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Learning to sniff out a crisis

Corporate boards should realise that their main fiduciary duty is to assist management in identifying and managing risk

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Every time a crisis breaks out — from the Satyam saga to the recent episodes in the Tata group, Infosys and Nestle — experts' keyboards have been rattling one advice after another on how to manage boardroom crisis. Yet, too many board members wonder and seek our counsel as to what they should do to sniff out a crisis before it unravels. Obviously, tomes have not been written on that.

Ever since the 2008 global recession, most company boards in the US seem to be obsessed with risk management. However, we don't see this trend in India where hardly any questions come up on how things can go wrong.

Corporate boards should realise that a central part of their fiduciary duty is to assist management in identifying and managing risk, and then monitoring those systems from the board level. What steps can a board of directors take to make this oversight a reality? Here are a few guidelines:

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■ **Define risk appetite:** When examining a potential business risk, how much risk should you expect, what is the most you're willing to consider, and what would be a lethal exposure? What is the risk culture for your company in its stage of growth, and in its industry?

■ **Assure that risk expectations are known:** Have your board and management set the above stated risk values down on paper so that they are known and accepted throughout the company? How do you check to confirm this, and how often?

■ **Table the risk oversight structure:** How does your board monitor risk internally? Is it the role of the full board, audit committee or a dedicated risk committee?

■ **Regularly review risk management:** Look at all the major categories (credit, market, operations, compliance, etc), for all your business units. How often are risk heat maps updated, and how is this review structured? Also, how often is your ability to respond to a change in a risk assessed?

■ **Who is responsible for which risks?:** Does your board know who are the front-line managers responsible for mitigating, managing and monitoring a particular risk? Do they have specific risk management expertise?

■ Do your employee incentives help or harm risk management? Do pay, incentives and promotion decisions encourage employees to take greater risks than seem wise? Are you saying one thing, but rewarding another?

■ **Is your board "risk ready?":** In your boardroom, do you have the expertise to properly weigh risks in business? Does the board have the needed blend of knowledge to assess the risks faced? Does the board discuss the links between strategy and risk?

Often, instead of a black swan event, the biggest risks come from inside the organisation — sometimes from your board itself, as in the case of the Tata group and Infosys. For board oversight, employee risk starts from the top down. What would you do if your CEO announced tomorrow that he is leaving? Whatever be the type of ownership of your company, they all carry their own risks that must be considered.

Suppose the venture investors in your firm want to cash out now. What will that do for your business model? There are family disputes among owners, or, as in Uber's case, a founder can't let go. Or an activist shareholder starts a campaign for the company to sell off a profitable division. How would you deal with such risks?

Even if your company has rationalised its supply chain to use fewer sources and more immediate delivery, there are risks that are inherent. What happens if a link in this chain breaks through a strike, bankruptcy, or sale of the entity to a competitor? How prepared are you for disruptions in electricity, water, fuel, mining rights or transport? What if a supplier is facing legal action for human rights failures at one of the factories? Do you have a plan for that risk? What if a member of your board is sharing confidential company information with a rival? Do you have mechanisms to deal with it? Acquisitions and investments have created a board of factions, with each group pulling in its own direction.

A government representative on the board is pushing investment in an outside company — one in which he has an interest. What do you do?

There are in fact a few crises that are wholly impossible to predict and no board can prepare for every one of these possibilities. Focusing on the risk tools and exposures covered here will build up the sniffing power of boards. That way, you may not have to echo Henry Kissinger: "There cannot be a crisis next week. My schedule is already full."

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