

# Deloitte.

Fit 4 VUCA

Towards a risk-intelligent culture



### What is VUCA?

The world is changing – fast. We live and operate in a constant state of turbulence, military planners (amongst others) have an official term for it. They call it VUCA – an environment of relentless volatility, uncertainty, complexity and ambiguity. In this state of VUCA, events coming at an organisation are increasing both in number and variety – at an unforgiving speed – it is survival of the fittest and the triumph of the agilest.

Financial institutions (Banks, Insurers, Lenders, Investment and Asset Managers) across Africa are feeling it - barriers are being eroded, invaders are entering their atmosphere from different industries, lands and vantage points.

Never before has technology been so disruptive, so exponential – so quickly. Regulations and risks so far-reaching. Employee and customer power so strong, transparent, expecting. Innovation so vital to survival. How do you future-proof your organisation in ever-shifting times?

### Towards a risk-intelligent culture

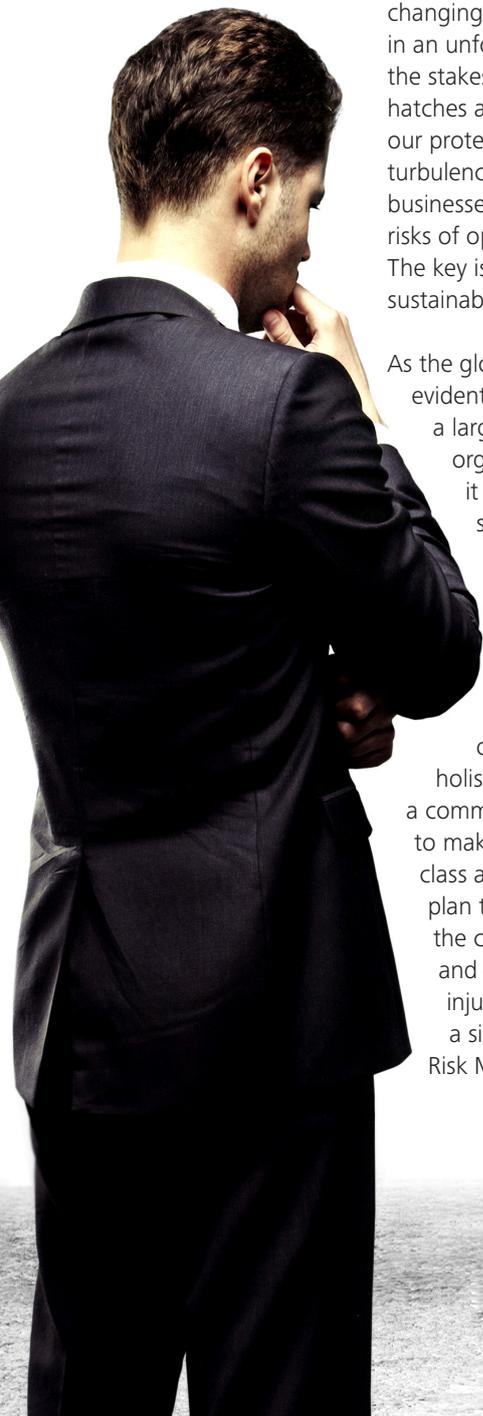
Economic instability, increasing competition from non-traditional invaders, a plethora of regulatory change, as well as new roles for the board and executive teams... financial-services institutions are operating in high-speed, dynamic and ever-changing times. How do we prepare ourselves in an unforgiving, competitive world, where the stakes are high? Do we batten down the hatches and wait for it to pass, or do we don our protective gear and launch ourselves into the turbulence? How do we continue to grow our businesses, be innovative and still manage the risks of operating in this new climate?

The key is around proactive, effective and sustainable management of risk.

As the global financial crisis unfolded, it became evident that cultural misalignment played a large role in organisational failures. An organisation's culture determines how it manages risk when under stress. For some organisations, their risk culture is a liability, while for others it facilitates stability, innovation and a competitive advantage.

One of the cornerstones of being Fit 4 VUCA in the financial-services sector is one's ability, as an organisation, to think holistically about risk and uncertainty, speak a common risk language and understand how to make risk-related decisions. Every world-class athlete and sporting team has a game plan that includes knowing and confronting the competition, knowing the boundaries and dealing with unforeseen events such as injury. Every world-class organisation needs a similar game plan, and this is what the Risk Management Framework involves.

Global economic events have highlighted weaknesses in many financial-services organisations in the area of risk governance and management. This, coupled with regulatory demands, has catalysed many organisations to devote significant time to developing and implementing enterprise Risk Management Frameworks, policies, procedures and technologies. Our experience tells us that there has been progress in revamping governance practices and establishing infrastructures, but that there is still a considerable need for cultivating risk-intelligent cultures within the African financial-services sector. It is like providing your team with the latest sporting equipment, world-class coaching, medical support and state-of-the-art training facilities – but not bothering to use any of these enablers when confronting the competition on the playing field, preventing and dealing with unexpected injuries or developing new talent. You can have all the risk management policies and structures in the world, but if you do not use them and do not behave accordingly, they will not enable you to triumph in the face of adversity or to deal with changes in the game plan.



Regulations stipulate that financial-services firms must have a robust Risk Management Framework (RMF) in place. This needs to cover risk identification, risk assessment, risk measurement, risk monitoring, risk treatment and risk reporting. However, having an effective RMF is absolutely predicated upon the firm having a true risk-intelligent culture – one that is tangible and real and that is almost the glue in the organisation. Without it, even the most sophisticated risk systems are merely expensive and bureaucratic dashboards.

Just as there is no magic formula in terms of maintaining a sporting team's position on the league table, there is no "silver bullet" solution to risk management. How a business manages its risk should be aligned with, and should support, its environment, strategy, business model, business practices, risk appetite and risk tolerance. This is especially true in the financial-services industry, where significant risk-based decisions are being made by businesses every day. One press of the button... and confidential information can go to the wrong place. One second too slow on a trade can result in massive misdeals – it is increasingly about excellence in execution. How well you execute strategy is your organisation's competitive advantage.

Essentially, a risk-intelligent culture exists in an organisation when its employees' understanding and their attitudes towards risk lead them to consistently make appropriate risk-based decisions. It is not about avoiding risk but rather about accepting the need for sufficient risk in order to create value. Let's use the analogy of a world-class rugby team such as the All Blacks. The game of rugby has changed drastically in the last 20 years; and the success of the All Blacks has been due to its ability to change the game plan, to adapt to changes in how the game is played and to set the standard so that other teams continually have to play "catch-up" to remain relevant. Your business is much the same in that it is increasingly up against threats that it cannot foresee and unstable climate changes that it needs to adapt to. Ultimately, it is how you cope with that unpredictability that counts. Risk management should not be limited to specific business areas and should not operate only as an audit or control function. It is not just a reactive mind-set; it is about anticipating what could happen in the environment. It is about embedding this mind-set and these behaviours in the way an organisation operates, and it covers all areas, levels and activities.

Consequently, risk culture drives the behaviours that influence day-to-day business practices, and it is a significant indicator of whether the organisation embodies the characteristics of a Risk-Intelligent Enterprise™.



Having a risk-intelligent culture means that everyone understands the organisation's approach to risk, takes personal responsibility to manage risk in everything that he or she does, and encourages others to follow his or her example – everyone becomes an active citizen in saving one's business, in conquering one's goals and in achieving one's aspirations. Codes, management systems, HR systems and behavioural norms should be aligned to encourage and enable people to make the right risk-related decisions, and to empower them to exhibit appropriate risk management behaviours.

So what are the characteristics of a strong risk culture? These can be summarised as follows:

- Commonality of purpose, values and ethics
- Universal engagement and application
- Learning organisation that emphasises risk culture
- Timely and honest communications
- Understanding the value of effective risk management
- Responsibility and accountability, both individually and collectively
- Encouraging an environment of constructive challenge



The four risk themes that help to shape the behaviour of a risk-intelligent culture are:

### 1. Respond

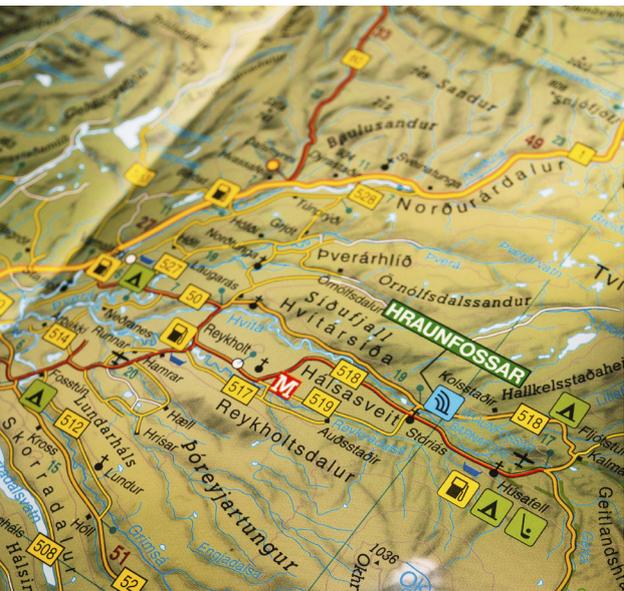
Build risk competence. The collective risk management competence of the organisation fosters collective wisdom and helps people to understand the risks the organisation is taking – they need to know the threat and have an idea of how to respond. This comes from proactive sharing of leading practices, consulting others when in doubt, and ensuring that your learning and development frameworks and interventions have a strong management of risk element running through them, at all levels.

### 2. Reward

Align motivational systems. The board and management should have an understanding and clear communication as to why the organisation manages risk the way it does. Secondly, there should be a consistent theme as to what organisations are motivating people to do. How does an organisation convey that its employees can admit to making mistakes? An effective risk-intelligent organisation is one in which everyone takes personal accountability for managing risk while still looking for those opportunities for innovation and growth. Key performance metrics should reflect this accountability and be aligned with the reward framework.

### 3. Recognise and relate

Strengthen relationships. This focuses on how people in the organisation interact with others. Do employees, management and directors all have a clear understanding of, and commitment to, a risk-intelligent culture? Does management provide a trusting environment and constructive response to challenges? Is there open and honest dialogue about risk? These are a few questions that boards can ask to strengthen and foster relationships at each level of the organisation. The behaviours that are displayed at the most senior levels of the organisation are critical in creating this environment. Leaders must find ways to connect with people inside and outside the organisation. They must be able to openly communicate their values on an ongoing and transparent basis. They must be able to make it very clear what the risk appetite of an organisation is. How innovative can people be across the organisation without putting the sustainability of the business at risk? People are suspicious of leaders whose behaviour does not support their words or who are closed about their values and standards.



#### 4. Recommend

Promote an organisational risk management infrastructure. Consider how the organisational environment is structured and what is valued. Each organisation typically sets up standards of expectations in the form of policies and procedures. Having a Risk Management Framework (RMF), following the risk management policies and involving risk professionals in risk decisions form the foundation on which to build the risk culture. A risk culture cannot be developed in isolation from the RMF – the two are so heavily dependent that approaching the two elements as separate initiatives (as many organisations do) is disjointed and inefficient. However, it is ultimately about the organisation knowing what level of risk is acceptable, what the boundaries are and what is in place to protect us from the turbulence around us.

These risk themes are examples that can be adapted to help organisations understand their current state. Shaping a risk-intelligent culture requires focused efforts and commitment on the part of leaders. Organisations that seek to achieve a risk-intelligent culture should set metrics against which they can define next steps and measure progress.

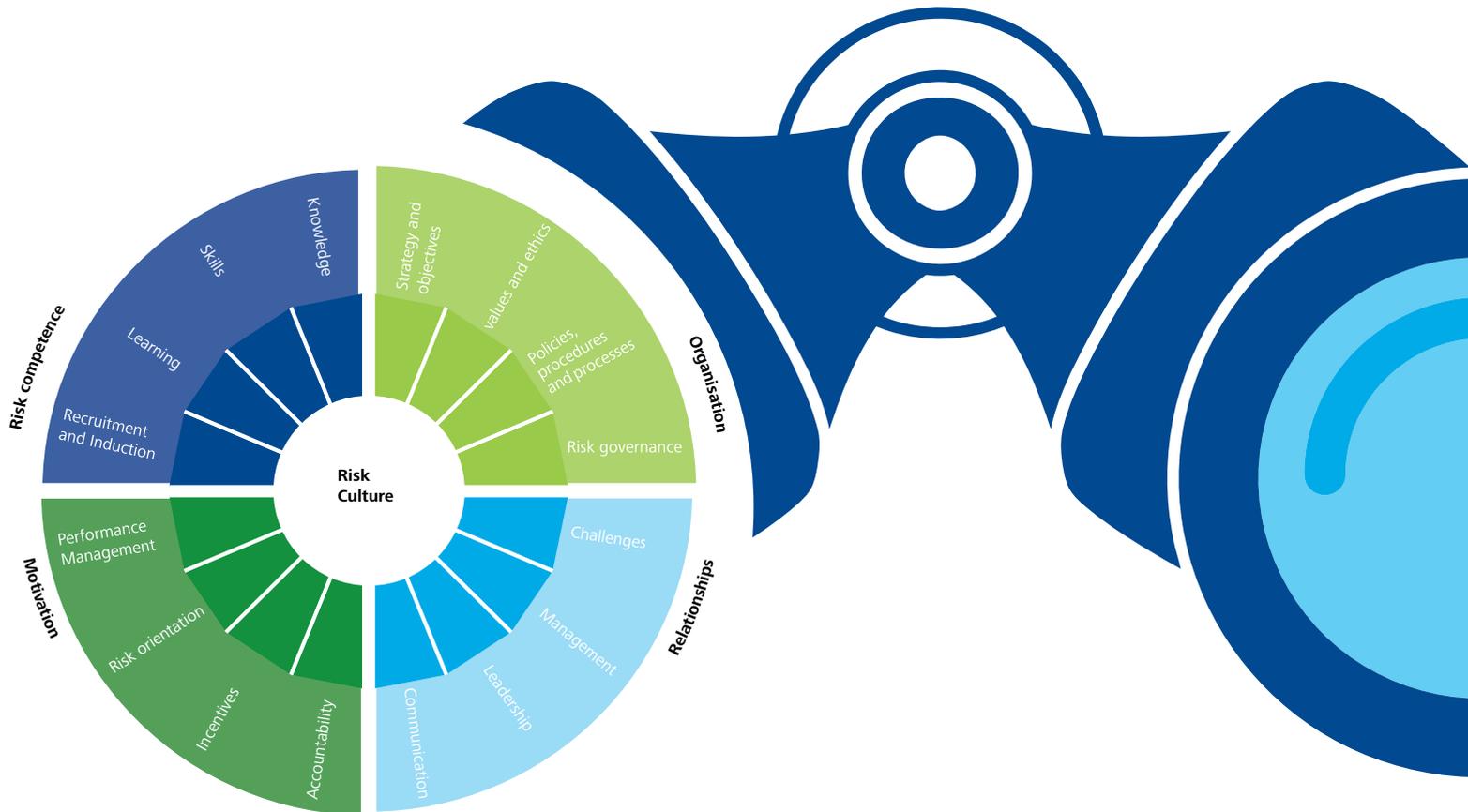
The first step is to understand the existing risk culture and to measure how well it supports the organisation's risk strategy and risk management approach. The Deloitte Risk Culture Framework and corresponding Risk Culture Survey provide a structure and process to help clients in their efforts to achieve this measurement.



# The Deloitte Risk Culture Framework

Deloitte has developed a broad approach to help financial-services clients assess and measure risk culture based on the Deloitte Risk Culture Framework. The framework consists of sixteen Risk Culture Indicators that are aligned to the four Risk Culture Influencers.

A Risk Culture Survey allows us to measure an organisation's risk culture against each indicator and then to analyse and gain a thorough understanding of the current maturity level of the risk culture. Once we have done so, we can use the Risk Culture Framework to identify and recommend specific target areas in order to help strengthen the risk culture throughout the organisation.



## Risk Culture Influencers

**Risk competence**  
The collective risk management competence of the organisation.

**Motivation**  
The reason why people manage risk the way they do.

**Relationships**  
How people in the organisation interact with others.

**Organisation**  
How the organisational environment is structured and what is valued.

Strengthening an organisation's risk culture requires both a focused effort and the direction of leadership.

The initial focus should be on building cultural awareness, predominantly through communications and education. Cultural improvement will be likely to require meaningful changes to established ways of operating. In the same way that the All Blacks are continually refining their game plan, financial-services organisations should continually refine their approach to managing risk to reflect ongoing changes in business strategy. The All Black team management will not stop considering where the team's strengths lie and what the limitations are. They will continually review their plan of attack, look for opportunities to improve their defence and analyse how they are doing on recognising patterns. Financial-services organisations that want to stay on top of the game will do something similar, continually refining their approach to managing risk in order to be relevant, ready, adaptable and frontrunners.

It is important to recognise that this roadmap focuses on the cultural aspects of risk management. To achieve a strong, effective and intelligent risk culture, all the components of a formal risk management structure should be implemented.



Risk competence

**Build risk competence**

- Risk function
- Existing employees
- New employees
- Future employees

Motivation

**Align motivational system**

- Incentive systems
- Reward systems
- Performance systems
- Individual and team accountabilities

Relationships

**Strengthen relationships**

- Leaders to manage
- Leaders/managers to employees
- Peer to peer
- Risk function to business

Organisations

**Promote organisational risk management infrastructure**

- Governance and reporting protocols
- Procedural protocols
- Behavioural and ethical expectations
- Compliance expectations

**Cultural awareness**

- Deliver communications from leadership using a common risk management vocabulary.
- Clarify risk management responsibilities and accountabilities.
- Roll out risk management general education and customised training based on role.
- Refine recruitment methods to include risk management capabilities.

**Cultural change**

- Create a culture of constructive challenge
- Embed risk performance metrics into a motivational system.
- Establish risk management considerations in talent management processes.
- Position individuals with the desired risk orientation in roles where effective risk management is critical.
- Reinforce behavioural, ethical and compliance standards.

**Cultural refinement**

- Integrate risk management lessons-learned into communications, education and training.
- Hold people accountable for their actions.
- Refine risk performance metrics to reflect changes in business strategy, risk appetite and tolerance.
- Reposition individuals to reflect change to business strategy and priorities.

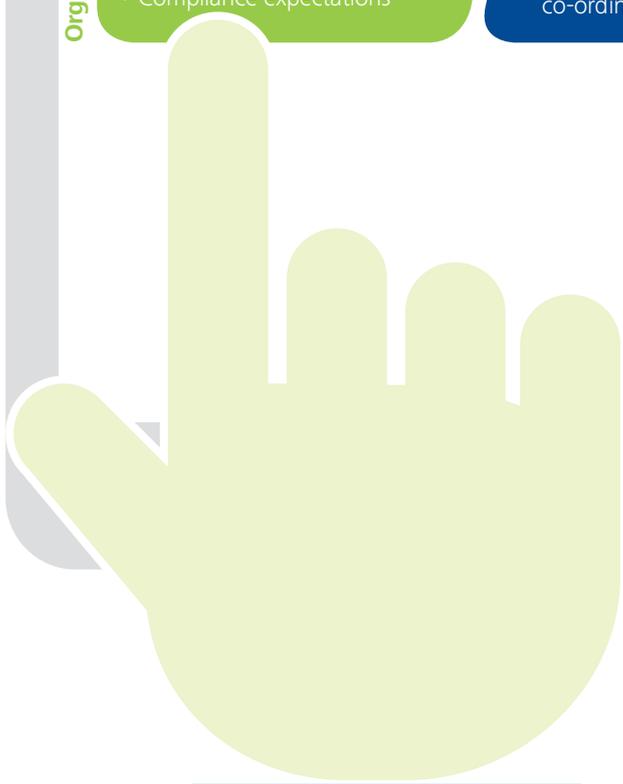
**Enablers**

**Leadership commitment:** secure the buy-in and commitment of the leadership team including executives and the board

**Communications:** Communicate programme goals to all stakeholders, and proactively seek out feedback

**Measurement and reporting:** Establish an objective measurement of the organisation's risk culture and report on it regularly.

**Programme management:** Manage as a programme of change, including co-ordinating with other relevant change initiatives



in the context of strengthening an organisation's risk culture, the "tone at the top" is critical in setting guiding values, ways of working and the ethical climate. "Tone at the top" has become a rather hackneyed expression, but if your organisation is to become Fit 4 VUCA, one needs to realise that it is the foundation on which the culture of an enterprise is built. We see the importance of this in our top sporting teams, and it is no different in successful organisations. Ultimately, it is the glue that will hold your organisation together. The risk culture cannot be changed if the change is coming from the risk management function alone. Leadership must represent the real driver of change.

It is all about ensuring that people know when to watch the weather reports to prepare for environmental threats, when to analyse how the competing teams are playing, when to use new equipment and training techniques to raise the bar, when and how to respond to a threat to the organisation's effectiveness and survival, when to make tactical substitutions, when to attack, how to organise your defence, when to play the ball wide, how to enable your fly-half to take a short pass from the scrum-half. These are all tactics that we prepare for in order to win the game, no matter what gets thrown at us.



The board, the CEO and the chief compliance/ risk officer (CRO) all play critical roles in setting this tone at the top and influencing the risk culture.

#### **The board:**

- Sets clear roles and responsibilities for risk management
- In terms of succession planning and senior level recruitment activity, ensures that the following are given as much weight as technical skills:
  - Risk understanding
  - Required character and moral fibre
  - “Chemistry” and communication/leadership skills
- Demands timely escalation procedures
- Receives training in terms of its new role and responsibilities
- Demands audit results that indicate a strong compliance culture
- Requires a regular cycle of risk reviews
- Allocates adequate resources for management of risk
- Sets a well-defined and clearly articulated risk appetite for the organisation

#### **The CEO:**

- Openly communicates his/her values on an ongoing and transparent basis
- Is unequivocal in what is permitted and what is deemed too risky in terms of growing the business
- Behaves in a way that tells employees what counts and what is rewarded and punished
- Works with the leadership team to develop a sense of shared values against which all decisions can be measured and tested
- Ensures adequate risk management education and training for the leadership team
- Ensures that performance management and reward systems support the embedding of the risk culture

#### **The CRO:**

- Needs to be a person with the appropriate integrity, stature and character to reflect the organisation’s commitment to ethics and to managing risk
- Plays a critical role in creating a “speak-up” culture – essential for tone at the top
- Proactively assists the board and the leadership team in understanding and executing their roles in terms of managing risk and seeing the tone at the top
- Is able to translate the risk appetite of the organisation so that everyone understands it and demonstrates appropriate behaviours
- Owns the training and education around managing risk
- Is responsible for setting and facilitating the Risk Management Framework



The financial-services sector is a world of changing game plans and strategies, of strengthening competition, of changing rules and unpredictable pitch and weather conditions. Your organisations cannot afford to play a sub-standard game, irrespective of the opposition, injuries or bad weather. To not anticipate these factors is a risky game. The reality is that financial-services providers are connected to every industry, every community. We don't have the option of shutting ourselves away to wait for better times or a weaker opponent in a world that demands that we stay in the game and on the league table. We are leaders, integrators and influencers; and we have a responsibility to anticipate the game and to do business in a responsible and ethical manner.

To survive opposition from non-traditional competitors, to change the game as we are playing it, to prepare ourselves for new and unknown patterns of play, to keep our defence strong but still be able to go on the attack – leaders in the financial-services sector should be preparing their businesses and their employees for uncertainty, so that when the disruption strikes their people are prepared, have the capacity and knowledge to succeed and are able to put the ball over the touchline.

It is critical to ensure that you have the Risk Management Frameworks and structures. Prepare and enable your organisation to lead, respond and set the standard for others. Activate your employees so they become active citizens and integral parts of the team, with a sense of personal responsibility in terms of winning the game. A winning team demonstrates its commitment, its ability and its passion through behaviours – that's what the shareholders respond to, that's what the sponsors like, that's what gets the fans cheering out of their seats. It's the same in your organisation. Does your game plan, your leadership style and your patterns of play establish the playing field for your team to be successful no matter what opposition, changes or poor conditions it faces?

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