ARTICLE

Rethinking Responsible and Ethical Governance and Risk Management

*Prof. Colin Coulson-Thomas

The theme of the '2020 Singapore Global Convention' on Corporate Ethics and Risk Management is 'The Board's Risk Resilience Strategies and Ethical Leadership'. Corporations and their boards confront multiple challenges and related opportunities. Fundamental changes are often required before they can be tackled. Some directors sit on the boards of companies that have operations and activities that damage the environment, degrade natural capital, contribute to global warming and are not inclusive or sustainable. Corporate purposes and priorities are not always responsible, ethical or resilient.

Many boards face ethical dilemmas and stark choices. The decisions they take and the directions they pursue will have profound implications for wider society and consequences for future generations. Directors need to ensure that boards do not overlook certain areas of risk, including those that relate to their own activities and practices. These risks may not appear among the 'usual suspects' on risk registers and yet they can be essential for effective and responsible decision making and for resilience, ethical conduct and sustainability. An example is 'thought risk' and the need to achieve a balance between thinking and doing.

Responsible and ethical leadership has never been more important. Directors should think before acting and think through the implications of board decisions and the consequences of corporate activities. Directors and boards need to be aware of the relationship between risk and resilience and ensure that risk governance and risk management encourage rather than inhibit the flexibility, openness and innovation required to ensure that an enterprise is resilient and responsible in the face of evolving challenges and potential opportunities.

Thought and Relationship Risk

Thinking should not be confined to the boardroom. Directors should think before, during and after board meetings. They should ensure that within their busy lives there is sufficient time, space and opportunity for quiet reflection. Are directors devoting sufficient independent and collective thought to their duties and responsibilities? Are they reflecting on: what is happening in the business and market environment; the changing aspirations and concerns of stakeholders; future prospects and possible opportunities; and/or the thinking behind what others are saying, advocating or opposing within the boardroom?

Some directors become so absorbed in matters before them, or distracted by red herrings, that they fail to register changes in consumer behaviour or boardroom dynamics and the emergence of factions and/or new patterns of opposition and support. Board chairs in particular should be alert to such changes. Wherever possible they should read the road ahead. For example, is a board dividing between those wishing to exploit existing capabilities, facilities and resources while this is still possible, and those who would support a move to a more sustainable and less environmentally damaging business model?

Do some directors need to think less about themselves and more about the state of certain key relationships upon which the continuing relevance and success of an enterprise may depend?

Directors and boards should monitor mission critical relationships. They should be sensitive to factors, and the consequences of

decisions and actions, that might harm them and lead to a loss of trust or the breakdown of an important relationship. They should be alert to changes in costs and benefits for the parties involved and the emergence of possible new partners.

Risks Relating to Purpose, Priorities and Values

As other companies stutter and fail or bound ahead more boards are considering whether or not they have adopted the right business model, but what about the risk of having an inappropriate purpose, the wrong priorities or questionable values as evidenced by corporate conduct in a changing world? Awareness of the changing aspirations and concerns of different stakeholders may suggest that a board should reassess corporate purpose, its priorities and what it stands for. Is further growth desirable? Should the emphasis be switched from financial measures of profit to increasing the social value of outcomes, safeguarding natural capital, sustainability and improving the quality of life?

Within a board there may already be some unease over current priorities. Should a lucrative area of business be expanded, if at the same time it is environmentally damaging and disproportionately so? In such circumstances, are justifications such as 'if the company stopped operating competitors would jump in and do the damage instead' running out of road? Should a more principled stance be adopted and responsible leadership exercised?

Stakeholders can vary in their views of what a board should do, as can different generations. Opinion on whether or not to retain or discontinue profitable activities that have harmful consequences can depend upon personal values and assessments of costs and benefits. People may favour growth or restraint depending upon the value placed upon outputs produced. Their views may also reflect wider social values, what they feel is important and lifestyle preferences. One person may value revving up a gasoline guzzling car. Another may value being able to breath fresh air and listen to birdsong while going for a walk.

Some boards risk lagging behind public opinion. Outdated and/or inappropriate values and perspectives can be another source of risk. Are directors still focused on current corporate activities, physical outputs and external appearances, when ever more customers worry about the future prospects of mankind and rank richer experiences more highly than further consumption? They may yearn for a cause. They may want to feel that they are doing the right thing. Rather than leading, have some directors and boards already been left behind?

Board Practice and Understanding Risk

Some board practices can be harmful. Uncertainty and insecurity can result in directors and boards following fads and fashions, without thinking through their consequences or relevance. Following the herd is usually not the best route to market leadership. The risk of distraction has already been mentioned. Directors face many potential distractions, including from those who seek to sell expensive, disruptive and general approaches and methodologies, some of which lock them in to continuing dependency, when quicker, cheaper and more focused and flexible alternatives exist that could be adopted by a company's existing people.

Thoughtful directors look for the root causes of issues that others seek to mitigate rather than prevent. Many complaints, problems and pressures result from a lack of understanding. Often people simply do not understand new developments, implications, opportunities, possibilities or technologies. Many of the critical success factors for key corporate activities identified by the author are concerned with understanding. For example, successful bidding, marketing and selling can all depend upon understanding the differentiators of an offering or proposal.

Complexity is sometimes used as an excuse for inaction. It can result from giving insufficient effort to trying to understand and/or attempted bamboozlement. There are those who do not want others to understand so that people will become dependent upon them. While involved in building performance and learning support tools the author never encountered an activity, matter or technology that was so complex that a means could not be found of enabling non-specialist individuals, groups and communities to understand it. Directors should be ever alert to those who do not really understand what they are talking about or set out to deceive.

Business Model, Structure and Process Risk

A terminal risk that has crystalized for many companies and retail chains in particular has been the retention of a business model that is more costly and less efficient than those operated by more flexible enterprises and new competitors. Many boards persist with out of date and/or damaging business models as a result of inertia and a lack of appreciation of changing customer and prospect behaviour and of how to adopt better alternatives. Their perspective and that of risk managers also needs to embrace supply and value chains.

Another risk that persists in spite of decades of advocacy of the merits of issue and/or task based multi-functional, multi-locational and sometimes multi-organisational teams is that of departmentalism. The continuance of a bureaucratic and functional form of organisation is a source of great frustration for many directors seeking solutions to issues and problems that have implications across an organisation as a whole. While the perspective of board members will hopefully embrace the whole of a business, that of many executives and professionals reporting to them may be limited to the boundaries of a particular functional silo.

Many companies operate antiquated and in some cases irrelevant processes. A good example, and one which may only exist because a board continues to show an interest in it, is a bureaucratic corporate planning process that occupies a significant amount of management time in certain months of the year and whose outputs are not or rarely used because they are usually quickly overtaken by events. Intelligent steering can be much more flexible and appropriate in an uncertain and fast moving business environment.

Risk managers and compliance officers sometimes appear negative, like referees who forever show red cards and rarely allow play to continue. On occasion, risk management and compliance can seem costly barriers to change and development, rather than a positive creator of value and active enabler of enterprise and entrepreneurship. They should be proactive. They should engage, anticipate future risks and propose solutions rather than just report problems. They should suggest alternatives and new courses of action, and contribute to more effective decision making. Not taking risks and/or pushing out the boundaries can erode competitiveness and lead to stagnation and obsolescence. Effective risk managers add value by enabling responsible risk taking and becoming business development partners.

Compliance, Accounting and Reporting Risk

A process designed to reduce or prevent some forms of risk can be the source of others. For example, ensuring and enforcing compliance with existing processes, practices and policies can inhibit or deter people from questioning them and discussing and/or suggesting better alternatives. Unthinking adherence to prescribed approaches can limit the diversity, challenge and exploration which can be so conducive of creativity and innovation. Top performers of tasks often devise better and quicker ways of undertaking them than those who follow a standard procedure. Capturing and sharing what such superstars do differently often increases performance more than teaching and/or enforcing a standard approach.

Inadequate understanding and practice can apply to the identification and assessment of risk. Boards should encourage a balanced rather than a negative view of risk. Widely adopted accounting and reporting practices that just present an immediate past and previous financial year's figures can make it difficult for directors and other users to understand longer term trends and drivers. They can also complicate or prevent the assessment of risk in arenas where outcomes are uncertain, for example major project risk.

In comparison with traditional approaches, probability accounting with its visual representation of distributions of possible outcomes can give a much better understanding of risk and uncertainty than selecting and presenting single numbers. A tight bell curve quickly suggests less risk than one that is broader, indicating a wider spread of possible outcomes or assessments. Reporting single numbers, with any qualification or comment hidden in unread notes to the accounts, can effectively conceal risks that users might wish to be aware of.

Decision, Opportunity and Political Risk

Risk, including the risk of inappropriate decisions and non-decisions is inherent in board decision making. Inadequate information and other factors can impact upon the quality of decisions. How information is presented to directors and the lack of understanding mentioned earlier can increase the risk of a board

making inappropriate and even disastrous decisions. Risks can arise from what directors and boards do and also from what they do not do. Overlooking or not seizing available options and possible opportunities, or missing them altogether, can have severe consequences for certain companies.

Many risks associated with staff decision making can be addressed by performance support tools. Windows can open to alert users to relevant considerations and options and alert them to when courses of action might infringe related laws, regulations, policies or guidelines. Such tools can benefit: organisations by increasing productivity and performance, reducing cost and risk, and speeding up responses; and people by reducing stress, making it easier for them to do difficult jobs and enabling them to learn and become more capable and confident with each use, wherever and whenever this might be, including when on the move. People who are made aware of environmental consequences often take more responsible decision.

Political risks can vary according to the context. Some investment decisions in the UK have been on hold while Brexit is being resolved. In the Gulf tension with Iran might disrupt shipping and lead to conflict. However effective the support that is provided to the people of a company, directors are required to make judgements on issues that cannot be authoritatively resolved elsewhere. They have to weigh advantages and disadvantages in decisions such as whether to insure against or carry a risk. They must compare costs and benefits, balance risks and returns, assess probabilities and determine when and how to act.

Shared and Changing Risks

Effective boards ensure that: external trends, developments and issues in the external political, economic, market and technological environment are monitored; their impacts at local, corporate, national and international levels are assessed; and responsible responses at each level are considered. Many boards share common concerns. Thus where skills are an issue, a common risk may be not being able to recruit, develop and retain the talent needed to achieve corporate objectives. Participation in IOD conferences can help directors to: identify shared issues such as cyber security and fraud; and in the case of a challenge such as climate change assess the risk of inadequate collaborative and collective responses.

Within traditional categories of risk there are new threats. For example, the sudden destruction of physical assets by extreme weather events may now be more significant than their theft or slow deterioration. Some emerging and contemporary risks may be no longer insurable at an affordable cost. Such risks might need to be carried. Arrangements may need to be made to mitigate them, reduce or limit residual risks, and crawl out and/or recover should they crystalize. Issues and activities are sometimes considered in isolation and boards fail to address the extent to which their objectives and initiatives and corporate programmes may be in conflict. Speakers at IOD events regularly highlight the inter-relatedness of issues and the value of a broad directorial perspective, competent directors and effective boards.

Attendance at IOD conferences can increase understanding of the risk of inadequate governance and/or not being sustainable; the reputational, relationship and other risks of not being ethical and/or responsible; the risk of inadequate board leadership and/or a lack of innovation; or the risks of continuing to degrade the environment and ineffective responses to climate change. The Singapore Global Convention presents an opportunity to discuss a wide range of contemporary areas of risk and how they might be handled. The event's ethical dimension reminds us that corruption, criminality, favouritism, nepotism, hypocrisy, self-interest and the risk of unethical conduct persist. Directors need to be alert and vigilant. ■

**Prof. Colin Coulson-Thomas holds a portfolio of leadership roles and is IOD India's Director-General, UK and Europe. He has advised directors and boards in over 40 countries.*