RISK CREEP AND THE SOURCES OF RISK

The current economic crisis, WorldCom and Enron all are economic disasters with similar causal roots. In each case practices, policies and product offerings began to be driven by financial and legal decisions that can best be described as "gray"; that is not quite over the line sufficiently to be considered illegal or unethical and certainly not very risky. In all three situations subsequent decisions continued to creep in the direction of "questionable to a substantial degree". By this time the common practices had both precedent and the blessings of management and the regulators.

The risk creep described above found its way to become common practice and everyone was doing it; so it must be acceptable. In the cases of WorldCom and Enron it was likely imbedded in the culture and DNA of the company cascading from the top down through the organizations. In the current economic crisis it became a series of unmitigated and unregulated practices that not only every one was doing but many were getting very rich from the practices.

As you think about risk in your own organization it is beneficial to regularly consider the sources and consequences of allowing risk to overtake the appetite of the enterprise to absorb and survive risky practices, policies and product offerings.

Internal risk often arises from the "pressure to perform" syndrome. That is we need to make the numbers so operating on the edges of acceptable practices is acceptable. Unfortunately history is full of company examples where this philosophy of operating creeps to the point of putting the company at legal, reputational and financial risk beyond the likelihood of recovery.

Often when looking at these type of situations it is clear that in fact the managers were incentivized to "make the numbers at all cost" and as expected when managers are rewarded for certain behaviors they in fact become very proficient in delivering results without regard to the risks. The incentive becomes a mechanism for rationalizing behavior to reach the goals.

There are also external drivers of risky behavior that only adds to the already stretched internal practices that put the enterprise at substantial risk. The external sources of risk to consider include the following:

Market Changes
Regulation Changes
Globalization Impact
Competitive Actions
Technology Changes
Societal Changes

As these external factors evolve it is important to understand how each impacts your company and just how each might lead to behavior by your managers that results in risky decision making that creeps to the point that it threatens your company on the fronts of financial, legal and reputational risks.

Clearly defining acceptable risk taking and understanding how to use it as a powerful, competitive tool can be leveraged for the benefit of the company. It is when the internal and external sources of risk tip the balance toward excessive risk taking with out regard to the consequences that risk creates situations like Enron, WorldCom and the current economic crisis.

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