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Risk Management: Importance, Methods and Process

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Abstract: ***Risk management can be used as a tool for greater rewards, not just control against loss. Enterprise risk management has become an important topic in today's more complex, inter-related global business environment, replete with threats from natural, political, economic, and technical sources. Risks are studied from different silo disciplinary perspectives, with a discussion of how various methods and tools are used to optimize risk management. Risk management for a group that does not actually manage anything leads to the notion that managing risk is somehow different from managing other affairs within the firm. Risk management is an activity which integrates recognition of risk, risk assessment, developing Strategies to manage it and mitigation of risk using managerial resources. Risk management plans should then be developed, based on the decision to avoid, assume, or transfer the identified risks. It may refer to numerous types of threats caused by environment, technology, humans, organizations and politics. The paper describes the different steps in the risk management process which methods are used in the different steps, identify risk factors, and improve performance, important of risk management.***

Keywords: Assessment, Energy, Economic Risk, Insurance, Procurement

1. Introduction

Risk is the possibility that something harmful or undesirable may happen. This could include harm, injury, or abuse to your organization's clients, volunteers, board members, employees, property, or reputation

Risk management is the term for the procedures that an organization follows to protect itself, its staff, its clients, and its volunteers. Practicing sound risk management is more than just looking out for potential problems, buying insurance and avoiding lawsuits. It is an ongoing process.

Risk is unavoidable and present in every human situation. It is present in daily lives, public and private sector organizations. Depending on the context (insurance, stakeholder, technical causes), there are many accepted definitions of risk in use.

The common concept in all definitions is uncertainty of outcomes. Where they differ is in how they characterize outcomes. Some describe risk as having only adverse consequences, while others are neutral. It is recognized that for some organizations, risk management is applied to issues pre-determined to result in adverse or unwanted consequences.

Definition of Risk Management

Risk is a condition in which there exists a quantifiable dispersion in the possible outcomes from any activity. It can be classified in a number of ways.

Risk management is a process including the identification and analysis of risk; and the decision to either accept or mitigate the exposure to such risk when compared to the potential impact on the achievement of the organization's objectives.

A process of understanding and managing the risks that the entity is inevitably subject to in attempting to achieve its corporate objectives. For management purposes, risks are usually divided into categories such as operational, financial, legal compliance, information and personnel. One example of an integrated solution to risk management is enterprise risk management.'

2. Importance of Risk Management

Some risk-taking is inevitable if an organization is to achieve its objectives. Those organizations that are more risk aware appreciate that actively managing not only potential problems there at but also potential opportunities provides them with a competitive advantage. Taking and managing risk is the very essence of business survival and growth.

Effective risk management is likely to improve performance against objectives by contributing to:
- Fewer sudden shocks and unwelcome surprises
- More efficient use of resources
- Reduced waste
- Reduced fraud
- Better service delivery
- Reduction in management time spent fire-fighting
- Better management of contingent and maintenance activities
- Lower cost of capital
- Improved innovation
- Increased likelihood of change initiatives being achieved
- More focus internally on doing the right things properly
- More focus externally to shape effective strategies.

3. The Methods to Identify Risk Management

These risks can be external and internal, as well as strategic and operational:

1) Strategic Risk
Risks that need to be considered in relation to medium and long-term goals and objectives of the organization they include:

- **Political Risk:**
  Risks associated with a failure to deliver policy for the entity that is served, or to meet the local administration's policy commitments (e.g. a failure to integrate sustainability considerations into acquisition decisions), and the impact of social unrest, changes in government, and the potential for political turmoil at home or abroad.
- **Economic Risk**:
  Risks affecting the organization's ability to meet its financial commitments (e.g. failing to consider the consequences of proposed major investment decisions prior to an acquisition effects of inflation, recession, and foreign exchange rates).
- **Socio-economic Risk:**
  Risks relating to the effects that changes in demographic, residential or socio-economic trends will have on the organization's ability to deliver appropriate services (e.g. failure to procure sufficient elderly care provision for an aging population)
- **Technological Risk:**
  Risks associated with the organization's capacity to deal with the pace/scale of technological change or its ability to use technology to address changing demands (e.g. a failure to procure the appropriate software to allow for the efficient financial management of the authority; failure to manage and protect the security of the data).
- **Legislative/ Regulatory Risk:**
  Risks associated with current or potential changes in law (e.g. a failure to address a legal directive).
- **Competitive Risk**:
  Risks affecting the cost, quality, or competitiveness of a service (e.g. the failure to address a failing service through improvement, market testing, or outsourcing)
- **Customer/citizen Risk**:
  Risks associated with the failure to meet the current or changing needs and expectations of customers and citizens (e.g. the demand to improve the availability of public transport).

2) Operational Risk
These are risks that managers and staff will encounter in their work. They may be

- **Professional Risk**
  Risks associated with the practice of procurement (e.g. failure to develop and implement robust procurement processes).
- **Financial Risk**
  Risks associated with a failure to secure a most economically advantageous outcome to an acquisition (e.g. the failure to apply lifetime costing techniques in a tender evaluation or the failure to apply appropriate financial appraisal techniques prior to contract award leading to supplier failure.
- **Legal Risk**
  Risks related to possible breach of legislation (e.g. failing to advertise a contract under required directives; failure to include specific contract terms leading to contract failure).
- **Physical Risk**
  Risks related to fire, security, accident prevention, and health and safety (e.g. failing to procure properly labeled cleaning materials).
- **Contractual Risk**
  Risks associated with the failure of contractors to deliver services or products to the agreed cost and specification (e.g. delivery by contractors of substandard or out of date food products; failure to meet specified outcomes)
- **Technological Risk**
  Risks relating to a reliance on operational equipment (e.g. exclusive reliance on an e-Procurement system to deliver critical supply acquisition)
- **Environmental Risk**:
  Risks relating to pollution, noise or the energy efficiency of on-going operations (e.g. reliance on unsustainable sources of commodities)

3) Method of Risk Factors:
The decision regarding which risk factors to focus on will vary by organizational goals and objectives.

- Escalating costs of fuel, energy, and raw materials
- General lack of internal risk management capability on the part of the supplier4
- Exchange rate fluctuations
- Financial instability of suppliers leading to supplier failure
- Conflicts in supply chain caused by cost cutting and survival activities
- The amount of emphasis on cost cutting over quality improvement
- Supplier failure to deliver on contracted obligations
- Sole sourcing arrangements
- Changes in environment or legislation that affect the supply base
- Product with no available alternatives
- Changes that result in obsolete technology and/ or products, or new unproven technology or products

4. Risk Management Process and its Steps

The six steps of the risk management process.

Risk management process: identify, analyze and prioritize, plan and schedule, track and report, control, and learn. It is important to understand that the process of managing each risk goes through all of these steps at least once and often cycles through numerous times.

- **Identify** - Risk identification allows individuals to identify risks so that the operations staff becomes aware of potential problems. Not only should risk identification be undertaken as early as possible, but it also should be repeated frequently.
- **Analyze and prioritize** - Risk analysis transforms the estimates or data about specific risks that developed during risk identification into a consistent form that can be used to make decisions around prioritization. Risk

prioritization enables operations to commit resources to manage the most important risks.

- **Plan and schedule** - Risk planning takes the information obtained from risk analysis and uses it to formulate strategies, plans, change requests, and actions. Risk scheduling ensures that these plans are approved and then incorporated into the standard day-to-day processes and infrastructure.
- **Track and report** - Risk tracking monitors the status of specific risks and the progress in their respective action plans. Risk tracking also includes monitoring the probability, impact, exposure, and other measures of risk for changes that could alter priority or risk plans and ultimately the availability of the service. Risk reporting ensures that the operations staff, service manager, and other stakeholders are aware of the status of top risks and the plans to manage them.
- **Control** - Risk control is the process of executing risk action plans and their associated status reporting. Risk control also includes initiating change control requests when changes in risk status or risk plans could affect the availability of the service or service level agreement (SLA).
- **Learn** - Risk learning formalizes the lessons learned and uses tools to capture, categorize, and index that knowledge in a reusable form that can be shared with others.

5. Conclusion

Several practical tips for risk management were presented throughout this chapter. The Keys for successful risk management are summarized**.** They are a variety of risk factors that arise from external and internal sources that must be assessed. A pre-condition to overall risk management is the risk assessment. The risk assessment is therefore a prerequisite for determining how the risks should be managed and mitigated. Mitigation seeks to put measures in place to lessen the severity of a risk event, should that event occur.

The formality of the overall risk management plan is a continuum based on the size or nature of the procurement. Planning can extend from simple consideration or incorporation of risk registers as a part of the procurement planning agenda, to inclusion of risks in more formal. Acquisition plans, to comprehensive risk management plans on enterprise-wide projects where their complexity and scope warrants it.

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