Unmasking Risk Before It Becomes a Crisis, or

Dangers of Believing Your Own PR

BY PETER FIRESTEIN

What do companies do when they want to measure the risks they face? They invite in the consultants.

Management and the board must leverage the best tools available to ensure their company's sustainability. Consultants bring broadly acquired experience and proven metrics that transcend what the management and board may find among their own resources.

But who knows the company best? Who has the most complete experience about how it interacts with the world from day to day? That would be the people who work there. Yet another characteristic pertains to them as well: They may be the least likely to say what they see.

Willingness to contribute one's own insights lies at the heart of personal and group survival, but the pressures of the group often dissuade us from candid expression, and corporations can suffer or fail as a result.

We need look no further than the roots of the financial crisis to observe the damaging effects of the impulse to keep quiet. Many were aware for years of real estate inflation and the deterioration of credit quality.

Yet virtually no one said what he or she saw, and those few who did often found trouble. Skeptics were deemed too unhelpful. If they couldn't be fired, they were simply ignored as fools.

It can be no more than a small exaggeration to say that many knew, but almost no one spoke. Perhaps the greatest oddity of all is that few expressed surprise when the grand illusion faded.

What might we call a sequence of events in which few had forecast the collapse, and yet few expressed surprise when it occurred? An example of mass denial? Of willful blindness? Whatever we call it, we might conclude that denial—large and small—is part of the fundamental human makeup.

For his book describing the prospect of environmental catastrophe, Al Gore chose the title: *An Inconvenient Truth.* Without violating the former vice president's meaning, we can turn the phrase around and suggest that catastrophes can arise from the belief in "convenient untruths."

We might call such untruths "concepts of convenience"—ideas we espouse because it would be highly beneficial to us were they to be true.

One concept of convenience is the belief that unregulated markets afford the most productive allocation of resources. Experience shows that speculative swings, allowed in part by light regulation, can destroy honestly earned fortunes as markets oscillate wildly before returning to their historical norms.

A second concept of convenience says that the financial system's inherent balances restrict abuse. The capitulation to profiteering by debt rating agencies in the years prior to the financial crisis argues against their ability to resist the tone of the times.

In the sphere of the individual corporation, concepts of convenience are often wrapped up in the company's definition of itself.

TOYOTA'S SITUATION

For decades, Toyota saw itself as one of the premier automotive engineering companies in the world, and so it remains. However, the unchallenged persistence of this belief prevented it from addressing a decade-long series of product recalls, including those of stuck accelerators that appeared to cause deaths. The company could not admit to a core failing at the center of these breakdowns. Before beginning to right its reputation, Toyota insisted it had been afflicted by a string of anomalies, by simple bad luck.

Bad luck was also the claim BP made when, after it ignored repeated safety warnings, one of its Texas plants blew up, killing 15 people and injuring 180. The subsequent spill of crude from a poorly maintained BP pipeline in Alaska failed to alert the company to serious safety deficiencies. BP management insisted there was no connection between these events. It later disowned responsibility for the Macondo blowout in the Gulf of Mexico.

How could such smart people make such dumb mistakes? The answer is that there are all kinds of smarts in the world, and these managements had some but not others.

At Enron, home of "the smartest guys in the room" in Bethany McLean and Peter Elkind's phrase, no fewer than 35 employees discussed the dangers of off-balance-sheet partnerships with the small group of managers who ran the company. Chairman Ken Lay told Sherron Watkins, who became the most famous of them, that the lawyers and accountants had "signed off." That was the end of both the story and of Mr. Lay's curiosity.

The profound human damage inflicted by the collapse of Enron and other failed enterprises, and of the financial crisis itself, has eroded the sense we used to have that adverse events happen to other people in other places. Now, few can anticipate with confidence a career free of the taint of scandal—not a scandal that one causes, necessarily, but whose reach one cannot escape.

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The question then becomes: How can we make ourselves the exception? What is the difference between a company that compromises itself with embarrassment and one that, with some predictability, pursues its business free of the impediment of reputation loss?

In my experience, there is a single core difference between these two kinds of companies. Those that persist relatively free of headline risk—the risk that they'll be the subject of negative press stories—are companies that constantly question themselves. They realize they can never grasp all there is to know, but they keep asking. Most important: They establish the institutional structures that enable such questioning.

Easier said than done:

It is essential, but not enough, to convene executive groups, particularly those organizationally and geographically separated from each other, to exchange views and solutions.

It is essential, but not enough, that the CEO maintains an open door and insists that staff members—with assurances of freedom from reprisal—pass through it to deliver their unvarnished observations.

Such conversations as the two just described fail the needs of the organization because, no matter how pure the intentions of all involved, they generally fail the test of candor. Companies seldom benefit from the real intelligence that resides with their people because the conventions of corporate dialogue fail to accommodate the unguarded exchange of views. The politics are generally too opaque and the stakes too high. The single factor most difficult to eliminate is fear. So, in the end, the company lies more exposed than it needs to be.

No one has expressed the reasons for this better than the still-active German philosopher Jurgen Habermas, who tells us in his theory of distorted communications that candor is impossible in a conversation among participants with unequal power.

Bosses who leave their doors open with the invitation to tell all almost certainly mean it when they say it. But will the subordinate bet his or her children's education on the safety of such an invited conversation at some future stressful moment when it is likely to become important?

How to access what your people really know: Candor requires safety, and safety requires confidentiality. Here are two approaches to creating those conditions. For better or worse, a consultant will be involved.

THE SOCRATIC DIALOGUE ON CORPORATE RISK

An experienced and empathetic moderator engages a group of executives invited by the CEO, who is not in attendance. The CEO may receive the results of the discussion but will never be able to associate a comment with an individual.

The moderator opens the dialogue by asking unreasonable questions meant to indicate that no subjects are off limits and that the result of the session will depend on the participants' contribution. One unreasonable question might be: "What is the greatest risk your company faces that you don't know about?" An unanswerable question on the face of it, but it inevitably leads to a more manageable question, such as one that asks how the group can go about identifying those still-hidden risks. This will turn into a discussion they've not had before and will reveal new possibilities for mutual investigation they'll take back to their work.

Here is a sampling of conclusions offered for the first time by senior and midlevel managers at a Socratic Dialogues on Corporate Risk, gathering.

- "We have great customers. But I don't think any of us on the management team really understand why we have them. So, if they leave, I'm not sure we'll know why they did."
- "My management team is focused on tactics while I think we ought to be entertaining the possibility that our entire industry will be replaced by another technology in the next five years."
- "One of our competitors has offered a product that may make one of our major sources of revenue obsolete. My management says we have a good answer. I have doubts that we do."

THE INTERNAL PERCEPTION STUDY

The term "Perception Study" derives from an investor relations tool that some managements employ to elicit investors' and analysts' confidential views. When done well, it can help management understand how the market values the company and suggest actions that might legitimately improve share value.

When a perception study is directed internally, confidential discussions between knowledgeable executives and a trusted interviewer can bring the CEO insights on leadership, risk and other crucial matters that would not otherwise be available.

While comments are never connected with a name, Internal Perception Studies have revealed to CEOs:

- Senior staff attitudes toward CEO succession.
- The precise terms on which the CEO earns, or fails to earn, senior staff loyalty.
- Perceptions of fairness in staff advancement.
- Frank and detailed opinions of CEO capability.

These two resources—the Socratic Dialogue on Corporate Risk and the Internal Perception Study—gather useful intelligence. At the same time, by their existence, they deliver a message that underscores senior management's interest in staff opinion. The demonstration of *inclusion* as a management principle has proven important in the retention of quality staff.

In the end, they help management do what any company should in order to survive well: They tell the Sherron Watkinses in their midst that they are welcome. MW

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