

What is risk?

Business risk is a circumstance or factor that may have a significant negative impact on the operations or profitability of a given business.

Business risk can result from internal conditions or external factors that may be present in the wider business world. Risk can also be expressed as "uncertainty". It means the possibility of incurring losses due to problems and circumstances, expected or unexpected.

Risk is inevitable. Nothing is entirely predictable in business and there will always be a level of probability that things will not work out as expected. Some of the risks facing businesses are reasonably predictable and the likelihood of these risks occurring, along with the impact of these risks on the business, can be measured. This type of risk is known as a **quantifiable risk** and can take a number of forms:

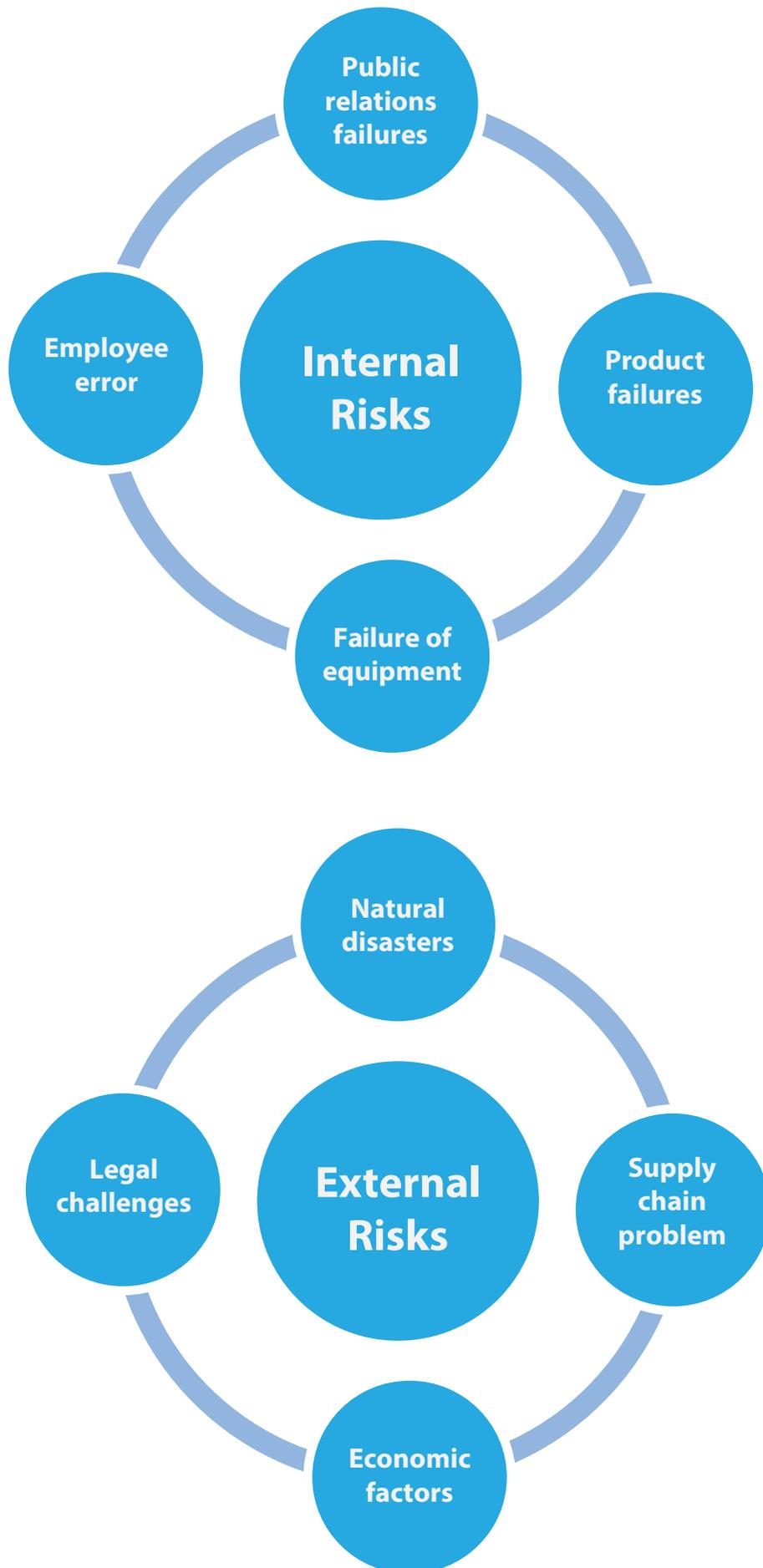
Financial Risk	For example – The probability that a major customer becomes bankrupt and does not pay money owed to a supplier.
Operational Risk	For example – The breakdown of key equipment or machinery.
Strategic Risk	For example – A new competitor coming on to the market.
Compliance Risk	For example – Responding to the introduction of new health and safety legislation.

The types of risk shown above can be planned for, and measures can be taken to minimise the effects of such risks on the business. Many quantifiable risks are also **Insurable Risks**. For example, insurance can be taken out against the failure of a major customer and a service contract can be arranged to cover the breakdown of equipment and machinery.

A more complex type of insurance is *Business Interruption Insurance*. This is used to cover the risk of an incident that prevents a business operating. Therefore, in the case of a large fire, Business Interruption Insurance will pay for new stock, premises, vehicles, etc. in order to get the business operating again as soon as possible. It is also possible to take out Key Employee Insurance; this can cover sickness or even the death of the most important of employees through paying for a suitably skilled and qualified replacement.

More difficult types of risk to manage are uninsurable risks. These arise when the probability of the risk occurring is impossible to quantify – so insurance companies are unable to price the risk. Some occurrences, such as those which take place during civil unrest, or even war, are simply too widespread to even consider insuring. Irresponsible managers, who are willing to undertake extreme risks that lead to a business failure, also fall into this category.

Risk can occur within the business or develop externally. Typical examples are illustrated below:



Risk management

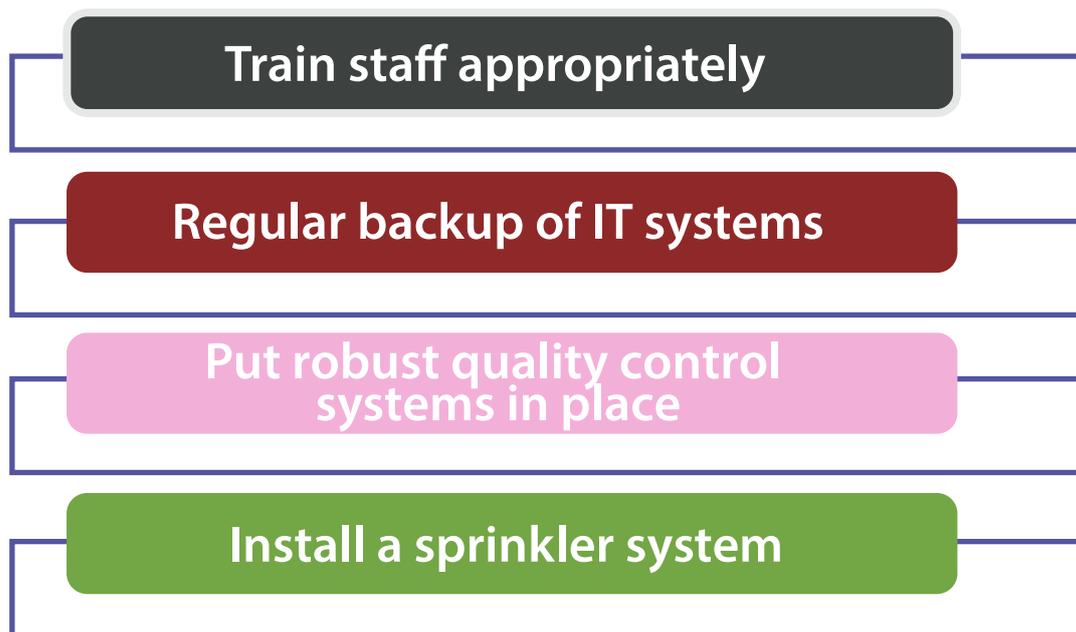
Risk management is the process of understanding and minimising what might go wrong in an organisation. It involves the activities undertaken by a business, which are designed to control and minimise threats to the continuing efficiency, profitability and success of its operations. The risk management process includes:

- the **identification and analysis** of risks to which the organisation is exposed
- a **measurement** of the likelihood of the risks occurring
- an **assessment** of potential impacts on the business
- **deciding** what action can be taken to eliminate or reduce risk

At the end of this risk management process, the business should have a comprehensive list of risks attached to the business. This list will form the basis for a risk register (the formal record of risks and their potential impact).

The next step is to analyse and attempt to remove the risks. Within large businesses, specialist risk managers have a role in measuring risk and putting in place systems that reduce chances of negative outcomes occurring.

Examples of preventative actions



Risk management strategies include taking out insurance against financial loss or legal liability and introducing safety or security measures.

Sometimes external bodies are involved in measuring and managing risk. We have recently seen this in the banking crisis where various government regulatory organisations, such as the Bank of England and the Financial Services Authority, have taken a great deal of interest in the levels of risk carried by banks.

Contingency planning and crisis management

A contingency plan is a plan of action to be followed in the event of an emergency or crisis occurring which threatens to destroy or significantly disrupt the continued operation of normal business activities. The plan should restore to normal, or as near to normal as possible, the business's day-to-day functioning. All this needs to be done as fast as possible. Crisis management is an unforeseen event that threatens the business. There are many recent examples of major events affecting businesses' capability of operating normally. These have varied from terrorist atrocities, natural disasters or extreme climate events, to failures of operational control. A well-run business will have plans in place to deal with the unexpected, reduce its impact and get back to normal as soon as possible.

The horse meat scandal that affected a number of supermarkets had potentially serious consequences for the businesses concerned. Tesco responded with full page ads in national newspapers.

This public relations exercise proved effective. Apologising to customers, and being straightforward and honest, could quite possibly have been part of a Tesco contingency plan. Such an approach would be part of a plan that would be put into action in anticipation of there being any major failure of food quality. However, Tesco's more recent misreporting of profits seems to have been handled less well, causing much more reputational damage.

Contingency planning is a complicated business. The first part of contingency planning is to identify threats to the business and to estimate what the impact on the business might be if these threats were to happen. There are of course costs involved in trying to examine possible threats and estimating their impact. This will take management time, and cost money, but there is an immediate advantage. The contingency planning process identifies weak points in any business, weak points that can be improved and made more resilient.

For example, what if there is only one supplier of a major component? What if supplies are disrupted? Once such a weak point is identified, the business can take action to reduce the risk from this threat. In this instance, they might seek out alternative suppliers or hold greater amounts of that particular component in stock. Actions such as this make the business more robust and increasingly effective.

The strategy for recovery needs to be tested and practised. Someone has to be in charge of the contingency plan. In large businesses, there might be several people coordinating the plan within different departments or divisions – so again a cost in training and man hours. However, having someone to take control, to ensure that there is no panic is essential. Effective and timely action needs to be taken.

The contingency plan has also to be kept up to date, and reviewed in the light of changing circumstances. These could be internal or external changes. The business may introduce new products, or start operating in different markets. External threats will evolve and change.

A good contingency plan can make the difference between survival and failure: between the protection of a brand or the destruction of brand value. It can be an 'insurance policy' that is worth investing in. Even small businesses should have back-up plans in place. It can be as simple as 'the van has broken down: do I have a contact number on my phone for van hire?'

What is the value of contingency planning?

It is likely that an effective contingency plan will minimise the risk and limit the damage caused by a crisis. If damage to a business's reputation can be minimised and profits/ dividends maintained, then undoubtedly it is of great value. The likely benefits of effective contingency planning that helps maintain staff morale and provides continuity of products or services cannot be underestimated. If it reduces the impact on customers and protects against potential losses, then it is well worth the money.

Nonetheless, it can be a very costly activity. Large multinational businesses involve huge numbers of very expensive staff in assessing risk and planning what to do if things go wrong. It is essentially a form of insurance. If nothing goes wrong, it might be seen as a complete waste of money. However, the growth in contingency planning, especially in large organisations, seems to suggest that businesses are keen to reduce their risks to as low a level as possible. In other words, they see the costs involved as being money well spent.

Discussion themes

Give 4 examples of a quantifiable risk.

Why are some risks uninsurable?

Describe the risk management process.

What is a contingency plan?

All businesses should carry out contingency planning. Evaluate this statement.

Use the Internet to find one recent example of how a business has been affected by internal risks and one by external risks.