THE BOARD MINDSET™

The vital attribute of exceptional boards

WHY LEADERS IGNORE STRATEGIC RISK

Business leaders are often sure about what they need; sometimes they are right. The best leaders have ways to check themselves and especially, their assumptions. They know that ignoring risks, even those that are vague, seem small or unlikely to cause harm, can be deadly.

James Lam, a director on the boards of E*TRADE and RiskLens, Inc., an expert on risk and a best-selling author of *Enterprise Risk Management: From Incentives to Controls*, says that 61% of risk comes from strategic risk. His research defines strategic risk in terms of consumer demand, competitive threats and M&A.

The dismal results from M&A alone, is consistent with this finding. Yet, leaders continue to pursue deals with supreme confidence that they will work out. Integration plans are often focused on the source of risk that is most concrete – operational risk. Lam's research, described in his book *Enterprise Risk Management: From Incentives to Controls*, finds that operational risk accounts for 30% of risk. The remaining risk, 9%, is due to financial, such as interest rates. Yet, great investment is made to mitigate financial risk, often with massive amounts of analysis. What can leaders and business owners do to prioritize the categories of risk according to their actual seriousness?

What can leaders and business owners do to prioritize the categories of risk according to their actual seriousness?

What Great Leaders Can Do To Prioritize Strategic Risk

1. Don't fall in love or at least don't act like you are.

As soon as we fall in love, we are looking through fogged lenses. When leaders are considering a major strategic move, they should ask themselves if the opportunity fits with their vision and strategy. A shiny new object that doesn't fit will quickly be pushed aside when the framework of vision and strategy exist and are simple and clear.

One company, a financial services firm, considered an opportunity that would have brought them increased revenue, but with increased risk and volatility. It took the board just a few minutes to say no because they had a clear framework for making such decisions and had the courage to follow their strategic direction.

2. Be agnostic.

No matter what the nature of your business you have stakeholders. Great leaders have a mindset characterized by strategic and systemic thinking, regardless of their particular expertise. Bart Becht, former CEO of Reckitt Benckiser reminded his team, often, that what mattered most was not what they thought, but what the people who weren't in the room with them, thought. The mindset of knowing the customer led Becht to prioritize key principles while maintaining an entrepreneurial culture that led to great success.

THE BOARD MINDSET™

The vital attribute of exceptional boards

3. Challenge assumptions.

This process begins best by articulating your assumptions, then asking, "Why do we believe that?" This is an actual exercise for leaders to engage in and write down their answers. Other questions that are valuable are, "How do we know that?" and "What is our evidence?"

Challenging assumptions will elicit emotional reactions

The process of challenging assumptions will elicit some emotional reactions. This is *normal*. It is precisely why leaders who tackle issues that are difficult to assess need a framework to do so and usually need help. The benefits are long-lasting because leadership teams who are willing to hold themselves accountable for their decisions will recognize more errors, but will also learn what caused them and develop better decision-making skills.

4. Be uncomfortable.

Leaders are expected to be certain, to make good decisions and create value. One reason some leaders get in a bind is they take short cuts; not out of laziness but discomfort. Pressure from a board, shareholders, competitors, global and secular changes may be hard to quantify, but are real.

Rather than resolve the discomfort with rigorous logic or accept fallibility, some resort to one of the following:

1. Ignore it,
2. Invest heavily in areas that are less vague, such as financial and operational,
3. Abdicate to a big-name consulting firm.

Any of these could lead to a deal that a leader or leaders want, but not necessarily the one that best serves the company.

When an opportunity presents itself, or is discovered by a company, it is easy to over-index on opportunity and look away from risks that are vague or seem insignificant. Lam's work can help leaders with practices that reduce risk and enable a business to profit from the risks their competitors failed to foresee. These ideas are invaluable, but are only available to leaders who have the maturity and courage to see that regardless of their intellect, experience or the reassurance of those around them, their decisions are influenced by the human processes of perception, cognition and emotion, all of which are needed and all carry risk.

Helping Define Your Company's Future Success

Together Constance Dierickx, Linda Henman, and Lorraine A. Moore co-founded The Board Mindset. Independently and collectively, we help boards achieve excellence in critical aspects of governance. We advise on any unaddressed issues to help the board and the company move forward. The services we offer:

Board Education - Board leadership, promotion of professional standards, CEO alignment of vision, and CEO advisors

Strategy Formulation - When and how boards should be involved in strategy and succession planning

Board 911 - Emergency plans, crisis prevention and addressing organization crises

If you have any questions about The Board Mindset, visit www.theboardmindset.com or contact us.