Section 3

Context of Risk Management

The purpose and cultural context for effective risk management in an organisation.

The purpose of risk management

Risk management is a widely recognised business management tool. It enables managers to look into the future so that they can plan and manage their activities in an understanding of what might happen in the future. A risk is defined as:

Definition

an uncertain event in the future that, should it occur, will have an effect on the achievement of an organisation's objectives. A risk is characterised by a probability of the event happening and its impact on the objectives.

Threats and Opportunities

There are two flavours of risk: an opportunity which is an event that would have a positive impact on the objectives which we would want to happen; and a threat that would have negative impact on the objectives and which we would want to avoid. Note that in normal English the word 'risk' implies a negative event so beware that in this course the word has a neutral implication.

Using risk management

Organisations use risk management to do two things:

- Studying the risks that lie in the future, many of which arise from planned actions, enables managers to understand how risky their plans and actions are. This view enables managers to decide if the return on the activity and its cost (investment) justifies the risks it is facing. It is the basis of a business case. If the future is deemed to be too risky then managers can change their plans. Sometimes the future is not risky enough and the returns on the investment are not good enough. Again plans can be changed with this information.

- Having accepted an overall risk profile for a set of planned actions and the return, managers can set about managing each individual risk: looking out for signs that it might become more (or less) likely to happen also planning actions to reduce threats and increase opportunities. These actions will affect the overall risk profile so that it is also regularly reviewed alongside the costs and potential return.

The purpose of risk management is to provide managers with information about what the future might hold so that they can make planning decisions now about actions and investment in the future.

THOUGHT EXPERIMENT

Risk management is not limited to organisations. Every individual considers the risks of doing things when planning future activity; sometimes quite unconsciously. Think about a significant activity you might be planning and consider some of the risks.

Say, going on a foreign holiday and thinking about risks from the weather, crowds, being misunderstood; and what sort of things you might do to manage these risks.

Scope of risk management

In this course we will focus on the use of risk management in a change situation. However, we will also be as general as possible so that you can apply the course material to any aspect of an organisation. When we use the term 'organisation' this will mean a specific change programme or project and define the scope of the risks to be managed. Each change programme or project will itself be part of a larger organisation, probably a corporate entity, which will also have a risk management scope. Delineating the scope of the organisation for which you are managing risk will identify the objectives which might be affected by risks. Any risks which do not affect the objectives will therefore be out of scope.

Managing the future

Risk management and planning

The link between planning and risk management is very close; they are the two main tools managers have to manage the future. A plan is a specific set of actions and milestones (planned events) that are planned to happen in the future. Risks are other events which, though not planned, might happen and for which we can do some preparation. However, that preparation needs to be proportional to the probability of the event happening and the potential impact of the event. This is considered further in section 7 on risk assessment.

Figure 3.1 shows how risk management and planning are both considering events in the future and how they relate through events.

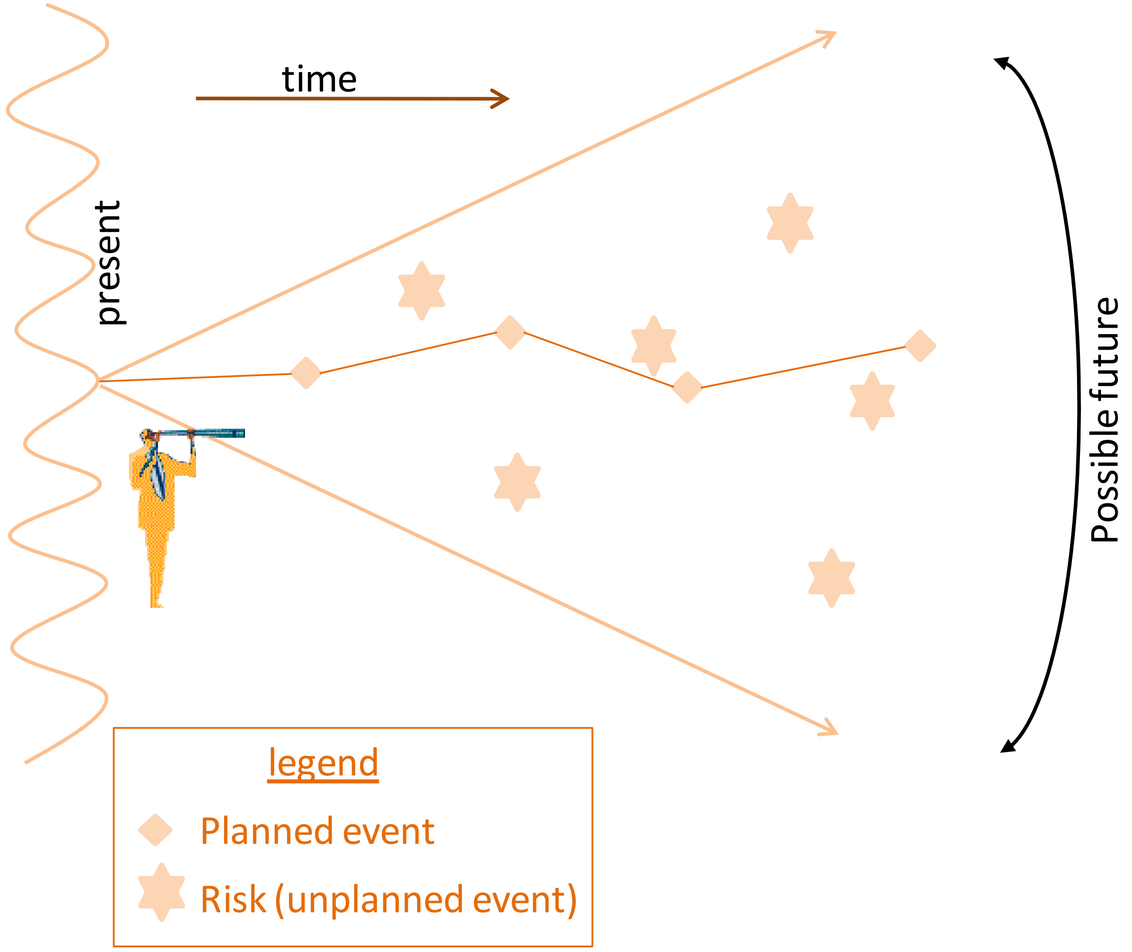

FIGURE 3.1 RISK MANAGEMENT AND PLANNING FOR MANAGING THE FUTURE

Event horizons

To make sure that we consider a full range of potential risks it is useful to think of three horizons in the future and the organisation to give us different perspectives on our risks and the risk profile of the organisation.

Short term – operational

This horizon is very close, often months. It is dominated by operations concerns in the business; in particular keeping the business going to deliver to customer needs. Imminent change activities will fall into this horizon and become part of the blend with activities in operations.

Medium term – change

This horizon is focused in the change environment in the organisation. It includes the portfolio of change programmes and projects which have been planned to deliver to strategic objectives. The sum of the programme and project risks and their impact on the medium term viability of the organisation are captured in this horizon.

Long term – strategic

This horizon looks into the distant future, measured in years. It covers the very survival of the organisation and sets out the strategic objectives which if achieved will ensure the organisation's future. It also includes any threat to the organisation as a whole, regardless of timescale – such as significant damage to reputation.

These horizons enable the categorisation of risks and help to identify potential owners. For instance, strategic risks will usually be owned by senior managers. Project and programme risks will be owned by project and programme managers. An organisation must be careful not to compartmentalize these risks. The overall risk profile of the organisation across all time horizons and categories needs to be carefully managed through Enterprise Risk Management activities.

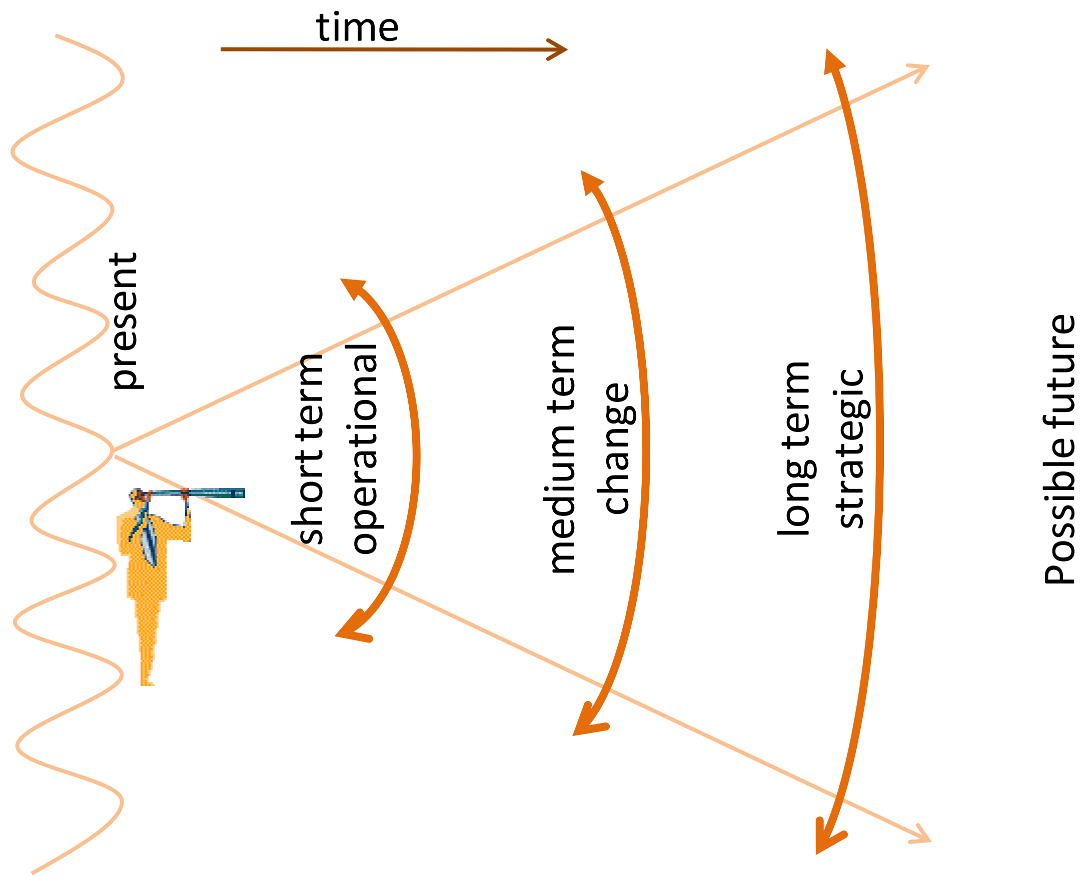

FIGURE 3.1 OPERATIONAL, CHANGE AND STRATEGY HORIZONS

THOUGHT EXPERIMENT

How is risk management broken down in your organisation?

In a change programme there will operational, programme, project and strategic risks. Can you think of one of each type?

Risk appetite

The overall appetite for risk in an organisation is an important characteristic of the organisation. It is obvious in its approach to investment (often higher risk gives potentially higher returns, or larger losses!). The risk appetite is very much part of the culture of an organisation.

The appetite for risk will determine how much risk an organisation is willing to take on. A change to the organisation (executed through a change programme or project) will involve more risk than normal operations; usually because the change has not been done before. However, how much extra risk the organisation will have an appetite for in a change is something the senior programme and project managers will want to keep close control over. The sponsoring group or project board will assess the change activity risk and determine if it is in line with the overall organisation appetite.

Risk appetite boundaries can be easily pushed by ambitious timetables, complex contracts with suppliers, reduced budgets, other changes in the organisation, and complex or linked changes. These characteristics should be captured in the project or programme objectives so that the risks can be clearly captured. Similarly, ambitious benefits represent risks to the ability to of the programme deliver its business case and thus its viability.

Corporate Policy and Governance

Most organisations have a corporate risk policy, governance, and risk manager. Many organisations are required to have these by law or industry practice. Corporate policies will determine the basis of risk management within a programme or project. The project or programme will add in further details for its specific needs. The corporate risk management governance will describe how risk management will be implemented in the organisation to deliver the policy. The governance can be tailored for different needs and circumstances in different parts of the organisation, but all will deliver the single policy.

THOUGHT EXPERIMENT

Can you identify the corporate risk manager?

If you can identify the corporate risk manager, how will they help support effective risk management in your programme or project?

Workbook exercise 1

Using evidence from your own organisation and a change programme that you are familiar with:

1. Identify at least three advantages you would expect from using effective risk management.
2. Identify at least 3 disadvantages you expect to avoid by using risk management.

Place these answers in section 2.1 parts a and b of your workbook.
