BIZCHANGERS

RiskBlog: Designing a Risk Management Process

Risk Management is not rocket science. It is possible to design an effective risk management process for any business by simply following a few very simple principles. This article will explain these principles and help you to understand the key elements of a good risk management process. If you are interested in this subject and would like to find out more, please take a look at my book "Value Trai Based Risk Management" published by Bizchangers Media.

The 10 key components of an effective risk management process are:

1. Clarity about what the risk 'subject' is
2. Comprehensive risk identification
3. Prioritisation to focus on more important risks
4. Understanding what causes the risks
5. Understanding the risk consequences
6. Designing actions to manage risk causes and consequences
7. Documenting risks, actions, owners and timelines
8. Monitoring the actions to ensure they are completed
9. Intervening when actions are inadequate
10. Repeating and updating the process regularly

These elements make up the **risk management cycle**. Let us consider each of these 10 points in more detail.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in England and Wales under the number 06767815

Copyright © 2012 Chris Duggleby

Website: www.bizchangers.com
E-mail: info@bizchangers.com

BIZCHANGERS

1. Clarity About What the Risk 'Subject' Is

The risk identification process is likely to be confused if you do not start with a clear definition of the thing that you are evaluating the risks for. This 'thing' is refered to as the risk subject. Defining a risk subject is not a complex process as long as you follow some simple guidelines.

A good risk management process needs to be able to accommodate many kinds of risk subject. Typical examples of subjects might be:

- A sales departmant
- A manufacturing process
- Somebody's job
- A change in a process, a job, or the location of part of a business
- A construction project
- The whole company

To be able to define such a wide range of risk subjects a simple standardised framework has been devised. This framework is refered to as the value TRAI (pronounced like value 'Tray': it can be thought of as a tray to capture all the important items which contribute to business value).

A value TRAI simply defines any part of a business using a small number of key:

- Targets
- Resources
- Activities, and
- Interactions

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

BIZCHANGERS

The initial letters of these four categories spell the word TRAI. They are used to define or characterise the risk subject. Once this has been done the same value TRAI elements are used to provide structure to the risk identification process.

What are the items which go into these four value TRAI categories?

- T= The Targets or goals the business area is expected to deliver
- R= The Resources it needs to it to deliver these targets
- A = The Activities used to convert resources into targets
- I = The Interactions with stakeholders needed for the activities

You can find a lot more detail about value TRAI's in my book (the title 'Value TRAI Based Risk Management' probably gives the game away!). Typically a value TRAI will have between 10 to 15 value 'elements' in each of the four T-R-A-I categories. For example:

- Under targets you might include the profit you expect to make this year.
- Under resources you could include the equipment and raw materials needed for the business
- Under activities you would describe the process you use, for example this could be a manufacturing or a service process
- Under interfaces you would list the key people or organisations you deal with as part of the business and describe how you interact with them (in other words: what do you need from them, what do they need from you, and how are these needs satisfied?)

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

BIZCHANGERS

2. Comprehensive risk identification

Once you have clearly defined the scope (value TRAI) of your risk subject it is much easier to develop a process to ensure you only identify risks which specifically apply to that subject. Usually this is done using some variant of the classical brain storming session.

However, one of the problems with using brain storming sessions for risk identification is that risks can be identified which may not have much to do with the business area you are really interested in. This is because, by their very nature, brainstorming sessions tend to be very unstructured.

By using the value TRAI to structure a risk identification workshop it is possible to introduce a more focused approach while at the same time being able to identify as many risks as possible which are relevant to the subject. In order to do this you simply use the individual elements identified in your value TRAI as prompts for the identification or risks in the workshop.

The objective of this workshop is to identify as many relevant risks as possible. Therefore in addition to using the value TRAI to provide a framework you need to select your workshop particants carefully. This selection process will depend on the nature and complexity of the risk subject but there are some basic guidelines you can follow.

It is important to try and introduce some 'not invented here' thinking into the process, so in addition to having participants who are directly involved in the business area you should try to involve one or two people with a more independent view. If the risk subject is part of a larger organisation these could be 'guests' from other parts of the organisation. Sometimes the guests may even be trully external

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

participants like an independant accountant, a bank representative or a company 'friend'.

If the risk area requires some special expertise try to ensure people with this expertise are included in the risk identification team. These could, for example, be legal or tax experts.

Ideally a risk identification workshop should contain 6-8 people. It identifies as many risks as possible for each of the Targets, Resources, Activities and Interactions defined in the risk subject's value TRAI. At this stage try to identify as many risks as possible: the only requirement is that the risks should have the potential to influence the value, safety, security or reputation of the risk subject.

3. Prioritisation to focus on more important risks

A good risk identification workshop will identify a large number of potential risks, both threats and opportunities. To be efficient we need to find a way to reduce this number so the process can concentrate on the more important risk exposures. This is done by making an estimate of the likelihood of the risk occurring and then multiplying this by the risk's influence on the value of the business.

It is important here not to get too bogged down with an overly detailed scientific analysis of the probability and value impact of a business risk. This process is, by its nature, very subjective. The important thing is that the estimate is made by someone who understands the risk and how it could affect the business. This process is often undertaken at the same time as the risk identification workshop described above. The 'experts' who identified the risk should have a pretty good idea about the likelihood of it occurring and the impact it will have on business value.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

Clearly this analysis will differ depending upon whether you are evaluating a threat or an opportunity. Threats have the potential to destroy value and so their value influence is negative. Opportunities have the potential to create additional value, so their influence is positive.

The probability should be based on a reasonable estimate of likelihood. If a risk is almost certain to occur its probability will be 1. The less likely the occurrence of the risk the closer its probability gets to zero. It is useful to list the risks in a simple table and place the probability and value in separate columns. The fourth column then simply contains the result of multiplying the probability by the value. This is an estimate of the risks 'importance' to the business. In my book I describe this process in more detail.

Risk prioritization uses the results in the importance column. Typically only about a third to a half of the risks from a thorough risk identification workshop will have significant value potential. It is these risks which should be subjected to a more thorough evaluation process.

The risk prioritization process will always require a degree of subjective judgment. For example, it is advisable for a business to take all risks to safety seriously and evaluate them thoroughly even if on the surface they appear to have a low 'financial' impact. In addition it is important to pay special attention to risks with a low probability of occurrence but which could be catastrophic for the business when they do happen.

4. Understanding what causes the risks

After identifying which risks are more important to the business the next step in risk management involves trying to understand what the causes of these risks are. If we understand what causes a threat we

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

may be able to stop it occurring. Similarly, if we understand what causes an opportunity we may be able to take actions which encourage it to occur.

Consider, for example, the threat of employees striking because their salary is not competitive. There are many potential causes of this threat. For example: perhaps the salary actually is too low, or the information your employees get about competitors' salaries is wrong. If management wants to control the occurrence of this risk it can take action against one, or both of these causes. It could bring the salaries more in line with the market and provide employees with reliable benchmarking information about competitors' salary levels.

Clearly the causes of some threats cannot be controlled by management. Consider the threat of an unusually powerful storm or a major epidemic or a pandemic which makes a large proportion of the work force ill.

Using the simple risk table described above add a new column and write down the causes of the threats and opportunities. Sometimes there may be more than one cause: for most types of risk it is normally sufficient to only consider the top three causes.

5. Understanding the risk consequences

Next you need to identify the consequences that important risks could have on your business. Once again the emphasis will be different depending on whether you are dealing with a threat or an opportunity. Threats generally destroy business value whereas opportunities create value. Identify either how the threat can exert its negative effect or how the opportunity can have a positive influence on the value of the business.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

For both categories of risk try not to simply identify a single influence or impact. What are the indirect or less obvious ways the threat or opportunity could potentially influence business value? Consider the long as well as the short term effects.

For example a strike could have a short term effect in that it disrupts production or stops goods entering or leaving the premises. This will reduce short term profit. A strike may also impact long term value because it could have a damaging effect on employee morale, customers may consider your company to be an unreliable supplier, and shareholders may consider management to be out of touch with the workforce.

Try to identify up-to three consequences of each risk and add them to another column on the risk table. Some risks may have multiple serious consequences. In such cases it may be appropriate to consider more than three.

6. Designing actions to manage risk causes and consequences

We can now turn the risk table into a powerful risk management tool. Add a further two columns, one for the management of risk causes and a second for the management of risk consequences. The objective of the risk management action will depend on whether you are dealing with a threat or an opportunity.

Let's start with the column for managing risk causes. If the cause of the risk can be controlled write a risk management action in this column to control the risk. Write who will carry out this action and when. If the cause of the risk cannot be controlled simply write cause uncontrollable in this column.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

Now let's consider the column for managing risk consequences. If the risk is a threat identify actions which minimize the negative impact from its consequences. If in the previous column you were able to identify a way to stop the threat occurring with 100% certainty there is no need to worry about managing its consequences (but be sure the certainty is 100%). For all other threats actions to mitigate (in other words to reduce or neutralize) the negative impact of the risk should be designed.

If the risk is an opportunity you want to maximize the value your business can get from it. This applies regardless of whether you can encourage the likelihood of the opportunity occurring or not. Once it occurs you want to be ready to do everything possible to maximize the value you get from it.

As with the causes you should identify a person who will carry out each action to manage the risk consequences and a date by which the action should be completed.

7. Documenting risks, actions, owners and timelines

After starting with a simple list of risks we now have a table which for each important risk describes its causes and consequences and captures the actions proposed to manage these. These actions should have 'owners' to ensure they are carried out and a delivery deadline. This can be referred to as a risk register and should become a living document.

When actions are completed this should also be noted on the risk register. If there are problems completing the actions in full by the required delivery date this should be explained in the register and either a delay in the delivery time or a modification to the action agreed.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

To be effective the risk register requires a governance process. If changes to risk management actions are required there needs to be an approval from somebody with sufficient authority and oversight and who understands the consequences of delaying or altering the action.

8. Monitoring the actions to ensure they are completed

The risk management governance process should include a mechanism to regularly monitor the progress of completing risk management actions to ensure they are not overlooked. A common failing in risk management is that there is a lot of enthusiasm early in the process and detailed lists of risks and actions are prepared which are then placed into a drawer and forgotten.

Therefore the management team responsible for the business should have regular meetings to review risk management progress. This is the risk governance body. One way of organizing this is to have a fixed agenda item in regular (either monthly or quarterly) management meetings in which a list is presented of any actions which have not been completed on time. These risks should be discussed in the meeting and kept on the agenda until they have been delivered or the management team has agreed an alternative course of action to manage the risk or accept the business exposure to the risk.

Exposure acceptance sometimes occurs when the effort required to manage a risk exceeds, or is similar to, the value potentially affected once it occurs.

Therefore with a threat, it may be possible to prevent it but a disproportionate amount of effort is required to guarantee this. With

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

an opportunity the effort to make it happen may actually greater than the value created by the opportunity.

Discussing the risks in a management meeting provides an opportunity for input from those who may be independent from the activities involved with the risk management action. This helps to prevent actions simply being left undone out of convenience. If the risk is important, so is the action to deal with it.

9. Intervening when actions are inadequate

Sometimes despite activity to manage a risk the exposure to the business remains. Perhaps the risk management action has simply been ineffective or perhaps the nature of the risk has changed from that originally identified. In addition it is possible that by attempting to manage the risk it more understanding has been gained of its exact nature and the most appropriate course of action to deal with it.

These issues usually require some kind of additional intervention. Perhaps the risk management action needs to be modified to make it more effective. Alternatively the true cause of a risk may be identified and it is now realized that it is impossible to prevent the risk from occurring. In such a situation the risk management action may need to change and focus more on mitigating the effects of the risk once it occurs.

The risk governance body should also be responsible for deciding when interventions are necessary and then agree on their nature. The details of the interventions should be added to the risk register under the original action for the risk and then their delivery should be tracked in

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

BIZCHANGERS

the same way that a risk management action is monitored. Each intervention should have an owner and a delivery timetable.

10. Repeating and updating the process regularly

The risk identification activity described above should not be a one off process. The exposure a business has to its risk environment will change with time. Some risks may disappear and others may arise. Risks may also change in their nature or composition. Therefore the risk identification process needs to be repeated or 'refreshed' at regular intervals. These intervals will depend upon the size and complexity of the business and its risk environment but at a minimum the risk refresh process should occur annually.

Rather than starting again from scratch the risk refresh process can take the original set of risks and determine whether they have changed and if so how. Once again it is important to introduce some 'not invented here' input into the risk identification process. There is a danger that if the risks are only reviewed by those who have been managing them they may be blind to other kinds of exposure and opportunities that a more independent person may see. Therefore it is a good idea to include someone in the risk refresh process who is not directly involved in the business area under review.

This process should be used to refresh the risk register and where risks have been changed or added their causes and consequenses should be identified to determine the most appropriate risk management actions.

At this point the risk management life cycle starts again.

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in England and Wales under the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com

BIZCHANGERS

It is not possible, in a relatively short article to describe in detail how to manage business risks but hopefully this information will provide some basics to help you understand what is needed. If you would like to find our more about risk management and how to use the value TRAI to break down business subjects and identify their risks please take a look at my book 'Value TRAI Based Risk Management' which can be obtained from www.bizchangers.com.

Chris Duggleby

©2012 Chris Duggleby

Hopefully this will be enough to help you get started with the design of a risk management processes. If you can think of any improvements or have any recommendations please let us know via the www.bizchangers.com or the www.ChrisDuggleby.com websites. The www.RiskTuition.com site also has more information on the risk identification and management processes mentioned here as does the book 'Value TRAI Based Risk Management' by Chris Duggleby (Publisher: Bizchangers Media).

BIZCHANGERS Ltd
9, Ashton Court,
Woking, Surrey
GU21 6AL
England

A company registered in
England and Wales under
the number 06767815

Copyright © 2012 Chris Duggleby
Website: www.bizchangers.com
E-mail: info@bizchangers.com