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Why Risk Culture Matters More Than Ever in the Current Polycrisis

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Interrelated geopolitical, economic, and climate change risks have led to a polycrisis, a concept that aptly characterizes today's dynamic and ever-changing risk landscape (Ramsden-Knowles et al., 2023). The World Economic Forum identifies cost of living, failures to combat climate change, and societal polarization are only some of the key risks that businesses will face within a two-to-ten-year span (Torkington, 2023). High inflation, geopolitical tensions due to the Ukraine war, and lingering impacts of COVID-19, currently present a complex breadth of risks for businesses to navigate with finite resources (Ramsden-Knowles et al., 2023).

Information asymmetries in larger firms present challenges to devising holistic mechanisms that manage complex risks (Kanu, 2020). Enterprise risk management (ERM) presents businesses with an opportunity to navigate the intricate complexities of the current and future risk landscape, by deploying integrated measures to identify, control, and monitor risks. Traditional risk management adopts a common approach to measure risk through likelihood, impact, and severity matrices. Furthermore, as ERM has evolved, various international standards and frameworks (e.g., COSO ERM-Integrating framework) have emerged to guide businesses' risk management approaches (Ching Ching et al., 2021). However, the polycrisis and various stakeholders involved, calls for businesses to rethink risk management and consider the importance of risk culture. Successfully utilizing ERM tools to implement frameworks, requires business leaders to consider organizational behavior concepts to comprehend how internal and external stakeholders are susceptible to risk.

To better recognize the purpose and benefits of risk culture, it is critical to first understand what constitutes a strong culture and then perceive how risk intertwines with organizational behavior. By research definition, culture is a system of collective values that dictate norms, attitudes, and behaviors within an organization (Bianchi et al., 2021). Furthermore, organizational culture is based on implicit assumptions which direct employees' abilities to respond to varying environments. Robust organizational cultures led by effective leaders, can enable learning and knowledge sharing (Pivec & Potočan, 2021). Conceptually, risk culture emerged as a prominent notion after the 2008 global financial crisis, as businesses were plagued by regulatory and financial uncertainties (Pan et al., 2017). Risk culture focuses on the explicit and implicit ways in which risk management is valued and supported through shared perceptions, risk management practices, and accountability. Transparency, cross functional teams, and leadership's commitment to a cohesive risk management approach, can enhance risk culture and thus, encourage proactive problem solving to mitigate risks in the current polycrisis. Furthermore, a 2020 research paper provided evidence that the financial benefits sound risk culture by analyzing a large sample of European banks; it concluded that a sound risk culture can contribute to increased financial performance indicators such as return on assets, return on equity, and return on assets on implied volatility. A 10% increase in risk culture indicators can lead to 0.2-1.32 percentage point increases in these metrics (Bianchi et al., 2021). Although concretely measuring risk culture within firms poses empirical challenges, tone from the top, levels of employee accountability, communication channels, and risk management linked incentives can be used as tools to determine the extent of a risk culture's influence within a firm (Bianchi et al., 2021).

The polycrisis and increasing relevance of creating positive risk cultures, calls for firms to strategically integrate innovative thinking, risk related incentives, and knowledge sharing as key pillars to sustainably implement ERM processes. Traditional frameworks solely view risks through a probability and severity standpoint do not encapsulate the interdependencies between business lines, segments, and functions. Thus, promoting cross-functional teams and collectively innovating ways to mitigate downside risks, and optimize upside risks can eliminate silos within risk cultures and management. Amid a slew of macro-economic, political, and social risks, larger organizations with complex business lines should continue to build, refine, and measure relevant key risk and performance indicators (i.e., effectiveness of business continuity plans, turnover rates, recruiting conversion rates, process and technological security issue measurements) (How to Develop Key Risk Indicators (KRIs) to Fortify Your Business, 2021). Then, tying leadership compensation incentives based on such indicators can help promote healthier risk-taking processes and encourage leaders to constructively enforce and contribute to a cohesive risk culture. Board members and management should prioritize dispersing risk related knowledge across the organization, by building team networks that promote knowledge sharing and collaboration; leaders play a critical role in creating and amalgamating an interdisciplinary intelligence team that understands the impacts of the current risk landscape on business operations with teams involved in recovery planning, long-term strategy, and business continuity (Alexander et al., 2020). Tailoring risk management practices to consider and discern challenges faced by leaders, employees, and business stakeholders is pivotal. An effective organizational culture, with risk appetite and control considerations embedded within it, can help foster innovation and creativity within teams to best navigate and overcome challenges presented in todays' polycrisis.

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