NANO TOOLS FOR LEADERS®

RISK MANAGEMENT: WHAT EVERY LEADER NEEDS TO KNOW

Nano Tools for Leaders® are fast, effective leadership tools that you can learn and start using in less than 15 minutes — with the potential to significantly impact your success as a leader and the engagement and productivity of the people you lead.

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THE GOAL:

Don't wait until it's too late: to disruption-proof your organization, every leader needs to take proactive steps for risk management.

NANO TOOL:

Risks to organizations have attracted far more public attention and concern in recent years. Media references to risk rose worldwide from 1990 to 2016 by a factor of 25 — and double that in the United States. Headlines with the word "crisis" and the name of one of the top 100 companies ranked by Forbes appeared 80 percent more often in the 2010s than in the previous decade. As a result, risk has entered the lexicon of virtually every company manager, and the now widely used acronym ERM — enterprise risk management — has become one of the essentials for almost everybody in business.

But that doesn't mean executives and managers are all better prepared. When attention is preoccupied by immediate concerns and pressing issues, executives and managers tend to ignore small warning signs of impending disaster — sometimes even those staring them in the face — that can morph unattended into genuine threats. To avoid getting caught off guard, recognize and work on the six action steps below. They correspond with the most common reasons some company directors, executives, and managers are unprepared for the likelihood and consequences of extreme events. Even well-intended risk-management strategies can still go wrong if all leaders are not vigilant and proactive.

ACTION STEPS:

Use the following steps in discussions and planning sessions with your organization's executives, directors, and managers. They will help you identify current shortcomings, realistically assess your readiness to respond to disasters, and have actionable plans in place well before a sudden crisis strikes.

1. **Prepare for Low-Probability Events.** Without clarifying what risks they are willing to take, and what risks they are not, company leaders are less able to identify the hazards that require attention. Moreover, they're likely to downplay or even deny that those hazards might ever occur. Many financial institutions ignored early warning signs of the 2008–2009 collapse that would take many of them down, denying that mortgage-backed securities

might massively implode. Similarly, a chemical company had never considered that it could be hit by a hurricane of Katrina's force, and it consequently had no backup when a plant that had been the sole producer of an essential ingredient was forced offline. If a low-probability event could seriously impact your ability to do business, you need to have a plan in place.

2. **Appreciate Global Connections.** A flattened world has increased international trade as well as the associated risks. Companies are increasingly relying on dispersed networks of suppliers and distributors, which opens them up to a broader range of geo-political risks. Manufacturers depending on a single supply source, for instance, can face disruptions from disasters on the opposite side of the globe, as the auto industry experienced in the wake of Japan's 9.0-magnitude earthquake in 2011. Take some time to review your global connections, be sure you know each supplier at every tier, and assess the risk factors at each step in your supply and distribution chains.

3. **Stop Thinking "It Will Not Happen to Us."** Directors, executives, and managers should not believe that threats or incidents at other firms are unique to them, devoid of implications or warnings for others. When it comes to risk, it's better to learn from other people's mistakes. Study what other companies have put in place to guard against disaster, and see what safeguards would benefit your department, division, or team.

4. **Don't Fight the Last War.** When company leaders believe that the next disruptive event will somehow be similar to the last one, they are likely to be ill-prepared. Learning from after-action reviews is essential (check this Nano Tool for action steps), but so too is recognizing that the next disaster is unlikely to resemble the most recent setback. For example, in the case of the Germanwings air crash in 2015, a suicidal copilot locked the pilot out of the cockpit — with a door bolt that was intended to prevent a recurrence of the terrorist seizure of four aircraft on 9/11. After you brainstorm your potential risks and come up with solutions, go one step further and assess what new risks might come from your proposed solutions. This step can help you bulletproof your risk strategy for the future.

5. **Learn from Near Misses.** Business leaders are likely to congratulate themselves on avoiding a disruptive event, which only ingrains their faulty "It will not happen to us" thinking. Instead, use the near miss as a critical learning opportunity. Ask yourself and your team: "What insights can we gain from this near miss if it had actually turned into a hit instead? How would we have reacted if it hit us? Would we have been prepared? What additional plans would we have needed to have in place?"

6. **Invest in Protective Measures Even if They Involve High Upfront Costs.** Many firms are reluctant to engage in protective measures because of their high upfront costs, downplaying the long-term benefits of otherwise sensible investments. A principal driver may be a measure's costly impact on the year-end balance sheet, which seemingly gives business leaders little to crow about if a disaster does not happen. But, akin to insurance, the best result is when there is no payoff. Despite the upfront costs, the firm should celebrate not having experienced a disruptive event for which it had prepared. To justify the costs, try doing a quick comparison of what you've spent on risk preparation versus the costs that other companies have had to pay for falling victim to a similar risk. This usually shows your preparations were a wise investment.

HOW LEADERS USE IT:

When a plane hit the North Tower of the World Trade Center on 9/11, Morgan Stanley's director of security, Richard Rescorla, asked the Port Authority for immediate guidance. It recommended against evacuating the South Tower, but Rescorla requested that his chief executive approve the instant evacuation of all employees, then spread across 20 floors. Rescorla's calculus was informed by his own experience with a prior disaster in the same building: the 1993 al-Qaeda truck bombing that killed six people. Fearing how many might have perished if that assault had succeeded in collapsing a building, Rescorla had instituted quarterly evacuation drills.

Rescorla and his staff succeeded in moving most of Morgan Stanley's 3,700 staff members down the South Tower's stairwells before the second aircraft hit that tower. Virtually all of the employees managed to exit the building before its collapse at 9:59 a.m. Just six staff members of Morgan Stanley were still inside when the tower finally imploded, among them Rescorla himself and three deputies who had returned to the offices to make sure no others remained inside.

When Hurricane Katrina hit the U.S. Gulf Coast in 2005, Walmart applied its technical understanding of complex global supply chains and its careful tracking of the storm itself to assist the region's recovery when other institutions faltered: "Make the best decision that you can with the information that's available to you at the time," Chief Executive Officer Lee Scott had urged his employees, and "above all, do the right thing." On that premise, swift decisions followed, including Walmart's dispatch of 2,500 trucks to deliver food, blankets, and clothing to thousands of hurricane-affected families for weeks after Katrina's landfall.

In the years that followed, Walmart built on its Katrina experience to strengthen its risk management worldwide for all kinds of disruptions, not just natural disasters, investing in an emergency operations center and a central coordination and response hub. When the U.S. Center for Disease Control confirmed in 2014 that an Ebola-infected traveler from Liberia had landed in the United States, the emergency center sprang into action, monitoring millions of Walmart employees and customers for signs that those who had been exposed to Ebola might be working or just shopping in one of its 11,000 stores worldwide.

ADDITIONAL RESOURCES:

- *Mastering Catastrophic Risk: How Companies Are Coping with Disruption*, by Howard Kunreuther and Michael Useem (Oxford University Press, 2018). Drawing on interviews with managers, executives, and directors from a range of industries, provides experiences of and insights into coping with large-scale disruptions. Offers a systematic framework so decision makers can prepare in advance and effectively respond to catastrophic risks.
- Among the many Executive Education programs Professor Useem is involved in, he serves as faculty chair and teaches in the *Advanced Management Program*, and directs and teaches in *Becoming a Leader of Leaders: Pathways to Success* and *Boards That Lead: Corporate Governance That Builds Value*.

ABOUT NANO TOOLS:

Nano Tools for Leaders® was conceived and developed by Deb Giffen, MCC, director of Custom Programs at Wharton Executive Education. *Nano Tools for Leaders®* is a collaboration between joint sponsors Wharton Executive Education and Wharton's Center for Leadership and Change Management. This collaboration is led by Professors Michael Useem and John Paul MacDuffie.