Cambridge - McKinsey Risk Prize

Risk Prize Overview:
The Centre for Risk Studies, in conjunction with McKinsey & Company, is pleased to announce the annual Risk Prize. An award will be made for the best submission on risk management by a current postgraduate student at the University of Cambridge who is enrolled in their course on the submission date of the Risk Prize.

Award Description:
The winner and two honourable mentions will be announced in early June. The winner will be awarded a prize of £3,000 at the Cambridge Risk Centre's Risk Summit. The prize award ceremony will be at a plenary session attended by finance, industry and academic delegates. Judges will include members of McKinsey's Global Risk Practice, the Editor-in-Chief of the McKinsey Working Papers, and members of the Centre for Risk Studies at Cambridge Judge Business School. Eligibility for the prize and honourable mentions requires attendance of the prize award ceremony. Additional information can be found at this link.

Entry Description:
Entries should be in the form of an illustrated document no longer than 10 pages, including appendices and references. Exhibits and data tables are encouraged. The subject matter should be broadly related to risk management including governance, risk in strategy, risk modelling, risk metrics, or risk as a general subject. Potential subjects include regulation, corporations, global strategy and financial institutions.

Entrants are encouraged to view the McKinsey's latest thinking on risk:

Entrants taking the MBA elective, Risk Management and Strategic Planning, may submit their course projects for the risk prize. The prize is open to any current postgraduate student at the University of Cambridge who is enrolled in their course on the submission date of the Risk Prize.

Your pdf document should include: 1) Bio-sketch and photo page with signed declarations (as below); 2) Title page and 3) essay 10 pages or less (including appendices and references)

Submission Process and Deadline:
Entries must be submitted as a single document in pdf format by **23:59** on **Monday 03 April 2023.** Please e-mail your essay to enquiries.risk@jbs.cam.ac.uk with a subject line of "RISK PRIZE: your name and essay title".

Cambridge - McKinsey Risk Prize Bio-sketch and Photo Page

Student name: Hannah Morgan

Email contact hmm61@jbs.cam.ac.uk

Date of submission: 3 April 2023

Title of submission: Reassessing Cultural Risk in Industry

I am a candidate for the degree: Master of Business Administration

Department: Judge Business School

Linkedin profile link:

Biosketch (approximately 150 words)

Hannah Morgan is an MBA candidate at the Cambridge Judge Business School. She has a background in digital advertising, working for ten years at an agency based in Washington, DC in the United States. She graduated from the University of Virginia in 2013 with a BA in American Studies and was a part of the Distinguished Majors Program.

Centre for
Risk Studies

UNIVERSITY OF CAMBRIDGE
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Cambridge - McKinsey Risk Prize

Declaration Form

Student name: Hannah Morgan

Email contact: hmm61@jbs.cam.ac.uk

Date of submission: 3 April 2023

Title of submission: Reassessing Cultural Risk in Industry

Number of words of submission: 3,407

I am a candidate for the degree: Master of Business Administration

Academic Institution/Department: The Cambridge Judge Business School

Declaration

I confirm that this piece of work is my own and does not violate the University of Cambridge Judge Business School's guidelines on Plagiarism.

I agree that my submission will be available as an internal document for members of both Cambridge Judge Business School and McKinsey & Co's Global Risk Practice.

If my submission either wins or receives an honourable mention for the Risk Prize, then I agree that (a) I will provide a recorded 2 minute overview of my paper, (b) my submission can be made public on a Cambridge Judge Business School and/or McKinsey & Co websites.

This submission on risk management does not exceed 10 pages.

Signed (Electronic Signature) Hannah Morgan

Please include this declaration form after the cover page of your paper submission.

Reassessing Cultural Risk in Industry

Submitted for the Cambridge-McKinsey Risk Prize 2023

By: Hannah Morgan

3 April 2023

Abstract: As cultural risk, a subset of enterprise risk management, gains more traction, there needs to be better frameworks around how to assess risk and implement mitigation strategies. Most culture risk research to this point has focused on the dual nature of cultural risk as born out of the financial crises in 2007-08 while still being relatively understudied and unmeasurable. This paper sets out to define cultural risk management as a dimension of enterprise risk management. Using the case study of a recent cultural scandal at a prominent international NGO, I show how cultural risk management is a real threat to organisational performance. From there, I look at how this kind of cultural risk can affect a wider sector mix and outline a possible framework for addressing risk before it becomes problematic.

Background:

It is widely accepted that risk management took off in the early 1990s in the financial sector, but took longer to filter into other industries (Freeman, 2020, p. 199).[1] Cultural risk management is an even later development, resulting from discussions around culture that stemmed from the 2007-08 financial crisis (Freeman, 2020, p. 200). Many organisations still do not know what to do with cultural risk as a dimension of company management. Yet cultural risk is a large, even if ambiguous, risk. The growth of corporate governance standards and risk management teams in major corporations in the last few decades has led to more conversations around intentionality when building culture in an organisation. One way to track this growth is by looking at the increase in public values statements. Starting in the mid-1990s, companies rushed to create values statements—sometimes dubiously tied to actual company actions—leading to an expectation that organisations need core values to drive strategy.[2] However, many organisations are failing to engage in the deep, sometimes contentious, discussions necessary to define their culture and values—both topics that generally comprise much more than can be easily outlined by looking at one layer of company organisation. Organisations that create values statements are publicly creating visible artifacts of what their company culture is and strives to be. These statements provide not just reassurance to customers, but also employees who are looking to see what kind of company culture they will join by working for the organisation. Coupled with the recent shift in employee preferences for meaningful work, which was accelerated by the COVID-19 pandemic, many organisations are standing at the forefront of a cultural risk revolution. According to a McKinsey study, almost two-thirds of employees in the United States said that "COVID-19 has caused them to reflect on their purpose in life" and half said that they are "reconsidering the kind of work they do" in the wake of the pandemic (Dhingra, Samo, Schaninger, & Schrimper, 2021).

The main challenge with managing cultural risk is measurement. By successfully addressing cultural risk, you are preventing hypotheticals, meaning that you are trying to measure potential issues *not* happening. However, what gets measured gets managed, so organisations should endeavour to find ways to triangulate cultural risk and define what a successful program. Companies should look to wider industry standards and performance to benchmark their performance. Additionally, organisations should set clear and measurable internal goals so that they can track performance against achievement of those stated goals. But, as a company develops a core culture, they also sow the seeds of future risk. By developing expectations and standards, a company opens itself up to the risk of cultural misalignment.

[1] Andrew Freeman cites the first appointment of a Chief Risk Officer in 1993.
[2] This movement is generally accepted to have started with *Built to Last* by Jim Collins and Jerry Porras.

This paper sets out to define cultural risk management as a dimension of enterprise risk management. Using the case study of the recent cultural scandal at a prominent international NGO, I will show how cultural risk management is a real threat to organisational performance. From there, I will look at how this kind of cultural risk can affect a wider sector mix and outline a possible framework for addressing risk before it becomes problematic.

Cultural Risk Management

It is important first to outline how cultural and corporate governance connects to enterprise risk management in the modern world. Traditionally, risk management has focused on risk in a limited sense. Many of the original pillars of risk management are now being reconsidered due to wider adoption across different industries that rightly stress test the assumptions of original frameworks. For example, the three horizons model created in 2000 by Baghai, Coley, and White is now accepted more as a heuristic than as an exact schematic for risk planning (Blank, 2019). McKinsey's definition of risk also continues to expand as innovation forces new approaches (Risk and Resilience - Our Insights, n.d.).

Given this environment, organisations should factor in new and potentially difficult to measure metrics when assessing risk, including metrics around internal organisational culture. As Anette Mikes notes in "Values at Risk", there are increased "calls for risk management to provide a systematic analysis of the ethicality of individuals or organisations" (Mikes, 2020, p. 232). These calls are born out of the 2008 financial crisis, and developments within the UK around culture and risk in the financial sector can provide relevant frameworks for broadly understanding cultural risk concerns. Mikes focuses on the concept of espoused risks versus exhibited risks, which is relevant in the case study of one NGO's espoused ethics versus the exhibited ethics and their relative associated risks (Mikes, 2020, p. 246). Similarly, Jennifer Howard-Grenville recognises both espoused from-the-top culture and articulated culture, noting that values become pervasive when they become "taken for granted" and "guide organisational members' actions even without their conscious attention" (Howard-Grenville, 2020, p. 24).

Where humanitarian aid organisations are concerned, the ethicality of an organisation is inseparable from its risk, as organisations centre ethical and moral behaviour as a foundational pillar. For humanitarian aid organisations ethical business practices are *de jure*. This becomes important where there are areas of "value displacement"; stated values do not align with actuality, leading to gaps in action that become inherently risky by their existence (Mikes, 2020, p. 234). In a field where public perception is as important as actual action, perceived gaps can be magnified in the public eye. As donor-funded organisations, NGOs are particularly exposed to risk between espoused and exhibited culture as one of their key stakeholder segments is donors. They have no stock and sell no goods; the budget for their operations ultimately comes from alignment between their missions, public perception of their effectiveness, and donor goodwill.

Through this lens, we can view donors as one of—if not the—key stakeholder that NGOs must satisfy, and thus the audience who should be primary in risk mitigation discussions. Mike Power argues that the risk appetite process needs to account for multiple viewpoints to best shape a risk management programme where there are clear delineations around which stakeholders should be exposed to risk. There should be "direct risk management attention to where it has likely been lacking, namely to the multiplicity of interactions which shape *operational and ethical boundaries* at the level of organizational practice." (Power, 2009). One must also distinguish between internal organisational culture and external perception of said culture. Like with the distinction between espoused and exhibited values, the two cultures may broadly align, but points of divergence indicate where there are high levels of enterprise risk. For example, if an organisation has an internal culture of competition, but the external perception is of a democratic, nurturing organisation, this difference could become a point of risk were the mismatch exposed. Crucially, this risk exists even where the mismatch leads to strong overall organisational performance. With that brief background in culture and risk management, we can now assess the case of institutional racism at Médecins Sans Frontières (MSF).

Médecins Sans Frontières: A Case in ERM

In 1971, French journalists working in Nigeria founded MSF (Who We Are, n.d.). Since then, it has provided independent humanitarian aid around the world, providing medical services in over 70 countries and aiming to be a first-responder during crisis. Despite its strong ethical stance and far-reaching work, however, MSF is not immune to the issues of institutional racism inherent in humanitarian aid work. Any organisation that brings outsiders and outsider funding into crisis zones inherently engages in some level of saviour mentality. The institutional structure at MSF includes local staff, which could help to offset this dichotomy between mission and values. However, in 2020, 1,000 current and former staff members signed an open letter to leadership alleging institutional racism at MSF and detailing various abuses suffered across MSF locations (McVeigh, 2020).

To establish the risks to MSF, one must establish where the gaps exist between espoused and exhibited organisational values. Drawing on the MSF-USA Annual Report for 2021, updates from MSF leadership, the website, news articles about the open letter, and experience working with numerous NGOs, we can create the following values chart:

Espoused	Exhibited
• Principle of *témoignage* • Independence and impartiality in order to provide the most possible aid • Providing aid in conflict zones where many other organisations do not or cannot • Belief that "racism is a public health crisis" • "Supporting a diverse and empowered staff will further improve the qualit of care we provide" • "We speak out" to hold people accountable and raise awareness	• Principle of *témoignage* •Two-tier system: 90% of staff are local, but most operations are run by European manangers • Pay disparity between local and international staff • Segregation between local and international staff • Allegations of casual racism in on-the-ground locations • White-saviour mentality • Repeat concerns around institutional racism raised from 2017 onwards with little change • MSF Italy supported using "all lives matter" talking points

There are clear gaps between the espoused ethics of MSF and ethics exhibited by staff and leadership. Some of these gaps are institutional, like disparities in staff treatment, pay, and the percentage of local workers in management. Some gaps, however, fall under the purview of leadership and corporate governance, like the failure to act on earlier reports of institutional racism within the organisation. No discussion of institutional ethics would be complete without addressing the concept of *témoignage*. French for “testimony”, it is a cultural touchstone for the organisation. The idea that MSF acts independently and bears witness to devastation brought to communities by everything from famine to natural disaster to war is a core part of their identity. Since this is essential to both espoused and exhibited values, the open letter sent by MSF staff can be read as an expression of *témoignage* within the organisation itself.

Where there is no gap between espoused and exhibited values, the risk to MSF comes not from needing to bridge any gap, but from needing to respond appropriately when the lens of impartial witness bearing is turned on itself. This aligns with Howard-Grenville’s view that "the culture-as-values perspective […] demands a clear and consistent ‘tone from the top’ that sets out the core commitments and associated expected actions” (Howard-Grenville, 2020, p. 36).

These risks facing MSF can be understood as an inconsistent development of expected actions. One reason for this is that MSF is an international organisation with multiple branches across multiple countries, all with semi-independent management. Part of the governance failure around earlier allegations of institutional racism is the result of differing priorities between staff in the US versus Europe, with the MSF-USA pushing for more action addressing institutional racism than European offices (Abdelmoneim, 2020). And, while the organisation works in over 70 countries, management offices are located primarily in Europe and the US, with only one located in the global South. Addressing disparity in management structures would signal that the board is working to erase the two-tier management system across the organisation.

In response to the open letter, multiple MSF offices released statements condemning and calling for investigations into instances of racial abuse (Abdelmoneim, 2020). However, progress two years later remains slow. A clear assessment of the stakes for the organisation, both now and in the future, will help them prioritise their risk assessment. One issue at stake is annual fundraising revenue from continued bad press. Another is the potential loss of talent at local centres, especially in a time of increased aid needed in locations like Afghanistan and Ukraine. Longer term, they should be concerned about their ability to attract and retain donors should the scandal go unaddressed. When interest in charitable organisations is trending downward, competition for donor funds can only increase. Wariness of how this scandal may affect their overall organisational performance in relation to macro-factors like continued cost-of-living crises or the climate crisis causing frequent natural disasters is key. A large organisation takes time to change, but it would be beneficial for MSF to undertake a risk analysis to address how they should approach this issue. From this brief case, here are a few options:

Continue	Start	Stop
• Stressing the prinicple of *témoignage* • Publishing regular updates to maintain transparecy • Mandatory anti-racism training for office staff	• Plan for MSF management offices in key locations in the global South • Data collection project on pay disparity between international and local staff • Identifying and promoting local talent to managerial positions • Quantify goals as much as possible and tie them to executive compensation	• Two-tiered pay and staffing system (using data collected) • Releasing updates with no states goals or timelines

Cultural Risk in Other Sectors

NGOs are not the only sector where espoused versus exhibited behaviours open organizations up to increased risk; this dichotomy can affect almost any organisation. While it is easiest to see how a company that directly deals with morality, like an NGO, is a clear-cut case of cultural misalignment risk, there are examples of this kind of disconnect in other sectors. Other relevant examples include companies and industries where customer trust is essential, such as the technology or automobile sector.

There are two recent examples from the technology sector where the misalignment between espoused and exhibited culture has opened the company up to risk. First, at Twitter. In 2014, Twitter's mission statement was: "To give everyone the power to create and share ideas and information instantly, without barriers." (Fox, 2014). While not all-encompassing, this statement sets out some clear company values: audience participation, speed of information, and increased access to information. And for many years, that statement largely held. There were adaptations to actual company culture and technological updates (for example, expanding from 80 characters to 140 characters), but the overall guide was still to hit those core three topics. And, if you asked an employee or Twitter user, it would be a safe bet that they would agree that Twitter accomplished those goals. However, with increasing scrutiny around misinformation on social media, especially around the 2016 US elections, Twitter's espoused values and the actual values experienced by employees and users of the product started to diverge. Most recently, with Elon Musk's recent takeover of Twitter and remodelling of the platform, that values statement is now widely divergent from the experienced values. Users are getting blocked or locked out of their accounts for using Twitter to publicly disagree with Elon Musk. Twitter has now introduced paid verification access, which actually increases barriers to creating and sharing ideas, not limits them. And this very public misalignment is causing real damage to the company's brand and bottom line. Before Twitter was delisted from the NYSE, but while Musk was in public negotiations to buy it, stock prices were volatile—dropping by almost 20% in the first month after Musk announced his intention to buy.[3]

[3] Figures pulled from historical monthly stock prices at https://uk.investing.com/equities/twitter-inc-historical-data.

After acquisition, when Musk started implementing changes to the platform that diverged from the core values of audience participation, speed of information, and increased access of information, Twitter started to haemorrhage users. The Guardian estimates that more than 30 million users are expected to leave Twitter over the next two years due to changes that Musk has implemented (Sweney, 2022). Public trust in the platform has been damaged, perhaps irreparably, due to the clear misalignment between stated values and actual action.

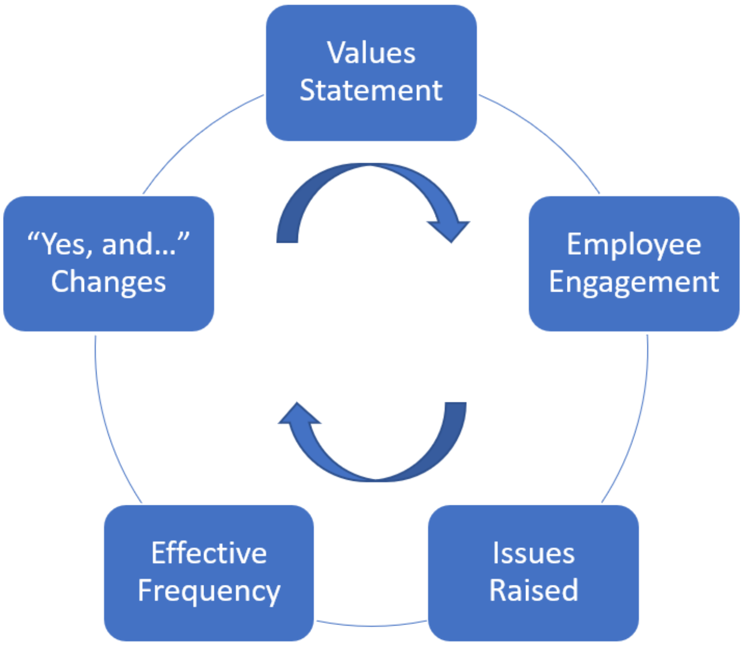
The second sector that has recently been affected by scandal related to espoused values deviating from exhibited values is the automotive industry. In 2015, Volkswagen (VW) was embroiled in an emissions scandal that eroded trust in the company when it was discovered that over 11 million VW vehicles cheated on emissions tests and were not hitting the emissions targets that they claimed (Ewing, 2015). The scandal caused a public backlash, even from consumers who were not VW owners, because the company had advertised their diesel vehicles as clean alternatives to regular gasoline vehicles. Thus, the stated culture of the organisation—one of an environmentally responsible company providing cars in global markets—did not map to the reality of a company who was knowingly cheating on emissions tests to put vehicles on the road that did not meet international emissions standards. Interestingly in this case, it was later revealed that there had been internal escalation by a whistleblower about the issue of incorrect diesel emissions four years earlier, but the complaint went unaddressed (Tutton, 2015). This is another example in which employees are trying to callout incongruities between espoused and exhibited values, where there is huge risk to the company, but no action was taken. As a result, VW suffered huge financial losses, with stock values declining by “€25 billion in two days of trading,” in addition to reputational losses (Ewing, 2015).

Proposed Framework

As the enterprise risk inherent in misaligned cultural values is clearly affecting a number of industries, it is essential to develop a framework to catch and address misalignment early. All risk management decisions struggle with issues of being taken seriously in company planning among so much uncertainty. As Paul J. H. Schoemaker notes in *Profiting from Uncertainty*, “the challenge facing champions of new and radical ideas in large organizations is that the existing business is based on facts, while the new ideas are largely based on speculation” (Schoemaker, 2002, p. 174). Put another way, it can be hard to measure and prioritize hypotheticals, especially hypotheticals tied to something as nebulous as organisational culture. However, as the cases above demonstrate, there is real value in organisations addressing cultural risk, even if hypothetical. Where risk cannot be measured objectively, organisations should instead focus on comparisons to wider industry trends and benchmarking. Additionally, each organisation should establish clear and measurable internal goals so that they can track achievement against that goal. For example, if there is no way to measure how employees prevented cultural misalignment from causing greater harm to an organisation, it would possible instead to measure employee engagement as a metric and to look for increased engagement year over year as a sign that employees feel connected to the company vision and psychologically safe enough to flag divergence.

Implementation of risk management is often the hardest part, and one key resources for implementation is the team chosen. Schoemaker distinguishes between two types of implementation teams: internal company managers and external consultants. However, there is a third option: employees who are not in management roles (Schoemaker, 2002, p. 184). This third option straddles the line between internal and external; they are not privy to internal management decisions, meaning that they may bring a fresh set of ideas of concerns to the table, like an external consultant. Unlike external consultants, however, they have strong ties to the company and understand company values implicitly, so their recommendations around cultural risk factors will take company values into account.

The proposed framework for dealing with cultural risk uncertainty needs to engage this third implementation methodology to fully leverage the organisations strengths in planning for uncertainty. With that in mind, I propose the following Cultural Risk Mitigation Cycle:



The Cultural Risk Mitigation Cycle

The cycle begins with the company values statement, as the most prominent cultural artifact of espoused organisational values. This is the metric by which actual behaviour must be judged in order to find points of divergence that could open the organisation up to increased risk. Then, the organisation should engage employees in active feedback so that they are participants in both creating culture and monitoring it. As issues are raised, they can be categorised until they reach an effective frequency high enough to need action. Note that for some major espoused versus exhibited divergences, like we saw at VW, the effective frequency might be once. The organisation should then engage in a "Yes, and…" period. Schoemaker notes that effective implementation has more in common with a jazz improvisation or sports practice than regular management duties because it "works within a broad and systematic framework but cannot be unduly mechanistic" (Schoemaker, 2002, p. 187). Borrowing from this idea, I would posit that effective risk management should be more like comedic improvisation, where there is an overarching scenario in which all actors are participating. In comedic improvisation, any new curveballs should be met with the phrase "yes, and..." while actors figure out how to slot the new information into their existing sketch without fully rejecting any suggestions. With that framework, managers can remain open to employee flags and send the message the engagement is always welcome, even if it may not fit managers ideas of how the scenario should play out. Those suggestions can then be held up to the values statement to assess if they require immediate action, either by adjusting the values or by adjusting the action, or if they are consistent with stated values and can be left unaddressed. The benefit of this model is the flexibility and modular approach that can be adapted across many industries.

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