

Strategic RISK

Why risk managers need a higher profile

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Craig Ferri says risk managers now have an ideal window of opportunity to make their voices heard and their practices adopted

At the end of June this year, Chancellor George Osborne made Mervyn King the most powerful governor of the Bank of England, giving him sweeping powers to curb City excesses and prevent another financial crash. In addition, from as early as January 2011, banks operating in the UK will be hit by a levy as their contribution to aid economic recovery. Talk of measures to tackle 'unacceptable' bank bonuses, along with other measures to reduce risk also continue.

These moves present today's risk managers with some interesting challenges, not least because it is the ideal window of opportunity to make their voices heard and their practices adopted. This is in stark contrast to the years leading up to 2008, during which the uneasy relationship between this sector and the bankers and traders they are supposed to monitor tended to favour to the latter.

Risk managers vs traders

In very simple terms, it is a common perception amongst traders that risk managers do not earn money for the bank. They also regard them as over-cautious, with the authority to refuse deals and therefore prevent business being done (and bonuses being earned). Combining this with the profit culture inherent in the financial sector and the calm markets in the years leading up to 2008, the result was that much advice on risk was ignored.

But there is now little doubt that, if we are to avoid another catastrophic meltdown in the future, the risk department must be given more prominence and risk analysis must become an integral part of financial institutions. So how can risk managers help to progress this change?

Risk analysis tools

One obvious answer is through the use of sophisticated risk analysis tools that enable complex models to be built. These enable the likelihood of an event occurring and the severity of its effects to be 'measured', or quantified. As such, different scenarios can be explored and compared extensively in order that informed decisions can be taken and unnecessary risk avoided.

Correct data

Risk managers must also be rigorous about ensuring that business users provide them with the right inputs for the risk analysis models. For example, historical information no longer matches today's financial products and using it will result in a false picture of the current climate.

Clear communication

Clearly their analytical skills and expertise will demonstrate that risk managers have a key technical role to play in resolving the current problems. But this is only one part of the equation. Too often, risk analysis is perceived as a 'dark art' and risk departments can therefore make significant inroads into enhancing their reputation (ie commercial credentials) through good communication. Bankers, traders and the board are likely to be more receptive to a cautious approach if they understand the reasons for risk managers advising against transactions.

The City and beyond

But this 'new' approach to risk that the City is required to adopt, is not just limited to the financial sector. The ongoing economic turbulence has promoted the word 'risk' to the top of many commercial conversations, regardless of business sector. As a result, there is also increased talk of risk analysis, which in turn has brought the disciplines of 'quantitative risk management' (QRM) and 'decision making under uncertainty' (DMUU) firmly into the business vocabulary.

Risk managers would – rightly – argue that these have always been present. In boom or bust, businesses make decisions every day, and each one of these has an associated level of risk. Where to invest, what product to produce in what quantity, which vendor to use, what price to charge, what marketing activity to pursue – the list is endless.

Survival strategies

In effect, recession has caused business decision-making to be examined in detail, and brought the idea of QRM to the forefront of many business owners' minds. Enterprises, struggling with reduced sales and rising costs, have concluded that their survival depends on taking a more strategic approach to the discipline of risk analysis. Cost estimation, budgeting, cash flow forecasting, operational risk assessments, sales forecasting – in fact any part of a business where there is uncertainty – all need to be made more robust and meaningful. QRM is therefore being recognised as a valuable aide to making better, more informed decisions, where the amount of uncertainty on which they are based is known.

Changing the attitude to risk

Despite green shoots of recovery in some sectors and regions, there is no doubt that difficult times lie ahead. Risk managers, who have the expertise to ensure that the accuracy of the information used to make any decision has been calculated and factored in to the final outcome, must therefore become increasingly pivotal to any organisation.

The result of offering as much certainty as is possible in our severely altered economic landscape, gives the risk department the opportunity to raise the profile of its profession. And the long term effects of this change in attitude will benefit everyone.

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