Risk management

This guide seeks to provide a brief overview of the risk management process for small and medium sized businesses.

Every business faces risks, arguably more so in these challenging economic times, but this in itself is not a problem. The problem arises when a business is unaware of those risks or unready for their consequences.

Risk management is a process that enables you to identify risks, prioritise them, and put appropriate measures in place.

This is particularly important when trading conditions change or the economic climate becomes uncertain. It is also important when engaging in a new venture such as launching a new product, investing in capital projects, upgrading a system, starting a joint venture or entering into a merger or acquisition.

The extent to which a business has a risk management process in place is becoming an increasing concern for insurers, lenders, investors, and other stakeholders – including customers and suppliers.

sanders geeson
Chartered Accountants

Sanders Geeson | 01924 254 802
jan@sandersgeeson.co.uk | www.sandersgeeson.co.uk
Raines Business Centre Raines House Denby Dale Road Wakefield WF1 1HR

BENEFITS

Introducing a formal risk management process will improve your overall credibility, increase the likelihood of your meeting your goals, and help protect the reputation of your business.

It will also make your business more efficient by helping you:

- Focus more of your energies on core activities by cutting out needless fire fighting
- Allocate resources more efficiently
- Improve decision-making and prioritising
- Produce more accurate plans, forecasts, and budgets

A further, potentially significant, benefit is that it can help you negotiate lower insurance premiums.

THE RISK MANAGEMENT PROCESS

The risk management process consists of four main steps:

1. Identifying potential risks in your business activities
2. Ranking them according to their likelihood and potential impact
3. Determining appropriate risk management measures
4. Implementing risk management procedures and monitoring their effectiveness

IDENTIFYING RISKS

As evidenced by the number of business failures in recent months, financial risks are a major threat to businesses of all size. In assessing financial risks you need to look at the your financial dealings with lenders, customers and suppliers, and especially at your cashflow situation. Include in this assessment any external factors that might have a bearing such as interest rates and exchange rates. You will also need to look at your financial structure and the financial systems you have in place.

Besides financial risks, businesses face many risks associated with their day-to-day operations, and areas that need to be examined here include among others:

1. IT systems
2. Financial controls
3. Employees
4. Supply chain reliability

More broadly, there are also strategic risks associated with the industry you operate in, which would include changes in market conditions, competitor activity, changes in consumer behaviour, industry changes, and mergers and acquisitions.

There are also risks arising from compliance issues, such as the possibility of new legislation being introduced, and of course risks associated with external factors such as the environment, industrial relations, political change etc.

The more methodical you are in identifying these various types of risk, the more effective your risk management process is likely to be.

Obviously some of these areas are potentially vast. Conducting a risk assessment of IT systems, for example, would merit a document all to itself. The point of this brief guide is just to map out the process of risk management. When it comes to the actual task, we would be more than happy to help and advise.

RANKING AND PRIORITISING RISKS

Risks can be ranked according to the likelihood of their occurring and their potential impact on the business. This can be done using a risk map, a matrix with likelihood charted on one axis and impact on the other. This will enable you to prioritise the risks, with those clustered in the high-impact/high-likelihood corner being the most in need of attention. Again we would be happy to help with this process.

DETERMINING APPROPRIATE RISK MANAGEMENT MEASURES

Having identified and ranked the risks facing your business, the task now is to decide what action to take. There is no generic solution and each risk needs to be assessed separately. Basically there are four things you can do about a risk:

- Accept it
- Transfer it
- Manage it
- Eliminate it

These are sometimes known as the 'Four Ts' – tolerate, transfer, treat, terminate. See panel.

THE FOUR Ts OF RISK MANAGEMENT

Generally there are four ways to deal with a risk:

Tolerate	accept the risk
Transfer	usually with insurance
Treat	introduce procedures for reducing the risk
Terminate	eliminate the risk altogether

ACCEPTING RISKS

Accepting risks is not as unusual as it might sound. When you think about it, almost all business involves risk of some kind or other, if only because most business ventures involve planning ahead and venturing into the unknown. That after all is what enterprise is all about. Indeed operating in certain sectors necessarily requires an acceptance of a certain level of risk. Moreover, taking a risk on something might be at the heart of a particular business strategy.

Each business needs to determine its own 'appetite for risk'. The important thing about accepting risks is that those risks are identified and wherever possible calculated so that you enter into the venture with eyes wide open. In short, a business must understand its own risk culture, determine its particular appetite for risk, and ensure that this is understood and accepted by its principal stakeholders.

TRANSFERRING RISKS

The most obvious way to transfer a risk is, of course, through insurance. Care must be taken in choosing the right types of insurance for your business and the amount of cover to take out. There are dangers in being under insured, but equally, being over insured can be detrimental to a business' profitability. Again, this in itself is a vast area and is the subject of a separate guide.

MANAGING RISKS

This generally means taking steps wherever possible to reduce or mitigate risks. Typical examples would be keeping a reserve to protect against future cashflow problems or having an alternative supplier lined up should your present one fail.

ELIMINATING RISKS

You might decide that a particular risk is not worth taking, in which case you need to change your plans so that you can avoid it altogether by, for example, changing a particular procedure, not proceeding with a particular product launch, or not entering into a particular joint venture at this time.

IMPLEMENTING AND MONITORING RISK MANAGEMENT PROCEDURES

Risk management is not a one-off exercise but an ongoing process. Because new risks are emerging all the time while existing risks change in both likelihood and potential impact, risk assessment must be conducted on a regular basis; and it is important to establish clear procedures for this with clear lines of responsibility.

Furthermore, risk management procedures that you put in place should be continuously monitored and evaluated, and appropriate adjustments made where necessary.

Risk management is very much a process of learning from experience.

BUSINESS CONTINUITY

Above all else, every business should have a business continuity plan that maps out an escalation of steps you would take in the event of a major emergency, whether internal or external in origin.

WHAT NEXT?

We hope this brief guide has helped to make you aware of the importance of risk management and how your business will benefit from it.

If you would like to introduce or improve risk management in your business or would like to find out more about this subject, why not give us a call and arrange a meeting?