



Harmonizing the Human Element: Navigating Operational Risk Management

| Introduction |

Effective operational risk management serves as the guardian of an organisation's financial well-being, shielding it from undesirable outcomes and downside risk. While technology and well-designed processes are pivotal, the intriguing facet of this equation must not be disregarded - psychology and human factors. This publication explores the intricate relationship between human psychology, human factors and operational risk management, uncovering how thoughts and emotions shape organisational decision-making and risk mitigation.

| The Importance of Comprehending Psychology and Human Factors |

The significance of comprehending human psychology and cognitive factors in risk management cannot be overstated. While technological advancements and well-established procedures and processes play essential roles in operational risk management, the human element remains the lynchpin in the decision-making process. Specifically, at the heart of risk assessment and decision-making, it is the inherent capacity of humans to execute key controls, interpret data, develop technology, and facilitate processes that ultimately defines the trajectory of an organisation. Noting this lynchpin in the decision-making processes, organisations should be aware of the cognitive biases, emotional responses, and social dynamics which profoundly meld how organisations perceive, assess, and respond to risks and make decisions. Some of the key human factors include:

- *Loss Aversion:* Human beings possess a natural aversion to loss, a psychological tendency that can foster risk aversion. Organisations may resist proposed changes or new initiatives out of fear of adverse consequences, potentially stifling innovation and obstructing the adaptation of new strategies.
- *Overconfidence:* Another cognitive factor with a substantial impact on operational risk management is overconfidence. Individuals often overestimate their abilities while underestimating the likelihood of adverse events. This overconfidence can lead to unpreparedness and a dearth of contingency planning.
- *Groupthink & Social Influence:* In organisational settings, group dynamics can exert a significant influence on risk management decisions. Groupthink emerges when a group's desire for consensus results in conformity, even if it entails ignoring warning signs or dissenting opinions.

- *Emotional Factors:* Emotions can obfuscate judgment and impact risk-taking behaviour. Emotions like fear, greed, and over-optimism can lead to poor decision-making.
- *Confirmation Bias:* Confirmation bias is a pivotal cognitive factor with substantial implications for operational risk management. When leaders or teams become entrenched in their existing viewpoints and strategies, they may inadvertently overlook warning signs, red flags, or alternative pathways. This bias can result in the persistence of outdated or ineffective approaches.
- *Fatigue & Stress:* Fatigue, whether physical or mental, can impair an individual's cognitive abilities, decision-making skills, and reaction times. In the context of operational risk, this can lead to suboptimal judgment, delayed responses, and lapses in concentration, ultimately increasing the likelihood of errors and adverse events. Fatigue can arise from various sources, including long working hours, sleep deprivation, stress, and extended periods of intense focus. It not only jeopardizes an individual's well-being but also poses a significant risk to the organisation as a whole.

| Strategies |

Organisations should explore key strategies for effectively managing and mitigating the influence on psychology and human factors on operational risk, ensuring a more resilient and reliable organisation. Some key strategies could include:

- Promoting a culture that recognizes the benefits of calculated risk-taking and learning from failures.

- Cultivating a culture that encourages open and honest discussions, welcomes diverse perspectives, and empowers individuals to challenge the status quo without fear of reprisals.
- Fostering emotional intelligence and self-awareness, assisting individuals in recognizing and managing their emotions when assessing and responding to risks.
- Developing a culture of open-mindedness and intellectual humility via promoting a willingness to seek diverse perspectives, actively challenge assumptions, and critically evaluate the evidence at hand.
- Engaging in thorough, impartial risk assessments and maintaining an ongoing dialogue about potential pitfalls are essential steps in mitigating the impact of confirmation bias.
- Prioritising employee well-being, promoting healthy work-life balance, and implementing fatigue management strategies to ensure individuals remain focused and capable of effectively managing operational risks.

| Conclusion |

In the intricate realm of operational risk management, understanding the delicate interplay of human psychology, cognitive factors, and the promotion of psychological safety is the cornerstone of a resilient and adaptable risk mitigation strategy. While technology and processes offer a solid framework, it is the people within an organisation who ultimately make decisions, interpret data, and drive risk responses.

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