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Over the many years that we've been writing Lucid Thoughts, we have touched on different aspects of what it takes for risk management to add tangible value to an organisation. You can look at the archive of Lucid Thoughts on 'making decisions in uncertain situations', in Chapter 4 of our website archive.

http://www.luciusconsulting.com/Thoughts/Lucid-Thoughts-Archive/Chapter-4

In this Lucid Thought we want to bring together our thinking over the years on this topic, and go one step further. Much of what we've said in the past has been about practical steps to take to get risk analysis and management to work better. All this remains valid, but this time we want to share our ideas about a **potential better way for investments in risk management to add value.** Our ideas build upon our thoughts and experience about how risk management is practiced in the majority of organisations. People search continually for ways for their risk management to **transcend 'tick-box'** approaches, and to **demonstrate the return on investment** of anticipatory management. We believe there is value in thinking differently, drawing on behavioural economics and risk psychology. We believe that risk management must be positioned firmly as a subject **about people and performance, not only about process and probability**.

To 'reconceive' risk management does not mean throwing away everything that exists now. The 'traditional' process-centric view has merits – it's not wrong – it's not superseded – it's just not enough.

Risk analysis is a necessary precursor to making informed decisions in the light of uncertainty; it stops unfounded guesses, or worse, unfounded guesses that are passed off as data-driven, 'correct' estimates. Whether we estimate based on data or hunches, the need to make plans and forecasts is obvious. Promises, expectations and confidence levels are derived from these plans and forecasts. It pays to know how to do this well.

It's valid to stop here. If the exposure to risk (variation from objectives) falls within tolerable limits, then there's a strong argument for accepting all that risk and getting on with the work. Of course you need to keep alert to changing circumstances, but there is probably little economic or stakeholder value that could be created by increasing certainty to a level that is not needed.

Most situations of course have a level of overall risk that decision-makers don't want to tolerate, so some proactive management is warranted. Yet it remains deeply counter-intuitive for many experienced managers to spend scarce time and money to manage a situation that may never happen in the first place. Couple this with the fact that the whole concept of risk is socially constructed - like love, risk is 'in the eye of

the beholder' – and you have a tricky situation to deal with. It's no wonder that risk management is not done well in most **organisations; subjective, people-centric things are difficult to manage using objective, process-centric approaches**.

There is no part of the risk management process that is more frustrating for experienced managers than the practice of prioritising individual risks (events) using some sort of probability/impact grid or heat map. Despite all good practice to calibrate impact scales based on overall risk appetite for the objective at risk, **the task of assessing (guessing) probability or likelihood is open to a myriad of human biases and is deeply flawed**. We must remember that although there are some risks that we take where probability can be calculated, for example in games of pure chance like playing the lottery, or where we have large, homogenous data sets; in most cases the risks we face are risks in the first place because we have a lack of knowledge. That lack of knowledge might be about the past, the present, as well as the future. We believe we need a better way to deal with assessing the chance of such events occurring when lack of knowledge is the problem.

So our thoughts about reconceiving risk management are built upon an argument that opportunity loss/gain from taking action is a superior metric for thinking about whether to proactively manage a risk than it's position on a probability/impact grid. It's sounder economically – which addresses the 'return on investment' problem. It's also matches more closely the natural thought processes of practising managers thus standing a chance of addressing the 'tick-box' problem.

You still need to understand objectives, priorities, tolerance for variability and what risks that stakeholders perceive exist. Then you can make a switch and ask **'at what level of probability would a proactive investment now be worth it?'**

Does this sound like a good idea?

If you're interested in reading more, Ruth and Sergio have published a paper that outlines the thinking and how it would work in more detail. If you'd like to read the paper, or see a worked example in a short powerpoint presentation, then drop us an email contact@lucidusconsulting.com and we'll send you a copy.

If your organisation is quite sophisticated in risk management, and is using probabilistic risk analysis to look at the combined effects of variability and risk events on a plan, then what we are saying is not as relevant to you as is it to those organisations (the majority in our experience) who don't do this as a matter of course.

It's perhaps radical for the establishment to suggest that risk management can be reconceived - but our experience is that 'traditional' risk management isn't working too well in many places, so radical is maybe needed if we are to add economical value from the management of risky and important situations.

Ruth Murray-Webster, Sergio Pellegrinelli & Peter Simon

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