Risk Management and the Board

Lessons learned from the COVID-19 crisis.

By Brad Oates

One of the most important skills for a board member is the ability to think strategically about risk management and that thinking requires looking at redundancy, diversity in the supply chain, and both financial and talent capacity within our organizations. Examining each of those should be viewed more as a productive investment than an unproductive cost.

We have focused on a relentless pursuit of efficiency for the past 30 to 40 years, looking to seize the day and maximize our financial returns with technology advances helping us to become more efficient more quickly. In doing so, we have created fragile — as much as agile — management and production systems. The fully loaded cost of risk management gaps and weaknesses is exposed in crisis situations, whether from supply or demand shocks to an economy.

The lesson here is there is always a risk cost of not having diversity, redundancy and capacity in our systems, and that risk cost is now showing up clearly in the COVID-19 crisis. Let's be honest with ourselves — we took out as much current expense as we could and there was always a risk cost to taking out those expenses. When we run the financial model, it is clear we did not "flatten the risk curve" and will pay a much higher net present cost for not doing so.

The unprecedented amount of stimulus injected into the economy will impact the long term. Perhaps the most important question will be who ultimately bears all imaginable "tail risk." What is the long-term impact of simply moving excess leverage from companies to the government? Make no mistake, this will have consequences.

We need to step back and think about what we created. We wanted process efficiency, and we found leaders who have run companies with maximum efficiency and adopted compensation structures to drive and motivate that even further.

We were on a path to create better clarity between tactical and strategic governance with the last year's debate of stakeholder vs. shareholder models. As an optimist, I think this current crisis will accelerate the trend to strategic governance and help us find the right balance for stakeholder interests, including shareholder financial interests. Efficiency is more tactical, while harmonizing shareholder and stakeholder interests is strategic intelligence. True competitive advantage comes from mastering both sets of skills.

As a result of these governance trends, the bar for directors has been raised substantially — and it was already raised with increased time commitment and more director independence, including rigorous and brutally honest board assessments.

Boards need continuous governance process improvement. But, even more, they need to raise the collective governance intelligence. That starts with a higher level of risk-management thinking. Much of my governance worldview comes from my professional football experience that says you need good talent and coaching to win, but that is only a starting point for competitive advantage talent. It's also about the constant pursuit of excellence at an individual level as a mission-driven team of players, coaches and support personnel to achieve championship outcomes.

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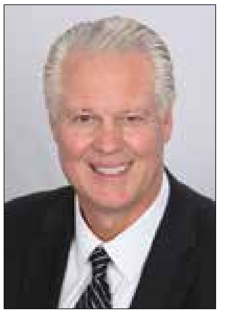
Boards need to learn and develop the skills for strategic governance thinking, which requires challenging our inherent biases and hubris. Before COVID-19, we thought we were smart, but maybe we were not as intelligent as we were tactically smart. I think many of us were perhaps thinking, "When we get to a fork in the road, we'll just decide then and there which path to take. We don't want to give up optionality now."

Increased governance intelligence would lead us to think through and address certain material risks now with redundancy, diversity, and capacity. Given that there were five virus pandemics in the past 30 years, it is easier to see now in the rearview mirror (more so than the front windshield) it was only a matter of time that a new type of virus would go global in a very short time in an increasingly interconnected world.

Finally, boards are going to need heart. The shareholder vs. stakeholder argument has been decades in the making, and the ESG movement has brought the debate to the forefront. There are reasoned arguments on all sides of the debate. We're at a tipping point now. The COVID-19 crisis will help us weigh the merits of the debate more intelligently when we get to the other side.

When this current crisis is over, there will be some who will want to go back to the world we knew — more financial efficiency and less risk intelligence. But I believe there are enough governance professionals who will see more clearly the gaps and weaknesses that created the underlying fragility that has caused the crisis to be more costly than it could (should?) have been. I believe there is a better way to think about effective governance in a post-COVID-19 world. We were already searching for ways to better balance shareholder and stakeholder interests. I believe this crisis gives an opportunity to raise our collective governance intelligence and risk-management thinking that includes more clarity about how redundancy, diversity and capacity are investments more than expenses. ■



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