

THE RISK MANAGEMENT ETHICS LINK

The definition, management and tolerance for risk have become focal issues for both public and private company boards of directors. The recent economic crisis brought about in part by behavior and practices that ignored risk in an environment absent of ethical responsibility has raised the level of board responsibility to create an atmosphere tolerant of defined risk supported by ethical behavior by the entire enterprise.

Internal risk taking often arises from the pressure to perform syndrome. That is the need to make the numbers at all cost. When managers are rewarded for certain behaviors they in fact become very proficient at delivering results without regard to the level of risk or the ethics underpinning the decisions made. The reward or incentive becomes the mechanism for rationalizing behavior to reach the goals even if risk levels rise while at the same time the consequences of unethical behaviors are minimized.

In the economic environment of today, in part, defined by the economic crisis of yesterday, the responsibility of boards of directors is to create an enterprise tolerant of defined risk in an environment of ethical behavior expectation.

A company culture void of ethical expectation is not likely to be capable of leveraging the power of defined risk taking as a tool of competitive advantage. Evaluating risk is likely impossible in a climate of unethical practices. The ethical environment of the company is clearly a product of the behavior and expectations of the board of directors and the senior management. The examples set, the tone created, the consistent high road approach to decision making from the top down throughout the organization can never be compromised or put into question.

Boards of directors have a clear responsibility to manage and leverage risk taking; but, to do so without the underpinning support of a strong culture of ethical behavior makes the exercise of risk management empty and likely useless.

Matching the organization of the board to the responsibilities of addressing the two issues of risk taking and ethics may take some new thinking. Generally the Governance Committee addresses issues around ethical behavior. The audit committee clearly focuses on defining the financial risks of the company. A separate board committee addressing risk evaluation and tolerance is generally new and has a narrow focus on identifying and defining risk levels in the organization. It is good practice to review the charters of these important committees to be sure each has a clear statement defining ethical expectations of the company.

Whether your company is risk adverse, risk neutral, or risk loving operate in a consistent manner, communicate clearly, and build reward systems that are in line with the company's tolerance for risk without compromising the published ethical standards set, and practiced by the board and the senior management.

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