WHY DO CARS HAVE BRAKES? – AN ANALOGY FOR CORPORATE RISK MANAGEMENT

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Seems an odd question given the obviousness of the answer: "so the driver can stop the car." Of course, that's a good answer. Viewed from a different perspective, however, this question reveals an even greater intrinsic value of why cars have brakes.

Consider that when a driver first gets in a car it's already stopped. In that situation, breaks provide little benefit. It is also true that no rational person would begin driving the car believing it has faulty breaks. Consequently, one could argue that the intrinsic value of breaks is not so much in the ability to stop the car as it is in enabling a driver to accelerate the car and drive relatively fast.

Similarly, the long-term effectiveness of a corporate risk management function is less about avoiding risk and more about the capacity to take reasonable risks. Knowing safeguards are in place to mitigate the likelihood of significant and costly mistakes allows companies to "press down on the gas pedal."

Risk capital seeks new and innovative ideas executed by a strong management team in an aggressive culture that tolerates some mistakes and losses but is not run with reckless abandon. This means being organized and disciplined without being bureaucratic and rigid. It means fostering an environment of creativity and innovation while also maintaining policies and procedures to serve as early detection mechanisms to minimize and even mitigate losses.

Like other parts of the company, the risk management function must be innovative and evolve with the changing risk profile of the company, including emerging legal and regulatory requirements. Further, the function needs to be flexible enough to accommodate some mistakes while being proficient at knowing when and how to apply the brakes.

Finally, risk management is central to a strong corporate culture. Whether it's the team that maintains the program or it's the business people that honor the system by recognizing that strong risk management fosters the ability to take risks, nearly everyone in the organization has an ownership stake in risk management's success.

The bottom line: cars have breaks so they can go fast and companies have risk management programs so they can take risks.

* Status as a CPA is inactive.