

RISK CULTURE

THINK OF THE CONSEQUENCES



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TEN TAKEAWAYS

1. Negligent, reckless, and improper behavior can materially undermine company performance, as manifest in customer backlash, burgeoning litigation costs and penalties, and lasting reputational damage.
2. Inadequate risk cultures are often characterized by performance complacency or the normalization of unwelcome incidents. Problems often germinate during times of organizational stress, when new pressures divert attention from business-as-usual risks.
3. A strong risk culture provides three key benefits: it can help mitigate exposures from increasingly complex operational practices; it can enhance workplace productivity; and it can avert mishaps that may have far-reaching consequences.
4. A mature risk culture is present when personnel at all levels routinely anticipate risks and report issues of concern, look out for each other and the firm, and respond to evolving opportunities and threats in line with corporate risk goals.
5. Each company should specify its own desired risk culture in a way that aligns with the organization's values and risk appetite, especially in the areas of safety and security, ethics and integrity, and risk-return trade-offs.
6. To change deep-seated practices, it is essential to develop initiatives that reflect how individuals acquire new habits and thereby tap into their motivations. A technocratic reliance on institutional control frameworks will have limited traction.
7. Change efforts must initially identify key exposures that are influenced by attitudes and practices, characterize prevailing employee behaviors, and specify expectations of personnel in different parts of the firm.
8. Effective programs of action balance infrastructural arrangements with enabling processes, rules and instructions with encouragement and empowerment. Leaders may need to adapt their own behaviors to be credible as visible and effective champions for the cause.
9. The regular collecting of incident data, leading indicators, and personnel perceptions is vital for continuous learning and the ability to re-prioritize efforts. It is also the basis for senior-level reporting and for ensuring steady top-of-the-house engagement.
10. To secure the sustained investment that is required, change efforts must prove their value. A clear alignment of programs with business performance goals, strong progress tracking, and periodic break points give comfort to budget holders.



WHY MAKE IT A PRIORITY

“Accidents happen.” “People will sometimes behave badly.” “No system is foolproof.” “Our peers have a worse track record than we do.” In light of the incidents that have destroyed billions in shareholder value and caused lasting reputational damage to companies, remarks such as these have proven increasingly unacceptable to customers, regulators, and investors. Whether it manifests itself via a mis-selling scandal or a plant explosion, the revelation of a slack risk culture raises pointed questions about the robustness of operational practices and quality of company leadership.

Watershed events (such as the Tenerife airport collision in 1977, the Piper Alpha oil rig fire in 1988, and the global financial crisis in 2008) and subsequent reports have done much in affected industries to prompt senior management discussion about risk culture, establish new regulatory requirements, and spur wide-ranging programs of action. But it is equally clear that many companies have struggled to implement consistent, meaningful, and sustainable solutions across their operations.

Our experience suggests that a strong risk culture preserves value and enhances performance in three ways.

First, and perhaps most significantly, it helps avert incidents that can impair corporate reputations. In today’s world, it is ever easier for customers to share views on the quality of service they have received and

for the victims of industrial accidents or product recalls to collaborate to seek redress. In many sectors, the level of regulatory scrutiny has increased, and a lower tolerance for misbehavior can be seen in stiffer penalties and tougher provisions. Fair dealing with customers is high on the oversight agenda, and many industries face a strong push to remove obstacles to customers switching providers, where possible. As a consequence, shareholders are increasingly pricing the strength of company risk management into investment decisions.

Second, a strong risk culture helps mitigate exposures that come from increasingly complex operational practices (often enabled by technological advances) and the challenges of properly supervising them. Companies in many sectors deploy multifaceted, interdependent systems that rely greatly on employee judgment at all levels for active risk management. By the same logic, individual employees or small groups are able

to inadvertently generate massive liabilities through recklessness, negligence, or simple adherence to inadequate procedures.

Third, a strong risk culture generates efficiencies that result in margin improvements. By anticipating potential incidents, good operational discipline in industrial companies can reduce downtime and increase productivity, as well as providing a safer environment for the workforce. A decline in the number of incidents can additionally mean lower workforce payouts, fewer regulatory fines, and less need for customer compensation. Firms with strong risk cultures, as evidenced in their safety record, can see a very significant discount on insurance premiums for operational exposures.

Tightening or transforming the risk culture of a company is neither easy nor fast. But it is certainly valuable and possible. The remainder of this paper looks at symptoms and conditions for corporate vulnerability, proposes how best to think about risk culture in a company context, and sets out practical steps for initiating a successful program of action.

4:1

Estimated return on investment from expenditure in safety, health, and environmental programs*

* As perceived by 231 corporate decision makers

Source: ASSE, "Financial Decision Makers' View on Safety: What SH&E professionals should know", *Professional Safety*, 2009

75%

Magnitude of savings on insurance premiums by companies with a strong safety history*

* In the US workers compensation insurance market

Source: Independent Electrical Contractors, "Spotlight on Safety", *Insights*, May/June 2011

DEFINITION AND DISTINCTIONS

This paper defines risk culture as "the behavioral norms of a company's personnel with regard to the risks presented by strategy execution and business operations". In other words, it is a key element of a company's enterprise risk management framework, albeit one that exists more in practice than in codification. It necessarily relates to risk taking by individuals and teams (at all levels of seniority), as well as to commitments to risk mindfulness and mitigation.

A company's risk culture should be aligned with, but distinct from, its risk appetite, which represents the firm's willingness to take risks against a backdrop of known and assumed tolerances. It should be embodied in the company's organizational values and compliance expectations. And it should be reflected in its safety culture – the operational norms designed to reduce the likelihood of accidents (large or small) and their associated damage.



VULNERABILITIES AND CHALLENGES

The robustness of a company's risk culture can never be taken for granted. In times of organizational stress, it pays to be especially vigilant, but even the routine of smooth business execution can erode desirable risk-based behaviors or impede efforts to nurture them.

Company leaders should consider how their teams might interpret what is expected of them, and appreciate that even laudable corporate objectives may unwittingly sap an effective risk culture. Aggressive revenue targets can lead to high risks being taken for low rewards, poor information-sharing between commercial units, or an unhealthy conflict between commercial teams and the risk function. Prioritizing risk-adjusted profits can result in attempts to game models and metrics, or the preference for projects with uncalculated risks. An imperative of loss avoidance can instill timidity, stifle innovation, and erode competitive advantage. A preoccupation with compliance can lead to a myopic "fixation for checklists", rather than a proper consideration of uncertainty and risk.

Inadequate risk cultures are often characterized by performance complacency or the normalization of unwelcome incidents. But the symptoms of a poor risk culture are many and varied. In our experience, affected companies often show a high degree of fragmentation with respect to expected behaviors and a low level of accountability for decisions and actions. Senior managers often exhibit a lack of knowledge or concern about the risks faced by front-line personnel and load commercial pressure onto teams at the

same time as promoting the risk agenda. Incentive structures implicitly encourage high-risk transactions or behaviors, or those that are unacceptable in ethical or reputational terms.

In these firms, front-line supervisors are regularly overwhelmed by the need to both resolve commercial challenges and drive standards for risk culture. Personnel have little faith in the sincerity of the risk management agenda and pay only lip service to rules and procedures, which may be weak or contradictory and therefore open to arbitrage. Rule-breakers largely go unpunished. Governance shortfalls and a culture of fear mean there is limited scope for challenging the status quo, and whistle-blowers face high levels of disapproval that affect their progression within the company and sometimes lead to an unwanted exit.

Distance often engenders a feeling of invulnerability. This may manifest itself in the more independent behavior of niche, complex business units or parts of the organization in far-off countries. Often subject to lighter oversight, they may nonetheless create exposures for the entire firm. It may also be evident in the false sense of security that develops as organizational memories of the last major incident fade.

Problems often germinate during times of organizational stress, when new pressures both divert attention from business-as-usual risks and give rise to new behavioral norms. Some frequently seen circumstances stand out:

- **Financial underperformance:** Increasing concern about targets can result in management pressure on business units, assets, teams, and individuals that leads to bypassed protocols and excessive risk-taking;
- **Major cost-cutting exercise:** Workforce downsizing, process adjustments, asset constraints, and other measures targeting redundancy can lead to the removal of traditional checks and balances, and damage employee morale and good will;
- **Very rapid growth:** Organic expansion based on new market opportunities and involving an influx of new personnel can generate unwarranted complacency and an emphasis on revenue generation at the expense of robust operations;
- **Joint venture engagement:** Conflicting objectives and values between participating companies can stimulate new, unwelcome risk behaviors as participating firms pursue financial returns from the partnership and prioritize efficient collaboration;
- **Post-merger integration:** A failure to align swiftly on common values and processes can lead to workforce confusion in joint teams, oversight difficulties, and a greater risk of accidents;
- **High use of third parties:** A failure to assess and monitor the maturity of the risk culture of contractors and subcontractors of all types can lead to unconsidered exposures that may affect the safety of one's own workforce and corporate reputation;
- **Arrival of a new chief executive officer:** The desire to be responsive to a new leader and their commercial priorities can result in the hasty rollout of new initiatives that may affect the risk behaviors of personnel.

By themselves, any one of these destabilizing factors can undermine corporate risk behavior. When several of them come into play at the same time, or when the risk culture within a company is already weak, the likelihood of a significant incident is high.

Inadequate risk cultures are often characterized by performance complacency or the normalization of unwelcome incidents.



\$38 BN

Total provisions currently set aside by UK banks to cover compensation, administration costs, and fines for misselling payment protection insurance (PPI), with periodically rising provisions indicating persistent uncertainty about the final costs. The current sum is broadly equivalent to all profits made on PPI sales since 2000 and does not reflect the often uneconomic pricing of the loans with which they were associated.

Source: Which?, bank announcements, July 2014



\$43 BN

Total provisions set aside by BP for costs relating to the 2010 Deepwater Horizon oil spill. This includes \$25 billion for litigation and claims and \$14 billion for cleanup activities. To cover these costs, BP sold \$38 billion of mature assets. A ban on applying for new government contracts in the US was in place until April 2014. The verdict of gross negligence in a September 2014 court ruling may result in an additional \$13.7 billion in penalties.

Source: BP announcements, financial statements, press, 2012–2015

COMMON DRIVERS OF INCIDENTS

- **Cost prioritization:** Investigations into the causes of industrial accidents (such as oil spills and infrastructure failures) often lament the prioritization of bottom-line performance over risk management. This leads to speed being emphasized over safety, warnings being ignored, plans being changed at the last minute, and a failure to appreciate big-picture risks rather than trips and falls. In short, companies forget to be afraid.
- **Supply chain uncertainty:** In 2013 and 2014, UK supermarkets twice found themselves exposed to major food quality concerns – the unexpected inclusion of horsemeat in pre-prepared meals from some manufacturers and alleged hygiene shortfalls in certain poultry-processing facilities. While the scandals challenged the risk culture – and in some cases the probity – of Tier 1 and Tier 2 suppliers, questions were also raised about supermarket inspection regimes and the sustainability of low prices in the food retail sector.
- **Prioritization of arbitrage opportunities:** Financial institutions often move risk between types of entity to take advantage of more favorable regulatory treatment in certain regimes or countries. This behavior may weaken oversight and effective management of the aggregate exposures.
- **Reliance on regulation:** Companies in sectors with high regulatory requirements (such as aviation and the financial sector) inevitably prioritize those demands, even though they may not cover all exposures equally effectively. This may leave worrying gaps to robust practice in unregulated, or lightly regulated, areas.
- **Perverse incentives:** Poorly designed sales commission structures, along with weak management oversight, have been responsible for a suite of mis-selling scandals in the financial sector. The incentivization of sales over fair customer treatment led to the sale of inappropriate retail products, such as payment protection insurance (PPI), and the misrepresentation of investment product risks, as in the case of mortgage-backed securities.
- **Rigid hierarchies:** Autocratic behaviors and weak protocols in the healthcare sector are reckoned to be a significant contributor to patient deaths in hospitals. In many institutions, nurses and other assistants find it difficult to question the judgment or actions of surgeons during procedures, resulting in complications not being anticipated, errors not being rectified, and high levels of mortality. The unwillingness of junior staff to air their concerns for fear of criticism or blame from senior doctors resulted in an outbreak of antibiotic-resistant infections in one hospital.
- **Apathy about irregularities:** Shortages in mutual accountability are often a factor in rogue trader incidents in investment banks. Colleagues either fail to connect the dots regarding strange behaviors by perpetrators or else feel they are not beholden to flag their suspicions. Similarly, unwillingness among personnel to break ranks with fellow workers at industrial sites reinforces poor workplace behaviors over time and frequently lies behind accidents.
- **Deaf ears to concerns:** Investigations into many of the scandals contributing to the financial crisis have highlighted poor processes for escalating concerns. One inquiry into repeated interference with the London Interbank Offered Rate (LIBOR) accused leaders at one large investment bank of nurturing the perception that they did not want to hear bad news and of discouraging the escalation of complaints.



DEVELOPING A ROBUST APPROACH

Risk culture is the glue that holds enterprise risk management (ERM) frameworks together. When working well, it can make a strong contribution to business performance. But to achieve this, it is essential to enhance not only governance arrangements but also the engagement of company personnel.

A company has a strong risk culture when its personnel, at all levels, consistently exercise sound judgment in the face of opportunities and threats. This does not simply mean that personnel are compliant with defined protocols, although compliance is an important early step on the road to a mature risk culture. It means that individually and collectively personnel are anticipating risks and reporting issues of concern, looking out for each other and the firm, and responding to evolving situations in line with corporate risk goals.

In such companies, leaders' commitment to the risk agenda is seen and felt by all staff, and senior managers are actively and personally involved in the development of their teams' risk management capabilities. At the same time, challenges by front-line personnel to established practices are welcomed in the pursuit of continuous improvement, and active discussions take place about the value of standard operating procedures versus the adaptive capacity required to handle novel incidents, the management of cultural differences between countries, and opportunities for innovation. Moreover, the firms that are most advanced on this topic exhibit an effective balance between the need to hold individuals to account for culpable failure and the

recognition that mistakes happen – and that, in order to learn from those mistakes, they must be freely reported. In short, there exists at all levels a culture of enlightened, chronic unease, which reveals itself in constant vigilance about operational threats and the periodic refreshment of initiatives for keeping them at bay.

A mature risk culture requires a strong positioning across two dimensions, the structural and the behavioral (*see Exhibit 1*). The structural dimension is grounded in the core mechanics of an ERM framework, in particular a well-considered and communicated risk appetite, clearly identified accountabilities and responsibilities for governance oversight, well-defined rules and procedures, established reporting capabilities, appropriate training, and properly aligned compensation structures and sanctions. By contrast, the behavioral dimension relates to the disposition of individual personnel, the respect they have for colleagues, customers, and suppliers, and their level of engagement with the risk agenda and the values of the firm. While the structural dimension primarily seeks to constrain (poor) conduct, the behavioral dimension focuses on influencing and promoting (good) practices.

Although there is no obligation to strive for the top right corner of the matrix in *Exhibit 1* (it may not even be appropriate in some instances), companies need to address both dimensions to instill and maintain a strong risk culture. Stable, boundary-setting rules and robust processes must co-exist alongside efforts to enhance interpersonal discussion and value-based behaviors. A technocratic reliance on ERM infrastructure and documentation risks the illusion of control, and will often result in rule fatigue – forgetfulness, confusion, gaming, the exploitation of loopholes, and blithe disobedience in pursuit of personal gain or mere convenience. Conversely, simply focusing on behaviors may result in inefficiencies and risk exposures due to unclear guidance, conflicting practices, inconsistent communication across teams, and discrepancies in expected behavioral standards as conveyed in new personnel inductions and performance reviews.

Given the natural gravitation of company efforts towards tangible outputs on the structural dimension, it is worth emphasizing the behavioral dimension. Neuroscience has shown that acquiring a behavior is a different process to learning a task and that the part of the brain where new behaviors are learned and embedded is rarely engaged when someone is given an instruction or offered short-term incentives. To address the neural networks where beliefs and habits reside and to “rewire” them, individuals and teams must be taken on a journey. In the first instance, this involves identifying which behaviors need changing and understanding what is driving them. Recognizing unconscious biases and particular dispositions that reinforce behavioral norms is critical for untangling intuitive preferences and refocusing them. It is then important that individuals experiment with new behaviors and rehearse them until they become second nature. When the journey has been undertaken by a cadre of people, it may be said that cultural change has been achieved.

Speaking practically, sustained behavioral change (in this case to enhance personal accountability) is most likely to take place when influences appeal to people both rationally and emotionally, formally and informally, consciously and subconsciously. Personnel must be guided towards acting in an appropriate manner, not tasked to do so – they should feel like they are choosing to behave in the right way.

In this context, two factors are critical: tapping into personal motivation and the development of an iterative learning program. Concerning the first of these, interactions should ensure that the issues resonate deeply with staff by appealing to their commitment to the firm’s success, the implications for their career progression or legacy, and the power of their own agency. While praise is valuable, being clear about the personal consequences of poor behavior is usually more effective than offering incentives for good behavior. Apropos the second factor, initiatives need not only to embrace experimentation but also to be regularly repeated and new behaviors periodically discussed over a number of months. Only in this way can new habits be formed.

As a result, many companies need to be more creative about engagement opportunities – developing learning loops to nurture new behaviors, blending formal training with informal nudges, and attending to details as varied as discussion formats, vocabulary choices, and even office design. At the end of the day, the art of molding desired behaviors is to make subconscious decisions conscious then engrain new practices in subconscious behaviors again. Initiatives that simply focus on the conscious brain and overt, rational decision making will fall short of their goals, as will efforts that assume behavioral adjustments will follow from a single intervention.

Exhibit 1: Personnel behaviors against the two dimensions of risk culture

STRUCTURAL – GOVERNANCE



Source: Marsh & McLennan Companies

To change deep-seated practices, it is essential to develop initiatives that reflect how individuals acquire new habits and thereby tap into their motivations. A technocratic reliance on institutional control frameworks will have limited traction.



HALLMARKS OF EFFECTIVE PROGRAMS

Healthy risk cultures are not accidental, but the result of carefully designed programs and sustained effort. To deliver long-term value, development must be grounded in a deep understanding of the challenges, deploy both hard and soft levers in an integrated manner, and be committed to continuous learning.

THOUGHTFUL PREPARATION

Before leaping to obvious levers of change such as leadership, rules, training, sanctions, and incentives, company leaders should first characterize the current situation. How are personnel behaving? Why are they behaving that way (well or badly)? Are the problems endemic or confined to particular business units, functions, levels of seniority, or geographies? What impact is this having, or might this have, on the firm's performance?

While existing incident and near-miss data, along with anecdotal commentary, is helpful in this regard, it may not always capture the extent of a company's exposure. It is often worth taking a more strategic look at the areas where a poor risk culture might form the greatest threat to a company – the lax operation of complex assets, procedures not undertaken with appropriate diligence, deliberate attempts to commit fraud or bypass control frameworks, and insufficient concern for the security of confidential information. Additional insights can be obtained from articulating the key risk-based decisions faced by front-line personnel, their supervisors, and senior management, and understanding where those individuals may need to make trade-offs. These latter

two perspectives ensure a focus on the big picture rather than just on the metrics that are currently available. Against this backdrop, staff surveys, focus groups, and an analysis of leadership behaviors are often helpful in diagnosing key vulnerabilities, as is the review of key risk governance, reporting, and compensation arrangements.

At the same time, it is important that leaders delineate the importance of risk culture to the company – what it should mean for everyone, and perhaps more specific expectations for personnel in key areas of the business and at different levels of seniority. Not only does this help with assessing existing deficits and future priorities, it is also an opportunity for a company to align the desired risk culture with the organization's values and risk appetite, especially in the areas of safety and security, ethics and integrity, and risk-return trade-offs. A firm that prizes commercial risk-taking or innovation may seek a different risk culture to a firm in the same sector that privileges operational stability and a "no surprises" environment. Senior managers will often have greater latitude for exercising judgment on risk-return matters than more junior personnel, although scandals in both financial and nonfinancial sectors reveal the significant scope for unchecked overreaching (often improper, fraudulent, or otherwise transgressive) by front-line employees.

BALANCED CHOICES

These preparations will ensure that corporate campaigns to strengthen risk culture target the right constituencies and make best use of the available tools, in line with the company's particular goals and situation. Achieving a balance between governance and engagement efforts is critical to creating a robust, dynamic approach. In the ideal situation, infrastructural approaches support enabling processes, boundary-setting rules permit opportunities for empowering interaction, and overt instructions go hand in hand with more subtle encouragement.

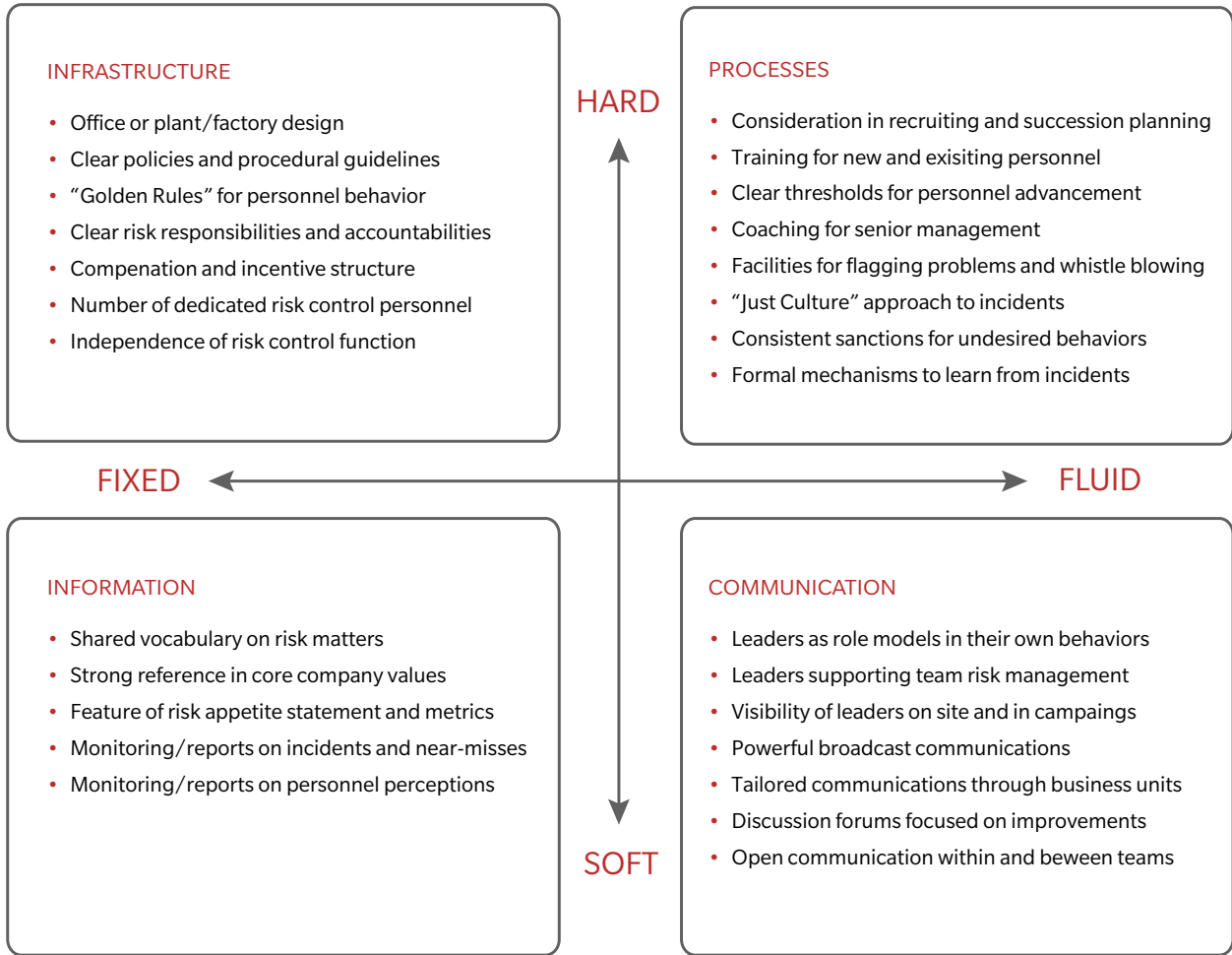
Exhibit 2 sets out some of the tools available to leaders, categorizing them by their core characteristics. Each grouping has its own merits and drawbacks. The infrastructure-based tools are stable and formalized, but they may be inflexible and have unexpected, adverse consequences. The process-based tools are more adaptable, but loopholes and inconsistent application may impede their effectiveness. The communication-based tools may be more motivational and responsive to differing circumstances, but can suffer from a lack of committed buy-in and follow-through. The information-based tools are valuable as background reinforcements, but in themselves are not capable of maintaining standards or achieving change.

To achieve traction, the tools need to be deployed in a coherent and consistent way to support the behavioral learning processes identified earlier. There should be appropriate alignment between, say, "Golden Rules" (in other words, absolute expectations of conduct) and monitoring regimes, and between broadcast communications and senior management behaviors. Likewise, mechanisms for flagging incidents and near misses, incident investigation processes, disciplinary protocols, and learning processes should all derive from the same overriding principles and goals. If they do not, they will lack credibility and trustworthiness. In a similar way, the different human resources elements (recruiting, training, performance reviewing, and succession planning) should convey compatible, reinforcing messages to personnel.

At the same time, multinational firms also need to think hard about how to reconcile a desire for consistent standards worldwide with the need to attune initiatives to different cultural contexts. For example, risk-minded challenges to authority may be laudable in some countries, but are less acceptable or workable in geographies where there is a high deference to authority or where such direct feedback might lead to managers "losing face." In such circumstances, sensitive modifications or alternative approaches may need to be deployed to ensure the same outcomes.

Studies frequently highlight the important role of leaders in enhancing risk culture. In our experience, this has a number of interesting permutations. No one would deny the importance of leaders taking ownership of the change process and threading it through their different interactions with personnel at all levels – visible champions for the cause are always welcome. Sometimes, however, leaders must change their own behaviors first in order to animate cultural change across their teams and ensure that desired behaviors are emulated. It is also key to work with those who are most influential in the company – which may not always be the most senior leaders. Often, it is well-respected personnel at more junior levels that have a major impact through informal influence.

Exhibit 2: Selected tools for enhancing risk culture



Source: Marsh & McLennan Companies

CONTINUOUS LEARNING

Leaders need to have an ongoing feel for the quality of risk behaviors in their companies, to understand where and how they might target effort. High-quality data on incidents and near misses, recorded either automatically or manually depending on the context, can quickly reveal trends and likely flash points. Monitoring and reporting, however, must be sufficiently granular to identify anomalies and inconsistencies – it is the isolated weaknesses in risk culture rather than the aggregate position that may bring a company to its knees. In some sectors, this data can be readily compared against a benchmark of comparable firms to understand strengths, weaknesses, and anomalies in one’s own performance that might warrant further investigation. Sometimes this needs to be calibrated to reflect situational differences.

Records for the completion of training and other drills or exercises may provide a proxy indication of competencies and compliance with core risk protocols. But the sudden financial outperformance of a sales team or poor equipment maintenance in a factory might be more telling as weak signals of aberrant behavior. In determining the most effective leading indicators, it is important to find a balance between the myopia that comes from too few metrics and the paralysis that comes from too many.

Regular “pulse” surveys can also be useful. These ask personnel about their own risk management behaviors, the support they get from leadership, processes and systems, and their ability to support improvements. Such surveys can provide valuable insights into employee morale, their trust in the company, and their willingness to take pre-emptive action on risk issues.

It may not be appropriate to widely broadcast some risk culture indicators through the organization due to an unwillingness to publicize weaknesses or a desire to reduce the likelihood of personnel gaming subsequent surveys. But communicating the results of regular monitoring can have multiple benefits. It raises awareness of key areas to watch and helps promote responsibility among personnel, especially managers. Downward trends can galvanize discussion about improvements at senior and local levels, while upward trends may be a reason to celebrate success.

Company leaders may need to adapt their own behaviors to be credible as visible and effective champions for the cause.



CORPORATE ACTIONS AND INITIATIVES

- **Understanding decision drivers:** “Day-in-the-life” analyses can help identify pressure points and the context for certain behaviors. One infrastructure company found that its processes for issuing daily permits to workers – itself a risk mitigation measure – was delaying the arrival of workers on site, thereby leading them to cut corners to get the work done on time.
- **Using benchmark data:** The new leadership of a large energy supplier recognized that simply benchmarking the company’s safety record against other firms was demoralizing personnel and doing little to raise standards. They therefore introduced an internal competition between facilities, which encouraged the continual development of risk practices and motivated employees to aim to become “safety champions”.
- **Being alert to weak signals:** Despite being imprecise predictors, weak signals may provide early warning of changes or shortfalls in a company’s risk culture. These indicators may take multiple forms – for example, observed rust on key industrial equipment, a spotty inspection regime of key suppliers, or an uptick in trading policy or limit breaches.
- **Formalizing personnel interactions:** In the aviation sector, investigations into major incidents have increasingly examined the human dimension of accidents, seeking to understand behavioral, physiological, and psychological factors. This has led to the institution of formal procedures such as Crew Resource Management (CRM) and Threat and Error Management (TEM), which clarify responsibilities and set out required interactions between pilots and flight crews. Some hospitals have now embedded a checklist approach into surgery procedures.

- **Setting clear expectations:** Some firms are crystallizing absolute behavioral requirements, and the consequences for breaching them, in a simple set of eight to 10 “Golden Rules” that are more targeted and digestible than large manuals of procedures.
- **Embedding risk in performance compensation:** The Bank of England’s 2014 proposals to improve responsibility and accountability in the UK banking sector include provisions for extending deferral and clawback periods for key Board members, senior executives, and other material risk-takers, and adjusting bonus pool calculations from single revenue-based metrics to fair-value profit measures. Other proposals expose senior executives and key Board members to penalties for oversight failures and to potential criminal liability in the event of institutional failure, and require the annual certification of employees who could pose a risk of significant harm to the firm or its customers.
- **Deploying monitoring technology:** Some companies are increasing their investment in technology to help them track breaches of rules and limits – in industrial sectors as well as financial services. This needs to be backed up by robust, consistent approaches to investigating culpability and applying sanctions.
- **Stimulating engagement:** Oil and gas companies often use photographs of members of staff who have died in industrial accidents to remind current personnel of the tragic outcomes of such events. Similarly, some professional services firms use case studies to highlight the problems that can ensue from losing laptops and other devices containing confidential information.
- **Improving workplace design:** Open-plan office environments and the judicious placement of equipment and control panels in industrial settings are often used to promote better personnel behaviors. Environments in which everything appears to be visible encourage self-monitoring, team-based vigilance, and greater opportunities for consultation on awkward topics.
- **Establishing a “Just Culture”:** Many companies try to strike a balance between a ‘no-blame’ culture, which encourages employees to report risks without fear of disciplinary action, and a culture of accountability where employees are punished for errors. While punishing intentional rule-breaking, a “Just Culture” encourages open communication between employees to promote learning from incidents, including both when such incidents tend to occur and how systems and processes can be improved to forestall them.





THE CASE FOR SUSTAINED EFFORT

Corporate risk culture is fragile, especially at inflection points of business performance and organizational change. Constant reinforcement is essential for stimulating and maintaining expected behaviors, and avoiding the growing downside of mistakes and failings.

Greater transparency with regard to corporate failings, advances in social media, and a stronger will to hold companies to account means that risk culture is ever more important as a determinant of corporate strength. Examples abound where recklessness, negligence, and improper behavior have materially undermined corporate performance via customer backlash and lasting reputational damage, burgeoning litigation costs and compensation payments, and ever stiffer penalties.

All too often companies respond by developing, announcing, and delivering large branded change programs to support their risk culture. Then, they simply stop and assume that the work is done. Efforts that focus on engaging with personnel tend to cease or be run down as soon as infrastructural solutions are in place. Not only does this result in a loss of momentum, it also sends negative signals to personnel about the value that management places on desired behaviors and the risks associated with falling short.

Although more sustained initiatives are critical, no company is going to invest significant sums for an unlimited time for uncertain value. To justify sustained effort, particularly on “soft” topics, it is critical to define from the outset desired changes in behaviors that

are supportive of business performance ambitions. Not only does this entwine risk management and commercial imperatives, it also (assuming the changes are measurable) means that incremental progress can be demonstrated against longer-term corporate goals via waves of activity that may last approximately three months. This helps create logical break points in programs, providing regular opportunities to redirect resources to the topics deemed most critical.

Enshrining realistic objectives for the quality of corporate risk culture in declared tolerances provides a platform for regularly reporting on performance to senior management and the Board. Top-of-the-house engagement on the topic is important given the potential reputational fallout from cultural failures. Periodic updates also help remind leaders about the need for them to be visible role models and advocates, as well as sponsors of key processes.

Companies that seek to strengthen risk culture in strategic and dynamic ways will reap the rewards through margin improvements and the lower likelihood of personnel-instigated crises. Those that pay lip service to the issue or adopt a piecemeal approach may be setting themselves up for a fall.

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ABOUT

This paper was developed by Marsh & McLennan Companies' Global Risk Center. The Global Risk Center generates insights and explores solutions for addressing major threats facing industries, governments, and societies. Drawing on the combined expertise of our companies and in collaboration with research partners around the world, the Center aims to highlight critical challenges and bring together leaders from different sectors to stimulate new thinking and practices.

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