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**Britten Coyne Partners**

**Excellence in Strategic Risk Management and Governance**

January 2018

Britten Coyne Partners

[www.brittencoyne.com](http://www.brittencoyne.com)

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# Boards Are Under Increasing Pressure to Improve Their Governance of Strategic Risk

- *The Travelers 2014 Business Risk Index report concluded that, "businesses feel least prepared to manage the risks they identify as most serious"*
- *A recent McKinsey Quarterly article echoed this point: "Boards often overlook existential risks. These are harder to grasp -- all the more so for executives focused on the here and now -- yet harm companies to a far greater extent than more readily identifiable business risks" ("Building a Forward Looking Board")*
- *"While boards pay attention to many aspects of risk, an important priority is to help management understand and manage the most strategically important risks...It is not as easy to assess big strategic risks as it is to assess narrower, more easily measured risks...Boards must assist in this process by discussing strategic risks frequently and seeking the input of outsiders..." ("Audit Committee Leadership Network Viewpoints", Issue 42, July 2013, by Ernst & Young)*
- *With this in mind, the UK Financial Reporting Council has emphasized that "boards need to focus especially on those risks capable of undermining the strategy or long-term viability of the company, or damaging its reputation" ("Boards and Risk")*
- *"Strategic risks are difficult to evaluate, incredibly important to the future success of the organization, and are the frontier to which good risk management should travel" (Deloitte/MAPI 2015)*

# These Comments Raise Four Critical Questions

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- What is strategy?
- What is risk?
- What is strategic risk?
- What is governance?

# What is Strategy?

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- Here is a generic definition: *“Strategy encompasses choices about the most important goals an organization must achieve in order to survive and succeed, and choices about how to attain them using scarce resources (i.e., a causal theory of success), based on an inherently uncertain assessment of how the current situation could evolve in the future”* (Britten Coyne)
- And here is one that is more business specific: *“Strategy is an integrated set of choices that uniquely positions a firm in its industry so as to create sustainable advantage and superior value relative to the competition”* (“Playing to Win” by Lafley and Martin)

# What is Risk?

- Like “strategy”, the term “risk” is also a source of confusion, because it is often casually used to describe very different underlying concepts. Think of these as three concentric circles
- The smallest circle is the Realm of Probability, or, “known knowns.”
  - In this region our understanding of the range of possible outcomes for a given variable as well as their consequences are based on a sufficiently large historical data set to enable their quantitative description using the language of frequentist statistics
  - However, as we saw in the 2008 financial crisis these statistical estimates can sometimes contain large errors
  - Many of the financial and operational risks that are the focus of traditional Enterprise Risk Management systems lie in this realm

# What is Risk? (cont'd)

- The second circle is the larger Realm of Uncertainty, in which we confront “known unknowns”
  - Here the full range of possible outcomes, their probability of occurrence, and/or their potential impact on an organization are not well understood (though in many cases early warning indicators to monitor can be identified). Because they are hard to quantify, uncertainties in this realm are usually impossible to price and transfer
  - However, these uncertainties are still often confusingly described using the language of probability, but in this case Bayesian rather than frequentist. These probabilities are based not on the frequency of past occurrences, but rather reflect degrees of subjective belief about the likelihood that future adverse outcomes will occur, and/or the potential size of their impacts if they do
- By far the largest of the three circles is the Realm of Ignorance, or “unknown unknowns”
  - This contains risks and uncertainties about which we are as yet unaware, but which could threaten the success of a strategy or the survival of a company
  - “Black Swans” are unknown threats that we could not have identified before they materialized. In practice however, many unknown threats are preceded by weak signals before they appear

# Strategic Risk Management and Governance Must Simultaneously Address Risk, Uncertainty, and Ignorance

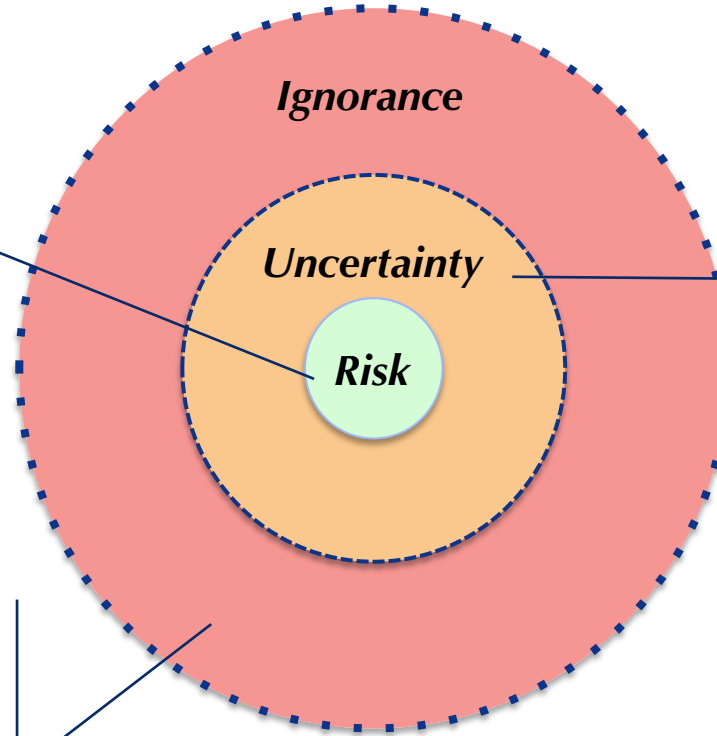
## *The Three Realms of Risk Governance*

### *Realm of (quantified) Risk*

- “Known Knowns”
- Range of potential outcomes, impact, and probabilities all known with an acceptable degree of certainty
- Risks can be priced and transferred relatively easily
- Key Challenges: Efficient risk transfer and designing effective controls

### *Realm of Ignorance*

- “Unknown Unknowns”
- Potential outcomes not recognized
- Key Challenge: Effectively probing the Realm of Ignorance to identify potential threats to strategy success and to corporate survival



### *Realm of Uncertainty*

- “Known Unknowns”
- Range of potential outcomes, impact, and/or probabilities not known with an acceptable degree of certainty
- Uncertainties cannot be priced and transferred
- Key Challenges: Designing efficient early warning indicators and adapting effectively, via options and mitigations

Note: The Realm of Ignorance is orders of magnitude greater in size than the realm of Uncertainty, which is orders of magnitude greater in size than the realm of Risk

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# What Then is Strategic Risk?

- Uncertainty (known unknowns) and ignorance (unknown unknowns) enter into our definition of strategy at three and potentially four points:
  - Assessment of the current situation and how it could evolve in the future
  - Decisions about the most important goals to pursue to ensure organizational survival and success
  - Choices about how to achieve these goals
  - And, possibly, uncertainty about the amount and/or quality of the resources that will be available to implement these choices
- Adjusting the ISO 31000 definition of risk, you get this: “Strategic Risk is the effect of uncertainty and ignorance on the establishment and achievement of goals that a board believes will enable an organization to survive and thrive in the future”
- Strategic risk failures lie at the heart of most cases of substantial value destruction
  - See *“The Lessons of Lost Value”* by Booz&Co

# Management of Strategic Risk is Inherently Difficult

- Management teams often have relatively short expected tenures, and face strong pressures and powerful incentives to focus most of their time and effort on achieving success, not avoiding failure
- This is reinforced by a range of natural human tendencies
  - At the individual level, we are naturally both overoptimistic and overconfident. Evolution has also predisposed us to choose people with these characteristics as group leaders
  - We unconsciously strive to maintain a coherent view of the world, and consequently pay less attention to, and underweight, bad news and information that does not fit well within our existing mental model of a system or situation. Most people seek information that confirms their beliefs, rather than information that calls them into question
  - When the fear center of our brain (the amygdala) is triggered by rising uncertainty or actual loss, our aversion to social isolation spikes, making us much more likely to conform to the views of a group and to resist voicing our concerns
- Effective board governance of strategic risk is critical to avoiding failure, and buying the time that is often needed to achieve success

# What is Governance?

- A simple definition of “governance” is that it encompasses the system of rules, practices, and processes by which a company is directed and controlled to establish and achieve its goals
- Most governance activities fall under a director’s duty of care, which has been described as acting in the same manner as a reasonably prudent person in their position would, using well-informed, good faith, rational judgment
- In practice, exercising directors’ duty of care encompasses five activities:
  - Setting direction, including establishing the purpose and mission of the organization, and approving its strategy;
  - Allocating resources to implement the strategy;
  - Hiring the CEO;
  - Monitoring, evaluating, and reporting performance; and
  - Governing risk

# The Root Causes of Strategic Risk Failures are Complex

- Failure to anticipate potential threats
  - i.e., to reduce the number of unknown unknowns that represent potentially existential threats to organizational survival
- Failure to accurately assess identified strategic risks
  - i.e., to appreciate the dangers they could pose, the speed with which they could develop, and the time it could take to adapt to them
- Failure to monitor and adapt to the most dangerous threats
  - i.e., to establish and update warning indicators, to develop a range of options, and to implement them in time
- Each of these failure modes is driven by a complex underlying mix of individual, group, network, and organizational factors
- Rather than fighting human nature, it is far more effective for companies to put in place governance and management processes, systems, and structures that deliberately offset predictable weaknesses

# We Help Clients Avoid Strategic Risk Failures

- We provide a range of strategic risk education offerings to management teams and boards that cover the external drivers and internal causes of corporate failure and how these challenges can be met
  - These develop both individual skills and team capabilities for addressing strategic risk
- We consult with boards and management teams, to design and facilitate processes that use our tools and methods to improve their discussions and interactions on strategic risk issues, and reduce the likelihood that failures of anticipation, assessment, and adaptation will occur
- We provide independent (“Red Team”) strategic risk monitoring and analysis services, focused, for example, on the deliberate search for evidence that is at odds with current strategy assumptions
- Our tools and methods are based on a mix of practical experience and research findings from a wide range of disciplines, including cognitive neuroscience, organization, corporate failure, and intelligence analysis

# Sample Agenda for a One Day Offsite

| <b><i>Time</i></b> | <b><i>Topic</i></b>  |
|--------------------|--|
| 08:00              | Welcome, Admin/Safety, Introductions, Objectives and Agenda          |
| 08:30              | Setting the Stage – Basic Terms and Concepts                         |
| 09:00              | Anticipating Strategic Risks: Challenges and Solutions               |
| 09:30              | Breakouts – Applying Multiple Tools to Identify Strategic Risks      |
| 10:00              | - 15 Minute Break -  |
| 11:00              | Report Outs and Discussion of Results                                |
| 12:00              | Lunch  |
| 13:00              | Assessing Strategic Risks: Challenges and Solutions                  |
| 13:30              | Breakouts – Applying Assessment Tools to Strategic Risk(s)           |
| 14:30              | - 15 Minute Break  |
| 14:45              | Report Outs and Discussion of Results                                |
| 15:30              | Monitoring and Adapting to Strategic Risks: Challenges and Solutions |
| 16:00              | Meeting Summary and Wrap Up  |

# Our Strategic Risk Governance Tools and Processes Easily Integrate Into a Board's Annual Meeting Calendar

|  | <b>Q1</b>  | <b>Q2</b>   | <b>Q3</b>   | <b>Q4</b>   |
|--|--|---|---|---|
| <b>General Theme</b>                   | <ul style="list-style-type: none"> <li>Review Previous Year's Performance</li> </ul>   | <ul style="list-style-type: none"> <li>Review Critical Assumptions About Future</li> </ul>  | <ul style="list-style-type: none"> <li>Review Strategy</li> </ul>   | <ul style="list-style-type: none"> <li>Review Resource Allocation</li> </ul>  |
| <b>Full Board</b>                      | <ul style="list-style-type: none"> <li>Review of negative surprises over past year (e.g., did we anticipate them? Did we accurately assess the danger they posed? How well did we adapt?)</li> <li>What changes have we made in light of our experiences?</li> </ul> | <ul style="list-style-type: none"> <li>Pre-Mortem exercise, as well as review of pre-mortems conducted with other groups (e.g. younger employees)</li> <li>Other ignorance/UNK-UNK reduction tools</li> </ul> | <ul style="list-style-type: none"> <li>Strategy Story/Strategic Risk Level and Appetite Heuristic and Discussion</li> <li>Review Strategic Risk Assessments and Update Threats to include in Threat Safety Margin Report</li> </ul> | <ul style="list-style-type: none"> <li>Threat/Adaptation Report – Review Planned Adaptations and timings to ensure adequate resource investment</li> </ul>                |
| <b>Audit and Risk Comm</b>             | <ul style="list-style-type: none"> <li>Assurance reporting on performance of corporate risk management processes and systems</li> </ul>  | <ul style="list-style-type: none"> <li>Other anticipation tools to complement Pre-Mortem</li> <li>UNK-UNK discussion</li> </ul>   | <ul style="list-style-type: none"> <li>Review Assessment Results and update Threats to include in MetOffice Metric/Safety Margin Report</li> </ul>  | <ul style="list-style-type: none"> <li>Review evolution of threats and adaptations to them</li> </ul>   |
| <b>Regular Reporting in Board Book</b> | <ul style="list-style-type: none"> <li>Early Warning Indicators</li> <li>Disconfirming Evidence</li> <li>Anomalies and Surprises</li> <li>Safety Margin Report</li> </ul>  | <ul style="list-style-type: none"> <li>Early Warning Indicators</li> <li>Disconfirming Evidence</li> <li>Anomalies and Surprises</li> <li>Threat Safety Margin Report</li> </ul>                              | <ul style="list-style-type: none"> <li>Early Warning Indicators</li> <li>Disconfirming Evidence</li> <li>Anomalies and Surprises</li> <li>Safety Margin Report</li> </ul>   | <ul style="list-style-type: none"> <li>Early Warning Indicators</li> <li>Disconfirming Evidence</li> <li>Anomalies and Surprises</li> <li>Safety Margin Report</li> </ul> |

# Who We Are

- **Neil Britten** is a UK Institute of Directors qualified Chartered Director, non-executive chairman and director with over a decade's board level experience of strategy, risk governance and strategic performance monitoring and evaluation
  - Prior to roles as a professional director Neil was Vice President for a major international consulting firm focused on strategy and strategic change and an executive with a major oil and chemicals conglomerate. His experience spans work, in the UK, France, Australia and over 20 other countries, as an executive in and advisor to mostly large, multinational corporations in technology, oil & gas, consumer goods, manufacturing and financial services sectors. He has also acted as an advisor to private equity investors in start-ups and SMEs
- **Tom Coyne** has served as the Chief Executive Officer, Chief Financial Officer, Chief Risk officer and Director of public and private companies and not-for-profit organizations in the United States and Canada
  - Tom began his career at Chase Manhattan Bank in South America, and later joined the London office of a major global consulting firm, where he led its Corporate Growth Center of Excellence. For four years, Tom was a member of the leading team in the United States Intelligence Advanced Research Projects Agency's forecasting tournament, whose story was later told in the book "*Superforecasting*". He has also written for a number of investment and academic research publications on the subject of risk management
- Neil and Tom's research on strategic risk governance and Chair/CEO/Lead Director relationships has been published by *Directors and Boards* and *Board Agenda*, as well as the Social Science Research Network



# What Our Clients Say ...

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- *"Britten and Coyne brought highly effective methods for our board to identify and assess our strategic risks, and efficient processes for us to identify mitigation actions. They provided a structure and objective challenge to our board conversation that made possible an openness and depth of informed discussion that was previously difficult. I would not hesitate to recommend them"*
- *"We got to apply new strategic risk concepts straight away to help our board productively address some critical issues facing the company. Very practical approach"*
- *"I've been involved in many board risk conversations. This was new, different, very practical, and extremely helpful."*
- *"We've had a lot of external speakers at our board meetings who have been rubbish, but you were really excellent."*
- *"We're having a board conversation that was impossible before."*
- *"This was a very worthwhile, useful discussion about risk that the board needed to have"*
- *"Excellent! Good balance between 'theory' and participation"*
- *"Helped in personal development in a specific, important director role"*

# Learn More About How We Can Help Your Company

*[www.brittencoynecom.com](http://www.brittencoynecom.com)*

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