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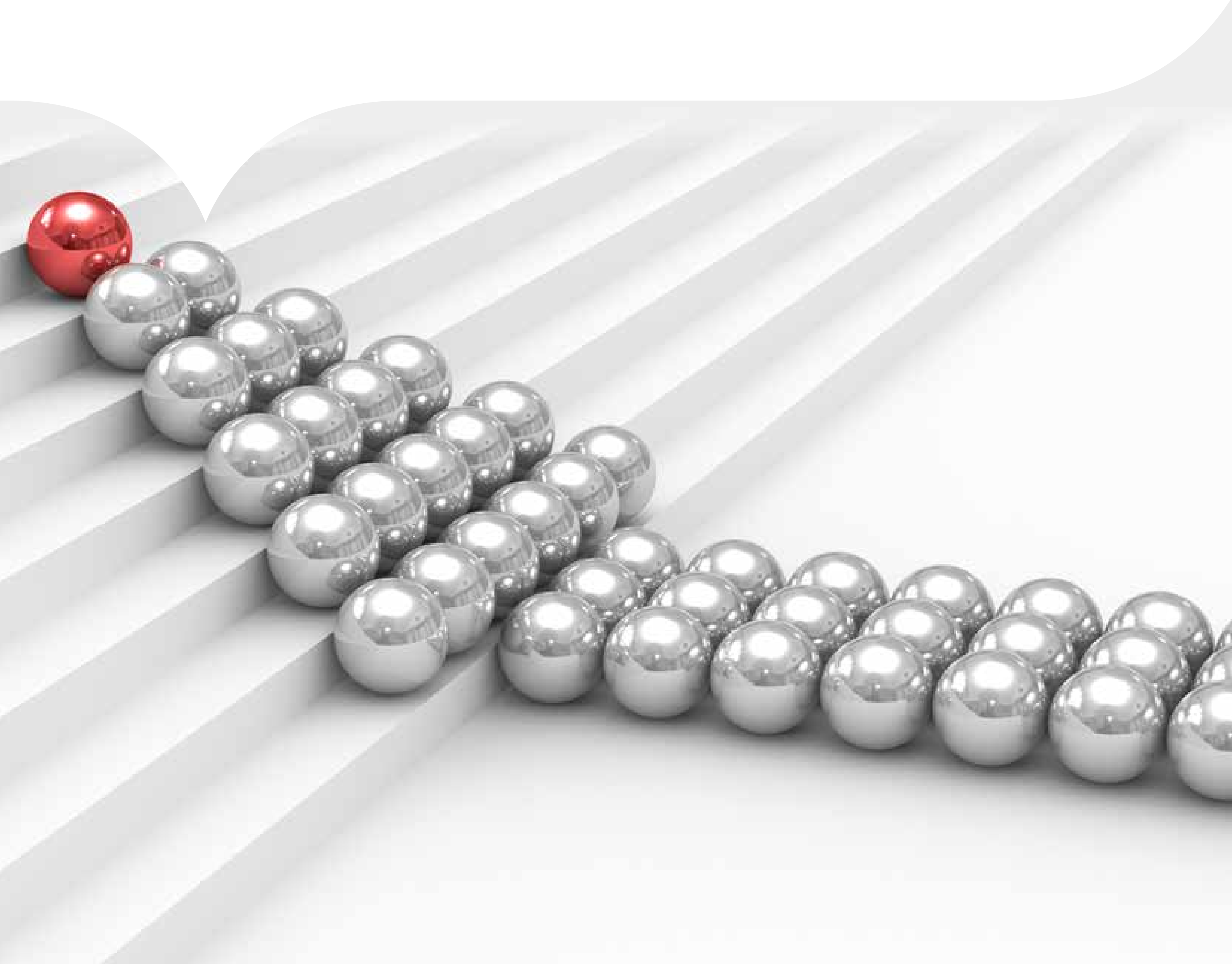
Your People are your Biggest Asset and your Biggest Risk

How People Risk Management is an Achievable Top Priority



"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."

Warren Buffett

With workforces estimated to constitute around 60% of operating costs, the case for managing people as assets and the risk to the effectiveness of those assets has never been more compelling. But too often people risk management is dismissed as risk management of HR processes.

The examples of when it goes wrong speak for themselves: from LIBOR rigging to Deepwater Horizon and BP; from toxic culture (Enron) to incentivising selling at all costs (Payment Protection Insurance), from failure to move with the technological times (Polaroid) to expanding too fast (Kaupthing). What many companies now fear most is the rogue trader or executive (UBS and Societé Générale). These cases demonstrate that conduct, culture and behaviours of leadership and staff have the capacity to create quantifiable and potentially fatal risk to companies and their markets.

In some firms, HQ will focus on the behaviour of a limited number of high value individuals. This can contrast with a failure to consider the customer facing workforce which is often industrialised or treated as 'branch staff' or 'frontline colleagues'. Customer interactions are mostly script and process driven. A sometimes transient workforce is expected to cope with complex consumer demands in an environment where consumers expect individual treatment. Failure to consider this is already costing some banks billions in PPI and other remediation.

This goes beyond operational risk management. The classic definition of operational risk incorporates elements of people risk through the risk of loss resulting from inadequate or failed internal processes, people and systems. But this views people through a process failure lens which, judging by the events of the global financial crisis, is demonstrably too narrow. An increased focus on culture, leadership and conduct and the role they play in success and failure is required.

This is all the more important in febrile markets, with low growth and tightening margins, and tough competition for consumers which makes operational efficiency and ability to manage change a key decider in market performance and management of internal risks.

"People are more difficult to work with than machines. And when you break a person, he can't be fixed."

Rick Riordan
The Battle of the Labyrinth

> *The crisis exposed significant shortcomings in the governance and risk management of firms and the culture and ethics which underpin them. This is not principally a structural issue. It is a failure in behaviour, attitude and in some cases, competence.*
>
> **Hector Sants**
> *Outgoing FSA CEO, 24 April 2012*

Authorities and regulators have responded to this by looking to Boards which now carry greater levels of exposure than ever before. Responsible for overseeing and dealing with risk, Boards and senior executives can also create risk, depending on their ability to deal with the tough issues dealt to them, and have therefore come under further pressure from regulators.

And with firms needing to adjust to a continuing challenging business environment, fluid global communications and dynamic social media, this presents a growing perfect storm of accountability, transparency, speed of impact and reactive markets.

Some businesses are responding to this by seeking to monitor key individuals such as high value traders. Others are focusing on building efficiency and greater reach with implementation of Digital solutions. Effective, Digital solutions can also pose potential risks in how staff and firms use and respond to them. In short, they create the potential to make old mistakes faster in new and immediate ways with a greater reach than ever before.

But particularly for leaderships more familiar with handling credit risk, and other more traditional forms of risk, the identification and management of the company's people risks has to date been hard to evaluate and action. "That's just HR's job" or groaning at the resources consumed by whistleblowing investigations, is a position which smart CFOs, Change Directors and CEOs should not wish to take. They should recognise that in every business the important strategic decisions about people are taken by the business leaders and the lead for the workforce comes from the top.

So what is people risk?

Our global research has concluded that no standard definition exists. So any effective approach must start with understanding and agreeing a definition that works for the firm, its business, customers and shareholders which is understood by its management and Board.

We would argue that while the people contribution to operational risk is a good starting point, people risk to firms is best broadly defined as the risk to the firm caused by its people and the risk to the firm caused by what the firm does to its people.

This is not to paint a collective workforce as lacking responsibility or will. But effective management demands recognition that the behaviour of companies is conditioned by the behaviour of its management and workforce. And the behaviour of that workforce at all levels is conditioned by the management and business environment. People will do what they think the company expects them to do.

> *I think there's just one kind of folks. Folks.*
>
> **Harper Lee**
> ***To Kill a Mockingbird***

The risks created by people are relatively easy to unpack and come, we would argue, at three levels. Effectiveness of delivery and change is the priority. The good news is that there are ways for firms to build on existing risk management approaches to identify and manage people risk so that senior management and Boards have the visibility and grip of people risk to reduce the firm's risk profile.

Extending existing risk management practices which focus on what people do to how they behave is key, enabling the development of strong people risk management.

Strategic risks

Examples include

- Unclear operation of responsibilities and accountabilities leading to failure to assure delivery of key priorities
- Inadequate corporate accountability, governance and decision making
- Leadership attitudes (and the perception of them) to ethics, culture and propriety
- Ability to operationalise changes in workforce management.

Strategic people risk management is about ensuring a clear line of sight between the goals of the organisation, the people required to deliver those goals and the operational HR and people levers that must be pulled to effect change.

Targeted risks

Examples include

- Rogue traders and other key individuals making losses and breaking limits
- Illness, or inability to perform, of key individuals
- Changing needs for specialist and generalist skills in key areas.

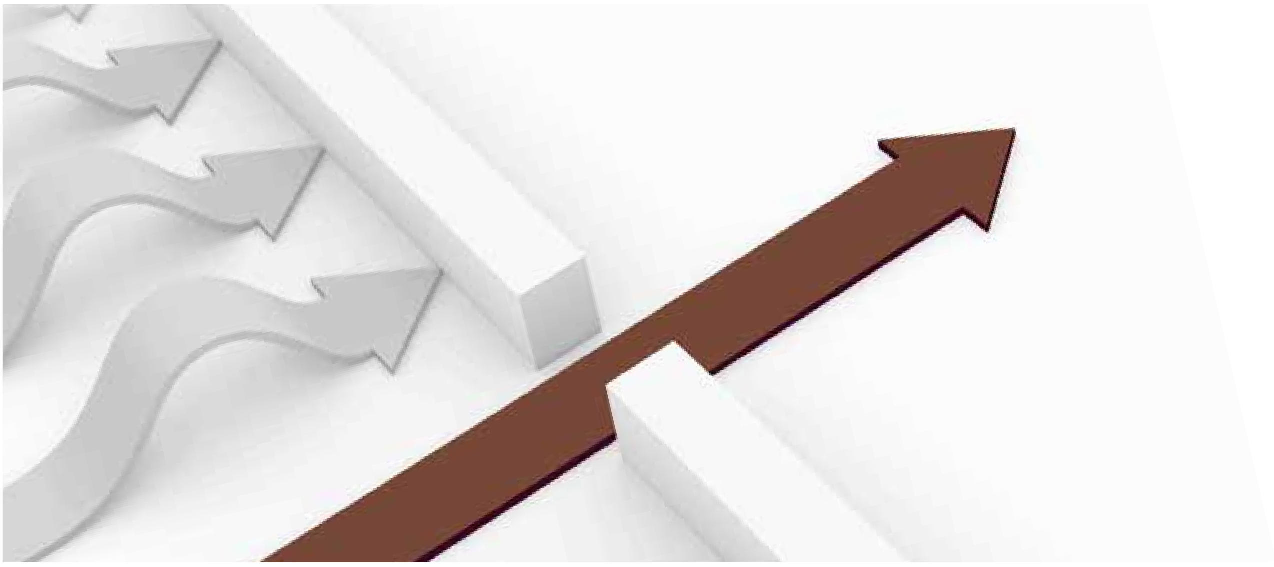
Tactical people risk management focuses on those key groups or individuals who create high value opportunities and deep impact risks.

Environmental risks

Examples include

- Misalignment of incentive structures with the right outcomes for customers
- Failure to follow processes and controls
- Retention risks
- Lack of availability of skills and capabilities in the market
- The outcomes for customers of the approach to remuneration and incentives (misselling).

Environmental people risk management focuses on the waterfront of indicators and touchpoints between organisations and their people. This is the background radiation of risk which damages the firm over time and which can be most difficult to target.



Looking at and across risks is crucial

Some of the most serious risks to firms will by definition be those which arise cross functionally or where firms fail to recognise the unintended consequences of business decisions and new strategies.

Case study 1

Firm A has strong commitment to customer delivery, an effective performance management and training framework. It has made clear to staff the importance of selling to customers only those products suitable to their needs. It requires customer facing staff to report daily on their sales to customers and uses a points system to incentivise staff. But as part of improvements to operational effectiveness and monitoring of sales, it increases this reporting to multiple times per day in parallel with increasing focus on meeting targets.

Result: Staff become increasingly competitive and fearful of reporting performance. They are more sales complaints mount and less suitability oriented. Risk of misselling to customers increases. Particularly in periods approaching the next report deadine. The authorities investigate and mount enforcement actions.

Case study 2

Firm B is required by its regulator to submit details of customer complaints as part of a regulatory investigation. Staff are directed by the firm to review files before they go to the regulator. The firm holds a conference call in which staff are told not to tamper with files but staff are also told that incomplete files will be unacceptable. Staff subsequently amend files and regulator investigates the changes made, noting that a significant number of the staff involved were on performance improvement plans and therefore likely to be concerned about their jobs.

Result: Firm is disciplined by its regulator and fined with substantial negative publicity.

Case study 3

Firm C has a key individual with authority to access accounts and with substantial limits. Staff changes and efficiency savings mean that the individual's breadth of responsibility extends, their limits increase and pressure on numbers increases. Support for the individual and oversight of their operations diminish. When they execute an inappropriate transaction and make up the funds from a customer account, no –one notices. The individual starts to develop potentially fradulent transactions.

Result: Individual makes losses for the firm which snowball. Firm makes significant loss, the individual is arrested, customers leave and negative publicity ensues.

> *"So don't let anyone tell you that the notion of a corporate culture is too loose or too soft to be real and to be important. The Enron corporate culture was certainly real."*
>
> **Robert Wright**
> *President, NBC*

Bring HR into your risk management

HR's effectiveness is critical to the creation and reduction of risks to retention, attraction of adequate talent and the operational effectiveness of staff systems and controls, including pay and performance management.

But given the impact of corporate culture, business direction and strategy, and the role of the business leadership on people, we would contend that HR's operational risk is a measure but not the measure of total people risk.

"It's a job for HR' is too often an easy refuge for management which cannot find a clear path to dealing with people, conduct, culture and behavioural issues.

So a practical approach to people risk, which breaks down the dimensions of people risk as we have and which focuses on the practical objectives of the firm to quantify its impact has to be a valuable tool for HR and for risk management more generally. This is a tool which takes account of corporate and reputational costs and shareholder value and helps HR mature its position as a strategic partner to the business. Identification and evaluation of people risk moves away from being the sole responsibility of HR.

Instead, a partner model emerges, with HR integrated into corporate risk management, in which short, medium and long term risks are developed into a structured portfolio to mitigate risks and manage opportunities.

A tool for non-executives in their risk armoury

People risks may represent the kind of latent, cross functional risks which keep (or should keep) non executives worrying about what they haven't gripped in the firm's risk profile. The people or HR information most commonly seen by Boards is reserved to headcount, senior succession planning, turnover and senior remuneration updates and reward plans.

Risks to adequate talent, service delivery capability, and corporate conduct are normally missing. 'I worry about what I am not seeing, but I don't know what I would do with even more information' is an increasing concern of many non executives.

Which is why evaluation of people risk as risk to corporate delivery, reputation, probity and value in the same way as other risks is key to enabling Boards to play their role in keeping the organisation honest and healthy, avoiding surprises, providing challenge and managing its waterfront of risks and opportunities.

“*Good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws.*”

Plato

A structured approach aligned with the organisation’s risk framework delivers value

A simple but structured approach enables companies to bring together:

- The identification of key people risks to priority programmes, projects and business objectives
- The clarification of risk appetite
- Evaluation of the effectiveness of HR and people services, including the direction of business decisions and the role of the business.

Using a swift diagnostic, the extent of people risk can be assessed so that mitigation can be dynamically integrated into existing programme and project plans.

With the option to develop a more holistic strategic approach, we recommend continuing to define key risk indicators (KRIs) to business value levers and major risk types, identifying controls relative to value to be achieved, enabling quantification of risks and mitigations.

Enabling the development of a people risk agenda, as part of the firm’s overall risk management, HR policies can become a risk management tool, linking standard controls and procedures to the risks they are seeking to mitigate in day-to-day operations. Newly identified risks and opportunities can be tackled through coordinated projects that design and deliver business-wide solutions.

Exposure and progress can be monitored via a digital risk dashboard which:

- Tracks measures against agreed Business Unit risk appetite statements
- Models current and future exposure to people risk across the business
- Runs scenarios based on causal relationships between lagging and leading indicators to test the impact of risk probability on strategic goals
- Models mitigating strategies to ensure that they are proportionate to risk and deliver optimal ROI.

This approach provides an opportunity to bring forward the ROI of projects by targeting investment on the basis of an understanding of the inherent people risks.

From knowledge to ownership to benefit

HR and risk functions must lead this agenda, working with business functions to understand emerging risks and engineer long-term responses that reflect strategic intent. Their collaboration creates a tangible link between risk on the one hand and HR strategy and execution on the other.

Benefits of people risk management include:

- Allowing the business to maximise the potential of its people through targeted investment
- Challenging people risk appetites across the company, reviewing them constantly against a macro-economic and business driver framework
- Integrating HR with risk management, enabling the HR function to add value through effective policy-making
- Bringing a comprehensive understanding of, and a culture of responsibility for, people risk to the business as a whole
- Improving people and HR change management, shifting the focus of HR away from the purely operational towards enablement of strategic change
- Providing a “one stop shop” to help HR directors and programme leads to handle people risk impacts of regulatory and mandatory change.

Organisations are all about people. So any risk management will always fall short unless it includes the people dimension.

“*Corporations are people, my friend.*”

Mitt Romney,
former US Republican presidential candidate. 11 Aug 2011

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