



## From counting risk to making risk count: Boundary-work in risk management

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### A B S T R A C T

For two decades, risk management has been gaining ground in banking. In light of the recent financial crisis, several commentators concluded that the continuing expansion of risk measurement is dysfunctional (Power, 2009; Taleb, 2007). This paper asks whether the expansion of measurement-based risk management in banking is as inevitable and as dangerous as Power and others speculate. Based on two detailed case studies and 53 additional interviews with risk-management staff at five other major banks over 2001–2010, this paper shows that relentless risk measurement is contingent on what I call the “calculative culture” (Mikes, 2009a). While the risk functions of some organizations have a culture of *quantitative enthusiasm* and are dedicated to risk measurement, others, with a culture of *quantitative scepticism*, take a different path, focusing instead on *risk envisionment*, aiming to provide top management with alternative future scenarios and with expert opinions on emerging risk issues. In order to explain the dynamics of these alternative plots, I show that risk experts engage in various kinds of boundary-work (Gieryn, 1983, 1999), sometimes to expand and sometimes to limit areas of activity, legitimacy, authority, and responsibility.

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### Introduction

Risk management has been gaining ground in banking for the last two decades (Mikes, 2009b; Power, 2009), fueled by regulators' and market participants' long-held dream of taming uncertainty. This dream, in itself, is a manifestation of the “quantificational spirit” of our age, in which a “tyranny of numbers” (Boyle, 2001) brings uncertainty and complexity to heel. In particular, developments in financial economics have organized market uncertainty into recognizable categories of quantifiable risk (Bernstein, 1996; Millo & MacKenzie, 2009). But is this growth of risk management in banking inevitable? Is it dangerous? And is it really “risk management” that is steadily staking out new territory—or is it a variety of risk managements?

Paradoxically, the growth of risk management is often stimulated by what appear to be its failures. The two-decade history of modern risk management in banking has

been punctuated by corporate failures (Barings Bank), large-scale one-off losses (often associated with fraud, such as those suffered by Allied Irish Bank in 2002 and Société Générale in 2008), relatively localized systemic crises (such as the Asian bank crisis of 1996 and the Russian bond crisis of 1998), and, last but not least, a systemic financial crisis on a scale never seen before. Each of these events was cast as a risk-management failure, yet the ideal of risk management has survived. The financial crisis of 2007–2009 led regulators and industry observers to call for firms to have executives exclusively devoted to enterprise-wide risk oversight, particularly since it emerged that one of the victims of the subprime credit debacle, Citigroup, had ineffective risk oversight and another, Merrill Lynch, had no chief risk officer (CRO) at all (Dobs, 2008). Many argue that the chief risk officer's role in corporate governance is going to grow. As National City's CEO, Peter Raskind, argued in a 2008 issue of *The American Banker*: “This environment has absolutely underscored the need for that person. But it's not just credit risk. It's operational risk, reputation risk, and so on. Nobody wants another 2007” (Dobs, 2008).

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In response to the proliferation of the measurement imperative in economic life, Power (2004a) proposes an explanatory framework which postulates that the evolution of performance management is a cyclical recursive process of “counting, control, and calculation,” punctuated by innovation, crisis, and revision. These two sequences are intertwined: Controlling experts develop methods of *counting* (each of which is an *innovation*) and use them for *control* until there is a *crisis*, which forces them either to (re)calculate in order to intensify their control or else to subject their counting methods to *revision* or reform.

What makes Power’s “metrological dramas” cyclical is that, in the face of crisis and criticism, proponents of “counting” do not abandon their measurement efforts but, rather, intensify them (Power, 2004a), something which made Power himself uneasy. Having modeled organizations’ relentless drive to expand performance measurement into hitherto uncontrolled areas, he began to warn against the consequences of that expansion (Power, 2004a, 2004b, 2009). He argues that, as risk management continues to evolve through cycles of innovation in measurement, crisis, and revision, it pushes metrics into more and more areas which are properly the domain of human judgment, with results that are “at best ambivalent and at worst dysfunctional” (Power, 2004a: p. 771). In light of the recent financial crisis, Power concluded that the risk management of everything turned out to be the risk management of nothing (Power, 2009; see also Taleb, 2007).

While Power’s framework of “counting, control, and calculation” and his expectation that pushing risk-management practices ever further is likely to be dysfunctional have provoked much thought and discussion, both still await empirical scrutiny. This paper is a first attempt to apply his framework in the field.

Based on two detailed case studies (first reported in Mikes, 2009a) and 53 additional interviews with risk-management staff at five major banks over 2001–2010, I show that Power’s cycle is contingent on what I call the “calculative culture.” Controllers who display “quantitative enthusiasm” would do what Power’s model suggests, but there is another control style which takes a very different path. One of my in-depth field studies fitted Power’s cyclical conception. In this organization (referred to as Fraser Bank), risk metrics gradually colonized hitherto uncontrolled areas of uncertainty, even in the face of recurring internal organizational crises when risk methodologies came under scrutiny from external and internal constituencies. The other field study (in an organization referred to as Goethebank), however, suggested an alternative style of risk management which resists the urge to push metrics into carefully protected areas of judgment. In this style of risk management, the emphasis is on using “softer” instrumentation<sup>1</sup> to frame and visualize non-measurable uncertainties.

<sup>1</sup> Power himself left open the possibility for another unspecified, unevicenced route when he wrote: “Emerging agendas in the field of risk management are a case in point, where dreams about measuring the future co-exist with demands for greater communication of the importance of ‘softer’ instruments with more qualitative calibration” (Power, 2004a). However, he later concluded that this was not happening in risk management (Power, 2007, 2009).

To understand how some organizations displaying a particular calculative culture come to be so committed to risk measurement while others with a different calculative culture do not, I draw on sociological studies of expertise to argue that risk experts engage in boundary-work (Gieryn, 1983). That is, for a variety of reasons, experts try to define what is and is not their remit, often with respect to competing or complementary fields of expertise. My field studies suggest that the boundary-work of risk experts furthers two different approaches to risk management, depending on the calculative cultures they display. Some risk controllers who adopt quantitative enthusiasm *expand* first-order measurements<sup>2</sup> (initial risk quantification) into new domains of risk, and use these measurements to create second-order measurements (risk aggregation), which not only demarcate an aspect of performance (risk-adjusted performance) but also signify a distinct expertise which entitles the controller to a degree of organizational control. Other risk experts (displaying quantitative scepticism) combine initial risk measurements with “envisionment” practices based on the controller’s experience and intuition, and *expand* “softer” instrumentation into the domain of non-measurable strategic uncertainties. By *focusing* risk quantification to first-order measurement, controllers in this group lack the analytical mystique wielded by those in the first group and they appear to have deliberately left the boundaries between themselves and the rest of the organization blurred and porous in order to influence decision makers in the business lines. But what might be a hindrance to creating a distinct expert group—one kind of boundary-work—can be a help in crossing organizational boundaries in order to “get things done” in the business lines—another kind of boundary-work. While the first approach appears to be more effective in creating an independent and distinct expert function, its practitioners seem to have limited relevance to (or lack the ambition to participate in) the discussion of non-measurable strategic uncertainties.

This paper is organized as follows: The first section introduces risk management and outlines four major themes that guide its technical development: first-order measurement, second-order measurement (or risk aggregation), control (risk-based performance measurement), and remedial calculations. The second section introduces the notion of boundary-work in order to focus and structure my analysis of the field cases. In the next sections, I apply this framework to the cases of Fraser Bank and Goethebank and show how the five additional cases shed further light on the characteristics and conditions of possibility for the alternative pattern of risk management—risk envisionment. The final section concludes and outlines further avenues for research.

<sup>2</sup> Power distinguishes between first-order and second-order measurements (Power, 2004a: p. 771). First-order measurement relates to the controllers’ attempt at classification that makes counting possible, the “translation” of the phenomenon into measurable quanta, and the creation of legitimate instrumentation, all of which requires protracted political work. Second-order measurement refers to controllers’ efforts to aggregate first-order numbers and to create ratios and indices. These further “measures of measures” have a life of their own as they become integral to performance measurement systems (e.g. by the calculation of profitability), compensation and insurance systems, and so on.

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