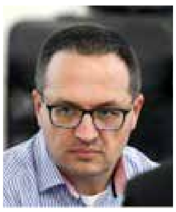
Risk culture beyond ticking boxes



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Introduction

In a previous article published in SIRK 1/2018 I challenged whether internal audit is meeting the challenge of addressing appropriately the area of risk culture and I suggested the need for the organisation to start by developing a better understanding and a common language for risk culture. In this article I wish to demonstrate further how it is possible for an organisation to develop and change its culture and what tools are available to guide this process.

> The corporate culture is the most powerful control in any organization.
>
> *Jim Roth, author of Best Practices: Evaluating the Corporate Culture*

Risk culture is not something that is static. It is an evolving process that can be influenced and where changes can be managed. Organisations have therefore the ability to develop the risk culture that they wish for. To manage this, we need to look at risk culture through cultural lenses. Culture has many dimensions and we need to decide which of them are the most important to focus on. Assessing and managing risk culture should definitely not be a box ticking exercise.

The box ticking syndrome

In the corporate governance field, the box ticking syndrome defines a formal approach to the implementation of corporate governance principles – doing something just because there is a rule that says that you must do it[1,2]. Over the last few years, financial regulators (mainly in the banking and insurance sectors) are requiring companies to implement processes for the development and management of risk culture as part of the corporate governance framework. Can risk culture fall into the box ticking trap?

According to the European Banking Authority (EBA) «Institutions should develop an integrated and institution-wide risk culture» [3] as a tool for effective risk management and to enable good decision making. The minimum elements of strong risk culture according to EBA are:

(1) tone from the top – the management body should be responsible for setting and communicating the institution's core values;
(2) accountability – employees should know and understand the core values of the institution and must be held accountable for their actions;
(3) effective communication and challenge – a sound risk culture promotes open communication, and
(4) incentives – incentives should pay a key role in aligning risk taking with the institution's risk profile and long-term interest.

This framework was first presented in the Financial Stability Board's (FSB) Guidance on supervisory interaction with financial institutions on risk culture[4]. It draws on the experience and efforts of supervisory and regulatory authorities across the FSB membership and insights garnered from the market participants through roundtables and bilateral discussions[4]. The Guidance proposes a wide range of indicators of sound risk culture in accordance with the defined framework.

The clear framework and the large set of indicators may lead to the temptation to develop a list to «diagnose» or «check» the level of risk culture in the organization and to prescribe actions to improve risk culture. Will it work? The use of the term «indicators» to refer to elements of risk culture could be misleading as it implies a linear relationship where the performance of each element can be manipulated individually. This is not the case as it is the totality and interaction of all the elements which makes the culture, and for this reason the checklist approach to measuring culture is wholly inappropriate[5]. If the supervisors and management of financial institutions want to assess culture and its influence on risk management, they need to consider the organisation's training and building of cultural experiences with a focus on behavioural analytics techniques. Culture is a complex issue and the temptation for boards and executives is to want to manage it in the same way as other business areas must be resisted.

Risk professionals (risk managers and internal auditors) need to dig below the surface and gain a deeper understanding of the true nature of the organizational and risk culture as the basis for understanding how culture can be both managed and changed.

Risk culture from the cultural perspective

If the appropriate definition of culture is not chosen then its application to the firm's management of risk opens up for many varied interpretations and may be subject to presumptions, misinterpretation and confusion[5]. Culture is the product of social learning by a group as it solves its problems of external integration and internal adaptation. As a product of learning from the interaction between the organization's members and their environment, the organizational culture evolves naturally (as organizations change) as well as by managed change (the leader may initiate change in an organizational culture when evolutionary processes are too slow or develop in the wrong direction)[6].

The definition of culture is important, but it is not sufficient in itself. We need to have a model or concept to support the definition. If we choose a model, we need to be sure that the selected model describes well enough the culture of the organization. Models are based on theoretical assumptions and empirical research and are developed to help us to simplify the process of the analysis and management of culture, but they have limitations[6]. We can dig deeper and discover the underlying concept of the management of culture by reviewing some of the widely used and well described approaches/models for the assessment and change of organizational culture e.g. by reference to Edgar H. Schein's[6,8] organizational culture model (box 1), The Competing Values Framework of Cameron and Quinn[9, 10] (box 2) and The Seven Levels Model of Richard Barrett[11, 12] (box 3) and identify the

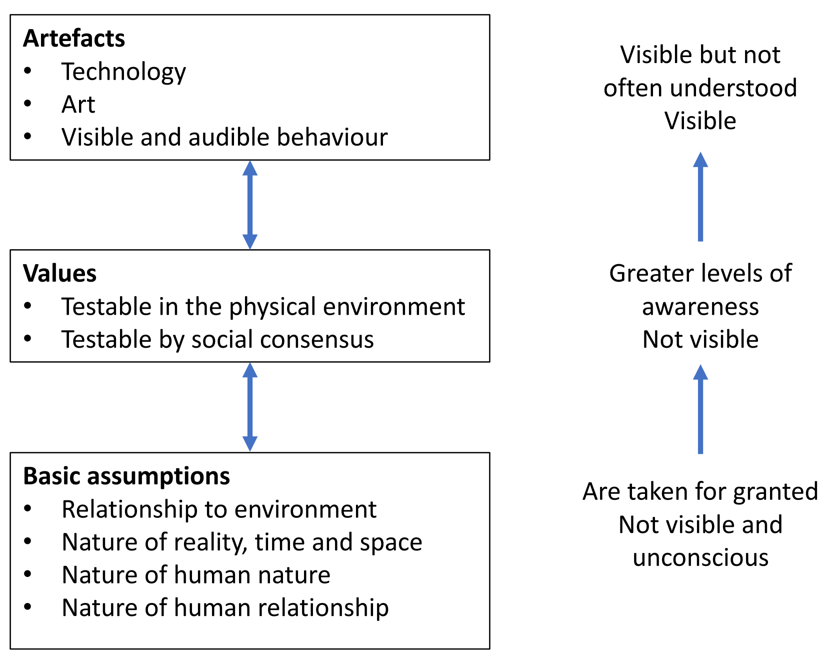
Edgar Schein Organizational culture model

Schein's Organizational culture model divides organizational culture into three different levels:

1. Artefacts and symbols
Artefacts mark the surface of the organization. They are the visible elements in the organization such as logos, architecture, structure, processes and corporate clothing. These are not only visible to the employees but also visible and recognizable for external parties.

2. Espoused Values
This concerns standards, values and rules of conduct. How does the organization express strategies, objectives and philosophies and how are these made public? Problems could arise when the ideas of managers are not in line with the basic assumptions of the organization.

Basic underlying assumptions
The basic underlying assumptions are deeply embedded in the organizational culture and are experienced as self-evident and unconscious behaviour. Assumptions are hard to recognize from within.



Box 1

common denominators in these approaches.

The first (and perhaps the most important) common thread is that managing culture is methodologically relatively similar to the process of managing change. The process used by the different approaches differs in the details, but is the same in general and can be defined as:

- Discovering the existing culture – there are two approaches to doing this: model based (Kim S. Cameron and Robert Quinn and Richard Barrett) and the "deciphering" approach of Edgar H. Schein. Both approaches use indepth interviews and discussions regarding existing culture and/or participatory approaches (like workshops). Model based approaches use, in addition, questionnaires and values inventories based on the models. As a result, a consensus view on the current organizational culture emerges.
Values also play a key role in forming culture. Effecting change in behaviour and actions by changing values and beliefs is the essence of cultural transformation according to Richard Barrett. Behaviour is the manifestation of the culture (Kim S. Cameron and Robert Quinn). Change remains superficial and of short duration if it does not lead to an alteration of fundamental goals, values and expectations both of the organization and of the individual. Behaviour is an artefact according to Schein and it is driven by espoused values and shared tacit assumptions
- Designing the target culture – the same instruments and tools are used as in the discovering stage and some additional tools such as appreciative inquiry[13] (a change management approach that focuses on identifying what is working well, analysing why it is working well and then doing more of it), four whys[12, 14] (this tool helps individuals in a group to create their team vision and mission and to clarify the
- connection to an external vision and mission for example to that of their customers and society) and other tools[12] are applicable. As a result, a consensus view on the target organizational culture is defined.

The Competing Values Framework

From a list of thirty-nine indicators of effectiveness for organizations, Cameron and Quinn found two polarities by statistical analysis that make the difference when it comes to organizational effectiveness. Organizations have to choose whether they have:

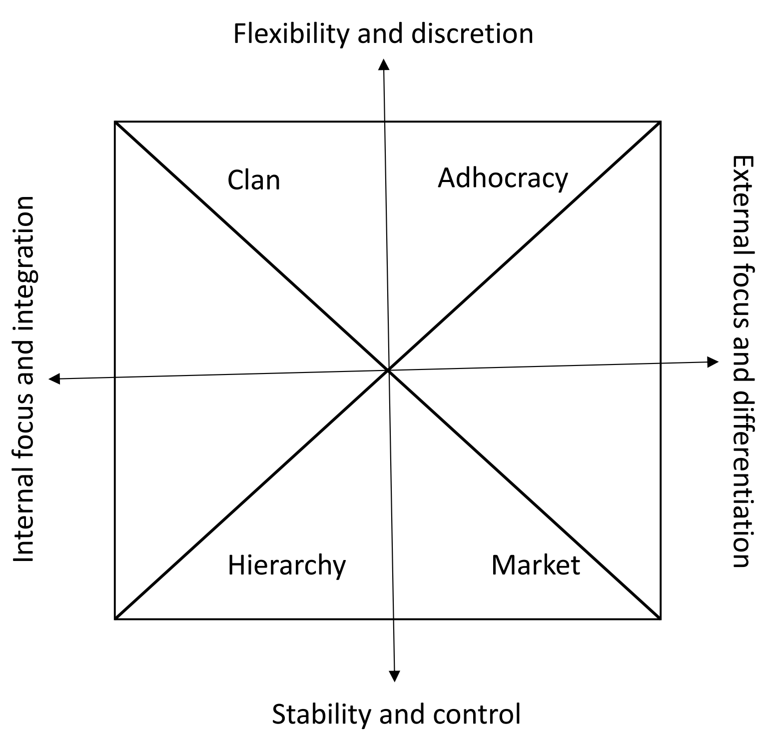
- Internal focus and integration - or - External focus and differentiation
- Stability and control - or - Flexibility and discretion

You can›t have both polarities at one hundred percent at the same time. Hence, they are competing values. By plotting those two dimensions in a matrix, the Competing Values Framework emerged. Its four quadrants correspond with four Organizational Culture Types that differ strongly on these two dimensions or four values: Clan Culture; Adhocracy Culture; Market Culture and Hierarchy Culture.

Box 2

To the left in the graph, the organization is internally focused: what is important for us, and how do we want it to work? To the right the organization is externally focused: what is important for the outside world, the clients, and the market? At the top of the graph, the organization desires flexibility and discretion, while at the bottom the organization values the opposite: stability and control.

https://www.ocai-online.com/about-the-Organizational-Culture-Assessment-Instrument-OCAI/Competing-Values-Framework
https://www.ocai-online.com/about-the-Organizational-Culture-Assessment-Instrument-OCAI/Organizational-Culture-Types/



- Delivering the necessary changes – this is effected by means of a change plan and the tools and the key performance indicators for culture change. The tools depend on the change management approach used and the cultural model chosen. Schein proposes two approaches:

(1) role models and behavioural examples or (2) stating clear behavioural goals and initiating a learning (trial and error) process. Richard Barrett uses personal alignment programs, group cohesion programs and value alignment programs. Kim S. Cameron and Robert Quinn combine organizational tools (stories, strategic action agenda, small wins, leadership implications, metrics and communication strategy) and personal development programs.

The role of leadership in the process of cultural change (management) is very important. According to Schein[6], culture and leadership are but two sides of the same coin and leaders are the ones who start the process of culture creation. The leaders of the group must drive the process of cultural change according to Richard Barrett[12]. Kim S. Cameron and Robert Quinn[10] state that leadership is an important factor of organizational culture and treat the ability to identify the most valued leadership attributes for the different types of culture as a separate cultural dimension. All this means that leaders are the main architects of culture and if elements of the culture become dysfunctional, leadership can and must drive culture change.

Practical implications for risk professionals

To avoid a box ticking approach and gain deeper understanding as to how culture works in our organization and how to manage it we need to:

Discover. Before trying to change our culture, we have to discover it "as is". As Richard Barrett says – you have to meet people where they are before you can take them where they want to go![12]. To discover our existing risk culture, we need to answer two important questions: (1) what are we doing when managing risk (what are the artefacts of risk culture)? and (2) why are we doing the things we are doing (what are our values and deep assumptions)? We can find the answers using models, that describe the culture (models are useful but must be deployed with care) or to use a culture deciphering approach.

Design. Culture has many dimensions and we need to decide which of them are most important and how they affect risk culture and risk management. Designing the target risk culture means to define what are the right behaviours when managing risks and what values and assumptions stay behind them.

Deliver. All work in risk culture management must be done with one simple concept in mind – managing culture is managing the change in the behaviour of people (Organizations don't transform! People do![12]). Change management can be done by using role models and behavioural examples or by employing a more sophisticated change management approach by using dedicated tools depending on the goals for example organizational tools (stories, strategic action agenda, small wins, leadership implications, metrics and communication strategy) and personal development programs.

Leaders play the most important role in this process – they are the main architects of culture and if elements of the culture become dysfunctional, leadership can and must drive culture change.

The Seven Levels Model of Richard Barrett

The Seven Levels Model describes the evolutionary development of human consciousness. There are two aspects to the model—the Seven Levels of Consciousness® Model and the Seven Stages of Psychological Development Model. People operate at levels of consciousness and grow in stages (of psychological development). The Seven Levels of Consciousness Model applies to all individuals and human group structures—organisations, communities, nations. The Seven Levels of Psychological Development Model applies to all individuals. The following diagram shows the correspondence between the Seven Levels of Consciousness and the Seven Stages of Psychological Development.

https://www.valuescentre.com/mapping-values/barrett-model

Box 3

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11. *The Seven Levels Model https://www.valuescentre.com/mapping-values/barrett-model*
12. *Richard Barrett, Building a Values-Driven Organization: A Whole System Approach to Cultural Transformation, Butterworth-Heinemann, 2006*
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