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Mastering Strategic Risk

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*A Framework for Leading and
Transforming Organizations*

JOEL E. MCPHEE, JR.

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This book is dedicated to the Past and the Future:

*The Past, in memory of my maternal grandfather,
Arthur Leon Roach Sr., whose tremendous insight and
vision inspires me to this very day*

And

*The Future, in the form of my wonderful
daughters, Kimai and Kiori . . . It's a blessing and an honor
to be the father of two amazing human beings!*

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Preface

If you've picked up this book, it's likely that you're someone who is a lot like the way I was: a senior executive at an organization charged with finding a way to help your group not merely survive but thrive in times of uncertainty. The challenge before us all is daunting. But the great news is that it can be done. And, in essence, nature has already shown us the way for it to happen.

For over 20 years I've been at the forefront of solving the critical challenges facing large, complex organizations. I've led organizations through troubled waters and changing market dynamics and I can help you lead yours through, too. Having held key executive assignments at industry leaders such as Wells Fargo Inc., and providing consulting services to top global brands, I possess an extensive background in understanding the keys to driving peak performance. Through these experiences I realize that more than ever before companies need new tools to manage the requirements and complexities of our new era. As we move steadily toward the future, I've also observed that, as individuals, we struggle to manage the intensity and pace of change we face.

But one of the most important things to realize is this: new challenges bring new opportunities, and markets yet to be culled and discovered. And the transformation of people, resources, and our world now lie within our reach in a way that we may have only dreamed about before.

Mastering Strategic Risk was written with these circumstances in mind. It provides a simple, yet effective solution to these formidable challenges. *Mastering Strategic Risk* offers a perspective that redesigns

organizational systems to manage the risk and complexities of a radically different world. I believe CEOs, executives, leaders, managers, and employees of all types should read this book. So should any other professional or function tied to ensuring optimal corporate performance, including external auditors, consultants, board members, and suppliers of services to companies.

Mastering Strategic Risk is also a book for anyone who desires to understand how our world works and would like to explore new ways of thinking through the opportunities and common pitfalls we face today. My goal is to introduce a fresh perspective, one that provides readers with a new approach. More than just case studies, we will look at how successful companies have navigated challenges and take the wisdom they have learned from these experiences to help you apply it to the challenges you face day-in and day-out. You will be equipped with tangible tools that are relevant and can be applied for immediate results.

I hope you leverage the observations in the book and that these concepts will stimulate new thinking, that these new learnings will enable you to unleash the tremendous resources and promise that lie dormant in your organization. It is also my hope that this fresh new perspective will help you to see the world in a way you've never seen it before. That it will further your understanding of how truly integrated and connected as a world we are and why it is critical to manage holistically in these uncertain times.

I also aim to move beyond the typical methods to deliver a compelling new vision. It is a perspective that will enable you to harness our unique opportunity and time, realizing that we live in a truly special era in our modern world. I hope that, armed with this new information, leaders and managers, with a renewed intent, will move forward to

consciously shape and mold their companies. We live in a world of amazing capabilities; let this new framework help you as you lead your organization in mastering the strategic risks of our new era.

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Last and definitely not least, I'd like to thank my family, who have nurtured and supported me through the years. I would like to first thank my parents: my mother, Dr. Clara McPhee, for being my hero and for providing me with so many important life lessons; and my dad, Mr. Joel McPhee Sr., for teaching me how to live; and to my stepmother, Rosalie McPhee. I'd also like to thank my two wonderful sisters, Cheryl McPhee and Carina McPhee Bridgewater,

for their love and support through the years. A special thank you to my brother-in-law Trevor, Sr., and to my nephew and niece Trevor, Jr., and Lauren. I'd also like to thank Sherryl Guthrie McPhee, for her support throughout the years and efforts in raising and co-parenting two wonderful daughters. A special thanks to my deceased and very dear uncle, Tony Roach, who served as a surrogate dad, big brother, and best friend. His impact on my life is immeasurable as his spirit and energy will always be with me! Thanks to my many aunts and uncles for all of your support. A big thanks to my numerous other family members, those past and present including my ancestors on whose shoulders I stand.

In addition to the individuals who worked directly on the book project are other individuals who have contributed in some way to my professional and personal journey. They include advisors and friends such as Dr. Richard Williams; Roy Hollman; Dr. Leon Higgs; John Waddy, Esq.; Michael Ozier, Esq.; Jordan Miller; and others. Other individuals I'd like to recognize include Jean Davis, David Carroll, Elizabeth Williams, Tom Wurtz and Lisa Brinkley. Thanks also for the support given by many dear friends throughout the years and during the writing of this book.

A special thanks to the close family and friends who have supported me through the years, including those in Nassau and Freeport, Bahamas, and those in Rochester, New York, and Columbus, Ohio.

Introduction

Mastering the Complexities of a New Age

On a cold and silent January morning I jolted awake. Startled, I sat up and peered through my bedroom window. The darkness engulfed everything, save the light dusting of snow blanketing the treetops and frigid ground below. It was still, and the solitude of the early morning hour seemed deafening—so deafening, those moments reverberate ever so loudly to this very day.

What time was it? As I glanced at my phone lying on the nightstand next to the bed, I saw that it was only 3:00 A.M. Though exhausted from a long week, I was wide awake. I'm not certain what woke me up so suddenly, but my mind was racing at a feverish pitch as a clear image came into full view.

Reflecting on what I saw, I stumbled out of bed, sprang to my feet, and rushed to the dining room table. As a deluge of thoughts poured through my head, I began to furiously map a framework of an idea. Unbeknownst to me, what I saw on that fateful January morning would eventually become the very foundation of *Mastering Strategic Risk*.

* * *

In contemplating my epiphany, I wonder: Where did it come from? How did these concepts come to me, and why did they come with such clarity? I never, prior to that day, consciously thought of the concepts, let alone aspired to write a book. Only after several months of prodding from a good friend did I take the agonizing step of putting pen to paper. I've been writing ever since.

What I do realize is that I was in a state of flux. I was one year removed from a rewarding career at a top financial institution, and carefully parsing through career alternatives. I also deeply desired to understand the enormous change occurring not only in my world but in the world around me. During this time the markets were in turmoil as organizations everywhere contended to survive amidst withering circumstances.

It was January 2009, and since the summer of 2007 the entire planet had been experiencing tremendous change. There was the collapse of the real estate markets, a debilitating credit crisis, government bailouts of the auto and banking industries, and a crippling global recession. Accompanying these conditions were a litany of corporate failures, from Washington Mutual to Lehman Brothers, Blockbuster, AIG's near collapse, and WorldCom, to name a few.

I also observed firsthand how Wachovia, a company I had grown to deeply admire, ascended quickly to the top of the banking industry, only to experience an equally rapid decline. The state of the economy, when coupled with our geopolitical tensions and environmental and social conditions, also signaled that we were living in unprecedented times.

In observing this sea of change, a common theme emerged. As a civilization we are challenged in managing our most critical systems, and even more so organizational systems. Whether it is on Wall Street or Chicago, in New Delhi or Shanghai, we contend mightily to manage a corporate agenda held captive to an increasingly complex and dynamic world.

As a result, I wanted to know how we could manage organizations more effectively. And if we couldn't, what would it mean for the future of the markets and our

wonderful planet? Now five years removed from that fateful January morning, we still live amidst significant uncertainty and face formidable challenges as we combat a lingering global recession.

Over the past 20 years we've also witnessed the failure of numerous organizations as they careened out of control due to the breakdown of fundamental management practices. Examples include the story of Enron and how the failure of critical governance mechanisms led to its eventual demise. Or consider how BP's catastrophic *Deep Horizon* spill emanated from its fractious risk management system.

Think of how over the past 12 years banks have failed to learn from the lessons of others, as evidenced by the enormous trading losses they still experience. In 1999 a rogue trader single-handedly took down the United Kingdom's most storied investment bank, amassing close to \$1.4 billion in trading losses. Then, over a decade later, UBS experienced \$2 billion in trading losses due to a rogue trader's activities.

Despite these painful lessons, only two years ago industry darling JPMorgan Chase racked up over \$5 billion and counting in trading losses. It was later discovered that these substantial losses were all due to the bank's failure to activate critical trading controls. To date, the company is still challenged in managing the risks that span its sales and trading activities.

The many examples from our most recent past point to similar yet fundamental challenges facing organizations across industry types. And while we spiral hastily toward the future, we are greatly in need of change.

On the following pages, I will provide you with new information to give you a fresh perspective into the

challenges organizations face in this new century. This insight will arm you with the knowledge required to effectively manage the most critical forces that dictate performance in organizations.

For close to 20 years, I have been a leader in large, complex organizations. During this time I've either led or been a part of key management teams charged with addressing some of the most critical challenges facing these organizations. Whether it is in the area of the global sourcing of resources (offshoring), large-scale operational efficiency efforts, key disaster recovery and business resumption activities, or helping to shape the strategic vision of a company's culture, these unique experiences have provided me with the opportunity to understand the critical drivers that underpin corporate performance.

The fundamental components on which this book is based are concepts that are well understood when considered individually in the context of companies and the key drivers of performance. What makes the approach in *Mastering Strategic Risk* unique is that it extracts patterns and realities in natural systems and applies them to organizational systems. These realities dictate performance in both nature and organizations. They illuminate how the elements and forces in nature are no different than those found in organizations or for that matter the world we've created for ourselves.

The intent of this new approach is to provide readers with a compelling guide. It is a new model that outlines how key activities and functions should come together to provide a holistic governance framework. In addition to introducing a new framework, *Mastering Strategic Risk* underscores how integrated and connected we are, not only in our commercial and social lives, but in the activities and realities that transcend our traditional view of our world.

It is also my hope that you will be inspired by these new learnings, applying them in navigating your organization through the risks and uncertainties of an unforgiving marketplace. Throughout these pages I've also distilled what I've learned and observed through the years to unveil a new framework in which to govern companies. And while there are many lessons to glean from the mistakes of the past, at such a critical time, there is none more important than for us to move forward with a renewed intent, to consciously shape our world into the type of planet we've deeply desired it to be.

Ultimately, I guess I am a teacher at heart; after all, I do come from a family with a rich teaching tradition. It is in this spirit that I share with you *Mastering Strategic Risk*. Whether you are a leader in a large or small organization, manage shared services or customer facing function, or simply desire to understand the key elements and forces that drive performance in organizations, this is the book for you. It is my hope that armed with this new insight you will thrive in these uncertain times.

Chapter 1

The Round World, the Square Pegs: Redesigning Organizations to Manage the Risks of a Different World

The markets are raging! They roar tumultuously toward an uncertain end. Meanwhile, the fates of billions hang in the balance, as we look to the future with fear and trepidation. The truth is that we've created a monster, as a beleaguered and mismanaged corporate agenda continues to wreak havoc on cities, sovereign governments, and communities everywhere. There is no doubt that the turbulence we are experiencing was brought on by our very own miscreations; however, the question remains: How do we move confidently toward the future while ensuring we do not repeat the mistakes of the past?

Righting the Ship: Managing the Complexities of a New Age

While we forge steadily toward a future of unlimited possibilities, at the center of these turbulent yet fascinating times sits the corporation. The commercial corporation has been in existence since the seventeenth century, yet, despite its storied history, still struggles to effectively govern its varied activities. Furthermore, the corporation of the twenty-first century is like none other, for it has become a critical aspect of almost every facet of life on our planet.

It is truly the most powerful and ubiquitous force in an unrelenting, high-stakes global marketplace. Think of the many ways corporations play a pivotal role in our society,

mainstream culture, and economic lives. Think of the role they play in your very own community.

To make matters worse, government has often needed to step in to provide much-needed oversight of corporate activities. There was the savings-and-loan (S&L) crisis of the 1990s, Sarbanes-Oxley, and now recently enacted Dodd-Frank legislation that was put in place on the heels of the 2008 credit meltdown. While often government intervention is necessary in order to protect the system, it is often reactive and done in order to avert a crisis. Although we must be responsive to a national crisis, shouldn't we find it indefensible that we've grown accustomed to addressing systemic issues from a reactive, knee-jerk posture?

As our beloved guardians at the gate work tirelessly to piece together overnight solutions to address systemic issues, is this reactionary posture the right approach? Moreover, the public outcry for swift and decisive action during a crisis often contradicts and outweighs the need to exercise prudence and good judgment. Government has a formidable role in providing oversight of commercial activities; however, we are at a point in this country where the regulatory agenda has become overly burdensome.

During the past few decades, we've experienced a crescendo in the volume and intensity of regulatory oversight. As we move hastily into the twenty-first century we will experience even greater regulatory oversight. From Sarbanes-Oxley to the Basel Accords, from Gramm-Leach-Bliley to Dodd-Frank, the regulatory agenda continues with no end in sight. Think of the tremendous costs these requirements have added to corporate bottom lines.

To make matters worse, these costs are ultimately borne by you and me, the end user and consumer. These efforts,

though well intended, will eventually cause the system to buckle under the intense burden of regulatory adherence.

Consider the world in which we now live and how, during the past decade, we've experienced such significant change. We live in unique and unparalleled times. Think of how just recently the credit markets were in a tailspin, ushering in an unrelenting and debilitating recession. Of how the auto and financial services industries were on life support, and how the saber rattling between nations, tribes, and people even today continues at fever pitch. When we consider the state of the environment, along with deteriorating health and social conditions across the planet, we attempt mightily to manage the risks and complexities of an ever-changing world.

We also sit at the most critical juncture in Earth's history: On one hand lies a future of unparalleled promise; on the other, a world filled with tremendous uncertainty. However, the truth is that we can no longer count on the old ways of managing our most critical systems; we must look to new models by which to govern a new age.

In addition to these formidable challenges, corporations continue to struggle to keep pace with an ever-changing world. As change continues at an unprecedented pace, the marketplace will continue to become even more dynamic and volatile. Coupled with this is how quickly we've moved into a truly global marketplace. As the Internet and technology have removed geographical boundaries and business has become ubiquitous, many corporations now serve and manage a global footprint. This reality is placing additional strain on corporate agendas and resources as the governance of activities has become more complex, integrated, and dispersed.

The time has come for organizations to change. Companies must change the manner in which they govern internal

activities, for the cost is too high for society to bear. Regardless of how ubiquitous and powerful the corporation has become, it has failed to regulate itself. It's time for corporations to take control of their destinies by transforming within. This change must occur from inside their hallowed walls, rather than being mandated from the external forces of government regulation and political influence. Yes, the time has come for stronger self-regulation. It's time to rethink business!

The Untold Story of Wachovia's Demise: The Rise and Fall of an Industry Giant

It was Friday, September 26, 2008, around 11:00 in the evening. It was a clear and cool autumn evening. As I made my way home after entertaining a few out-of-town business guests, my mind began to drift slowly, far away into the distance. I was in a fog! The events of earlier that day created a dark cloud of despair, and a deep sense of anxiety loomed over my head. To make matters worse, a state trooper had just pulled behind me and turned on his lights. After finally realizing what was occurring, I slowly pulled over to the side of the highway and anxiously waited. What could I have possibly done wrong? Why was I being pulled over? The tension and anxiety began to build!

After what seemed like an eternity, I was startled by a pointed tap on the glass. As I rolled down my window, I was greeted by the trooper. With a surprised look on his face, the trooper asked, "Are you okay, sir?" I replied, "Yes, I am." He then asked, "Are you sure?" In a frustrated and irritated tone, I answered, "Yes, I am, I'm sure, why? What did I do?"

“Well, I’ve been following you for a few miles and you have been swerving repeatedly to the right, as if you were about to drive off of the highway. I’m going to have to give you a few field sobriety tests,” the trooper said. I ended up passing the tests; however, what dawned on me that very moment was how emotionally immersed I had become with the events of the day—so much so that I became overrun with an overwhelming sense of apprehension and fear.

It was that fateful day when the proverbial writing had been written on the wall, as the day’s events signaled the coming demise of Wachovia. That Friday was a crazy day, as I had become deluged with myriad phone calls, conversations, and e-mails concerning the fate of Wachovia. These conversations were with former colleagues, employees, and others who were associated with the bank. Many of them still played significant roles at the bank. We were all anxious.

Those of us who were no longer at Wachovia had similar concerns. We all owned company stock and stock options, and were concerned about our pension. Those who remained were concerned about whether they would have to pack up their boxes in the next few days and be required to leave. We were all worried about whether Wachovia would survive through the weekend as conditions regarding the bank’s financial status were rapidly deteriorating.

This was the Friday right on the heels of the federal government’s intervening to save Washington Mutual by seizing it and arranging the sale of most of its operations to JPMorgan Chase. As news of this transaction spread and as the market was in a tailspin due to instability as a result of the credit crisis, questions began to arise about Wachovia’s stability and liquidity. And remember, Lehman Brothers had

just failed a few weeks earlier. On that Friday, Wachovia's stock was in a free fall.

Rumors that day began to emerge regarding a silent run on Wachovia's deposits. We would later discover that these rumors were well founded, as many of Wachovia's commercial customers began to draw down their balances to below the \$100,000 limit that the Federal Deposit Insurance Corporation (FDIC) insured. Approximately \$5 billion in deposits was lost that day. There were also rumors that Wachovia was in the midst of talks with Citigroup and Wells Fargo.

The concerns were so serious that many wondered if Wachovia would make it through the weekend. These concerns prompted FDIC Chair Sheila Bair to declare that Wachovia was "systemically important to the health of the economy and therefore could not be allowed to fail." This was no routine announcement, for it was the first time that the FDIC had made this determination since the 1991 passage of a law that allowed the FDIC to handle large bank failures on very little notice. To confirm the state of emergency concerning Wachovia, on the evening of September 28, Blair called Wachovia's then-CEO, Brian Steele, and informed him that the FDIC would be auctioning off Wachovia's assets.

Eventually, Wachovia would be purchased by Wells Fargo, with most of its banking operations intact. Although Wachovia technically survived through Wells Fargo's purchase, its overnight failure evidenced one of the most significant events in banking history.

A Legacy to Be Proud Of

"Come to the mountain called First Union, or if you prefer, the mountain will come to you"! These were the words that bellowed from a deep and enchanting voice in First Union's

newly released commercial. The commercial was especially created to position the bank's powerful new brand. It was a branding approach that would serve as a key plank of First Union's strategy to becoming a national player.

CEO Ed Crutchfield desired to quickly build his branch banking network into a power national franchise. And it was his carefully positioned branding effort, coupled with an aggressive acquisition spree, that would serve as the launching pad in its new chapter.

It was the fall of 1998, and I first saw the commercial as a new recruit during the first hour of my orientation into the Finance division. The leaders managing the orientation were proud of the new ad and, more important, First Union's new strategic direction. The entire company was excited, as it was on the heels of two significant acquisitions, both signaling that the best was yet to come. You could feel the energy in the air while interacting with employees in different pockets of the organization. There was no doubt our future was bright!

Three years later First Union would purchase Wachovia, and the once fledgling interstate banking operation would blossom into a financial services powerhouse!

At its height, Wachovia was one of the largest financial services institutions in the United States, amassing a banking empire that stretched from New York to California. Its banking franchise extended to every major market from Miami to New York and continued throughout the Midwest, South, and all the way to the Pacific Coast. In addition to its extensive network of branch banking operations, Wachovia was well positioned in each major market it served.

Its banking footprint served coveted metropolitan markets such as Philadelphia; Washington, D.C.; New York; New Jersey; Atlanta; and South Florida, to name a few. Wachovia