Maximize Good and Minimize Bad – The Needed Revolution in Risk Management!

Preface: This is the seventh in a series of eight articles on issues of importance to the management of organizations and the leadership of people. The first article created a Management "Jambalaya" using various ingredients - "leftover" ideas that still have application in the world of people and work. The articles that follow will use the same series of ingredients and a "fresh" approach to create an entrée – nutritious food for thought.

Disclaimer: The Consultant who suggested this series of articles, proposed the following set up for the article. "Professionals in safety, security, quality assurance, human factors, environmental control, loss prevention, and other fields devoted to minimizing risk have pursued for many years a path which has precluded their being accepted in the executive "inner circle." Without a radical change in approach, that situation will continue. If you believe this situation merit changes, what do you recommend for employers consideration?"

The Good News is that I believe not only is the function of Risk Management (RM) important in business; I believe based upon my definition of RM it is the most important or only function that needs to be addressed.

The Bad News is that my view of RM is from the trenches not from the Ivy Towers of Academia. I look at the Art of RM more than the Science. I see this as a craft that needs to permeate the entire organization rather than a narrowly defined profession that is isolated from the customers, employees, Board, etc.

RM is about people – people who produce products / services, people who buy and use these products, people who make mistakes, people who make claims, people as heroes and as self-described victims. I think one of the greatest risks in business today is "techies" (MBAs, CPAs, CFOs CIOs, self-described nerds, etc.) who discount the people aspect of organizations and believe that numbers, trends, data, and technology are more important. THEY, IN MY OPINION, ARE WRONG.

My case for Risk Management follows:

The Ingredient / Entrée – The Needed Revolution in Risk Management!

For ten years I taught Risk and Insurance at LSU (Geaux Tigers!) in Baton Rouge. The following is the short form version of the first lecture in each class.

Risk is Uncertainty. Uncertainty is the difference between good things and bad things happening in your life / business. Good things are our dreams, goals, and assets. Assets are dreams and goals that have been achieved. Bad is anything that destroys or damages an asset or interferes with the achievement of a dream or a goal. Management is control. Risk Management is control of uncertainty.

Simply stated, the purpose of Risk Management is to maximize good and minimize bad (and mitigate the damage caused) in our life / business.

In general (big picture) terms the process of RM is simple:

1. **Organization – identifying and prioritizing dreams and goals**
2. **Accumulation – obtaining / creating the resources needed to pursue the goals**
3. **Protection – protecting the process to pursue goals and the assets obtained**
4. **Perpetuation – assure over the long term that the organization survives and prospers and the assets are utilized based upon the wishes of the principals**

To maximize good the need is planning - applied strategic planning to create and operate the organization and marketing planning to assure that the organization profitably meets the wants and needs of the customer.

"In this market-oriented view of the strategic-planning process, financial goals are seen as results and rewards, not the fundamental purpose of the business. ***The purpose is customer satisfaction, and the reward is profit…"*** **(Peter Drucker) (The Role of Leadership in the Implementation of Marketing Strategy That Results in Customer Value [Louis A. Martinette and Melaura H. Stein])**

To maximize good (strategic planning) the four steps are:

1. **Identifying what you want**
2. **Determining what it costs (in terms of time, dollars, and other resources)**
3. **Developing a plan to achieve the "want" inside of the budgeted cost**
4. **Implementing, monitoring, and adjusting the plan and process**

To profitably satisfy customers wants and needs (marketing plan) the five steps are:

1. **Determining who the customers are**
2. **Identifying their wants and needs**
3. **Developing products or services to meet these wants and needs**
4. **Pricing these products to sell (discount or add value)**
5. **Build a profitable delivery system (streamline or build relationships)**

Once the above five steps are addressed the process requires that the organization determine the best method to:

1. **Prospect – find customers and prospects**
2. **Communicate – determine ways to speak with each prospect as a niche of one**
3. **Sell – initially establish customer relationships**
4. **Service – serve new customer needs and create repeat sales**
5. **Compensate – assure that all stakeholders' needs are met – win / win / win**
6. **Manage – control the process, report results, anticipate changes, adapt, etc.**

To minimize "bad" and mitigate the damage caused the process includes four steps:

1. **Identifying the assets (What do you have?)**
2. **Establishing a price on these assets (What are they worth?)**
3. **Determining the exposures (What bad can happen?)**
4. **Managing the exposures / losses (How do you handle the chance of bad?)**

Every person (and business) has two assets - their person (in business - people) and their things. The price of things can be defined in multiple terms – replacement cost, actual cash value, book value, etc. The "price" of people must be determined in terms of people as economic machines. Their life is the machine, their health is the maintenance of the machine, and their income is the production of the machine.

Only five bad things can happen to people:

1. **Premature death**
2. **Unplanned aging**
3. **Accidents / Sickness**
4. **Unemployment**
5. **Other contingencies – divorce, behavioral problem children, bankruptcy, etc.**

Only two bad things can happen to things.

1. **Destruction of or damage to property and loss of its use**
2. **Lawsuits**

The best method to handle bad is determined by the potential loss. Losses are defined by frequency (how often) and severity (how bad). The options are:

1. **Avoid (high frequency / high severity)**
2. **Assume (low frequency / low severity)**
3. **Reduce (high frequency / low severity)**
4. **Transfer / Insure (low frequency / high severity)**

Please note – insurance is the last step in the RM process. It should be used to transfer only those risks that present catastrophic exposure to the organization. Traditionally many people believed Risk Manager / Management was a euphemism for an insurance buyer or seller, a claims manager, or loss control person.

Further analysis of risk subdivides the term into categories of pure (chance of loss only) or speculative (chance of loss or chance of gain). The risk of doing business is speculative (fast horses, slow women, and Enron stock). Pure risk (fire, windstorm, lawsuits, etc.) has traditionally been identified as creating the need for insurance.

Another subdivision of the term includes dynamic risk and static risk. Static risks are not influenced by a changing environment (lighting, hurricanes, earthquakes,

floods, etc.). Dynamic risks are influenced by change. Yesterday cowboys and Indians created risk for each other. Yesterday wars (with bricks and sticks) were a problem; nuclear war wasn't. Train and stagecoach robberies were an issue; "car jackings" weren't. Pollution yesterday was about road apples; today its about super fund sites and oil spills. In yesterday's world, "hurt feelings" were often answered with a duel – today these are addressed in a courtroom.

The world of business is changing. Now there is a need for planning (strategic / marketing), an evolving entitlement mentality, a growing sense of victimhood, and expectations for large short-term return on investments. Also we see more class action lawsuits, punitive damages, loss of confidence in our institutions / professions (legal / accounting), etc. These are huge challenges / threats for all organizations.

Traditionally the role of insurance has been the transfer of catastrophic risk. The process used by the carriers to accept transfer of this exposure included identifying (selecting) the risk, defining coverage, and establishing a price. As a practical matter in recent years the courts have often "reinterpreted coverage" to provide protection not anticipated or priced for when the policy was issued. It is this writer's opinion that we are rapidly moving to a system of policies without exclusions. Policies that will do more loss funding and less risk transfer.

Tomorrow – the dominant exposures (threats / challenges) for business will be:

1. **The power shift from the manufacturer, distributor, and provider to the consumer (today the consumer is truly king).**
2. **The cost of the legal system and its lawsuits**
3. **The cost of health care and its financing**

An article recently stated that we now have over 1,000,000 attorneys in the U.S. This translates into one attorney for every 280 people. This means a huge cost. The growth of punitive damages, frivolous claims, and class action lawsuits is magnifying this cost. Today our legal system is addicted to huge amounts of cash and will find new sources of lawsuits / settlements to feed their addiction.

Today our health care system is out of control. We spend about $5,035 for Health Care (HC) for every person in America. The inflation of HC costs could see the average premium for Health Insurance double in 3 – 5 years. HC costs drive much of our WC, Casualty, and Group Benefits premiums. These costs / trends linked to aging Baby Boomers and our growing societal entitlement mentality will only continue to accelerate unless we can engage HC users as responsible buyers.

In yesterday's world a business could effectively mass market based upon a cost driven pricing model. Today companies must mass customize for a niche of one and compete with a price driven costing system (Drucker). Power belongs to customers.

So, now – How important is the Risk Manager and the Risk Management Process?