

GREY PAPER

insights



Why all organizations need to search for Blind Spots.
Risk control entropy and how to combat it.



Pilko & Associates Grey Paper

Information and insight at your fingertips. Simple, yet profound steps you can take right now to increase or grow your control of operational, EHS, and transactional value risk. Pilko brings you what you need to succeed.

Pilko & Associates is the industry leading operational and environmental, health, and safety risk advisory firm—working with clients in 59 countries and advising on M&A deals worth more than \$600 billion.

Concise summaries of key operational/EHS and transaction risk challenges and how to increase control of risk for your project, assets and enterprise.



US +1 713 357 1000

pilko.com
700 Louisiana St. | Suite 4500 | Houston, TX 77002
info@pilko.com

BACKGROUND

In discussions with corporate boards and CEOs, we often encounter the bold statement that absolutely no Blind Spots could ever develop in their organization with respect to operational safety and risk control.

Ironically, this belief is often most strongly held within companies that have built very strong operational and EHS systems and standards and are known across the industry for their rigorous processes. Unfortunately, these very companies have since experienced catastrophic events.

This Grey Paper discusses the operational and organizational factors that, if unchecked, can inevitably lead to Blind Spots and failure points. Such hidden risk control fault lines often become the root causes leading to significant failures and incidents.

A key principle of effective risk control is the continuous search and correction of systemic Blind Spots to reduce or eliminate the next catastrophe.

THE REALITY OF RISK CONTROL “ENTROPY”

Operational risk experts observe that systems and standards built to control operational risk in complex facilities and organizations suffer in effectiveness right from the start and further disintegrate over time.

A large part of process decay is due to organizations inevitably acquiring Blind Spots that contribute to overlooking or ignoring danger signals when they occur. This lapse occurs because other systems and priorities divert attention and focus from critical safety systems, inducing disorder and distraction into protective procedures and standards.

Even with strong systems, companies struggle to counter a degree of “complacency creep” in mindset. This disorder or “entropy” affects risk control efforts designed to protect the enterprise.

CONTRIBUTING FACTORS

Many factors directly affect risk control entropy. Below are common and avoidable “entropic” factors often experienced by energy and chemical organizations:

- **Director information bias.** Directors of energy and chemical companies have acquired a healthy level of concern and vigilance for operational risk. This cognizance has led to periodic measurement and discussion and the creation of independent EHS committees. Communications at such a high level can be politically charged affairs—leading to a tendency for operational leaders to “smooth” presentations for board consumption. An unintended consequence is the creation of positive bias regarding the strength and effectiveness of risk processes and standards leading to a (sometimes inaccurate) belief that all is well and that operational risks are controlled and acceptably small. Information bias leads to overconfidence, diminishing board vigilance pertaining to operational risk factors, and creates Blind Spots at the very top of the organization.
- **Routine, rote audits.** Internal EHS audits provide an organization’s operational key performance metrics in control of operational risk. Plant manager careers are influenced by periodic audit performance. Over time, audit protocols designed to detect faults become stale, leading operational units to provide “check the box” documents—indicating compliance and readiness that may not actually be grounded in reality. Similarly, a dogmatic requirement to close audit findings sometimes results in focusing plant teams on lower-yield activities. As a result, plants are in danger of “missing the ball” on effective and efficient risk control efforts.
- **Budget-driven backlogs.** Process safety management backlogs commonly grow due

to budget restrictions, because operational budgets are, by nature, a zero-sum game. Process safety efforts often compete with efficiency, capacity and quality objectives leading to tough choices in lean budget cycles. The result can be the reduction or elimination of process safety risk control capital projects in favor of competing initiatives, which then leads to delay in process safety improvements. The result is an increase in risk control failure probabilities. Process safety management backlog statistics aren't often visible, frequently creating organizational Blind Spots.

- **Misallocated capital.** Risk management/control dollars often get reallocated to priority programs outside the enterprise risk management allocation processes. Even funds intentionally earmarked for risk control improvement get moved to projects that are not truly critical, but are diverted for reasons of capacity, streamlining and productivity. Alternatively, risk control capital is sometimes consumed through "sprinkling" capital across operational units, ironically without considering risk need and priority. Risk control capital must be spent on an enterprise-wide priority basis to grow real, sustainable risk control and eliminate Blind Spots.
- **Leadership readiness.** Operational organizations always have some leaders who are new to positions as critical experience "ages out" of the organization. In the rush to fill critical positions, preparation is key. A learning "ramp-up" period is required to fully understand critical risk control elements within the position and responsibility. During this period, new decision-makers present a greater risk of making critical errors that could result in an incident.

Assuming new leaders recognize operational risk as effectively as their experienced predecessors is a serious Blind Spot. For example, industry

research by Pilko & Associates revealed that the chance of a major safety incident occurring at a plant with new leadership is a near certainty within the ensuing 24 months.

- **Improper or inadequate training.** Critical training for key operational jobs becomes less effective over time. The rise of computer aided training has greatly increased the ability of an organization to deliver high-volume training with a smaller staff requirement. Unfortunately, the results sometimes fall short; computer-aided training often provides the information, but not the knowledge required, and "certifies" operators who actually are ill-equipped to adequately control the risk and eliminate Blind Spots.
- **"Soft" risk growth.** Soft risks increase gradually over time because indicator metrics are difficult to determine and track; especially as compared to "hard" metrics such as engineering data. Leading board members and executives know that leadership soft risks (i.e., capability, competency and culture) are critical for proper and comprehensive risk control. Most organizations, though, lack the means to effectively measure soft risks leading to lower risk control. Soft risk "drift" grows Blind Spots and risk control entropy.

A WAY FORWARD

Maintenance experts will tell you that "rust never sleeps," which is an apt characterization of entropy in risk control capabilities, even within outstanding top decile organizations.

Continuous decay in capability accumulates, providing hard-to-detect declines in risk control and inevitable Blind Spots. This "slow boil" lulls organizations into thinking that all is well – up to the catastrophic event that proves otherwise.

grey paper

pilko

These facts point to the need for a comprehensive approach to risk control, one that protects business assets, balance sheets and reputation made up of four key elements:

- **Commitment.** For risk control to take root and become a key, fully integrated component of the organizational culture, board and corporate officer leaders must start with demonstrated commitment.
- **Comprehensive, independent assessment.** Full spectrum risk control assessments that span the full organizational structure can detect and define risk control shortfalls.
- **Tools.** Companies must implement rigorous, proven hard and soft risk control tools to identify and prioritize hard and soft risk elements in a scalar method that measures and achieves real, quantifiable risk control progress.
- **Continuous improvement processes.** The utilization of thorough, organization-wide risk control improvement processes that detects, prioritizes and addresses known and previously undetected risk areas help to prevent further recurrence.

NEXT STEPS

Blind Spots are the enemy of risk control improvement that delivers real value. Elimination of Blind Spots is not an option for any organization—no matter how good the organization may be at managing risk.

ABOUT PILKO & ASSOCIATES

Pilko & Associates provides industry-focused advisory services in three core areas –Transactions, Operational Excellence and Governance & Assurance –to enhance value for our clients and their stakeholders in the chemical and energy sectors. We deliver innovative solutions for publicly and privately-held companies, helping them to identify, understand and manage their Operational Risk and Environmental, Health & Safety needs. For more information, visit www.pilko.com.

Pilko & Associates' clients consistently and successfully root out and eliminate risk control Blind Spots in operations and EHS through Pilko-led:

- Independent third-party perspectives that eliminate built-in organizational bias and truth avoidance;
- Risk control tools (Pilko 8IGHT DRIVERS®) that create transparency, accountability and clear, easy to understand risk control progress measurement;
- Integration of industry-proven best practices;
- Risk control culture creation – from the board to the plant; and
- Tangible value creation through improved operations, EHS, balance sheets and reputation.

Pilko & Associates is the single, best pathway to achieving rapid, dramatic and sustainable risk control through the creation of a comprehensive risk control culture and elimination of natural risk control entropy that occurs within complex systems.

If you think your risk control efforts are "good enough," you're most likely wrong. Ask yourself the following:

- Are you sure you're controlling risk sufficient to accelerate business advantage and protect profitability and reputation?
- How do you know?

With Pilko & Associates, you can answer these questions and confidently increase control of operational and EHS risk. Stop risk control entropy in its tracks, right now.

Grey Paper Author:
Rick Monty, Senior Advisor, Pilko & Associates



US +1 713 357 1000

pilko.com
700 Louisiana St. | Suite 4500 | Houston, TX 77002
info@pilko.com