Risk Management

by Sophia

WHAT'S COVERED

What's the riskiest thing that you've ever done? Was it to jump out of an airplane? Or perhaps taunt a neighbor's dog? When you did this risky thing, did you do anything to lessen the risk a bit or mitigate it in some way? This tutorial will provide an overview of risk management. Our discussion breaks down as follows:

1. Risk Management

Risk management is classifying and evaluating potential hazards for an organization and developing a systematic response, or non-response, to avert or lower the damage. Risk management is something that both large and small companies have to consider. You can't go into risk without evaluating it and having some type of risk management plan in place.

There are basically two types of risk:

- **Speculative risk**: A type of risk that can create a loss or gain in the situation. You may not always be sure about the magnitude of that loss or gain, such as designing a new product, for instance, or investing in a stock. There is risk involved with either of those actions, and it could go either way. You can have a gain or a loss, but you won't always be sure of what the magnitude, or that amount of gain or loss, is going to be.
- **Pure risk**: A type of risk that creates only a loss or no loss situation. You either survive and do well, or you have a complete loss. Think of a hurricane hitting a house or destroying a building. This is a risk that is completely beyond the risk taker's control; it exists outside of their ability to speculate on it or control it in some way.

TERMS TO KNOW

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2. Five Steps in Risk Management

The five steps to risk management are:

STEP BY STEP

Step 1: Identify risks and potential losses.
What can go wrong? Are your suppliers being paid on time? Are your employees happy at their job? Are the key business activities secure? All of these things are important for any business, small or large, to look at and analyze.

Step 2: Measure the frequency, severity, and impact of losses.
What is the likelihood of the risk occurring, and if so, what is the impact? Do you pay your suppliers late all of the time? What would be the potential impact of this to your business? It is very important to analyze this because it can impact your business for years to come.

Step 3: Consider the organizational alternative solutions that you have to deal with the risk.
What are the choices you can make, as an organization, to deal with these types of risks? There are basically four different choices that you can use:

Responses to Risk	Description
Risk avoidance	Where you are avoiding, or stopping, risky practices altogether.
Risk control	Where you're attempting to minimize the frequency of those risk practices. This involves not taking as many risks going forward as you did beforehand.
Risk retention	Where you cannot avoid the risks. You'll want to make sure that the costs of those risks are assumed. For instance, if people aren't paying their credit card on time or at all, you look at that risk and make sure you're accounting for it.
Risk transfer	Where you're transferring large risks to another firm. For instance, having insurance would be transferring that risk to someone else. If you suffer a loss, then the insurance company will be the one who pays for that loss.

Step 4: Implement a risk management program.
What are the needed resources? What do you need to do to get the necessary approval? After you've identified the risks, measured how severe they are, and considered the choices that you can take as an organization to deal with them, you need to have a good, solid risk management plan in place. This is an organization's plan to mitigate and deal with potential risk, both internal to the organization and risk that happens outside the organization that you may or may not have control over.

Step 5: Monitor and evaluate the risk management plan.
Is your plan working? Are changes or updates required for the organization? Make sure that the risk management plan is doing everything that you want and need it to do. This is absolutely essential to ensure that new risks are being considered and that the organization is reassessing the risks that you already know about, in light of the new risks.

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SUMMARY

Today we learned about **risk management**—what it is and how it is absolutely critical for companies large and small. We learned about the **five steps in risk management**: identifying risks and losses; measuring how often they occur and their severity; considering the choices that we can make, like risk avoidance, risk control, risk retention, and risk transfer; implementing a risk management plan; and finally, monitoring it to make sure that it's doing exactly what we need it to do.

Good luck!

Source: adapted from sophia instructor james howard

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