

Opinion: The future – beyond our control

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An Ernst & Young sponsored 2008 survey¹ of the world's largest banks identified, what is self-evident truth to all SMEs and sole traders, that *Liquidity is King*. But it was the other lessons learned that interest me, amongst them being the need to:

- Institutionalise a risk culture;
- Stay attuned to what is going on in the industry;
- Not forget the capability and importance of people;
- Prepare for the unexpected.

The Ernst & Young report notes that an overwhelming majority (90%) of respondents cited an *over-reliance on short-term funding*, that growth was “king” and that liquidity was just not factored into the equation. Nearly three quarters (73%) of them considered it essential to *institutionalise a risk culture... that goes beyond a narrow compliance focus*. And over half (60%) of the respondents expressed the view that their organisation had been *lulled into complacency by the benign market environment and the flow of new product offerings*. A view expressed by a significant number (40%) of respondents was their *underestimation of the importance of the human factor in managing risk*, that human judgment, insight and experience should be more highly valued and utilized. And finally, 35% expressed the view that the banking industry as a whole had *adopted a reactive, compliance-driven approach, rather than a forward-looking stance to risk management*.

Equally applicable to business, non-profit and government organisations, these lessons bear repeating. Indeed, they should echo in our ears because I suspect that many organisations have found themselves belatedly learning the same lessons!

Uncertainty

Of particular interest to me was the failure of the banking industry across the board to prudently factor uncertainty into business strategy, management process and decision-making. Donald Rumsfeld² in his infamous response to a question at a Nato press conference inadvertently (or so it seemed at the time) classified uncertainty very simply into: *Known Knowns*, *Known Unknowns* and *Unknown Unknowns*.

As Rumsfeld correctly observed, we discover *Unknown Unknowns* (cf. the banks lesson learned – prepare for the unexpected) as they are discovered or they reveal themselves.

The prevailing ethos of business and government is understandably to attempt to control *Known Knowns* and *Known Unknowns*; and, that compliance is evidence of control – *that all is well*. Indeed, if you dare to challenge this assumption, that compliance is evidence of control, you face being ostracised – sent to Coventry. To again quote Donald Rumsfeld:

Simply because you do not have evidence that something exists, does not mean that you have evidence that it doesn't exist.

But as the largest, seemingly untouchable and impregnable organisations (including governments) continue to falter, management's and indeed society's reliance upon control through compliance needs to be questioned – revisited.

Compliance and control

Compliance-based control frameworks are based upon policy and procedure, and the assumption, maybe

¹ Navigating the crisis. A survey of the world's largest banks. Ernst & Young December 2008. Source: http://www2.eycom.ch/publications/items/200812_navigating_the_crisis/200812_ey_navigating_the_crisis.pdf

² Donald Rumsfeld (United States Secretary of Defence) Nato Press Conference, June 6, 2002. Source: <http://www.nato.int/docu/speech/2002/s020606g.htm>

even presumption, that the recipient of compliance information (...? Yes/No) is capable of accurately interpreting this information – that they have a full understanding of the environment and the circumstance of the respondent. Let's attempt to put the above into context.

Suppose, for example that an employee's bonus is tied to performance, which is not uncommon. Further suppose, that in response to market pressure, management is demanding greater productivity i.e. increased output with fewer resources and in shorter timeframes – sound familiar. And to complete our picture, the employee's pragmatic reality that the only way that management's expectations can be met is by short cutting procedure – by not doing something that should be done – is expected to be done, that perhaps regulation demands be done.

Failure to meet performance KPIs (key performance indicators) will in all likelihood prejudice the bonuses of both management and employees. So long as nothing untoward happens and expectations continue to be met, both management and employee have a vested interest in maintaining the status quo because bonuses are dependent upon it. Employees tell management what they want to hear and management doesn't inquire because they don't want to know. The illusion is complete and the attribution made, that all is well because the controls are working as evidenced by compliance assessments.

Our belief in compliance and control goes beyond today's activities to the achievement of future objectives based upon what we have done in the past – a fallacy which has historically left armies decimated and nations all but bankrupt. *Unknown Unknowns* cannot and are not included in the compliance managed control frameworks that society relies upon, yet they are real and exist in the uncertainty of our futures.

There is a choice

Organisations have the choice, *to know or not to know* what is going on internal to and external to their environments. Internally, to engage with their people, to value their insight and judgment or to ignore them and prefer instead to use policy and procedure based upon the past encapsulated in compliance managed control frameworks or computer software. Neither such frameworks nor computer software are of themselves capable of articulating a potential future, of formulating a strategy that embraces such a future. Yet until the *financial crunch*, that has been and unfortunately continues to be, the belief of many.

We can continue to take on the chin, so to speak, the consequences – the logical out-workings of compliance and control as circumstances unfold before us in a seemingly random manner or we can choose to seek out uncertainty, to attempt to shine light on what may or may not be and in doing so increase not only our awareness, but also our preparedness. The question then is:

Can we encapsulate this awareness in a compliance managed control framework?

The short answer is *no* – we can't.

Awareness is often tacit in nature, remaining uncodified until an event or circumstance facilitates its recognition and then possibly, its codification. The banking industry has apparently recognized the importance of the *people factor* (the repository of the tacit); something they had ignored for too long to their own detriment and to that of society as a whole. But I remain skeptical, as rarely does *espoused theory* match the *theory-in-use*.

Banks, indeed our own organisations will not survive if we fail to up our game and acknowledge the uncertainty, in which both risk and opportunity can be found. To survive, we need to embrace uncertainty – not be fearful of it because in uncertainty is the opportunity, the very essence of our future.

Black swans – the Unknown Unknowns

In his book entitled *The Black Swan*³, the author Nassim Nicholas Taleb tells the story of how before the discovery of Australia, people in the Old World were convinced that all swans were white, an unassailable belief as it then seemed, confirmed without exception by empirical evidence. Yet, as those of us living in Australasia know, *black swans* do exist – in abundance. The people of the Old World had no reason to even consider the possibility that black swans could exist, just as before the advent of the *financial crunch* people (with short memories) had little cause to question the ethos of compliance managed control frameworks.

But now there is a reason. We can choose a mindset limited by the past or learn a new one – one that is unlimited, that does not seek to control the future but rather embraces its implicit uncertainty, unafraid and trusting in the human capability to change and adapt in truly novel and emergent ways.

How can we know the future, given knowledge of the past; or, more generally, how can we figure out the properties of the (infinite) unknown based on the (finite) known? (Nassim Nicholas Taleb)

About the author

For the last 25 years **John Bircham** has run his own management systems development, risk management, learning & development and organisational governance consultancy practice. He consults to a wide range of organisations and regularly conducts advanced master-class workshops on a range of topics that reflect his eclectic background and experience: all aspects of organisational risk and resilience, leading and effecting organisational change – political savvy, creating and sustaining self-organising organisational culture, facilitating emergent capability and strategic leadership.

3 Nassim Nicholas Taleb (2007). *The Black Swan. The Impact of the Highly Improbable*. Allen Lane