Boards & Risk

Unseen risk – why boards often fail to see the obvious

Risk is a priority topic in the boardroom: investors and regulators demand clarity on appetite, employees and customers demand clarity on control systems, our risk management industry is booming and yet boards frequently fail to see, or act on, risk which ultimately leads to crisis. Is this a failure of process, people or perception? Why is the news regularly filled with stories like Carillion construction or Greensill capital where risk was hidden in plain sight? Could it be that risk *identification* rather than risk *management* is at fault, why do we fail to identify risk?

Learning objectives -

This session explores reasons why some risk is always unseen and explores major causes of 'risk-blindness' around the board-table. The aim is to encourage participants to recognise this problem within their own organisations and to discuss ways to improve risk recognition and appreciation. Through a better understanding of the causes of risk blindness, pragmatic solutions can be identified to improve judgement calls and ultimately better policy decisions by the board.

Content summary -

There are basically three types of unseen risk:

1. Limited knowledge - we don't see risk because we just don't know it even exists.
2. Risk blindness – we don't see risk because we won't or can't see it (wilful or accidental).
3. Cognitive bias – Risk is distorted through the prism of bias so we under-estimate it.

Limited knowledge distinguishes between 'unknown unknowns' and 'known unknowns' and explores how much of risk assessment is based on extrapolating knowledge into forecasts and estimates. Boards of course like to promise certainty as uncertainty is considered a weakness. There is a whiff of alchemy in turning uncertainty into certainty, not to mention hubris and bravado.

Risk blindness builds on the work of Margaret Heffernan's 'Wilful Blindness' but goes further to distinguish between wilful and accidental blindness. The former deriving from a refusal to recognise a risk for ideological reasons, while the latter caused by information overload - too many signals or 'cockpit confusion'. We examine different types of blindness from 'won't see' to 'can't see'.

Cognitive bias comes from limited processing ability of the brain and its preference for seeking shortcuts to selecting information. Overlaid on these are emotional and moral motivations, social influence and our ability to store and retrieve memories. In short, these lead to irrational decisions boards call prejudices, preferences and politics. All boards have cognitive bias in risk perception.

Who benefits most from this module -

Non-Executive Directors will benefit most because it provides them with arguments and persuasive tools to ensure their Executive colleagues give due consideration and time to considering the nature of risk their organisation faces. If the risk committee is to be effective and inform the board, then the board must first recognise why some risks are unseen.