

INTRODUCTION TO RISK MANAGEMENT

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I. Views from Belgium

Introduction

Risk Management, as explained by George Head, has to be integrated in the organizational life of any company: how to make it effective in the complex network of relations inside a company.

As our exposes are devoted to new Risk Managers or to people having the problem in charge only as a part of their activities, let's philosophize a little bit.

I personally started to think about from information I found in two different sources, the first being the practice of epidemiology in the medical world--illnesses and other diseases are also "risks"--the second being the ideas of the Palo Alto research group on psychiatry, involving the problem of "communication" between groups and between individuals.

To be more precise, I feel extremely comfortable to find some confirmation of my own thinking in other disciplines. Let me explain quickly the major points of the sources I have cited:

1. Epidemiology: the first approach followed the old scientific understanding, looking to the relationship between causes and effects. That approach is called "linear".

Very quickly the doctors came to a more complicated understanding of the illnesses they were studying, discovering that one effect was generally related to different combined causes: that approach has been called "reticular".

After a while and probably under the influence of the growing of the computer science, they admitted that there was some reaction from the effects on the causes. That approach is called "feedback".

2. Palo Alto: the research group also left the old and simple approach of "causes-effects" dynamic, and, under the influence of the cybernetic science started to think in terms of feedback relations. The cybernetic gave them a much better model to understand the interactions and interrelations of the "communication" in general, and of the psychology in particular.

One should note that the same approach has also been used a little later, consciously or not, by communication specialists summarized in the simple design of the Almigu helix: the feedback operates in any organization, or should operate, in a spiral way.

This having been said, let's have a look on the way it works or should work inside a company, but related to risks and Risk Management.

A. Company's management feelings

Any living body, or organization, tries to answer the very simple question: "How to survive?"

If you look to Nature, you will discover a lot of attitudes, from the oyster laying millions of spawns without care, leaving to chance the survival of at least very few of them, to the so-called superior "mammals" where a lot of care is given to one or two young or babies.

The common hope is, of course, that the breed will survive.

Applying the same reasoning to the management of a company, we come to the following questions:

Do we accept the uncertainty of the future?

As nobody knows the future, we should say that the uncertainty is the rule just like in Nature.

Do we try to handle that uncertainty?

Again the uncertainty of the future involves a lot of risks on which we may have an influence. Many parents answer positively to that question when they try to educate their children, in order to give them the best possible weapons. Why should a company defer in that field?

Do we accept that the approach should be multidisciplinary?

Again, let us take the answer given by the parents. They will send their children to the school; they will ask the doctors to vaccinate the children, etc. If the natural answer is de facto multidisciplinary, so must a company do: problems are split between financial people, technicians and engineers, personnel managers, lawyers, salesforce, etc., meaning that all of them are to be involved in a risk management approach.

Do we accept a risk management cell?

In the beginning of my expose, I spoke about the feedback relationship: if we accept that the same feedback relations do exist in a company,

that means that a coordination should exist between the different trends, in order to facilitate the feedback influences, especially on a problem split between the different entities.

B. The role of the Risk Management cell

What kind of risks are to be handled by a Risk Management cell: you will note that I am consciously using the term of "cell" instead of a "risk manager" because, depending on the size of the company, it is extremely unusual and difficult to concentrate on one man a satisfactory knowledge of all the problems.

In the literature, there are many ways to seriate the risks, but from my personal point of view, I divide them into three categories:

1. Human risks

Those risks are mainly related to the humans working for the company.

Please do not restrict the terminology to the physical integrity of the employees, as it is covered by workmen's compensation, but also to many other aspects, like absenteeism, death in service, medical costs and, of course, pensions.

Some do include in the human risks fraud and misconduct.

2. Material risks

Those risks are related to the patrimonium of the company. Of course it means not only property damages, but also the different liabilities and legal risks.

3. Entrepreneurial risks

From the beginning, the Risk Management specialists decided that such a risk was not involved in any Risk Management approach. That attitude was true in the past, but there are signs that the ideas are starting to change, especially in the economic, financial and political areas.

Our expose being an "introduction", I would prefer not to start the discussion.

C. The way Risk Management could be made effective

As I said in the beginning, I am expressing my personal views on the subject. Again the technical literature has emphasized a lot of different techniques. I feel that those techniques depend much too much on the size and the type of industry. So I would prefer to come to the basics: they might be summarized in two words--audit/advise. Audit,

because to be operational, a management cell has to have the right to ask questions and to receive answers from any other entity of the company or of the corporation.

The second part of my formula is "advise".

When you are confronted with a quite complicated problem, it is extremely seldom that only one answer is possible, but if you obtain a necessary sensibilization and if you generate sufficient dialogue between the different responsables, you will discover that generally the solutions are numerous and that a choice has to be made. In addition if you follow the advise concept, you will never be hurt if your own personal solutions are not retained.

D. Must Risk Management intervene outside the company?

I also said before that risks involve a lot of different techniques, engineering, accounting, fiscality, laws and, especially after a claim, become very sensitive and sometimes emotional problems. In addition, those aspects mean nothing "per se", because legal and fiscal aspects are in the hands of the government, raw products are coming from outside, manufactured products are sold out of the company and very often abroad. This means again another kind of feedback relationship between the internal world of the company and the external world. That means also that the Risk Management approach definitely has a role to play also outside the company.

II. How are the Problems Handled in Other Countries?

From the experience I have, which is very limited, I have the impression that in the Western world, three different trends apply:

1. North America

Generally Risk Management applies to the human and material risks. There are many reasons doing so and the fact that human risks are generally involved, comes from the fact that the employer's liability or workmen's compensation, sometimes the medical costs coverage, are under the responsibility of the employer. This may also include or not the complementary pension.

2. Continental Europe

Generally the risk management is restricted to the material risks: this is most probably due to the fact that the social security systems are much more sophisticated in those countries, so that employers think that everything is settled (which is not true, of course).

On the Continent, there are two exceptions, Belgium and Portugal, where the workmen's compensation is still in the hands of the employers and covered by the private insurance market.

3. U.K.

That country occupies a place between the other two. There are most probably historical reasons, a lot of big U.K. companies having subsidiaries abroad, which is an advantage. When you have to deal with different risks outside the country, you are inclined to look at them from a global point of view.

The disadvantage of the U.K. situation comes from the fact that London is known as an insurance market; that means that generally Risk Management is linked to the insurance problem and for that reason could sometimes fly on a too low level.

In general I could also say that U.S. and Canada are certainly in advance of the rest of the world, that U.K. is not far behind, but that on the Continent, we are still starting.

III. What is the Future of Risk Management in Continental Europe?

It is a problem of society and market.

Society

My personal view is that we are just ending the security age. Especially these last years ruling was predominant on everything. If before doing something, you need a lot of approvals and you are forced to follow a lot of rules, there is less space for Risk Management. If the new libertarian trends emerge from the present mutation, Risk Management will be more and more necessary: if you have more freedom, you automatically bear more liability.

Market

I am not referring to the insurance market, but to the risk market. As in any other markets you see new risks appearing. Some are due to the evolution of national or international rules, political risks, products liability f.i. Some others are related to the evolution of technique and of society. Computer risks, telecommunication, robots, satellites were only unknown not too long ago. New services are emerging: if you look to the price of the products at the door of the plant, you understand immediately that the retail price is much more influenced by different services (transportation, publicity, maintenance, etc.) than by production costs.

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