't developed risk management processes or mindsets to the point that they can effectively manage risk. (In fact, most companies struggle to some extent because the field of risk management is still immature).
- **Lack of insight on the human element of risk.** Organisations often create policies to manage risk that are completely undone by humans who don't follow the policy. If the leaders think that a well-crafted policy or set of rules is enough to control risk, then they are likely to be rudely disappointed.
- **Weak at defining accountability.** Some big risks may go unnoticed or not acted upon because no one person feels responsible.
- **Doesn't select leaders who are wise risk takers.** Organisations may not consider whether candidates for leadership have the appropriate mindset for taking risks.

POINTS TO PONDER

- Do any of these six factors affect your organisation?
- Do any of them affect HR?

4.2 BLINDED BY SCIENCE?

Formal analyses of risk (complex risk registers, fancy forecasting, advanced modelling) could blind the organisation to problems. Traditional economic models saw no signs of an impending financial meltdown in 2008; trust in those models blinded people to some self-evident truths about, for example, people with no income getting large loans to buy homes.

POINTS TO PONDER

- Are we fooling ourselves into thinking our complicated risk management processes are indeed dealing with the deepest risks? What would a cabbie (one who likes betting at the track) say about our biggest risks?

05

ORGANISATIONAL RISK

RISK THINKING

There are some perspectives about risk from Nassim Nicholas Taleb (most famous for his book *The Black Swan*) which are interesting to consider. See if any of these are relevant to your role in risk.

WHAT'S COVERED

ORGANISATIONAL RISK

5.1
TAKE RISKS YOU UNDERSTAND

Taleb says, *"Take risks you understand; don't try to understand risks you are taking."*

POINTS TO PONDER

- Has your organisation ever been guilty of taking on risks it didn't really understand?
- Have you?

5.2
LONG-TAIL RISK IS OVERLOOKED

When risk managers talk about long-tail risks they are talking about unlikely events at the far end of the distribution (think of the ends of a bell curve). The problem with long-tail risks is that if we think something is unlikely, we tend to ignore it altogether. Taleb has argued that events in the long-tail may be more common than we think (i.e. it's a fatter tail than in a normal distribution) and that the magnitude of these events may be much greater than we expect (e.g. not just a flood, but the worst flood ever).

A closely related idea are Black Swan events which are large and unforeseen, perhaps unforeseeable. For the UK, the most recent Black Swans have been the 2008 financial crisis and the unexpected result of the Brexit vote. For Oracle, the rapid movement to cloud services was apparently a surprise, leaving their HCM far behind Workday. For makers of combustion engines, the sudden shift towards electric engines must feel like an event of Black Swan proportions.

POINTS TO PONDER

- What are the very unlikely but very serious events that could occur? (e.g. a plane crash that kills your top executives).
- Has your organisation ever faced a Black Swan event?

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5.3 CAN WE BE 'ANTI-FRAGILE'?

A fragile item breaks under stress; a robust one survives stress. An anti-fragile item gets stronger. For example, a glass vase might break in the mail (fragile) while a metal one might survive even rough handling (robust). What kind of item might get stronger when badly handled by the post (anti-fragile)?

The concept of anti-fragility seems foreign, but it is really quite familiar. Consider the tennis player who gets better each time they face a really difficult opponent; they are anti-fragile.

The essence of anti-fragility is often learning. If you have a person or a business or a process that is continually facing difficulties and learning from those difficulties, then you have something that is anti-fragile. Taleb argues we should design for anti-fragility rather than robustness, because something is robust only to the point where forces are so strong it breaks. Robustness can prevent learning. For example, an industry protected by regulations may be robust (e.g. taxis) but end up being unable to cope when someone breaches those walls (i.e. Uber).

If you are anti-fragile you appreciate volatility because it creates upside risk (opportunity) that your competitors may be unable to seize.

POINTS TO PONDER

- How anti-fragile is your HR function? Do changing needs for skills, new regulations, geopolitical disruptions, and/or new technology give you an advantage because you are quick to learn and fast to react?
- Do difficulties in hiring or engagement make you stronger rather than weaker?
- At the dawn of the PC era was IBM fragile, robust, or anti-fragile? How about Michael Dell selling PCs from his dorm? (Hint: Which is still making PCs?)

5.4 SKIN IN THE GAME

One of Taleb's pet peeves is decision makers who don't have skin in the game. In other words, they are not affected if a risk goes sour. It's not surprising that people who don't have a stake in an outcome are poorer risk takers than ones who do. More surprising is work by Robin Hanson on prediction markets. His work shows that where people (who are not necessarily seen as experts) put money up to back a prediction they are more accurate than the experts (who are rarely held accountable for poor predictions) – skin in the game seems to be more important than expertise.

Since HR designs incentives, HR should be an expert on ensuring people have 'skin in the game' on any decision they make that creates risk. This doesn't come easily because people generally don't want skin in the game. Furthermore the important outcomes are often years in the future and managers quite consciously think 'If it does go bad I'll be long gone'.

POINTS TO PONDER

- Can HR play a crucial role in risk management by becoming adept at ensuring decision makers *genuinely* have skin in the game?

06

ORGANISATIONAL RISK
RISK SKILL SETS

In this section, we consider a good risk taker's key skills.

WHAT'S COVERED

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6.1
SKILLS FOR BECOMING A GOOD RISK TAKER

- **Think in terms of scenarios.** It's natural to assess risks from one familiar point of view. To be a skilled risk taker you need to consider differing contexts, differing ways of looking at a situation, and different scenarios.
- **Base risk assessment on data.** It's a mistake to think that data analysis on its own will make us good risk takers; however, if we don't have any numbers our risk assessment is likely to be poor.
- **Pay attention to intangibles.** Some say that in addition to the usual five senses, humans can sense 'the vibe'. A keen attention to the intangibles will inform good risk taking.
- **Learn to observe reality as it is.** Often, we see the world as we think it should be or as everyone tells us it is, rather than as it really is. For example, on paper the head of an overseas unit might officially be running the show. However, someone paying close attention might notice that it's really the second in command who makes the crucial decisions. Observing the world as it is, and not dismissing anomalies that go against what everyone else believes, will lead to better awareness of risks (see the famous story of the emperor's clothing).
- **Pay more attention to the world outside HR.** Big risks often originate far from the everyday world of HR. Keep a closer eye on political, social and technological developments. Go beyond what you (and everyone else) hears on the BBC.
- **Making sure you yourself have skin in the game.** If a poor decision won't affect you then you are less likely to make a good one (any more than experts are likely to make good predictions). Create situations where you have skin in the game to develop your risk taker mojo.

POINTS TO PONDER

Would becoming a skilled risk taker make your work more fun?

07

ORGANISATIONAL RISK
TAKING ACTION

While risk is an ancient subject, it's only recently that we've seen the creation of Chief Risk Officers and a more professionalised risk function. HR leaders will be expected to play a bigger role in risk management than in the past and to be able to see their work through a risk lens.

This paper has covered some of the main things an HR Leader should be thinking about in terms of risk. Now let's ponder what you might actually do.

WHAT'S COVERED

ORGANISATIONAL RISK

7.1 ESTABLISH THE BASICS

This briefing has steered away from discussing the basic processes of risk management; however it could be an important area to focus on.

What to do: If your organisation does not have a strong risk management function then the HR leader may want to champion investment in that. If there is a solid risk function but it doesn't have a close relationship with HR, then the HR leader could focus on improving that relationship. This relationship matters mainly for the risk function since so much risk is driven by behaviour, but it's also good for HR since HR will benefit from their expertise.

7.2 WORK ON RISK SAVVY

Risk savvy is what this briefing has focused on. Risk savvy is all about approaching the world through a risk lens so that you foresee risks, recognize opportunities and make good decisions.

What to do: Invest in educating yourself and your team about risk, schedule conversations about risk, bring risk into discussions, and encourage the leader of the risk function to engage you in strategic conversations. Perhaps the organisation needs to create the role of CRO if it doesn't have one to ensure a risk savvy mindset takes hold across the organisation.

7.3 BUILD STRENGTH

The organisation should have some reserves of time and money so that it can step away from ongoing operations to prepare for or deal with risk. A 'free' resource is having relationships with people who can help identify or deal with risk.

What to do: It's worth looking back at risks gone bad and asking if the organisation has made itself so busy or so tight-fisted that it's running into problems it could have avoided. If you find that the costs of being 'efficient' are too high, then you can get support for adequate 'slack' so that the organisation can handle risk.

With respect to risks you've identified ask 'who do I wish I knew with respect to this risk'? Then go out and build that connection. That's another way of building strength.

ORGANISATIONAL RISK

7.4 STRIVE TOWARDS RESILIENCE

The concept of resilience sits somewhere between robust (able to survive shocks) and the more radical anti-fragile (benefits from shocks). Being resilient includes the three issues mentioned above (The Basics, Risk Savvy, Strength) and also requires the right mindset.

The right mindset includes:

- Mistakes and near misses are not hidden or brushed aside; they are seen as signals about risk.
- The organisation avoids blaming people and instead focuses on problem solving (e.g. if something is going off the rails then the collective goal is to reduce the risk of failure, not find a culprit).
- Seeing setbacks as just part of the learning journey (i.e. a 'growth mind-set').
- A willingness to do things differently when it is called for.

What to do: Assess your culture on its attitude towards mistakes, setbacks, and learning. Investigate whether existing incentives or organisation structures get in the way of resilience (e.g. too many stakeholders can create gridlock, too strict silos can prevent collaboration).

7.5 IMPROVE CAPABILITY FOR RAPID RESPONSE

Since even with the best risk management things will go wrong from time to time, organisations need crisis plans so they are prepared for foreseeable problems (e.g. a hurricane) and a crisis team that is ready to respond when crises foreseen and unforeseen actually hit.

What to do: If you don't have crisis plans and a crisis team create them. If you do, check on what they are doing.

POINTS TO PONDER:

Which of these should you work on first?

Who would you meet within the next few weeks to move this forward?

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