Can Healthcare Boards Learn to Embrace Risk?

More boards need to see the benefits, and not just the pitfalls, of risk taking.

BY ANDREW CHASTAIN

As with individuals and institutions, entire industries have preferred tolerances for risk—from low to moderate to high. The sector within which I work, healthcare, has never had much of an appetite for risk. Hospitals, health systems, clinics and other facilities are bedrocks of their communities. Financial and operational conservatism have always governed strategy.

What's more, competition among healthcare providers has historically been relatively modest, discouraging even calculated risk-taking. Organizations have encroached upon each other's territories but the industry environment has been anything but open-market survival of the fittest.

All that has changed in recent years, with the Affordable Care Act but also as providers have turned to marketplace economics to rein in costs, establish efficiencies, and tap new revenue sources. All organizations are on the lookout for disruptive competitors. Meanwhile, patients are now being viewed as *health consumers*, prompting providers to pursue more and more aggressive strategies. Such strategies include all-out efforts to broaden patient populations and geographic reach.

Mergers and acquisitions are rampant. Executives and boards are more opportunistic. I am surprised by the new conversations they are having today: Who do we partner with? Which competitors do we reach out to? How do we double or triple our patient base? What creative messaging do we take to the marketplace? Only a few years ago these discussions would have been almost unimaginable.

What has this strategic shift meant in terms of calculated risk? Whereas in the past it was something to be *managed* and often cited as a deterrent to experimentation and innovation, now it is a fundamental element of doing business. Healthcare leaders are pushing the boundaries of risk tolerance, entertaining bold strategic moves that could impact both cash and credit ratings and that would never have been considered before.

Boards, CEOs and Risk

Healthcare certainly isn't the only industry headed in this direction. Higher education, pharmaceuticals, banking, and even non-profits are other areas where regulatory and market forces are conspiring to promote innovation and higher risk profiles.

How should boards react? Isn't it still their role to stress stability and accountability—noses in, fingers out—while C-suite executives take the deliberative risks? Yes, but it is generally agreed across industries that boards must get in tune with their CEOs and executives and play a more engaged governance role. To solve embedded and historical challenges, boards must foster an environment where they communicate with and expect leadership to take calculated risks and experiment without the fear of undue reprisal.

More boards need to see the benefits, and not just the pitfalls, of risk taking, noted a recent KPMG study ("Calibrating Strategy and Risk: A Board's-Eye View," October 2015). Interestingly, the study said that most corporate boards have deepened their involvement in strategy over the past few years. Only half of those surveyed, however, believed that risk is being satisfactorily addressed within strategic discussions.

Directors may not speak the language of risk. They may lack familiarity with how it is formally assessed and documented. This knowledge takes time to develop and guidance from the executive team. Until boards become more educated in this regard they may struggle to effectively oversee and support their organizations' risk-related activities. (See "The Next Frontier for Boards: Oversight of Risk Culture," *The Conference Board*, June 2015.)

Fostering an Innovative Culture

I do not see board functions changing dramatically, nor should they. Rather, it is the scope and sophistication of all governance matters that are changing, and thus it is incumbent upon boards to learn to ask better, more insightful questions of each other and of executives. This includes questions surrounding risk.

I'm not suggesting that boards lean in more strongly (unless it is requested or clearly warranted) but rather, incrementally, become more knowledgeable and conversant on matters of risk. "Often, the board is more comfortable allowing the CEO to take a few 'small bets' on innovative ideas or

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projects considered less risky because of their size and scope," wrote author and board consultant Beverly Behan ("Innovation Starts in the Boardroom," *Directors & Boards*, Dec. 1, 2014). "Victories achieved with these smaller initiatives can then be used to 'move the needle' on innovation within the larger organization—and with the board itself."

Behan argued that, when a board sanctions more risk taking, its response to failure is critical. A board that conveys the message "try again" in the face of failure will engender confidence in its CEO and foster a culture of innovation.

Just as an organization must develop its own risk culture, so must a board. How does it want to be perceived (and how seriously will it be taken) by the CEO, other executives, and varied stakeholders on matters related to calculated risk? Developing a risk culture takes a continued, concentrated effort. The following are steps that boards can take:

1. **Clarify the board's role on risk.** Work with management to delineate responsibilities. Put structure in place.

2. **Recruit new members with backgrounds in risk and risk-related expertise.** Boards are increasingly taking a skills and competency approach to their composition, and risk management should be a healthy part of the mix.

3. **Steadily increase membership expertise.** Educate trustees via training, mentoring, consulting, engagement with the executive team, and frequent discussion of current market conditions. Learning includes technical understanding of enterprise risk management principles, IT and analytical platforms, advanced diagnostic and predictive modeling, cybersecurity issues and much more.

4. **Keep risk on the agenda.** Make it part of every meeting, and engage with the CEO and team (legal, finance, etc.) regularly on risk so that it becomes baked in to governance practices.

5. **Engage with stakeholders.** Share information (as appropriate) and the logic behind innovation and new initiatives to increase buy-in among key stakeholders and ensure there are fewer surprises in the future.

As the board addresses risk intentionally and becomes more comfortable with its role in relation to the CEO and executive team, discussions become second nature and easier (not easy) to have. In short, boards need to view calculated risk as something that provides clear opportunities and not just anxieties. ■