

Lecture 4

Scope of risk management

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MGM510
Risk Management

Origins of risk management



- Risk management has a variety of origins and is practiced by a wide range of professionals.
- The practice of risk management became more widespread and better coordinated **because the cost of insurance in the 1950s** had become prohibitive and the extent of coverage limited.
- Organizations realized that purchasing insurance was insufficient if there was inadequate attention to the protection of property and people.

Origins of risk management



- The maturity of the risk management discipline is now such that the links with insurance are much less strong.
- Insurance is now seen as one of the risk **control techniques**, but it is only applicable to a portion of **hazard risks**.
- Risks related to finance, commercial, marketplace and reputational issues are recognized as being hugely important, but outside the historical scope of insurance.

Origins of risk management



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Organization	Definition of risk management
ISO Guide 73 BS 31100	Co-ordinated activities to direct and control an organization with regard to risk.
Institute of Risk Management (IRM)	Process which aims to help organizations understand, evaluate and take action on all their risks with a view to increasing the probability of success and reducing the likelihood of failure.

Origins of risk management



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Organization	Definition of risk management
HM Treasury	All the processes involved in identifying, assessing and judging risks, assigning ownership, taking actions to mitigate or anticipate them, and monitoring and reviewing progress.
London School of Economics	Selection of those risks a business should take and those which should be avoided or mitigated, followed by action to avoid or reduce risk.

Origins of risk management



- Historically, the term risk management has been used to describe an approach that was applied only to hazard risks.

Specialist areas of risk management



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- Many functions within large organizations will have a significant risk management component to their activities, such as tax, treasury, human resources, procurement and logistics.
- One of the best known and specialist areas of risk management is that of health and safety at work.
- Another specialist area is that of disaster recovery planning and business continuity planning.
- Quality management is a very well-developed branch of risk management.

Specialist areas of risk management



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- Other specialist areas of risk management have developed over the past decades, including:
 - project risk management;
 - clinical/medical risk management;
 - energy risk management;
 - financial risk management;
 - IT risk management.

Simple representation of risk management



- Risk management has well-established stages that make up the risk management process.

Simple representation of risk management

TABLE 4.3 8Rs and 4Ts of (hazard) risk management

- 1** Recognition or identification of risks and identification of the nature of the risk and the circumstances in which it could materialize.
- 2** Rating or evaluation of risks in terms of magnitude and likelihood to produce the 'risk profile' that is recorded in a risk register.
- 3** Ranking or analysing the current or residual level of risk against the established risk criteria or risk appetite.
- 4** Responding to significant risks, including decisions on the appropriate action regarding the following options:
 - tolerate;
 - treat;
 - transfer;
 - terminate.

Simple representation of risk management

- 5 Resourcing controls to ensure that adequate arrangements are made to introduce and sustain necessary control activities.
- 6 Reaction planning and/or event management. For hazard risks, this will include disaster recovery or business continuity planning.
- 7 Reporting and monitoring of risk performance, actions and events and communicating on risk issues, via the risk architecture of the organization.
- 8 Reviewing the risk management system, including internal audit procedures and arrangements for the review and updating of the risk architecture, strategy and protocols.

Simple representation of risk management

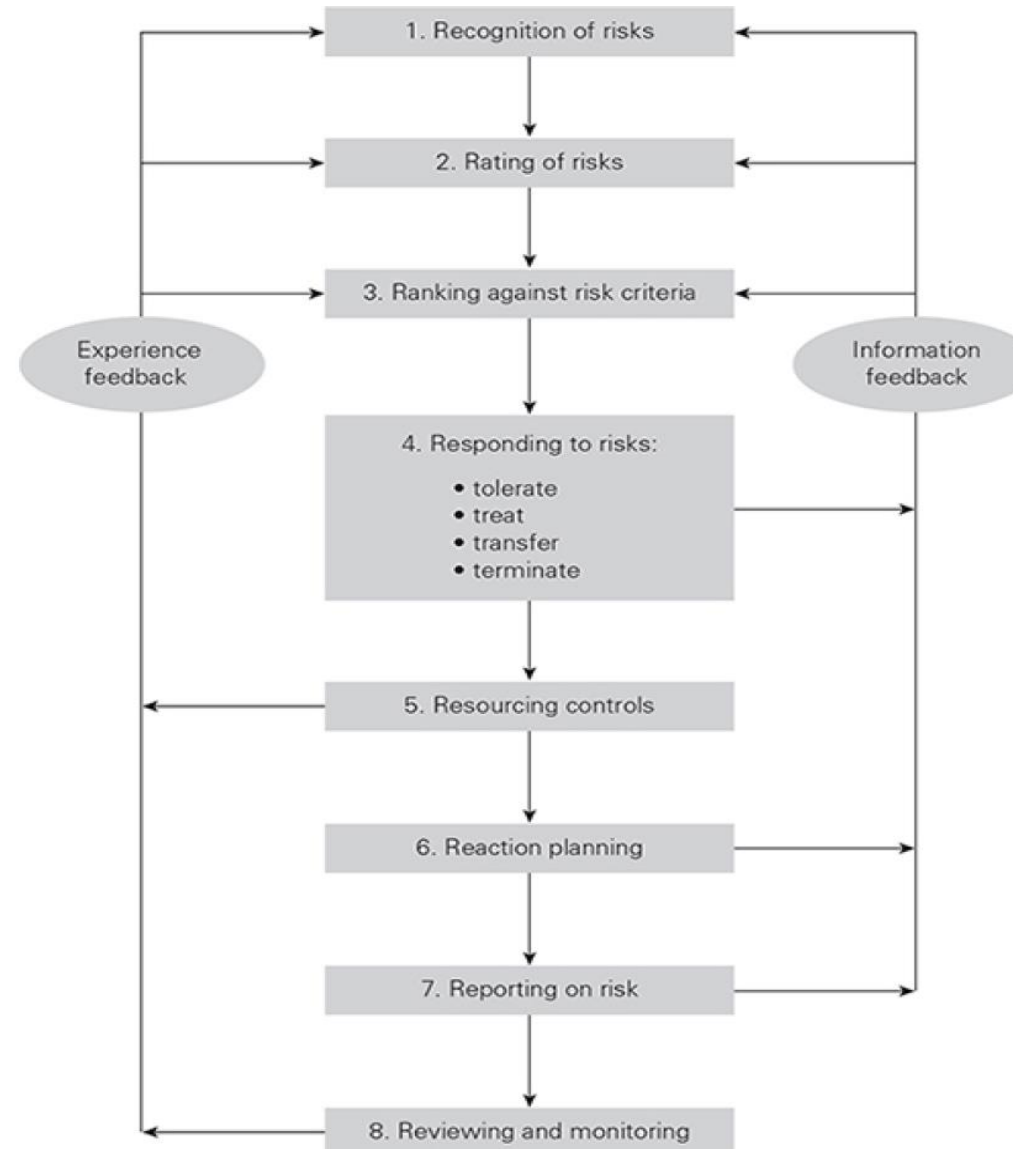


- This basic explanation of the risk management process is referred to as the **8Rs and 4Ts** of hazard risk management.

8Rs and 4Ts



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Enterprise risk management



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- When an organization considers all of the risks that it faces and how these risks could impact its strategy, projects and operations, then the organization is embarking on an enterprise risk management approach.

Enterprise risk management



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ERM in the pharmaceutical industry

A good example of the ERM approach is the pharmaceutical industry. If a person is reliant on a particular medication, then it is vitally important that the medication is constantly available. From the point of view of the pharmaceutical company, this means that a core process for the organization must be the 'constant availability of medication' process.

If the pharmaceutical company takes this approach, it will look at the risks that could affect this core process or stakeholder expectation on an enterprise-wide basis. This will involve analysis of the supply chain, evaluation of manufacturing activities and analysis of the delivery arrangements. The overall question that needs to be answered is what could prevent the continuous supply of medication. Risks to the continuous supply will include unavailability of ingredients, disruption to manufacturing activities, contamination of the product, breakdown in supply transportation arrangements and disruption to distribution.

Enterprise risk management



- An enterprise-wide approach has considerable advantages, because it analyses the potential for disruption to the overall stakeholder expectation. Health and safety, for example, is then viewed as a component in ensuring that staff are always available so that the overall operational core process will not be disrupted, rather than (or perhaps as well as) a separate hazard management issue.

Levels of risk management sophistication

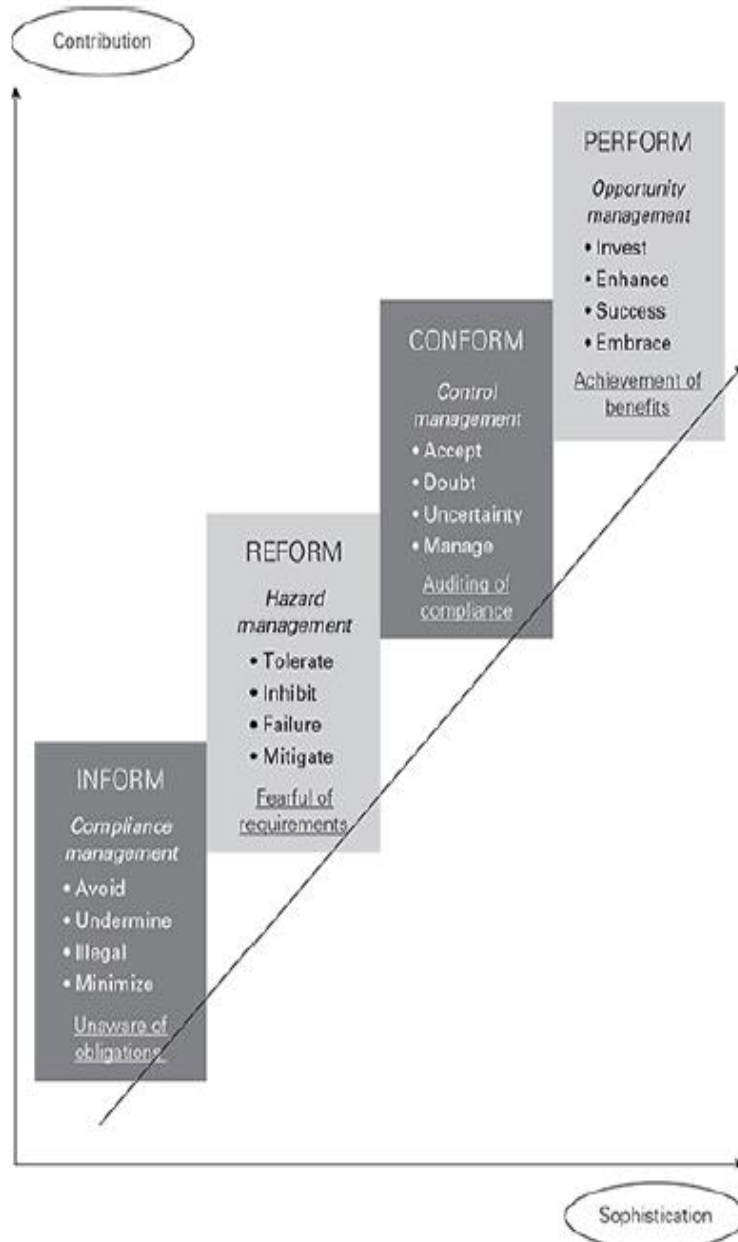


- At first, an organization may be unaware of the legal and contractual obligations that it faces. In that case, it will be necessary to **inform** the organization of its obligations in relation to the risk.
- As the level of sophistication develops, the organization will become aware of the need to comply with obligations and the more general need for improved risk management. Once it is aware of obligations, there will be a need for the organization to **reform** in response to the hazard risks.
- As the organization responds to the risk, it will seek to **conform** to the appropriate risk control standards.
- After this stage, the organization may realize that there are benefits to be obtained from the risk. The organization will then have the ability to **perform** and view the risk as an opportunity risk.

Levels of risk management sophistication



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Levels of risk management sophistication



- As a simple example, a publisher might realize that it was not fully complying with equal opportunities legislation, because there was no ethnic minority representation within the workforce. The company will identify the actions necessary in order to reform its procedures, so that it conforms to legal requirements.
- Having achieved compliance, the publisher should become aware that a significant proportion of the workforce comes from ethnically diverse backgrounds. The company should see this diversity in its workforce as a benefit that will enable it to perform better in the marketplace by exploring opportunities to produce and publish new magazines that appeal to a more ethnically diverse readership.

Levels of risk management sophistication



- Benefits can be obtained from the successful management of that risk at whatever level of sophistication is appropriate at the time. In summary, risk management need only be as sophisticated as the organization requires in order to bring benefits.
- There is a danger that organizations will become obsessed with risk management to the point that important decisions are not taken. At this point, it may be said that too much attention and concern about risk and risk management will cause the organization to deform its operations.

Levels of risk management sophistication



- In summary:
 - unaware of obligations – **INFORM**;
 - awareness of non-compliance – **REFORM**;
 - actions to ensure compliance – **CONFORM**;
 - achieve business opportunities – **PERFORM**;
 - inactivity caused by obsession – **DEFORM**.

Levels of risk management sophistication



- The development in risk management approach can be summarized as follows:
- Compliance management must not be undertaken in a fragmented manner, even if excellent standards of compliance are achieved.
- Hazard management specialists may find that there has been a trend towards a desire to retain more insurable risks (and buy less insurance) as a result of a more holistic approach to risk management.
- Control management specialists must not squeeze entrepreneurial spirit and effort out of the organization.
- Strategic planners must recognize that risk management tools and techniques can contribute to better strategic decisions and the successful exploitation of business opportunities.

Enterprise risk management



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Enterprise risk management



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Enterprise risk management



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- Other resources to know more about ERM:

<https://www.youtube.com/watch?v=bAoBJpz9K5E>

<https://www.youtube.com/watch?v=PTXexxUckIM>

<https://www.youtube.com/watch?v=QgyiRWcZYS4>