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Anticipating risks, averting the worst

3 steps for natural disaster or corporate calamity.

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With Congress balking at a bailout, General Motors soon could be driven into the dustbin of history. How did an icon of American business reach such a disastrous state?

For an answer, it's instructive to consider natural disasters - which, like corporate calamities, have been particularly devastating to the country in recent years.

Hurricane Katrina killed 1,300 people and forced 1.5 million from their homes. If GM declares bankruptcy, hundreds of thousands will lose their jobs, and many of them could lose their homes, too. Whether the risk at hand is a natural calamity or a corporate disaster, we see parallel lessons for those most responsible for avoiding the worst.



One problem is that executives rarely seek out probability estimates when making decisions that involve risk. One study found that less than a quarter of managers asked for likelihood estimates when undertaking risky decisions. When another group of managers was informed of the odds, less than 20 percent used the information.

Most executives tend to avoid thinking about low-probability events until after they occur. They fall into a trap of believing such events will not take place - at least, not on their watch. The implicit principle is "NIMTOF": Not in My Term of Office.

Most auto executives could hardly conceive of - let alone prepare for - a world in which oil was priced at \$140 a barrel and auto sales plummeted 40 percent. Even if such shocking possibilities were considered, preparing for them would be left to future leaders - not today's executives, who feel daily pressure from short-term investors.

Myopia and its consequences have a long history in business. Prior to the 1984 Bhopal catastrophe in India, executives in the chemical industry deemed the chances of such an accident to be essentially zero.

And even after the first terrorist attack on the World Trade Center, in 1993, insurers continued to include terrorism as an unnamed peril covered by their policies. That made insurers fully liable for the 2001 attack even though they hadn't received an extra penny for the coverage.

Individuals fall into the same traps of short-term thinking. Few residents of hazard-prone areas voluntarily purchase flood or earthquake insurance before a disaster. Only after a catastrophe do homeowners buy coverage. And they are likely to cancel their policies several years later if they don't experience another loss.

What steps can be taken to avoid such mistakes? The art of leadership is anticipating the unpredictable. Three ways of doing that apply to both natural and corporate catastrophes.

The first is mitigation. There would have been far less devastation in New Orleans if it had well-maintained levees and evacuation plans, if its hazard-prone areas had land-use management programs and well-enforced building codes, and if insurers were allowed to charge premiums that reflected risk. But short-term concerns ended up trumping long-term safeguards.

Likewise, if General Motors had trimmed its product lines, heightened fuel efficiency, and restored some of its reputation for quality before the bottom fell out of the market, we might be talking triage rather than bankruptcy for the company. But short-term greed trumped long-term gain.

The second remedy is management. Mindful of those abandoned in New Orleans after Katrina, officials in Houston and Galveston required residents to evacuate in advance of Hurricane Ike in September.

Mindful of GM's sharp descent from more than 45 percent to less than 25 percent of the American market, a new generation of executives might have restructured the company - much as Louis Gerstner remade IBM when its mainframe sales were in precipitous decline.

Third, consider governance. Good governance implies appointing forward-thinking directors with long-term perspective, who will guard against low-probability, high-consequence events.

The White House failed in its oversight of the pre-Katrina Federal Emergency Management Agency. The board of directors failed in its oversight of pre-crisis GM. It was up to the overseers in both cases to ensure that the executives they put in charge were savvy about the risks they faced and ready to respond.

Hurricane Katrina and General Motors remind us that we are likely to underpredict the next catastrophe, whether natural or man-made. We need to act now to anticipate such events, instead of just waiting for them to happen. And, above all, we need to remember that low risk is not the same as no risk.

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