Effective risk management and its impact on governance

Business, Company

Risk-taking drives corporations to push ahead and make steep gains. Consequently, interconnectivity makes the perspective of risk-taking extremely complex. The changing landscape of risk is creating a global conversation about how principles for corporate governance need to evolve to respond more appropriately to the relationship with risk management.

The world’s corporations are keeping a keen eye on how large corporations are managing and responding to risk failures so they can avoid the same mistakes. They’re learning that companies tend to underestimate the cost of risk failures internally, as well as externally. In many cases, corporations are also underestimating the cost of time that managers need to address damage control.

Banks and other financial institutions have long set the standards for good corporate governance principles. While the world has much to learn from their strategies and missteps, the governance principles they’ve established don’t necessarily translate well for all types of businesses. As the conversation continues, corporations are trending toward wanting to take a broader-based approach toward corporate governance principles to suit more diverse situations.

Corporate governance principles could take on many different forms. Most likely, changes will be fluid and evolving for the foreseeable future. Despite vast changes, corporate governance principles need to be structured, integrated and balanced. Corporations will continue to look at the roles of existing reward structures and how they align with financial and non-financial risk. Recent risk failures have taught us that all corporations are

vulnerable and that they need to prepare just as stringently for low chances of catastrophic risk as for higher chances of major risks.

Existing reward structures for corporate executives tend to correspond to how well they manage financial risk as it relates to internal controls and audit functions. The new standard for reward structures may include not only rewarding the success of businesses, but also rewarding managers for having a keen awareness of risk management. This means that corporations may begin reducing financial incentives, such as stock options for managers who regularly engage in excessive risk-taking.

Companies may also factor in how well managers pay attention to reputational risk in addition to financial risk, and how strategic risks manifest as operational risks. Let’s take a closer look at what this might look like in practice.

Corporate executives are giving thought to forming guidelines as basic steps to new approaches to managing risk. Many executives are encouraging their companies to establish some common risk language that they can use throughout the company. Using commonly accepted terms for risk management will aid them as they set new standards for risk management. In turn, new standards for risk management will help them to balance qualitative and quantitative perspectives as they devise standards for measuring risk.

The future of corporate governance may move toward a broader perspective of standards that are more practical and useful for all types of businesses,

including banks and other financial institutions. Such issues as outsourcing and supplier-related risks are examples of risks that apply to most businesses that haven’t been addressed very much in governance in the past.

Additionally, corporate governance of the future may place a heavier emphasis on catastrophic risk even when the risk is low. Just because the probability of a catastrophic loss is low doesn’t mean a catastrophe won’t happen. Good corporate governance principles may account for standing ready to manage any potential catastrophe at any given time.