Can Financial Regulation Make You Too Risk-Averse About People?
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The growing fear of risk can lead to human capital mistakes, but you can take a systematic approach to managing your human capital risk

Evidence suggests that investors, leaders and others may become excessively fearful of risk. That creates dangers and opportunities when it comes to human capital, and "retooling" human capital risk with principles from finance and other management disciplines can help leaders stay balanced.

Financial crises may be an inevitable product of capitalism due to the mismatch between the term of assets banks hold (long-term loans) and their liabilities (short-term deposits). Financial crises disrupt the usual positive relationship between risk and return, because of a "flight to safety." Some predict that the most recent financial crisis, followed by a long period of painful recovery and broad exposure to the trauma of unemployment may create a generation of overly risk-averse investors.

A joke on Wall Street is that the recently passed Dodd-Frank law to regulate U.S. banks will require "psychiatrists" to peer into the intentions of traders, warning that "the only foolproof protection is inactivity." Attempts to regulate risk may have the effect of stifling opportunity seeking.

If excessive fear of risk can make financial decisions overly conservative, it is an even greater danger when it comes to human capital. The most tangible effects of people decisions are costs and compliance with (or violation of) legal requirements. The potentially much greater effects on future performance, culture and innovation are more distant and less tangible. Wayne Cascio and I have noted that risk aversion is the dominant perspective for managing human capital risk today, and may become even more pervasive if risk aversion in finance increases. I have written about how making risk a "four-letter word" can cause leaders to attempt to remove all risk from human capital decisions, and how PNC Bank applied actuarial principles to its incentive systems to achieve greater balance.

Actuarial risk frameworks are just one of many systems that take a balanced approach to risk, and can be applied to human capital. How can you insure a more balanced perspective to human capital risk? Try applying your best management models to human capital decisions. The table below describes typical human capital decisions that are framed as risk-prevention, and shows how frameworks from other management arenas can "retool" the HR decisions for a more balanced approach.

Retooling Human Capital Risk Using Management Frameworks		
Traditional HR Risk Framing	**Management Framework Applied to HR**	**Retooled Approach to HR Risk**
"Minimize the risk of talent being unprepared for the future by developing generic competencies that will apply across the board."	Portfolio analysis balances the risks of several uncertain future scenarios against their returns, combining resource investments that fit several future possibilities.	"Balance risk in talent planning, by investing in talent for several future scenarios according to their relative likelihood and risk."
"Top performers in every position, to minimize the risk of bad performance"	Performance- tolerance analysis optimizes performance improvement against risks, costs, and benefits.	"Minimize risk in risk-averse performance situations, embrace it in risk-loving performance situations, by focusing on return on improved performance (ROIP)"
"Minimize the risk of employee dissatisfaction by agreeing to customized deals, or minimize the risk of inequity by doing the same thing	Customer segmentation optimizes product and service features to customize against market segments, according to their value and cost.	"Balance the risk of dissatisfaction or inequity against the return by customizing where it achieves the greatest return and standardizing where it does not."

"Minimize the risk of employee shortages by filling all requisitions as quickly as possible and keeping turnover to a minimum."	Inventory management optimizes holding costs, ordering costs, and shortage costs by planning for shortages or surpluses.	"Turnover levels and time-to-fill are optimized to create the level of employee shortages or surpluses that best balances risks of surpluses and shortages against costs.
"Minimize risk by having successors for every position, who have all completed the career-development path requirements"	Logistics management optimizes transport patterns to balance the risk of unavailability against the costs and returns to following various pathways.	"Optimize the risk and return to succession by balancing the costs, benefits and timing of different career paths."

As your world becomes increasingly risk fearing, you'll be under pressure to manage your human capital to protect you if something going wrong. Prudent risk optimization requires balancing that by asking, "what if something goes right?"

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