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Dr. Barry Carbol, Learning Consultant, Canada
Dr. Roger Powley, VUSSC e-Learning Consultant, Innovative Training Solutions Inc., Canada
Dr. Sherwyn Millette, College of Science, Technology and Applied Arts, Trinidad and Tobago
John Lesperance, Commonwealth of Learning, Canada
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COURSE OVERVIEW

INTRODUCTION

This Risk Management course is designed to prepare future entrepreneurs to understand and mitigate risks associated with their new business venture. When starting a new business, it is important to understand the need for risk management and how to address issues that could jeopardize the future development of a business. During the course, entrepreneurs will consider the principles of risk management, processes associated with managing risk, identification of a variety of forms of risk including financial, operational, and political, risk management tools, analysis, and planning. The course is intended to provide future entrepreneurs with a practical, how-to guide to risk management and highlights best practices in risk management that will be useful for entrepreneurs as they build a new business.

COURSE GOALS

Upon completion of this course, future entrepreneurs should be able to:

1. Understand the principles of risk management and apply them in a practical way in a small business context.
2. Explain key risk management concepts within the context of lessons learned by small business entrepreneurs.
3. Identify that forms of risk that impact a new business venture including financial, operational, social, political, and technological risks.
4. Understand and apply risk management processes and tools to small business and entrepreneurial contexts.
5. Understand and apply risk management strategies to a new business venture.
6. Develop a risk management plan for their new business venture.

COURSE STRUCTURE

The course is divided into five units:

Unit 1: Introduction to Risk Management
Unit 2: The Principles of Risk Management
Unit 3: Risk Management Tools and Processes
Unit 4: Risk Reduction, Mitigation, and Control Strategies
Unit 5: Risk Management Planning
Each unit is further broken down into related topics. Each unit and many topics include self-reflection questions to ponder, activities to complete and formal assignments to send to your instructor.

The units contain a number of references that learners are encouraged to review as they progress through the course. This may require that you have access to a computer with Internet connection to download the reference. Each unit should take between two and three weeks to complete.

**ASSIGNMENTS AND PROJECTS**

A series of activities and assignments will guide you through the concepts in this course and ask you to demonstrate that you can apply the concepts to support the creation of your risk management model and approach. A summary of this work is included at the beginning of each unit. The major assignment in this course is found in Unit Five, where you will develop a risk management plan for your business venture. Your institution / tutor will help you through this material and will also assign additional projects.

**JOURNALING REQUIREMENTS**

To capture the output from the reflective questions and activities you are asked to keep a personal journal. At the end of the course the personal journal will be submitted to your instructor for feedback and grading.

**ASSESSMENT PROJECTS**

Assessment takes the form of responding to activities, as well as written assignments and examinations as determined from time-time by the institution. In cases where coursework assignments, fieldwork projects, and examinations are used in combination, a percentage rating for each component will be communicated to you at the appropriate time.
**TIME REQUIRED**

This course is worth 14 credits, or a credit value assigned by your institution. Each credit is equivalent to 10 notional study hours. You are, therefore advised to spend a minimum of 140 hours of study time on the course. This notional time includes:

- completing activities embedded in the study material;
- peer group interaction (where necessary);
- face-to-face tutorials (where necessary);
- working on tutor-marked assignments;
- reading assignments, and
- preparation time for and sitting examinations (where that is a requirement.)

**COURSE SCHEDULE**

A course schedule with due dates and additional readings will be supplied to you by your institution.
STUDENT SUPPORT

ACADEMIC SUPPORT

<The delivery institutions should insert the following information if relevant>

- How to contract a tutor/facilitator (Phone number, email, office hours, etc.).
- Background information about the tutor/facilitator if he/she does not change regularly. Alternatively provide a separate letter with the package describing your tutor/facilitator’s background.
- Description of any resources that they may need to procure to complete the course (e.g. lab kits, etc.).
- How to access the library (either in person, by email or online).

HOW TO SUBMIT ASSIGNMENTS

<If the course requires that assignments be regularly graded by a tutor/facilitator, then insert a description of how and where to submit assignments. Also explain how the learners will receive timely feedback.>

TECHNICAL SUPPORT

<If the students must access content online or use email to submit assignments, then a technical support section is required. You need to include how to complete basic tasks and a phone number that they can call if they are having difficulty getting online>.
UNIT ONE – INTRODUCTION TO RISK MANAGEMENT

UNIT INTRODUCTION
Welcome to the first unit in this course on risk management. In other courses in this certificate program you have been introduced to the world of entrepreneurship, and a range of topics that will help you to run your business and put it into operation. One of the many challenges faced by a new business is achieving a thorough understanding of the risks involved and developing strategies to address them. In the first unit of this course, you will gain an understanding of what is meant by risk management and will consider the types of risks faced by entrepreneurs.

UNIT OBJECTIVES
Upon completion of this unit you should be able to:

1. Describe what is meant by the term ‘risk management’ and relate this concept to a business venture that you are planning to undertake.

2. Describe the types of risks faced by entrepreneurs (i.e. financial, operational, social, political, and technological risks).

3. Describe risks that apply to your small business venture.

ASSIGNMENTS AND ACTIVITIES
There are a number of learning activities and assignments throughout this unit. The major assignment for this unit involves creating a description of the risks associated with your small business or a small business idea that you are considering launching. As in other courses in this program, you will also be asked to complete a self-assessment to help you identify your own strengths and weaknesses. This will help you identify areas that need improvement and strengths that you can build upon.
TOPIC 1.1 – WHAT IS RISK MANAGEMENT?

TOPIC INTRODUCTION
Entrepreneurs are generally thought to be risk takers by nature and while there is some debate about this let’s assume that it is true. In the process of developing a new business idea as an entrepreneur it is important to consider the risks that are inherent in what you are about to start. There are many different kinds of risks associated with any business enterprise.

In this topic, you will consider the meaning of the term ‘risk management’ and begin to determine ways that an understanding of risk management can assist you in the development of your business idea and in turn make your business planning more effective.

You may find it useful to refer to the definitions of common risk management terms found in Appendix 1 as you move through this course.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to:

1. Describe what is meant by the term ‘risk management’.
2. Explain why an understanding of risk management is important for a small business.

Let’s begin by looking what is meant by risk management.

DEFINING THE TERM ‘RISK MANAGEMENT’
As can be seen in the cartoon on the right, the ‘elephant in the room’ is often forgotten during business and budget planning in companies both large and small. In many cases, companies don’t take the necessary steps to assess risk and determine how they are going to address risk factors.

So what is risk?

Risk can be described in probability terms. That is it can be thought of as the probability that a particular undesirable event will actually happen. For example, in some parts of the world the probability is high that a catastrophic event such as an earthquake is likely to strike within a relatively short time frame (perhaps in the next 20 years). Knowing this can help businesses to plan for such
likelihood and develop various scenarios and make plans to address each potential scenario. Some potential risks to a small business include:

- **External Risks**
  - Strategic risks: Competition, Customer needs & demands, Industry changes
  - Operational risks: Government regulations, Political environment, Culture, Vendors/suppliers, contracts
  - Financial risks: Interest rates, Foreign exchange, Credit
  - Hazard risks: Natural disasters

- **Internal Risks**
  - Strategic risks: R&D, Intellectual capital
  - Operational risks: HR, Systems & processes
  - Financial risks: Cash flow, liquidity
  - Hazard risk: Safety (Employee and Equipment), Security

So what is meant by ‘risk management’ exactly? Before defining the term, it is important to recognize that risk management is an emerging discipline and while there is considerable agreement of some aspects of what it entails and what standards should be applied there is also some disagreement among standards organizations and practitioners about what it entails.

Here are a few of the more common definitions that will be helpful for you as an entrepreneur to consider.

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**Risk Management** is... “the process whereby organisations methodically address the risks attaching to their activities with the goal of achieving sustained benefit within each activity and across the portfolio of all activities” (as outlined by AIRMIC (an association of risk management professionals, 2002) in its standards.

**Risk Management is** the identification, analysis, assessment, control, and avoidance, minimization, or elimination of unacceptable risks. (The Business Dictionary)

**Risk management (as defined by the ISO 31000 series of standards) is the identification, assessment, and prioritization of risks. Risk is defined as the effect of uncertainty on objectives, whether positive or negative) followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events—or to maximize the realization of opportunities.** (Wikipedia, retrieved on Feb1, 2012)

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Risk Management
Let’s spend some time considering the common elements concerning risk management in these definitions. The common elements in all of these definitions are:

✓ All of the definitions refer to a process or series of processes – among them are the processes of identification, analysis, assessment, and prioritization that need to be undertaken by a business in order to understand where and when they are at risk.
✓ All of the definitions infer a need to apply resources to address risk within a company.
✓ Two of the three definitions speak to the importance of achieving benefits or impacts from the risk management activity.

To this last point, it is important that you actually DO something with the risk information or issues that has been collected otherwise it has little value for your business.

Now it is your turn to think about risk and risk management by considering the following self-reflection questions.

Self-Reflection Questions

Given the definitions of risk and risk management that are outlined in this topic, and considering the small business that you are planning or are operating,

1. What do you think are the greatest risks that your business is facing or could face at the start-up phase? After 1 year of operation?
2. Why do you think these risks are important and will have a potential impact on your business?
3. Of the risks that you identified, which risks do you think you can avoid? Why do you think that you can avoid them?

Record your thoughts in your personal journal.

Why is Risk Management Important?

Starting a new business venture by its very nature is a risky proposition. As a first time entrepreneur you may asking yourself ‘why should I pay attention to risk? According to a number of studies of small businesses across the globe, only 2/3 of all small business start-ups survive the first two years and less than half are still in business after four years. As a result of this reality it is critical for small business owners to pay attention to risk. Unplanned activities and events will limit your ability to achieve the goals and mission set out for your new business venture. It is also essential that as you create your business plan that you include risk exposure as an integral part of the plan.
The amount and type of risk a business venture will be exposed to will vary from place to place and from time to time and by industry to industry. That is to say the risk you are exposed to is affected by the industry you choose to operate, the country and region (some exposure may be specific to region for example setting up a business in a high crime area or one that has limited infrastructure). In addition, time itself can affect risk, something as simple as the time of year for example the risk of the unavailability of raw materials or labour or a current temporary economic situation.

Behind entrepreneurial drive, risk management is the most important aspect of entrepreneurship. As stated before, entrepreneurs by their very nature are risk takers, however they manage this risk so as to gain benefit for opportunities they see in the environment. Most business (both for profit and not for profit) have a creative or innovative vision to achieve. You should not move forward based solely on gut feelings (for profit etc.) it is essential that you are honest with yourself (and those you may be leading) and as far as possible ensure that the venture is viable (feasibility studies can help with this) and balance level of risk with rewards. The truth of the matter is that mistakes will be made (making a mistake does not necessarily spell doom for the business), it is however imperative that the entrepreneur re-evaluate the business plan and model after a mistake or failure. The key is to learn from the mistake and ensure that the same mistake is never repeated.

**ENTREPRENEURS AND THE MANAGEMENT OF RISK**

Managing risk is important to both private and public organisations. Private organisations manage risk almost daily. Most public organisations try to reduce risk to a minimum; arguably, because this approach is part of an ingrained, bureaucratic culture.

At the personal level, one of the defining differences among individuals is the willingness of some to accept risks and develop opportunities while others avoid them. Many of the authors on entrepreneurship cite two primary reasons for this.

- The traits of a stereotypical entrepreneur, and
- The uncertainty of entrepreneurial environments.

The stereotypical entrepreneur has a 'can do attitude', is highly positive and will take risks as they have little time for planning and research. The environment is usually risky and ambiguous but provides opportunities for entrepreneurs where the right business strategy
can enable their business to develop and grow rapidly and in an unconstrained and unimpeded manner.

Risk is often characterized by an entrepreneur’s decision to improvise or not and is normally based on past experiences. For corporate entrepreneurs with a supportive organisational structure, risk is arguably limited to the employees’ place in the organisational structure. Research and development can arguably reduce risks where the organisation has the ability to make the new knowledge available to organisational stakeholders, which will include front line workers and also may include suppliers and outsourced companies.

**RISK: FACTORS & BARRIERS**

Factors that may influence the decision to accept risk include trait based factors. Entrepreneurs, for example, accept a level of risk, are more likely to accept risk where they have high confidence, some entrepreneurs are risk seeking, some are risk averse; some accept marginal risks and others have risk awareness. It has been found that some entrepreneurs accept risk to 'show off'. Deciding whether to act upon an opportunity will depend on the individual's attitude to risk but there are other influential factors. These will include access to capital, entrepreneurial ability, education and work experience.

Barriers to entrepreneurship which prevent acceptance of risk include:

- Raising finance.
- Fear of debt.
- Gaps in knowledge and skills.
- Lack of a business idea.
- Lack of support for a business idea.
- Fear of failure.
- Losing the security of your current job.
- Losing the income from your current job.
- Good future in your current organization.
- The complexity of start-up regulations.
Analysis of these barriers quickly shows that in a large corporate environment, all barriers are removable. Particularly where, the individual has awareness and self-perception, entrepreneurial skills and capabilities. On the other hand in a small business environment, it may be harder to address all of the barriers described above but knowledge of which ones exist will go a long way to addressing them. Knowing the potential barriers is part of the risk management process.

**FINANCIAL INPUTS AND OUTCOMES OF RISK**
The biggest risk is usually financial and this can be limited where there is financial support. However, success will depend upon the ability to encourage financial providers to support the entrepreneur. Research has shown that some entrepreneurs take greater risks for larger returns in comparison to those who accept more regular smaller profits for lesser risks. It has also been found that those more likely to assume risk would be wealthier, whereas the risk averse would be less financially stable and thus, there is a direct link between risk and wealth. Arguably, there is no evidence that this would not mean that poor employees are more risk averse than their wealthier workmates. The difficulty here is that wealth and risk are subjective to the individual and lifestyle. However, where entrepreneurs have solid financial backers the normal financial barriers to entrepreneurship are removed and financial outcomes remain a possibility.

**PERCEPTION OF RISK**
Risk is often perceived as low since most new entrepreneurial activity comes from an exceptional execution of an often ordinary idea. For example, modifying or imitating an existing idea or through resource scarcity the entrepreneur is focused on selective strategic targets which in some way creates a competitive advantage. However, managers working in the business have been found to have a lower risk taking propensity than individuals who take most risks and have more entrepreneurial ability.

There is conflict in the research as to whether an opportunity will be acted upon at managerial level. Organisations at the recruitment stage may need to profile potential managers for either transactional or transformational characteristics depending on the designated role. Clearly, setting the organisational parameters for entrepreneurial activity and providing research and development information for prospective entrepreneurial talent shows organisational commitment towards empowerment and a delegated level of risk perceived at organisational level.

**CREATING OPPORTUNITIES**
Opportunities either arise or are created; action usually depends upon the perceived risk. The perception of events and opportunities rely on information, communication and knowledge. Profit or loss will depend on the experience and influence of the decision maker, but other factors include the determination and persistence to make the
opportunity a success and overcome both anticipated and unforeseen obstacles (i.e. sometimes called entrepreneurial Will!!). Therefore, the risk needs to be measured against the opportunity. This can be done by accountants or other professionals, or as is often the case entrepreneurial 'superior insight', this is the ability to identify an opportunity for new products or services that may or may exist or may have become more valuable to customers and unknown to competitors are now feasible.

**RISK BENEFITS**

Risk adverse people want to avoid the risk of losing something unless adequately compensated for it. This situation is often encountered in sales negotiations where unless the benefits of the product to the customer must outweigh the value of the money required to fund the purchase. Where two courses of action exist, the one with the lower risk will often be preferred; the remaining higher risk opportunity remains an opportunity. However, where the riskier venture has a higher rate of return, the increased incentive may force the risk-averse person to pursue it.

Risk is inherent in entrepreneurial endeavours since a start-up often lacks a formal structure and access to business information to guide decisions. Success in starting a new business often depends upon being disciplined and skilled enough in rooting out weak business opportunities and focusing on value-making projects. This will reduce the probability of making costly mistakes and introduces measured risk taking as an organisational concept. Organisations will however, need a method of control since not all entrepreneurs are aware of risk, are not even concerned about risk and, if there is a risk they will deal with it as and if it arises.
Some of the benefits of incorporating a risk management approach in your small business will help you:

- Achieve organizational objectives.
- Better focus on business priorities. Additionally, it enables you to focus your resources on the primary objectives. Resources are not re-directed to deal with problems. This results in increased confidence of shareholders. Taking action to prevent and reduce loss, rather than cleaning up after the fact, is an effective risk strategy.
- Create a culture that supports open discussion about risks and potentially damaging information. Your business culture should tolerate mistakes but should not tolerate hiding errors. Also, your business culture should emphasize learning from mistakes.
- Improve financial and operational management by ensuring that risks are adequately considered in the decision-making process. Improved operational management will result in more effective and efficient service delivery. By anticipating problems, your business may have more opportunity to react and take action. The company will be better able to deliver on its service promises.
- Strengthen the planning process and provide a way to help management identify opportunities.
- Increase accountability of management in the short term. In the longer term, increase overall management capabilities.
- Increase value to owners and shareholders.

Risk Management (RM) enables you to scrutinize your business and identify blatant risks that are easily managed - for instance, a weak cash-flow position, potential health and safety hazards, or key customers who could be wooed away by the competition. By grappling with these potential problems in advance, you can head off some of these problems and take the rest in stride.

Succession planning is a key part of risk management. By reviewing the risk of having to replace each of your best people, you'll know exactly what to do when your controller retires or your top sales rep turns to the dark side.

Risk Management is simply good management. It ensures that you always know the defect rate of your products, the lifespan of your equipment, the age of your receivables, and what to do if there's a flood or a flu epidemic. It helps you reduce the risk of this happening at a critical time in the business cycle.

Your staff will be more engaged and more confident knowing the business is being well managed and risk is being identified and controlled. A credible risk-management program will help you retain great people and attract new ones. They will feel confident that their job will be there tomorrow. It also ensures that all your costly talent will spend less time searching for information and more time making informed decisions.
If you have a management team you don’t need a risk specialist. Each member could start tracking appropriate risk areas. Different risk areas can be assigned to different staff or managers. For example, marketing risks can be monitored by the Marketing Manager, production risk monitored by the Production Manager, financial risk monitored by the Comptroller and so on.

**Risk and Time**

Time is recognised as an important factor in studies into entrepreneurial activity. The difficulty is measuring risk at a particular moment in time is difficult because an individual's perception of time and urgency is subjective. Here barriers to entrepreneurship will be alleviated where research and development resources are made available, however, risk seeking entrepreneurs may not be restrained by organisational structures, cultures and boundaries and will continue to acquire resources to satisfy their need for being creative and innovative.

Researchers have reached a conclusion that organisational structures which encourage flexibility are considered as referents for change but found that time impedes effective management of improvisational activities. There are different measures of time (i.e. clock time, linear time, cyclical time).

- Clock time is based on a 24 hour day and encompasses all of the events in a specified time period.
- Linear time is a concept where by time is seen sequentially, as a series of events or characteristics that are leading toward something: e.g. towards a beginning and an end.
- Cyclical time is based on specific events occurring regularly over a year. For example, spring, summer, winter and fall. Other events occur regularly, birthdays, anniversaries, etc.

For example, it is apparent that entrepreneurs are more successful on subsequent ventures and this is coherent with cyclical time as the event has happened before, perhaps many times, therefore, the risk is limited by the entrepreneur’s experience. Contrast this with emerging 'grey entrepreneurs' and linear time where exposure to opportunity and risk has been limited by age, wealth and experience become factors of time that trigger entrepreneurial activity and the taking of risks.

Clearly, the management of risk within an organisation or small business is an important competency. Identifying the people, the environment and circumstances which contribute to risk taking opportunities can enable innovations leading to a 'competitive advantage'. There are many variables to consider but organisational change is must be planned and managed based on a specific timeline. However, planning for and controlling risk and helping increase certainty will enable effective change management and help reduce the
risk of ineffective time management. Understanding risk can help improve returns and to plan for contingencies or emergencies.

Now, let’s move on and consider some questions that will allow you to reflect on what you have just read and learned.

**Self-Reflection Questions**

Think about your own approach to entrepreneurship and answer the following questions.

1. Do you see risk as an opportunity or something to be avoided?
2. What kind of risks are you particularly concerned about in your business?
3. Do you think of yourself as risk averse? Is this a good or bad trait in your opinion?

**Record your thoughts in your personal journal.**

**Topic Summary**

In this topic you have learned about some of the elements that help to define risk and risk management and how entrepreneurs view risk. You have also considered the benefits that result from implementing a risk management approach. As we move into the course, you will become familiar with each of the processes that make up risk management and begin to learn ways to apply them in a practical way to your business situation.

Now, let’s move on to the next topic in this unit and consider why it is important to undertake a risk management process as a part of your new business venture. After considering this topic you will have an opportunity to re-visit your answers to the self-reflection questions outlined above.
TOPIC 1.2 – THE TYPES OF RISKS FACED BY ENTREPRENEURS

TOPIC INTRODUCTION

Every type of risk has its own distinct set of characteristics that require different management approaches. Most people will recognise the ‘obvious’, or most apparent, risk that they are facing. For example, the owner of a take-away restaurant will immediately recognise the risk to the safety of their staff from using hot cooking oil and implements. However, the risk to the business from a new local competitor may not be as readily identified.

Small business owners are most often so focused on getting their product or service to market that they have little time to focus on the types of risk that their business potentially faces.

In other courses in this program including the Business Plan Development course, you considered a framework for analyzing markets and market opportunities. The acronym PESTEL (Political, Environmental, Social, Technological, Political and Legal) was used as a way of helping an entrepreneur to undertake an industry analysis. In this topic you will look at business risk through this lens and beyond as a way of beginning to understand the scope of risks that small businesses face.

TOPIC OBJECTIVES

Upon completion of this topic you will be able to:

1. Describe the types of business risk faced by a small business including the financial, environmental, social, technological, political, and legal risks associated with running a small business.

2. Categorize risks in relation to the type of business that you are operating or intend to operate.

FINANCIAL RISK

Let's first of all consider some of the personal and business-related financial risks that you may face as an entrepreneur starting a new business.

- Examine your personal finances

Entrepreneurs, and in particular those in start-up mode need to examine their personal finances to ensure that they can manage times when they potentially will not be able to draw a paycheck.
immediately from their new business. Remember that you’re not in this alone and realize that your family is there with you and thus share the benefits as well as the risks of your new enterprise. To ensure their support, it is important to make sure they understand exactly what you’re doing, and why. You must have a personal or home financial plan that allows you go for potentially several months without any source of income. You may need to rely on your spouse’s income or your personal savings to support your family during start-up.

✓ Know how changes in the economy will affect your business

In terms of the economy, you will want to ask yourself the following questions. What would happen to a business in your industry if inflation rose by two points? How has your type of business performed in various economic conditions? If the business is a seasonal one such as in the tourist industry, will patrons of your business be willing to travel or spend less during hard economic times?

✓ Assumption means assuming the risk and the accompanying financial burdens

Sometimes absorbing a risk is prudent. If you’re a one-person graphic-design business, no employees are going to be injured on the job. Nor are you likely to be sued for personal injury if clients infrequently visit your office. However, if you own a bakery that employs 10 people, you need to identify and where possible eliminate all of the workplace risks pertaining to employees getting injured on the job.

**OPERATIONAL RISK**

As an entrepreneur you will make hundreds of operational decisions in setting up your business and producing your product or service. All decisions that involve money involve impact the financial viability of the business, and many, like employment and facility decisions, may affect your personal finances as an owner depending on what start-up funds you need. These decisions are never finished. They will adjust and evolve as your business evolves and so will your business and personal finances.

Business operational decisions may include the following:

✓ Employment and employees

Whether to have employees, how many, and what kind of compensation to provide them are decisions that affect business finances in obvious ways. Decisions about employee benefits and retirement plans will affect you. You may elect to use part employees or
contract labour at the beginning of your business start-up. This reduces the cost, but may increase the productivity and product quality risks. Whatever you decide to do for them may have consequences for your business. In many countries, you can elect to participate in government benefit and retirement plans, which is often to your advantage. You may decide to use yourself and your spouse and/or family members as employees. But this can impact your family’s personal finances if you need their income while the business grows.

✔ Facilities and location

Early on, you’ll have to decide what kind of location, building and infrastructure your business needs (unless you are a small home-based business). That type of accommodations and infrastructure you need will likely be modified as the business grows. Facility costs are a major factor in the finances of most businesses. Key decisions on building ownership--buy vs. lease, owner buys and leases to business--are important to your personal finances and the business financial situation. Depending on the business, many entrepreneurs look to buy their facilities or to build. This could potentially become an asset that forms the basis of your long term retirement or exit strategy from the business when you are ready to leave. Sometimes the use of a home or other personal space in a business has potential personal finance consequences (and tax implications in some countries).

✔ Growth strategy and plans

Every viable business requires a strategy and plan to grow and evolve. Decisions on how to evolve and how fast you grow must be made in the context of both your business and personal finances. Many good businesses fail because they grow to quickly and they don’t have the asset base and working capital required to support rapid growth. An entrepreneur must plan for this growth and ensure the finances are in place and the market is ready to support growth. Without such a plan the business risks failure.

✔ Organization

Every entrepreneur must decide how to organize his or her business. Not only are we talking about organizing facilities and human resources, but also the basic legal and management structure of the business. The decision to incorporate or not to incorporate is an important one. If the decision is not to incorporate, decisions must be made between or among partners since these impact the tax status of the organization.

Management guidelines and collective decision making methods must be agreed upon. Who has the final say about the direction of the organization must be decided. Individual responsibilities must be captured and shared with everyone in some form of job description
or management document. Contingency plans must be in place in case things change. Like most operational decisions, the organization will continue to evolve.

✓ **Operational Risk**

Operational risks are generally considered as the risk of accident, mistake, or omission. These risks can produce potential liability for the business and the owners, depending on how the business is structured. Continuation risks concern the ability of the business to function in the case of unexpected catastrophe or unavailability of a key employee or owner. Operational risk could also include personal issues, like the health and well-being of the owner and his or her family. If the owner becomes sick or disabled who will carry on managing and growing the business? Many of these risks are assumed and covered at the business level, but the owner must consider the risks at the personal level as well.

**SOCIAL RISK**

Today, many businesses and entrepreneurs use social media web sites to market their products and do business with their clients. This media leaves certain businesses open to risk. These risks can extend to individual professionals and the owner/entrepreneur as well.

As social media sites such as LinkedIn, Twitter, and Facebook increasingly facilitate the proliferation of information about individuals, employers are increasingly using these sources to screen applicants. Entrepreneurs and professionals should not be surprised that potential investors, institutional lenders, prospective partners, or customers are also incorporating a social media investigation into their “due diligence” process. Be careful how you use these tools and only publish those ideas or messages that everyone in the public could potentially review.

To reduce your risk it is critical to take care in how you use social media and what you use it to say. According to some social media experts it is important to focus on three key “social media rules”. These are:
Rule No. 1 – Assume anything you blog about, tweet, update on Facebook, or otherwise publish will appear on the cover of the local newspaper.

Rule No. 2 – Assume you will have to explain to your mother, father, children, or any loved one why you published any of the preceding and what you were thinking at the time.

Rule No. 3 – If your social media publication involves your employer, any of its managers, employees, products, services, or customers, assume you will also have to explain why and what you were thinking when you made any such post to any of these constituents.

In addition to these “rules,” entrepreneurs and business organizations should also consider the following general points when it comes to their use of social media:

Have a social media road map

Before engaging in social media for business purposes, you need to identify the message or messages you want to communicate. For example, how your audience will benefit from the content and relationship with your social media site. It is unproductive (and annoying for the audience) to publish chaotic, incoherent messages. Potential clients must see a reason to regularly return to the site. They must feel comfortable with the message or ideas you are presenting on site.

Set the tone and make sure it is followed

It is not enough for you and your team to be on the same social media page. If multiple individuals are contributing to the site you must ensure that everyone is writing the same paragraph. In other words, you need to convey the same company message in a consistent manner and style.
✓ **Be relevant**

Just like your business, your social media strategy must be relevant. Social media must produce relevant, focused, and helpful content. Otherwise it is just noise that your target audience will ignore. To drown out the social media noise, provide relevant value in the form of tips, solutions, incentives, or new ideas.

✓ **Stagnant social media is useless**

Social media is (when done right) a dynamic conversation between you and your customers and potential customers. If your social media message becomes a one-time thing or a sporadic, infrequent event, you’ll quickly find you are the only participant in your social media conversation.

Social media is widely considered a “must’ for business organizations and professionals. Many small businesses around the world are also beginning to take advantage of this form of communication as well. Careful planning by entrepreneurs and professionals is also a must when it comes to using social media. Otherwise an errant tweet or post could bring down your career or business plans. You need to have a coherent, consistent road map for how you will deliver relevant, dynamic content to your target audience.

**POLITICAL RISK**

Small and midsize companies hesitate to venture into new markets in other countries because so much is unfamiliar: the language, the regulatory environment, the tax system, the culture. Another and often greater concern is political instability. In many parts of the world, business leaders count on predictable electoral cycles and domestic peace when they calculate risk-reward ratios. In some countries, however, eruptions of violence or widespread labor unrest periodically disrupt commerce, and governments seem to come and go with the seasons.

Those events and many others fall into the category of political risk--the impact of politics on markets. For entrepreneurs, countries fraught with such risks sometimes present the best opportunities. Nimble, small companies can respond more rapidly than large corporations to shifting political and economic conditions. With fewer fixed-asset investments, they can more easily seize on new opportunities and exit when changing costs and benefits warrant.
But that doesn't mean small companies don't suffer when things go wrong. Many look to foreign countries for critical functions like sales and operations, not just commodity services like call centres and data entry. These are significant business risks when the politics of a country is unstable or local and regional crime is not controlled because of an uncertain political climate.

Unfortunately, political risk is a subject many small and midsize businesses get wrong. Some see other companies making money in a country and dive in blindly. Some take what they consider adequate precautions by talking with a person that has spent some time working or living in the country. Others hire a local person to act as a local business agent for the business and to provide guidance on what to do and how to do it.

Before trying to manage political risk in any given market, business leaders must understand the fundamentals that pertain to all markets. The same thing applies to small business owners.

Political risk is composed of two elements: shock and stability. Shock isn't a particularly useful object of analysis because there are so many kinds and most are difficult to forecast and impossible to model. Who knows when an earthquake will hit your country or when an attack on a government by a terrorist group will occur? Events like this can change a country's balance of power and have serious implications for businesses large and small.

By contrast, stability is relatively easy to assess. Stability is the measure of a government's capacity to implement policy during a political, social, or economic crisis. Consider this scenario: A presidential election in country X generates controversy when much of the population questions the legitimacy of the official outcome. The defeated candidate challenges the result in the nation's highest court. Hundreds of thousands of demonstrators flooded city streets and crippled the government. A new election was held, and the original outcome was reversed. But the battle of political personalities at the heart of the dispute undermined public confidence in governing institutions. For businesses, questions remain about the state of corporate governance, the rule of law, and the regulatory environment.

In a politically stable country, it is institutions, not personalities that influence stability.

Now let's consider technological risk.
**TECHNOLOGICAL RISK**

For companies that rely on technology to serve their customers there are many risks. There are countless stories about servers being attacked and customer information including credit card details being compromised. If you rely on technology, and increasingly even small business does, then you need to consider the risks that come with technology.

Not that long ago this happened to a large corporation and since it was so well documented let’s spend some time considering what happened. The company in question was SONY and the incident involved its PlayStation gaming network which ended up offline for weeks and compromised the millions of its users credit card information.

In terms of the SONY crisis let’s look at some important crisis management principles employed by Sony. If implemented properly these principles will help any size company to manage technology and other types of crises more effectively by helping to prevent them or at least control them.

First, understand your customers’ perception about risk. The figure to the right provides some insight. If a company is experiencing a combination of financial issues, provides adequate financing and support to service its customers and is experiencing poor customer satisfaction, then the company is at risk of losing its customers.

Customers understand that in today’s world, that unanticipated events are bound to occur. Especially in the case of technology. It is clear that most customers are aware that there are risks inherent in providing their personal information to any company no matter how secure their services claim to be. But that does not remove the company’s responsibility from protecting that information.

When security issues arise, customers want to be assured that the company is on top of the situation. In the case of the SONY example, one wonders if they did enough to prevent the situation and protect the information that their customers shared with the company. There are also questions about whether the company communicated effectively when the security breach was discovered and whether SONY took timely actions to repair the damage that had been done.
Regardless of the how SONY handled the crisis, it was clear that they should have been more forthcoming about the situation from the outset. As some analysts have pointed out, it took the company a full week to shut down its systems and warn customers that their financial information had been compromised. That is far too long. It appears that SONY did not have a proper security breach alert mechanism.

The second risk management principle that the SONY situation demonstrates is the need to quickly restore critical business and operations processes. If that doesn’t happen the company is at risk of losing customers who, in spite of their investment in the hardware and software, will look for other solutions. When customers move to other solutions, it will not be easy for the company to regain these lost customers.

Finally, it is necessary to rebuild trust with your customers. That can be done in a number of ways but the most important in the case of SONY was the need to demonstrate to customers that they had improved their online security system and were prepared to compensate customers as a way of taking responsibility for what happened. One of the ways that SONY did this was to encourage the customers to use the SONY online platform by providing them with free credits to be used at the online SONY store.

Now that we have considered the financial, political, social and technological risks lets categorize business risks in another way.

**CATEGORIZING RISK**

An emerging concept in risk management is that there are three types of risk that companies need to manage. These are:

- Opportunity-based risk.
- Uncertainty-based risk.
- Hazard-based risk.

**Opportunity-based Risk**

There are two main aspects of opportunity-based risks: risks associated with not taking an opportunity because it is too risky or those associated with taking an opportunity even though there is considerable risk involved. The latter is a conscious decision to accept identified risk associated with an opportunity and then to implement processes to minimize any negative impacts and maximize the potential gains. Opportunity-based risk may or may not be visible or physically apparent; it is often financial; it can have a positive or negative outcome; and it can have both short-term and longer-term outcomes.

Opportunity-based risks for a small business could include:

- Moving a business to a new location.
- Acquiring new property.
✓ Expanding a business.
✓ Diversifying a product line.
✓ Using unproven technology.

Now let’s consider an opportunity-based risk case study.

**Opportunity-based Risk – Case Study**

A clothing retail store is operating in a shopping strip of a suburb of a large city.

The business relies on passing trade for sales and has had to do very little marketing over the four years of operation.

In recent times sales have been steadily decreasing. In review of the sales figures and the reasons for decreasing sales, the business owner recognizes that the foot traffic on the shopping strip significantly reduced when a shopping centre was established only five kilometres away.

The business owner had resisted moving to the shopping centre in support of the survival of the shopping strip. However, the risk to the survival of the business is now obvious and the business owner must decide to relocate or to implement additional sales and marketing strategies.

1. What are the opportunities that are associated with changing locations?
2. What are the risks associated with changing locations?

*Write your answers in your personal journal.*

**Uncertainty-based Risk**

Uncertainty-based risk is the risk associated with unknown and unexpected events. This type of risk has attracted more recognition as a result of events such as Y2K, September 11 and recent natural disasters such as the Asian tsunami.

Uncertainty-based risks are: unknown or extremely difficult to quantify; catastrophic or disastrous in nature; associated with negative outcomes; and not possible to control or influence.

Uncertainty-based risks for small business include:

✓ Physical damage to buildings, equipment and/or inventory by fire or flood.
✓ Financial loss due to an economic downturn or recession.
✓ Loss of a vital supplier.
✓ Changes in government policies or regulations.
✓ Increase in crime in target area.
✓ Loss of market share.

By their very nature, disaster and other unexpected events are unpredictable. A business owner must plan accordingly and determine how to minimize business disruption.

Now, let’s take a look at an exercise involving uncertainty-based risk.

**Uncertainty-based Risk – Case Study**

A local gardening business services a small rural town. The volume of business is enough to justify the employment of two staff on a part-time basis. It is a home business that has been in operation for three years, and is the only one of its type in the town. A new operator moves to the town and is operating under the branding of a popular franchise well known for the delivery of quality gardening services. The business owner of the existing gardening business is now faced with a major competitor and is at risk of losing market share.

1. What are the uncertainty risks that the small business owner faces in this situation?
2. What kind of strategies could you suggest to mitigate the risks faced by the owner?
3. What market research would be necessary in order to support the strategies that you are suggesting?

*Write your answers in your personal journal.*

**Hazard-based Risk**

Hazard-based risk is the risk associated with a source of potential harm or a situation with the potential to cause harm. This category of risk is the most common one associated with business risk management and is addressed by occupational health and safety programs.

Hazard-based risks for small business include:

✓ Physical hazards – including noise, temperature or other environmental factors.
✓ Chemical hazards – including storage and/or use of flammable, poisonous, toxic or carcinogenic chemicals.
✓ Biological hazards – including viruses, bacteria, fungi and other hazardous organisms.
✓ Ergonomic hazards – including poor workspace design, layout or activity and equipment usage.
Psychological hazards—that may result in physical or psychological harm, including bullying, sexual discrimination, workload or mismatch of job specification to employee capability.

Next, let’s consider the following example of a hazard-based risk:

**Hazard-based Risk**

A small cleaning company specializes in providing contract cleaning services for medical providers. A recent occupational health and safety audit conducted internally by this company identified the following hazards:

- Manual handling tasks including heavy lifting and repetitive, forceful or awkward movements.
- The work environment, including wet floors and cluttered workspaces.
- Unsafe work practices, including faulty electrical equipment.
- Prevalence of sharp materials resulting in exposure to dangerous blood-borne viruses.
- Use of hazardous chemicals.

1. What kind of approaches would you take as the owner/operator of this company to manage the risks in the workplace?
2. How would you document progress toward the elimination of the risks outlined above?

*Write your answers in your personal journal.*

You have almost completed this topic on the types of risks faced by entrepreneurs. Turn to the next page for the Topic Summary, some self-reflection questions and the assignment for this introductory unit.

**Topic Summary**

You have now completed this topic on the types of risks faced by entrepreneurs. You have learned about financial, operational, social, political, and technological risk. You have also learned how to categorize risk. This information in this topic will be useful when you deal with risk mitigation and control strategies later in this course.

Before you move on to the next topic, take a moment to reflect on what you have learned by answering the following questions.
Now let’s move on to the assignment for the first unit in the course.

ASSIGNMENT 1: DESCRIBING RISK FOR YOUR SMALL BUSINESS

Think about the small business that you are trying to establish. Provide a brief description of the business opportunity, your products/services and your potential target audience.

Once you provided a business description list the potential financial, operational, social, political, and technological risks that your business is likely to face. Classify these risks as opportunity, uncertainty, or hazard-based risks. In your report, provide a matrix that summarizes the risks your business faces. Begin to think about how to reduce or eliminate these risks.

Write your description of risk for your small business in your personal journal and provide a copy to your instructor for review and feedback.
UNIT ONE SUMMARY

In this unit you have been introduced to the subject of risk management and why it is an important issue that all entrepreneurs need to consider. The various types of risks faced by entrepreneurs were described. These included financial, operational, social, political, and technological risk. You were also provided with a way of categorizing risk that will enable you to gain a deeper understanding of where your business may be vulnerable.

NEXT STEPS

In the next unit, you will have an opportunity to develop an understanding of the principles of Risk Management by looking at from an organizational context. You will also consider how to establish a risk management approach for your business, how to look for early warning signals that your business may be at risk and how to consider ways that you can build a work culture that is supportive of uncovering risk and focusing on continuous improvement.

REFERENCES


OTHER RESOURCES

If you have access to the internet you may wish to refer to the following links as a source for ideas related to risk management principles and definitions and types of risk:


http://www.entrepreneur.com/encyclopedia/term/82574.html

UNIT TWO – THE PRINCIPLES OF RISK MANAGEMENT

UNIT INTRODUCTION

Welcome to the second unit in this course on risk management. The topics in this unit are intended to provide you with an overview of the principles of risk management especially as they impact how to structure a small business or company to better address the matters of risk and risk management.

Let’s take a moment to consider the learning objectives for this unit.

UNIT OBJECTIVES

Upon completion of this unit you should be able to:

1. Describe risk management for your small business in terms of your business goals.
2. Establish a risk management approach that is tailored to your business.
3. Understand the early warning signs that indicate your business is at risk.
4. Take steps to establish a business culture that is supportive of identifying risk.
5. Describe a business environment that will enable continuous improvement.

ASSIGNMENTS AND ACTIVITIES

There are a number of learning activities and assignments throughout this unit. The major assignment for this unit involves applying risk management principles to your business or your new business idea.

As in earlier courses, you will also be asked to complete a self-assessment to help you identify your own strengths and weaknesses. This will help you identify areas that need improvement and strengths that you can build upon.
TOPIC 2.1 – UNDERSTANDING THE ORGANIZATIONAL CONTEXT

TOPIC INTRODUCTION
In this topic you will consider the organizational context within which you will be designing and implementing a risk management program or approach. Some of the factors that you will consider are:

✓ Your business goals.
✓ The roles and responsibilities that are affected by a risk management approach.
✓ The manner in which risk is reported and communicated within your company.
✓ The degree to which stakeholders and partners are involved in managing risk.
✓ The degree to which you engage in a regular risk review cycle or process.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to:

1. Describe the SWOT and PESTEL risk analysis process.
2. Describe the steps in the initial creation of a risk management plan.

INITIAL APPROACH TO RISK ANALYSIS
There are a number of steps that small business owners can take to manage risks associated with their business. Although more will be said later in this course about many of the concepts outlined in this topic, it is useful to have this brief introduction to them at this time so that you are oriented to what you need to do to manage risk.

SWOT Analysis
It is important to remember that the impact of any risk could be either positive or negative. One way to start identifying risks is to undertake a SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. An example SWOT matrix is provided on the right.

Some events in your business environment are considered Weaknesses or Threats and will have a negative impact on your business. Similarly, events that are considered Strengths and Opportunities will have a positive impact on your business.
Let's assume that you are a small janitorial firm with 6 employees. Your company has been servicing 20-25 small business buildings in a suburban area. You have recently found out that a large office building nearby is looking for a new janitorial service. It would be a very lucrative contract, but you would have to triple the size of your company overnight to handle it. You don't want to jeopardize what you already have. Here is your SWOT analysis of the situation:

### Strengths

<table>
<thead>
<tr>
<th>1. What are your organization's core strengths?</th>
<th>Know how to do janitorial work well</th>
</tr>
</thead>
<tbody>
<tr>
<td>2. What unique resources are available?</td>
<td>Have close relations with another janitorial company.</td>
</tr>
<tr>
<td>3. What strengths can be acquired?</td>
<td>Could contract with other janitorial companies to meet the load.</td>
</tr>
</tbody>
</table>

### Weaknesses

| 4. What are the perceived weaknesses?         | Not experienced servicing large facilities. |
| 5. What resources are inadequate?             | Not enough manpower. |
| 6. What weaknesses cannot be overcome?        | Time conflicts with current contracts. |

### Opportunities

<table>
<thead>
<tr>
<th>7. What is the value of the present opportunity?</th>
<th>The contract would be very lucrative.</th>
</tr>
</thead>
<tbody>
<tr>
<td>8. Is value enhanced by evolving market-technology conditions?</td>
<td>There are many new office buildings being constructed.</td>
</tr>
<tr>
<td>9. Is value enhanced by your organization's core strengths?</td>
<td>Yes.</td>
</tr>
</tbody>
</table>

### Threats

<table>
<thead>
<tr>
<th>10. Are there market-technology conditions that reduce the value?</th>
<th>There are a limited number of available workers.</th>
</tr>
</thead>
<tbody>
<tr>
<td>11. What is the level of competition?</td>
<td>Competition is moderate.</td>
</tr>
<tr>
<td>12. Will your weaknesses limit your success?</td>
<td>Must be able to find additional workers.</td>
</tr>
</tbody>
</table>

PESTEL Analysis

If you have not yet learned how to do a SWOT analysis you might choose to undertake a PESTEL analysis. This approach was discussed in earlier courses in this program. The diagram to the left illustrates the six areas of risk that you will want to consider in such an analysis. You can use this framework to identify risk factors in your business.

Example of PESTEL Analysis

In order to formulate a strategy view, the current business environment of the auto industry is analyzed. We analyze the Opportunities and Threats of Toyota...

Political Factors
In the background of the financial crisis, each country’s government carried out the relating remedy policy to protect or stimulate each important industry, including the annotative industry. For example, in end of 2008, U.S. government gave $17.4 billion short-term loans to General Motors and Chrysler to help them. In March, 2009, Toyota has asked for $2 billion loan from the Japanese Government. These loan policies may help the vehicles corporation survive in the difficult position caused by the financial crisis. In addition, the U.S. Federal Reserve Board took the quantitative easing policy, which leads the global asset price inflation to protect U.S. trade. Therefore, these policies would help each country to spur its own automotive industry and protect others country automotive corporations to occupy the market share.

Economic Factors
The automotive industry shows the recovery evidence. The General Motors paid back $8.1 billion in emergency government loans and Chrysler demonstrated that it started to produce an operating profit. In the United States, the passenger vehicle sales rose 12.3 million in 2010 compared with 11.3 million in 2009. It is the first time that the sales exceed 10.0 million since the financial crisis, September 2008. In Canada, the revenue of passenger vehicle was 1.61 million compared with 1.56 million last year, due to the new growing point light trucks. The Asian automotive market was the bright point in the past several years. For example, the Chinese new automotive reached 9.32 million in 2010, while the Indian automotive reached to 1.82 million, which is shown in the Figure 1. These positive data will increase the confidence of investors, and the rising of Asia market will attract more automotive corporations.
Social Factors
Due to the increasing price of the oil, more and more people choose the small displacement engines due to its high efficiency. For example, 140,000 Chevrolet Cruze with small displacement engines were purchased in the first six months of 2010. This tendency will lead the manufacturer to produce the small displacement engines. For instance, GM and SAIC develop small displacement engines, and Toyota plans to launch more such types of cars in China. In addition, with the rising power of the middle class in China, they became the main purchasing power of automotive, which help China to become the largest growing car market in the world. It is demonstrated that China’s middle class occupies 23% of its total population. And the luxury cars also are preferred in China. For example, Beijing includes 8,800 billionaires and 143,000 millionaires. Most of wealthy own between a minimum of two to five luxury cars millionaires. This may lead the changing of the production direction about the vehicles types.

Technology Factors
Regarding to the precious energy resource, the demand for vehicle drove by other types of energy caused the interest of vehicle interest, so such types of vehicles were invented by the vehicles manufactures. For example, Hybrid electric vehicle is such type vehicle which comprises of a conventional engine propulsion system with an electric propulsion system. The features of these cars are to achieve both the better fuel economy and a better performance. Toyota leading brand Prius, was sold in 80 countries for 2 million in 2010. General Motor was developing innovative battery technologies and hybrid systems that will help hybrid and electric vehicles travel farther, which may be used in the brand Cleveland. This tendency may cause the basic transformation in the automotive industry, and attract more automobile manufactures concentrate on the hybrid engine system.

Environmental Factors
The waste gas emitted by the vehicles became the hot point in the recent years. The stringent emission standards for the passenger and light vehicles were adopted by the European Union (EU) Commission and the EU Parliament since 2005. In the standards, the automotive corporation must be responsible for the emission performance of these vehicles. And another severe emission standard was adopted by EU in 2009. And the EU Commission plans to carry on more severe standards. And different countries have the different emission standard. For example, the national emission standard of Australia is more stringent than several Asian countries. Thus, with the more stringent emission standard, the additional costs should be spent by the automotive manufacturers to meet it in the factors of product development, testing and manufacturing operations.

Legal Factors
Each country operated the legal policy to protect its own automobile corporation benefit. The Asian countries changed their import duty for the automobiles. For example, it is demonstrated by China government, the preferential taxes will be ended on the small displacement cars, in order to reduce the pollution in the large cities. India also reduced the import duty and excise duty on hybrid cars, and reduced the tax on the auto component aimed at helping the Indian auto component manufacturers. In 2009, U.S. government would restrict imports of Chinese commercial low cost tires, and increased the additional tariffs. This caused that the U.S. automotive corporation cannot chose the expensive European tires instead of Chinese tires, which increased the cost of the manufacturers.
Thus, the manufactures should adjust their strategy according the various ration legal policies.


A word of caution is in order. You cannot do either a SWOT analysis or a PESTEL analysis on your own. You need to brainstorm with your colleagues, mentors, employees – and if you have never done this before – a risk management consultant. Within each functional area of your organization, you should look at each process and identify risks associated with each process.

You should note the difference in the two examples provided above. Here is another example that was created using a brainstorming method. It is based on a typical sales process in a small business that sells products:

### Sales Process – Areas of Potential Risk

**Objective:** To sell the company’s products while maximizing its profit margin.

**Areas of Risk:** The sales process has the following potential areas of risk:
- product development,
- pricing,
- promotions,
- lead generation,
- lead contact,
- moving the lead to sale,
- offering the product as a demo,
- gain prospect’s trust and establish relationship,
- close the sale.

**Questions to Ask:**
- What could go wrong in each step of the process?
- If I am flooded with orders, can my production team handle the volume?

**Document Risk:**
Create a document called the Risk Register for each of the risk identified (more will be said about this document later in the course). The questions you ask are the risks. See the SWOT example.

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**Quantify the Risks You Have Identified**
The first step in the risk identification process is to determine the probability that a particular risk will occur. You could define the occurrence of each risk as a percentage or just as “High”, “Medium” and “Low”. This becomes a matter of judgment and experience; and more importantly, your perception of what the future holds in store.

Against each risk described in the risk register, you will also need to determine the impact if each risk were to occur. If you two of your key employees quit, will it positively or negatively impact your goals? Write down details on how the risk will impact your business and rate them according to the impact they will have and the probability that they will occur.

Here is a quick example of how to arrive at a risk rating. More detailed approaches will be presented later in this course.

Suppose you determine that the impact of a certain key employee leaving your organization will cost you $40,000. You also determine that the probability of this risk occurring is 40%. The risk rating in this case would be 16,000 (or 40% of 40,000). Go through this exercise with each of your risks. It is most likely that at the end of this exercise the risk with the highest rating will have the highest priority and will be the one that you want to address most urgently.

Plan a Response to Each Identified Risk

Now that you have rated each of your risks, you can decide what to do if the risk were to occur. You can:

- **Mitigate the Risk**
  This implies that you can find ways to reduce the probability of the risk occurring or that you try to reduce its impact. Usually, it’s the latter that can be controlled.

- **Accept the Risk**
  Sometimes we just have to accept the fact that there is nothing you can do if the risk occurs.

- **Transfer the Risk**
  Think about insurance. You are transferring your risk of something bad happening to another party for which you typically pay a premium.

- **Avoid the Risk**
This typically would mean changing your goals and objectives entirely. The most radical form of risk avoidance would be to shut down your business. Some other risk avoidance strategies would include:

- Don’t create the new product or provide the proposed service.
- Avoid or dump difficult customers.
- Reduce costs.
- Fire the non-productive employees.

**Exploit the Risk**

If a positive risk was to occur how could this opportunity be exploited to further your goals and objectives? For example, a potential client wants you to fly across the country to discuss a potential opportunity. This could be considered a positive risk since it will cost you money to participate in the meeting and there is no guarantee of a financial return.

The above steps support the creation of a risk management plan. As you develop your plan you should review and update your list of risks at least every quarter. You’ll be surprised on how the risk priorities change in as little as three months.

**Topic Summary**

You have now completed this topic on the principles of Risk Management. You have considered how risk can be identified using different analysis methods. This brief introduction and background will help you design and write a risk management plan that is appropriate for your small business. More detailed information about how to write a risk management plan and strategies to mitigate risk are presented later in this course in Units 3, 4, and 5.

Now, turn to the next page and take a moment to consider the self-reflection questions for this topic.
Now, let’s move on to the next topic in this unit on establishing a Risk Management Framework.

**Self-Reflection Questions**

Think about the small business that you are starting or own and its organizational context.

1. Outline your business goals.
2. Briefly describe the Political, Economic, Social, Technological, Environmental, and Legal context for your business.
3. Indicate one risk in each of the PESTEL categories that you think your company is facing or will encounter in the next year.

You may wish to put this information in the form of a table or matrix.

*Write your answers in your personal journal.*
TOPIC 2.2 – ESTABLISHING A RISK MANAGEMENT FRAMEWORK

TOPIC INTRODUCTION
In this topic, you are going to learn about how to establish a risk management framework that will enable you to identify risks and take actions to address, mitigate, or avoid risks in the future. This topic describes the common elements of a risk management framework as well as categories of risk criteria and basic capacities required by a business for effective risk management.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to:

1. Understand the use of benchmarking as a way of gauging the performance of a small business organization.
2. Use a risk management framework to help you assess risk for your business.

ESTABLISHING A RISK MANAGEMENT FRAMEWORK FOR YOUR BUSINESS
Each business must design its own risk management framework through the selection and detailed design of different risk elements. The design of a business’s framework depends on the nature of the risk it must manage, legal and regulatory considerations, available resources, and the relative value of risk assessment, operations to modify risks, risk communications, and monitoring and review.

Table 1 on the next page identifies the basic elements in a “benchmark” risk management framework. The benchmark framework is organized in terms of the typical structure of a mid-sized business; corporate decision-making (the board and senior executive), operations (line functions, supervisors, area managers, etc.), and policy and program planning (risk assessment and treatment). This framework can easily be adapted for use by small businesses.

Table 1 also indicates categories of risk criteria and risk management system criteria for each level as well as five basic capacity requirements for any risk management function. These requirements apply across all criteria. Capacity refers to your ability as a small business to actually undertake the management tasks and functions outlined in the framework.

As mentioned above, this framework can be adapted for use in a small business since many (but not all) of the tasks, functions, criteria and capacity requirements are similar. After reviewing the framework in Table 1, we will explore its use in your small business by asking a series of self-reflection questions. You may wish to create your own version of the framework for use in developing your risk management plan which will happen later in the course in Unit 5.
### Table 1: Benchmark Framework for Risk Management Decision-Making

<table>
<thead>
<tr>
<th>Management Task</th>
<th>Functions</th>
<th>Criteria</th>
<th>Capacity Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic</td>
<td>✓ Decision-making</td>
<td>✓ Business Objectives</td>
<td>Risk Communication and Consultation</td>
</tr>
<tr>
<td></td>
<td>✓ Monitoring</td>
<td>✓ Capacity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Stakeholder Relations</td>
<td>✓ Trust of stakeholders</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Transparency</td>
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<td></td>
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<td>✓ Flexibility</td>
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<td></td>
<td></td>
<td>✓ Budget</td>
<td></td>
</tr>
<tr>
<td>Tactical</td>
<td>✓ Preliminary Analysis</td>
<td>✓ Cost-effective</td>
<td>Documentation</td>
</tr>
<tr>
<td></td>
<td>✓ Risk analysis</td>
<td>✓ Stakeholder acceptance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Risk treatment options</td>
<td>✓ Uncertainty explicit</td>
<td>Best Practice</td>
</tr>
<tr>
<td></td>
<td>✓ Evaluate risk and risk treatments</td>
<td>✓ Reasonable relationship</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Pre-cautionary principle</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ comprehensive</td>
<td></td>
</tr>
<tr>
<td>Operational</td>
<td>✓ Implementation</td>
<td>✓ Achieve operational plan</td>
<td>Partners</td>
</tr>
<tr>
<td></td>
<td>✓ Quality control</td>
<td>✓ Correct failures</td>
<td>Staff</td>
</tr>
<tr>
<td></td>
<td>✓ Programs to reduce risk</td>
<td>✓ Continuous improvement</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>✓ Customer satisfaction</td>
<td></td>
</tr>
</tbody>
</table>

### AN INTEGRATED RISK MANAGEMENT FRAMEWORK

The remainder of this topic was extracted from: Treasury Board of Canada Secretariat – Available at: http://www.tbs-sct.gc.ca/pol/doc-eng.aspx?section=text&id=12254

The Integrated Risk Management Framework provides guidance to adopt a more holistic approach to managing risk. The application of the Framework is expected to enable employees and organizations to better understand the nature of risk, and to manage it more systematically.

### FOUR ELEMENTS AND THEIR EXPECTED RESULTS

The Integrated Risk Management Framework is comprised of four related elements. The elements, and a synopsis of the expected results for each, are presented below. Further details on the conceptual and functional aspects of the Framework are provided in subsequent sections of this document.

**Element 1: Developing the Risk Profile**

- the organization's risks are identified through environmental scanning;
- current status of risk management within the organization is assessed; and
the organization's risk profile is identified.

Element 2: Establishing an Integrated Risk Management Function

- management direction on risk management is communicated, understood and applied;
- approach to operationalize integrated risk management is implemented through existing decision-making and reporting structures; and
- capacity is built through development of learning plans and tools.

Element 3: Practicing Integrated Risk Management

- a common risk management process is consistently applied at all levels;
- results of risk management practices at all levels are integrated into informed decision-making and priority setting;
- tools and methods are applied; and
- consultation and communication with stakeholders is ongoing.

Element 4: Ensuring Continuous Risk Management Learning

- a supportive work environment is established where learning from experience is valued, lessons are shared;
- learning plans are built into an organization's risk management practices;
- results of risk management are evaluated to support innovation, learning and continuous improvement; and
- experience and best practices are shared, internally and across government.

The four elements of the Integrated Risk Management Framework are presented as they might be applied: looking outward and across the organization as well as at individual activities. This comprehensive approach to managing risk is intended to establish the relationship between the organization and its operating environment, revealing the interdependencies of individual activities and the horizontal linkages.

Element 1: Developing the Corporate Risk Profile

A broad understanding of the operating environment is an important first step in developing a company risk profile. Developing the risk profile at the company level is intended to examine both threats and opportunities in the context of an organization's mandate, objectives and available resources.

In building the risk profile, information and knowledge at all levels of the organization is collected to assist in understanding the range of risks they face, both internally and externally, their likelihood and their potential impacts. In addition, identifying and assessing the existing risk management capacity and capability is another critical component of developing the risk profile.
An organization can expect three key outcomes as a result of developing the risk profile:

- Threats and opportunities are identified through ongoing internal and external environmental scans, analysis and adjustment.
- Current status of risk management within the organization is assessed and challenges/opportunities, capacity, practices, and culture are recognized in planning the organization-wide management of risk strategies.
- The organization's risk profile is identified including key risk areas, risk tolerance, ability and capacity to mitigate, learning needs.

**External and Internal Environment**

Through the environmental scan, key external and internal factors and risks influencing an organization's policy and management agenda are identified. Identifying major trends and their variation over time is particularly relevant in providing potential early warnings. As noted in an earlier topic some of the external factors to be considered for potential risks include:

- **Political**: the influence of international governments and other governing bodies;
- **Economic**: international and national markets, globalization;
- **Social**: major demographic and social trends, level of citizen engagement; and
- **Technological**: new technologies.

Internally, the following factors are considered relevant to the development of an organization's risk profile: the overall management framework; governance and accountability structures; values and ethics; operational work environment; individual and corporate risk management culture and tolerances; existing risk management expertise and practices; human resources capacity; level of transparency required; and local and corporate policies, procedures and processes.

The environmental scan increases the organization's awareness of the key characteristics and attributes of the risks it faces. These include:

- **type of risk**: technological, financial, human resources (capacity, intellectual property), health, safety;
- **source of risk**: external (political, economic, natural disasters); internal (reputation, security, knowledge management, information for decision making);
- **what is at risk**: area of impact/type of exposure (people, reputation, program results, materiel, real property); and
- **level of ability to control the risk**: high (operational); moderate (reputation); low (natural disasters).

An organization's risk profile identifies key risk areas that cut across the organization (functions, programs, systems) as well as individual events, activities or projects that could
significantly influence the overall management priorities, performance, and realization of organizational objectives.

The environmental scan assists the department in establishing a strategic direction for managing risk, making appropriate adjustments in decisions and actions. It is an ongoing process that reinforces existing management practices and supports the attainment of overall management excellence.

**Assessing Current Risk Management Capacity**

In assessing internal risk management capacity, the mandate, governance and decision-making structures, planning processes, infrastructure, and human and financial resources are examined from the perspective of risk. The assessment requires an examination of the prevailing risk management culture, risk management processes and practices to determine if adjustments are necessary to deal with the evolving risk environment.

Furthermore, the following factors are considered key in assessing an organization's current risk management capacity: individual factors (knowledge, skills, experience, risk tolerance, propensity to take risk); group factors (the impact of individual risk tolerances and willingness to manage risk); organizational factors (strategic direction, stated or implied risk tolerance); as well as external factors (elements that affect particular risk decisions or how risk is managed in general).

**Risk Tolerance**

An awareness and understanding of the current risk tolerances of various stakeholders is a key ingredient in establishing the risk profile. The environmental scan will identify stakeholders affected by an organization's decisions and actions, and their degree of comfort with various levels of risk. Understanding the current state of risk tolerance of employees, customers, suppliers, as well as your own risk tolerance will assist in developing a risk profile and making decisions on what risks must be managed, how, and to what extent. It will also help identify the challenges associated with risk consultations and communication.

In general, there is lower risk tolerance for the unknown, where impacts are new, unobservable or delayed. There are higher risk tolerances where people feel more in control (for example, there is usually a higher risk tolerance for automobile travel than for air travel).

Risk tolerance can be determined through consultation with affected parties, or by assessing stakeholders' response or reaction to varying levels of risk exposure. Risk tolerances may change over time as new information and outcomes become available, as societal expectations evolve and as a result of stakeholder engagement on trade-offs.
Before developing management strategies, a common approach to the assessment of risk tolerance needs to be understood organization-wide.

Determining and communicating an organization's own risk tolerance is also an essential part of managing risk. This process identifies areas where minimal levels of risk are permissible, as well as those that should be managed to higher, yet reasonable levels of risk.

**ELEMENT 2: ESTABLISHING AN INTEGRATED RISK MANAGEMENT FUNCTION**

Establishing an integrated risk management function means setting up the corporate "infrastructure" for risk management that is designed to enhance understanding and communication of risk issues internally, to provide clear direction and demonstrate management support. The corporate risk profile provides the necessary input to establish risk management objectives and strategies. To be effective, risk management needs to be aligned with an organization's overall objectives, corporate focus, strategic direction, operating practices and internal culture. In order to ensure risk management is a consideration in priority setting and revenue allocation, it needs to be integrated within existing governance and decision-making structures at the operational and strategic levels.

To ensure that risk management is integrated in a rational, systematic and proactive manner, an organization should seek to achieve three related outcomes:

1. Management direction on risk management is communicated, understood and applied—vision, policies, operating principles.
2. Approach to operationalize integrated risk management is implemented through existing decision-making structures: governance, clear roles and responsibilities, and performance reporting.
3. Building capacity—learning plans and tools are developed for use throughout the organization.

**Strategic Risk Management Direction**

The establishment and communication of an organization's risk management vision, objectives and operating principles are vital to providing overall direction, and ensure the successful integration of the risk management function into an organization. Using these instruments can reinforce the notion that risk management is everyone's business.

It is essential that management provides a clear statement of its commitment to risk management and determines the best way to implement risk management in its organization. This includes establishing a corporate focus and communicating internal parameters, priorities, and practices for the implementation of risk management. To reinforce the corporate focus on risk management, organizations may dedicate a small number of resources to provide both advisory and challenge functions.
In establishing the strategic risk management direction, internal and external concerns, perceptions and risk tolerances are taken into account. It is also imperative to identify acceptable risk tolerance levels so those unfavorable outcomes can be remedied promptly and effectively. Clear communication of the organization’s strategic direction will help foster the creation and promotion of a supportive corporate risk management culture.

Objectives and strategies for risk management are designed to complement the organization’s existing vision and goals. In establishing an overall risk management direction, a clear vision for risk management is articulated and supported by policies and operating principles. The policy would guide employees by describing the risk management process, establishing roles and responsibilities, providing methods for managing risk, as well as providing for the evaluation of both the objectives and results of risk management practices.

**Integrating Risk Management into Decision Making**

Effective risk management cannot be practiced in isolation, but needs to be built into existing decision-making structures and processes. As risk management is an essential component of good management, integrating the risk management function into existing strategic management and operational processes will ensure that risk management is an integral part of day-to-day activities. In addition, organizations can capitalize on existing capacity and capabilities (e.g., communications, committee structures, existing roles and responsibilities, etc.)

While each organization will find its own way to integrate risk management into existing decision-making structures, the following are factors that may be considered:

- aligning risk management with objectives at all levels of the organization;
- introducing risk management components into existing strategic planning and operational processes;
- communicating corporate directions on acceptable level of risk; and
- improving control and accountability systems and processes to take into account risk management and results.

The integration of risk management into decision-making is supported by a corporate philosophy and culture that encourages everyone to manage risks. This can be accomplished in a number of ways, such as:

- seeking excellence in management practices, including risk management;
- having managers champion risk management;
- encouraging innovation, while providing guidance and assistance in situations that do not turn out favorably;
- encouraging managers to develop knowledge and skills in risk management;
- including risk management as part of employees’ performance appraisals;
• introducing incentives and rewards; and
• recruiting on risk management ability as well as experience.

Building Organizational Capacity

Building risk management capacity is an ongoing challenge even after integrated risk management has become firmly entrenched. Environmental scanning will continue to identify new areas and activities that require attention, as well as the risk management skills, processes, and practices that need to be developed and strengthened.

Organizations need to develop their own capacity strategies based on their specific situation and risk exposure. To build capacity for risk management, there needs to be a focus on two key areas: human resources, and tools and processes at both the corporate and local levels. The risk profile will identify the organization's existing strengths and weaknesses vis-à-vis capacity. Areas that may require attention include:

**Human Resources**

• building awareness of risk management initiatives and culture;
• broadening skills base through formal training including appropriate applications and tools;
• increasing knowledge base by sharing best practices and experiences; and
• building capacity, capabilities and skills to work in teams.

**Tools and Processes**

• developing and adopting corporate risk management tools, techniques, practices and processes;
• providing guidance on the application of tools and techniques;
• allowing for development and/or the use of alternative tools and techniques that may be better suited to managing risk in specialized applications; and
• adopting processes to ensure integration of risk management across the organization.

**Element 3: Practicing Integrated Risk Management**

Implementing an integrated risk management approach requires a management decision and sustained commitment, and is designed to contribute to the realization of organizational objectives. Integrated risk management builds on the results of an environmental scan and is supported by appropriate corporate infrastructure.

The following outcomes are expected for practicing integrated risk management:

• A company risk management process is consistently applied at all levels, where risks are understood, managed and communicated.
• Results of risk management practices at all levels are integrated into informed decision-making and priority setting—strategic, operational, management, and performance reporting.
• Tools and methods are applied as aids to make decisions.
• Consultation and communication with stakeholders is ongoing—internal and external.

**Tools and Methods**

At a technical level, various tools and techniques can be used for managing risk. The following are some examples:

• **risk maps**: summary charts and diagrams that help organizations identify, discuss, understand and address risks by portraying sources and types of risks and disciplines involved/needed;
• **modelling tools**: such as scenario analysis and forecasting models to show the range of possibilities and to build scenarios into contingency plans;
• **framework on the precautionary approach**: a principle-based framework that provides guidance on the precautionary approach in order to improve the predictability, credibility and consistency of its application across the federal government;
• **qualitative techniques**: such as workshops, questionnaires, and self-assessment to identify and assess risks; and
• **Internet and organizational Intranets**: promote risk awareness and management by sharing information internally and externally.

Below is another example of a risk management model. In this model, one can assess where a particular risk falls in terms of likelihood and impact and establish the organizational strategy/response to manage the risk.
In developing methods to provide guidance on risk management, the different levels of readiness and experience in the company need to be recognized. Therefore, methods need to be flexible and simple using clear language to ensure open channels of communication.

Several practical methods that could be used to provide guidance are:

- a managers' forum: where risks are identified, proposed actions are discussed and best practices are shared;
- an internal risk management advisory function: dedicated to risk management, either as a special unit or associated with an existing functional unit; and
- tool kits: a collection of effective risk management tools such as checklists, questionnaires, best practices.

**Communication and Consultation**

Communication of risk and consultation with interested and affected parties are essential to supporting sound risk management decisions. In fact, communication and consultation must be considered at every stage of the risk management process.

A fundamental requirement for practising integrated risk management is the development of plans, processes and products through ongoing consultation and communication with stakeholders (both internal and external) who may be involved in or affected by an organization's decisions and actions.

Risk communication involves a range of activities, including issue identification and assessment, analysis of the environment (including stakeholder interests and concerns), development of consultation and communications strategies, message development, working with the media, and monitoring and evaluating the public dialogue.
ELEMENT 4: ENSURING CONTINUOUS RISK MANAGEMENT LEARNING

Continuous learning is fundamental to more informed and proactive decision-making. It contributes to better risk management, strengthens organizational capacity and facilitates integration of risk management into an organizational structure. To ensure continuous risk management learning, pursue the following outcomes:

- Learning from experience is valued, lessons are shared—a supportive work environment.
- Learning plans are built into organization's risk management practices.
- Results of risk management are evaluated to support innovation, capacity building and continuous improvement-individual, team and organization.
- Experience and best practices are shared—internally and across government.

Creating a Supportive Work Environment

A supportive work environment is a key component of continuous learning. Valuing learning from experience, sharing best practices and lessons learned, and embracing innovation and responsible risk-taking characterize an organization with a supportive work environment. An organization with a supportive work environment would be expected to:

Promote learning

- by fostering an environment that motivates people to learn;
- by valuing knowledge, new ideas and new relationships as vital aspects of the creativity that leads to innovation; and
- by including and emphasizing learning in strategic plans.

Learn from experience

- by valuing experimentation, where opportunities are assessed for benefits and consequences;
- by sharing learning on past successes and failures; and
- by using "lessons learned" and "best practices" in planning exercises.

Demonstrate management leadership

- by selecting leaders who are coaches, teachers and good stewards;
- by demonstrating commitment and support to employees through the provision of opportunities, resources, and tools; and
- by making time, allotting resources and measuring success through periodic reviews (e.g., learning audits).
Now, let’s take a moment to answer the following questions before moving on to the next topic.

**Self-Reflection Questions**

Consider the small business that you are trying to start or are already running and answer the following questions.

1. In your company, who has responsibility for strategic, tactical, and operational tasks?
2. Who are your stakeholders and how important is their trust and acceptance to your business?
3. From a tactical management perspective, what would you consider important when undertaking a preliminary risk assessment?
4. How do you currently gauge the satisfaction of your customers?
5. How could customer satisfaction be considered a risk factor for a small business like yours?
6. How would you go about creating a culture of continuous improvement in your small business?

**Write your answer in your personal journal.**

**TOPIC SUMMARY**

You have now completed this brief topic on establishing a risk management framework for your small business. You have explored the relationship between a company’s structure and culture and how these factors align in a risk management framework.

The Integrated Risk Management Framework advances a more systematic and integrated approach for risk management. By focusing on the importance of risk communication and risk tolerance, it looks outside the organization for the views of Internally, it emphasizes the importance of people and leadership and the need for departments and agencies to more clearly define their roles. The Framework provides a tool that helps organizations communicate a vision and objectives for management of risk based on government values and priorities, lessons learned, best practices and consultation with stakeholders.

Now let’s move on to the next topic in which you will consider some of the early warning signs that your business may be at risk.
TOPIC 2.3 – EARLY WARNING INDICATORS

TOPIC INTRODUCTION
Many small businesses fail to recognize the early warning signs that indicate that they are at risk. In this topic you will guided through a series of questions that will enable you to determine if your business is at risk.

TOPIC OBJECTIVES
Upon completion of this lesson you should be able to demonstrate an understanding of the early warning signs that indicate when your small business may be at risk.

UNDERSTANDING THE EARLY WARNING INDICATORS OF RISK
When a company is headed for trouble, all stakeholders share the risk. Company directors, however, face added accountability. As a small business entrepreneur it is likely that you are a director of your own company and one or more of your family also sits on the board.

If a company is failing courts (based on a suit by the shareholders or co-owners) may step in to evaluate a board’s performance and look for ways to ensure that secured creditors are paid.

Board members accept the fact that they are legally responsible when they agree to serve on the board. The way the board as a whole, and its individual board members, respond will face close scrutiny should the company fail. Note: Every company that incorporates needs some form of board of directors. If it is just the co-owners and few key advisors, like your lawyer or accountant. The board approves policies and appoints senior managers.

Board denial of management problems too often render directors unable to recognize key warning signs. Astute directors and company managers will watch for these early indicators of trouble.

Directors and the small business owner are often fully aware that problems exist, yet they may delay in implementing corrective action. Excuses become easier to generate rather than the hard work it takes to bootstrap a failing company back to financial and operational health.

This denial is often veiled in stubborn pride which renders the business owner unable to recognize the key warning signs that suggest the company is on its way toward trouble.
By the time a company is in financial or operational trouble, business owner can usually do very little to save the company. Business owners need to take control of the situation before the company fails. Owners and board members must be proactive and respond appropriately to the potential signs of failure.

So what are the early warning signs that small business owners and board members need to pay attention to? The next section outlines the ten most common early warning signs that mark a company heading for trouble.

**Is the business owner over-extended?**

Whose work is the business owner really performing? When the business owner continues to perform functions that should be done by others, they are over-extended. Business owner should perform work for which no one else is as qualified. Gerber (1995) in his book the E-Myth Revisited explains that a new company has three main functions: visionary; managerial; and technical. He goes on to state that no one person can effectively perform all three functions and as entrepreneurs begin to establish their company they must clearly define their role in the company and hire or contract others to complete the activities essential to company growth and success.

You must also ask if the business owner is managing the areas critical to meet company goals or are they managing tasks that have little impact on the goals? As noted earlier, many small business owners focus on tasks with which they are familiar and avoid completion of those tasks that are needed for vibrant corporate growth. In addition the business owner may spend time at one task (such as producing a new product) and not have time to perform other essential tasks, like marketing or financial management.

Delegation is the key to dealing with over-extension, provided one has others to delegate tasks to. In a small business that may not always be the case. Define key managers' jobs to clarify role responsibility. Assess subordinates' competence; retain them if appropriate, replace them if not. Monitor key metrics so you...
will remain informed about conditions without being immersed in them.

Experienced small business owners know that financials do not show you how to run the business. Consider instead two areas: On the revenue/sales side, look at where and how revenue is generated. Is it from existing customers, contracts or new business? On the throughput/production side, look at getting the products or service out the door as fast as possible without sacrificing quality. Ask yourself how else can I bill for it? Can I use progressive billing? Do I ask for payment upfront?

**Is the turnover rate excessive?**

A sure sign of underlying problems is rapid employee turnover. This can be the result of such failings as a faulty hiring process, inadequate training, poor management or lack of employee engagement in their work. The price for ignoring this problem is high -- low morale, lost wages, recruiting costs, lack of productivity, and ultimately, failure.

You must uncover the real causes of rapid turnover early on, and rectify the problems. Clearly defined job responsibilities, performance expectations, rewards, and scope of authority will help. Spend time guiding and mentoring new employees. Talk to your employees regularly, but more importantly, listen to what they have to say. Be assured, employees know when problems exist and often they have the solution. Let them own their work.

Now, turn to the next page and answer the self-reflection questions about employee turnover.
Are communications ineffective?

Ineffective and unnecessary meetings, poorly relayed management information, or lack of inter-departmental coordination can destroy a business, even one that is growing. The larger a company the more there is a need for effective and open communications.

If all that is accomplished during meetings is a lot of personal discussion that is not on task, the blame rests squarely on the shoulders of the meeting leader. It is a leader’s duty to limit the scope of topics discussed, to establish an agenda, and stick to it. As a small business owner it is your responsibility to demonstrate leadership, organization, and management skills in relation to meetings and company communications.

That being said you can also fail to communicate important information. Communications among workers and supervisors and workers must be open and informative. Workers must not fear raising issues with superiors. Managers must be not only willing to listen, but willing to act when necessary.
Are compensation and incentive programs yielding unsatisfactory results?

While it seems obvious that you should clearly and directly reward successful job performance, it is remarkable that many companies unwittingly set up pay structures that reward performance for just doing their job, vice going above and beyond. Incentives must be tied to performance and performance must be defined and performance criteria established for each employee to achieve before a bonus is provided.

Here is an example of how one company dealt with its incentive system for employees. This company operated in a matrix organization with four selling divisions and a central support operation. The manager of professional support was on an incentive plan based on 80% utilization of labour in the pool. In this company it turned out that the “good” people were always used while the “poor” performers were not. The sales department required more support to achieve its objectives but the manager did not replace poor performers because he feared they would not be replaced. The result was lost revenue opportunity, added costs for nonperformers and a failure to meet company goals. The manager of professional support achieved his number of 80% or better utilization and therefore received his bonus even though he should have been relieved of his responsibility because he failed to provide his subordinates the qualified and motivated personnel needed to do the job.

Managers who are paid incentives based upon gross margins can be more effective than those paid on gross sales. Why? Because they share the burden of poor performance, they are more likely to take corrective action when faced with substandard performers. Pay-for-performance systems should be tied directly to the company’s goals and business plan.

Are goals not clearly stated?

Chronic failure to achieve stated business goals suggests a problem more serious than a lack of performance. Often, it implies a lack of clarity regarding the goals of the company and the goals that individuals must achieve. The goals of the shareholders, the board, the management team and employees must all be aligned. Failure to achieve business goals also indicates a failure to secure management team "buy in."
Let’s look at the goal-setting process and how to set goals and hold managers accountable for their success. Goals must be clearly articulated and agreed upon. If you cannot step back and explain the goal to others and how you will achieve it the goal has no substance. Goals need to be time limited, measurable, observable and achievable.

What is the company's goal? Goals are multi-tiered but they should start with the company vision and mission statement. What usually comes through is "... we are the best at providing a lot to everybody..." which does not really say anything. Set a vision and mission statement that tells customers, employees, and stockholders where the company is headed. If it cannot be articulated, does it really exist?

Most companies are too generic in their definition, but competition dictates that you focus on your market and your products or services. Avoid the pitfall many companies experience. Many times the strategic and operational planning process produces a plan, which sits on the shelf gathering dust until the next cycle. Performance measures that evaluate the plan’s success and resulting course correction should be a continuous process. Most of the gains your business will experience are as a result of setting business goals, measuring performance and taking corrective action to assure the business goals are achieved.

Is new business waning?

If the operation cannot foster new business opportunities and develop those into new customers than it may out of touch with the marketplace. There are several reasons that a business wanes. This includes:

- charging too much for products or services;
- being unresponsive to your customer needs;
- your products have been superseded by other competitive products;
- you have not made appropriate changes based on the ever changing needs of your market; and
- the company has failed to diversify and expand into other markets.

Commitment to winning new business is essential to corporate success, so it is crucial to identify sales targets early on and tailor specifications whenever possible. Always keep a
close eye on the customer's special needs. Develop a "we will do what it takes" attitude toward developing new business.

Are any key client relationships deteriorating?

It is hoped that every customer you have will be a repeat customer and that they will be your best sales person pitching your products and services to others. But you fail to attract and hold customers you must determine if a decrease in business from long-time customers is due to poor market conditions in your industry or poor service from you. If it is you, your small business is probably no longer meeting the customer's needs and you need to address it immediately.

You must manage customer relationships carefully. Customers are your source of revenue. Customer needs, like your own, change. Ensure you give specific responsibility for nurturing customer relationships to everyone in your company and not just to those with sales responsibilities. You must ensure that those in the company who can reach out and talk with the customers are properly trained in customer relations, have pleasant and outgoing personalities and have authority to address the immediate customer needs. Few customers will call to tell you that they are not going to buy your product or use your services any more, they just stop buying.

This is where consultants can really help small businesses with strategies to address the real issue of how customers perceive the company and its products and services relative to competition.

Does the company create products in search of markets?

Markets and competitors must be properly analysed. Disciplined self-analysis is required. Products or services developed based on potential market needs must be assessed properly or they can waste resources and be difficult to sell. One example of a well-researched product was the iPhone and iPad. No one really needed these products, or needed their capability, until the new capabilities were introduced into a virgin market place. But not every innovative idea as the same potential. For everyone one that succeeded in capturing a new and untried market, there are hundreds that failed. Money and time was wasted at chasing windmills.
It is less expensive to create awareness of a product or service that meets an existing demand, than to develop a market for products or services that does not currently exist and thus has no demand in the marketplace.

**Do financial and management reports cover the wrong information at the wrong levels?**

Financial and operational reports must be accurate, timely and pertinent since business decisions are made based on the bottom line or potential profit margin. Many businesses are managed on a profit and loss or earnings per share performance basis, rather than on the basis of cash flow or new business generated. Many small businesses, however, do operate on a cash flow basis. A few key symptoms for that a small business owner should watch for: recurring negative cash flow; excessive year-end adjustments; focus on what happened rather than what is needed to fix it.

Cash flow remains the best indicator of business health. Information is often prepared at the wrong level, making it difficult or impossible for a business owner to know what is going on inside their operations. It is important to prepare forecasts, and then manage the company to these forecasts. It is important for the entrepreneur to know how to interpret his or her financial reports and understand the budgeting and financial cycle of his or her business.

**Does the operation have a track record of failed expansion plans?**

Setbacks drain businesses of cash and effect company personnel morale. When companies fail business owners tend to 'pull in their horns' and not risk a new venture as readily. As a result the company will be less likely to grow and expand. In some cases the owners will not want to undertake expansion. They are happy with the size and scope of the company. The reason many do no wish to expand includes: because of inadequate cash; poor management; lack of vision and innovation; lack of thorough market analysis;

“This is us.”
or ineffective control systems.

If the business has more than one location, these operations must be adept at independent problem solving, decision making, team building, and managerial analysis. Managers of these independent locations may not be willing to take risks or make decisions, relying on the central office to do so.

Try to understand why you are successful in the market space and try to 'model' those conditions in a new marketplace. Modelling success can produce growth. The entrepreneurial spirit craves growth, but desire alone can drive the company only so far, and often into trouble. By modelling management skills, you can adapt to new management environments and bypass mistakes that can harm the bottom line.

Learning to look for the first signs of trouble involves a willingness to truly commit yourself as a small business owner to proper management. Likewise, the solutions are not difficult to find, and do not require magic, if you take the appropriate management action.

Another reason for failed expansion plans rests with the leadership or lack of leadership that a small business owner applies to the company.

To whom should a small business owner turn to for help during times of crisis? Diminishing sales, declining profits, mass employee exit, creditor suits, the threat of bank foreclosure, and no cash are only part of the equation are all potential problems that can be addressed if the leadership takes appropriate action. As a small business owner it is important to know who can handle the crisis management role. In most instances you will only need to look in the mirror.

If, on the other hand you have a qualified leader within the company, then delegate the job of turnaround to that person, and provide them with the support they need to get the job done. If there is no qualified or experienced person in the company, and there usually is not, you should not hesitate to locate a professional or consultant who has experience required to restore value to your troubled company. The answer often resides outside the company in the form of a corporate renewal or turnaround specialist, who has expertise in the company's lines of business. Many small business owners are reluctant to take this step but it may be the only way to save their business.
Small business owners also need to be brave enough to ask "Am I the problem?" Many times the answer is yes. It may be a question of leadership or leadership style that has led to the crisis. Leadership requirements differ between healthy, growing companies and those in trouble. These differences in style are a key to success. The business owner must decide which style is needed (or seek help to identify a style that will work in the circumstances), then act on that decision. In the stable or growth scenario, "team building" and "coaching" are often most appropriate. But in the initial crisis and subsequent turnaround situation, time is an enemy, and decisive action is mandatory.

A stable business environment allows for mistakes and longer lead times to achieve goals. Troubled companies have primarily one goal and that is to survive and get well.

There is one critical question every small business owner should ask himself or herself: "Can I stand before a bankruptcy judge, before a creditor's committee, before a shareholders’ meeting and defend with pride and conviction the path I have allowed this company to follow?"
Now, let’s take a moment to answer the following questions before moving on to the next topic.

**Self-Reflection Questions**

Think about your small business or one that you are familiar with and answer the following questions:

1. Which of the early warning indicators represent a risk factor for your business? List three that are the most likely to contribute to increased risk for your business.
2. Why did you choose the indicators that you did?
3. What would you do to prevent mitigate risk in each case?

*Write your answers in your personal journal.*

**TOPIC SUMMARY**

This topic provided you with a description and an understanding of early warning signs that your small business could be at risk. These warning signs included high turnover rates for employees, ineffective communication both internally and externally, unclear business goals, a recent loss of business, poor customer satisfaction ratings, and a tendency to build products that are in search of a market, to mention a few.

Now, let’s go on to the last topic in this unit on building a business culture that supports the identification and treatment of risk and creates a high performing organization.
TOPIC 2.4 – BUILDING A SUPPORTIVE CULTURE

TOPIC INTRODUCTION
In this topic, we will discuss the importance of building a work environment and culture that is supportive of identifying and addressing risk. Today many large organizations are focusing on what they can do to become high performing organizations with cultures that promote the identification of risk. Small companies and organizations also need to consider what they can do to build a culture that enables its employees to speak out freely about risks that they see both in the workplace and in the business environment. The time to begin creating a culture is when you are small and can consider what it means to be part of a growing and successful company.

TOPIC OBJECTIVE
Upon completion of this brief topic you should be able to list the key elements that are required to build a culture that supports the identification of risk and enables employees to address risk.

WHAT IS CORPORATE CULTURE?
Bolman & Deal (1997) in their book Reframing Organizations state that some would argue that an organizations have cultures, while others believe organizations create cultures. They go on to describe (as defined by Shein) that organizational culture is a pattern of shared basic assumptions that a group learned as it solved its problems and that the assumptions were considered appropriate to share with new members of the organization. They go on to state that over time organizations develop their own belief systems and patterns of behaviour. Symbols are important in developing cultural identity.

Wikipedia (2012) define organizational (corporate) culture as “the collective behaviour of people that are part of an organization, it is also formed by the organization values, visions, norms, working language, systems, and symbols, it includes beliefs and habits”. Culture changes from organization to organization. As an organization grows the values, systems, beliefs and habits may change as new people are hired and old ones leave the organization. This opens the organization up to potential risks as the culture changes.

Now let’s explore how we can build and maintain a healthy and supportive corporate culture that helps reduce risk and enhance productivity.
BUILDING A SUPPORTIVE CULTURE
Generally speaking, high-performance organizations are superior to their low-performance counterparts in the following areas:

✓ Their strategies are more consistent, are clearer, and well thought out.
   They are more likely than other companies to say that their philosophies and culture are consistent with their strategies.

✓ They are more likely to go above and beyond for their customers.
   They strive to be world-class in providing customer value, think hard about customers’ future and long-term needs, and exceed customer expectations. And they are more likely to see customer information as the most important factor for developing new products and services. Customer support becomes part of the culture of the company. Their employees use their skills, knowledge, and experience to create unique solutions for customers.

✓ They are more likely to adhere to high ethical standards throughout the organization.
   Everyone in the company understands and operates with the ethical standards that the company embraces. Unethical activities are not accepted.

✓ Their leaders are relatively clear, fair, and talent-oriented.
   They are more likely to promote the best people for a job, make sure performance expectations are clear, and convince employees that their behaviors affect the success of the organization.

✓ They are superior in terms of clarifying performance measures, training people to do their jobs, and enabling employees to work well together.
   The organization is people centred and treat their employees as their most valuable asset. Their employees are more likely to think the organization is a good place to work.

✓ They emphasize a readiness to meet new challenges and are committed to innovation.
   The organization is not afraid of innovation and will support the need for a research and development approach. This organization will encourage their employees to innovative and take ownership of their jobs.
High-performance organizations should strive to continuously improve. It has been found, for example, that high performers are much more likely than low performers to report that their organization-wide performance measures match their organizations’ strategies. The research reported that this was the single largest difference between the two groups.

There's likely a lesson to be learned here: like great athletes, even high-performance organizations must continuously strive to improve and “work on their games.”

Without the passion for improvement, they are unlikely to remain high performers. Change and improvement must be part of the culture. After all, there’s no shortage of business leaders who are working hard to ensure that their own companies reach the top echelons of organizational excellence.

Now, let’s consider some questions about building a supportive culture in your small business.

<table>
<thead>
<tr>
<th>Self-Reflection Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Think about your small business and answer the following questions:</td>
</tr>
<tr>
<td>1. Rate your business on the high performance criteria outlined in this topic using the following scale:</td>
</tr>
<tr>
<td>Poor – 1</td>
</tr>
<tr>
<td>Fair – 2</td>
</tr>
<tr>
<td>Good – 3</td>
</tr>
<tr>
<td>Very Good – 4</td>
</tr>
<tr>
<td>Excellent – 5</td>
</tr>
<tr>
<td>2. For each criterion, provide a reason for your rating.</td>
</tr>
<tr>
<td>3. What steps are you considering taking to improve your company’s performance?</td>
</tr>
</tbody>
</table>

Write your answers in your personal journal.
TOPIC SUMMARY
You have now completed the last topic in this unit. In this topic, you learned about the distinguishing characteristics of high performing companies and how these performance criteria positively impact corporate culture. Now it is time to work on an assignment related to what you have learned in this unit. Turn to the next page to start the assignment.
ASSIGNMENT 2: APPLYING RISK MANAGEMENT PRINCIPLES TO YOUR BUSINESS IDEA

In this assignment, you will be expected to apply risk management principles and guiding questions to your small business.

Use either a SWOT or PESTEL analysis to categorize the risks for your business that you identified in Assignment 1. Provide a written description that justifies the outcome of your analysis. You may wish to use diagrams and charts in your answer.

*Write your response to this assignment in your personal journal and submit your paper to your course instructor for review and feedback.*
UNIT SUMMARY

In this unit you considered the principles of risk management by looking at the concept through a number of different lenses or perspectives. For example, you considered the organizational context including your company’s goals, the way it is organized, the inclusion of stakeholders in feedback or review cycles, and reporting and communication. You also learned about the importance of establishing a risk management framework and building a supportive culture within your company. You also considered a number of early warning indicators that might suggest that your company is at risk.

NEXT STEPS

In the next unit, you will have the opportunity to learn about tools and processes that can be used to identify and assess risk in your company. While there are many tools that risk managers’ use, the two that we will focus on are business risk mapping and scenario building.

REFERENCES


SUPPLEMENTARY READINGS

If you have access to the internet you may wish to consider the following resources which will support your learning about the principles of risk management:


An online assessment of risk for entrepreneurs: Available at: [http://www2.gsu.edu/~wwsbp/entrepre.htm](http://www2.gsu.edu/~wwsbp/entrepre.htm)

Business Link. (nd.). Managing Risk. Available at:
http://www.businesslink.gov.uk/bdotg/action/detail?itemId=1074405311&type=RESOURCES
UNIT THREE – RISK MANAGEMENT TOOLS AND PROCESSES

UNIT INTRODUCTION

Welcome to the third unit in this course. As you learned in the last unit it is important to understand the organizational context within which you will undertake a risk assessment. An understanding of the organizational context helps you to establish a risk management framework that will work for your company. Being aware of the early warning signs that indicate that your company may be at risk is also important. Regardless of how big or small your company may be, building a culture that focuses on and supports continuous improvement by all staff at all levels will help you to determine where your company is at risk and take actions to address risk.

Building on this background, in this unit, we will consider some tools and techniques that you can use to identify your business risk and assess or map them. We will also be taking a look at how to build risk scenarios and gain experience in using these tools for situations that you face in your small business.

UNIT OBJECTIVES

Upon completion of this unit you should be able to:

1. Describe what is meant by risk identification and assessment and apply these concepts to your small business idea.

2. Apply business risk mapping tools and scenario building tools to your small business venture.

ASSIGNMENTS AND ACTIVITIES

There are a number of learning activities and self-reflection assignments throughout this unit. The major assignment for this unit involves applying the risk management tools that have been discussed to a business venture that you want to launch or one that you have already begun to implement. This assignment will help you to learn how to use these tools in ways that aligns with your organizational context, business plan and strategy.

As in earlier courses, you will also be asked to complete a self-assessment to help you identify your own strengths and weaknesses. This will help you identify areas that need improvement and strengths that you can build upon.
TOPIC 3.1 – RISK IDENTIFICATION AND ASSESSMENT TECHNIQUES

TOPIC INTRODUCTION
Historically, businesses have viewed risk as a necessary evil that should be minimized or mitigated whenever possible. In recent years, increased regulatory requirements have forced businesses to expend significant resources to address risk, and shareholders in turn have begun to scrutinize whether businesses had the right controls in place. The increased demand for transparency around risk has not always been met or met in a timely manner, however—as evidenced by the financial market crisis, where the poor quality of underlying assets significantly impacted the value of investments. In the current global economic environment, identifying, managing, and exploiting risk across an organization has become increasingly important to the success and longevity of any business.

In this brief topic you will learn about risk identification and assessment techniques that will enable you as a small business owner to address risk effectively and efficiently in your business.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to:

1. Describe what is meant by risk identification and assessment.
2. Apply the concepts of risk identification and assessment to your small business idea.

BACKGROUND

Risk assessment provides a mechanism for identifying which risks represent opportunities and which represent potential pitfalls. Done right, a risk assessment gives organizations a clear view of variables to which they may be exposed, whether internal or external, retrospective or forward-looking. A good assessment is anchored in the organization’s defined risk appetite and tolerance, and provides a basis for determining risk responses. A robust risk assessment process, applied consistently throughout the organization, empowers management to better identify, evaluate, and exploit the right risks for their business, all the while maintaining the appropriate controls to ensure effective and efficient operations and regulatory compliance.

For risk assessments to yield meaningful results, certain key principles must be considered. A risk assessment should begin and end with specific business objectives that are anchored
in key value drivers. These objectives provide the basis for measuring the impact and probability of risk ratings. Governance over the assessment process should be clearly established to ensure that risk ratings align with the business’s overall risk appetite and tolerance. Finally, capturing leading indicators (as is done through business and industry analyses and market research) enhances the ability to anticipate possible risks and opportunities before they materialize. With these foundational principles in mind, the risk assessment process can be periodically refreshed to deliver the best possible insights.

Businesses that vigorously interpret the results of their risk assessment process set a foundation for establishing an effective risk management approach and are better positioned to capitalize on opportunities as they arise. In the long run, this capability will help steer a business toward measurable, lasting success in today’s ever-changing business environment.

Now let’s move on and define exactly what is meant by risk assessment.

**DEFINING RISK ASSESSMENT**

Risk assessment is a systematic process for identifying and evaluating events (i.e. possible risks and opportunities) that could affect the achievement of objectives, positively or negatively. Such events can be identified in the external environment (e.g., economic trends, regulatory landscape, and competition) and within an business’s internal environment (e.g., people, process, and infrastructure). When these events intersect with a business’s objectives—or can be predicted to do so—they become risks. Risk is therefore defined as “the possibility that an event will occur and adversely affect the achievement of objectives.” While businesses have been conducting risk assessments for years, many still find it challenging to extract their real value. The linkage of risk assessment to drivers of shareholder value and key objectives has sometimes been lost.

The diagram to the right illustrates risk assessment as part of a four phased risk management cycle.

Risk assessments can be mandated by regulatory demands. Risk assessments can also be driven by business owners’ goals, such as business development, talent retention, and operational efficiency. Regardless of the scope or mandate, risk assessments must bring together the right parties to identify events that could affect the business’s ability to achieve its objectives, rate these risks, and determine adequate risk responses.
A robust risk assessment process forms the foundation for an effective enterprise risk management program. It is important to recognize the interrelationships between risk assessment and the other components of enterprise risk management (such as control activities and monitoring) and understand the principles and steps that help ensure the relevance and effectiveness of a risk assessment.

A heightened interest by stakeholders and a growing number of requests by interested third parties to see the results of risk assessments have triggered questions about what a risk assessment should entail, who should be involved, how to sustain and refresh the process, and how to translate results into actions and risk-informed decision making.

Let’s now consider the key principals of risk assessment in more detail.

**KEY PRINCIPLES FOR EFFECTIVE AND EFFICIENT RISK ASSESSMENTS**

For risk assessments to yield meaningful results without creating too many challenges for a business, the following key principles should be considered.

- **Governance over the risk assessment process must be clearly established**

  Oversight and accountability for the risk assessment process is critical to ensure that the necessary commitment and resources are in place, the risk assessment occurs at the right level in the business, the full range of relevant risks is considered, these risks are evaluated through a rigorous and ongoing process, and appropriate actions are taken.

  In a small business the role of oversight usually falls on the business owner or a trusted manager should the business be large enough to include one. Everyone in the company must also understand the importance of the risk assessment process. The validity of the process will in turn help to enable risk-informed decision making and guide strategy and objective setting.

- **Risk assessment begins and ends with specific objectives**

  Risks are identified and measured in relation to a business's objectives or, more specifically, to the objectives that are considered in scope for the risk assessment. Defining objectives that are specific and measurable at various levels of the business is crucial to a successful risk assessment. Evaluating the risks relative to such objectives enables resources to be reallocated in order to manage these risks and best achieve business goals.

  Failure to define risk appetite (or the amount of risk that is acceptable) could result in taking on too much risk or, conversely, not taking on enough risk to seize crucial
opportunities. A business’s definition of its risk appetite serves as a basis for determining risk tolerance, or the acceptable levels of variation that management is willing to allow for any particular risk as it pursues objectives. For example, consider the objective of pursuing employee satisfaction and retention, with an appetite of up to 6% employee turnover and an acceptable variation (or tolerance) of 2%. This would indicate that the business deems employee motivation programs and compensation structures to be appropriate as long as turnover remains at or below 6%. If turnover were to exceed 8% (6% plus 2% acceptable variation), the business would need to take further measures to counter the potential loss of institutional knowledge and the likely decline in employee morale and customer service, all of which would impact its business too significantly.

Risk tolerance levels differ based on the relative importance of the related objectives to the overall mission and the relative cost/benefit of achieving such results.

✔ Risk rating scales are defined in relation to business’s objectives

Risks are typically measured in terms of impact and likelihood of occurrence. Impact scales of risk should mirror the units of measure used for business objectives, which may reflect different types of impact such as financial, people, or reputation. Similarly, the time horizon used to assess the likelihood of risks should be consistent with the time horizons related to objectives.

Risk rating scales may be defined in quantitative or qualitative terms. Quantitative rating scales bring a greater degree of precision and measurability to the risk assessment process. However, qualitative terms need to be used when risks do not lend themselves to quantification, when credible data is not available, or when obtaining and analyzing data is not cost-effective.

Businesses typically use ordinal, interval, or ratio scales. Ordinal scales define a rank order of importance (e.g., low, medium, or high), interval scales have numerically equal distance (e.g., 1 equals lowest and 3 equals highest, but the highest is not 3 times greater than the lowest), and ratio scales have a “true zero” allowing for greater measurability (e.g., a ranking of 10 is 5 times greater than a ranking of 2). Risk rating scales are not one-size-fits-all and should be defined as appropriate to enable a meaningful evaluation and prioritization of the risks identified and facilitate dialog to determine how to allocate resources within the business.

An example of a risk matrix is provided below. This type of matrix can be used to determine the relative likelihood that a particular risk will actually impact your business. Ordinal, ratio, or interval scales could be applied to the risk rating labels on the left side of the matrix.
Management forms a portfolio view of risks to support decision making.

While risks are rated individually in relation to the objectives they impact, it is also important to bring risks together in what is called a portfolio view that pinpoints interrelationships between risks across the business. Correlations may exist, in which an increased exposure to one risk may cause a decrease or increase in another. Concentrations of risks may also be identified through this view.

The portfolio view helps businesses understand the effect of a single event and determine where to deploy systematic responses to risks, such as the establishment of minimum standards.

Consider a bank that has a number of business lines, each responsible for providing specific types of lending. Each of these business lines may be providing support to a large number of retail clients, each within its own risk tolerance level. A portfolio view of all business lines, however, might show that the business as a whole may be facing risk exposure that may exceed what it deems acceptable. It is important for businesses to recognize such concentration and the associated level of exposure it presents. If an industry is suddenly affected by a downturn in a specific sector of the economy and the lending business’s clients suffer financial hardship, the consequences could be large enough to severely impact the business’s bottom line. A portfolio view of risks enables the business to identify significant exposures across the business, determine how to reduce these as necessary, and realize potential opportunities that may exist to diversify the client base across the business and its lines of business.

The portfolio view of risks can be presented in a variety of ways but requires a certain level of consistency to enable a business to identify and monitor key issues, trends, and progress in relation to its strategic performance targets. A consistent portfolio view provides meaningful information that allows the owners and sponsors of risk assessments (senior
management and the board) to make informed decisions regarding risk/reward trade-offs in operating the business.

The portfolio view therefore enhances the ability to identify events and assess similar risks across the business, to ensure that risks are managed consistently with risk tolerance levels reflecting growth and return objectives, and to develop adequate risk responses.

**Leading indicators are used to provide insight into potential risks**

Risk reports are most meaningful and relevant when they draw out not only past events but also forward-looking analysis. Historically, businesses have tracked key performance indicators (KPIs) to help detect issues affecting the achievement of objectives.

In recent years, businesses have also been developing key risk indicators (KRIs) to help signal an increased risk of future losses or an uptick in risk events. KPIs and KRIs are tactical in nature, can be collected at any time, reported on a regular basis or as requested by management (e.g., as part of a balanced scorecard), and typically include statistics and/or metrics (often financial) that provide insight into a business’s risk position. Capturing KPIs and KRIs remains necessary, but it is also important for business leaders to prompt broader consideration of market issues that could potentially create risk to the business. Leading indicators—those data points that signal a change in the environment—are central to anticipating these types of potential risks, but they are often difficult to capture since they tend to arise from a broad set of circumstances, often in the macro-environment, that may seem remote and initially disconnected from day-to-day operations.

To illustrate these three types of indicators, consider the global credit crisis. Leading indicators included increasingly lax lending practices in which lending decisions were not adequately matched to risk (loan approval rates relative to credit ratings in the general population). KRIs included increases in refinancing activity, reduction in home values, and increases in late mortgage payments. KPIs included defaults and loan losses, including the corresponding decline in liquidity.

To identify meaningful leading indicators, management must identify and analyze changes in the business environment, such as rapid growth, changing technology, or the emergence
of new competitors that could impact the business’s ability to reach its objectives. The discipline to look beyond past events and anticipate new risks requires a forum for discussion, along with strong leadership and facilitation as part of the risk assessment process.

**Risk Assessment Examples**

It is recommended that you review one or more of the risk assessment examples provided in the following site. It provides detailed examples for retailers, service providers, administrative services, vehicle services, tourism and a wide range of industries. To view the different examples go to:


With this as an introduction to risk management assessment and a review of the examples above, take a moment to reflect on what you have learned in this topic of the course.

### Self-Reflection Questions

Earlier in this course you identified a number of risks that could impact your small business. Using a matrix similar to the one found in this topic, rate each of the risks you identified as likely, unlikely, or highly unlikely and identify the consequences for each risk as slightly harmful, harmful, or extremely harmful.

1. Based on this analysis, where do you now think that your business is most at risk?
2. What actions do you think you need to take in order to mitigate these risks?

**Write your answers in your personal journal.**

**Topic Summary**

You have now completed the first topic in this unit related to risk identification principles and assessment techniques. In this topic you learned about the key principles of risk identification and assessment and some of the ways that risks can be reported. A sample risk assessment for a small business is provided in Appendix 2.

Now, let’s go on to the next topic in the course which deals with using scenario building tools as a way of determining business risk.
TOPIC 3.2 – BUSINESS RISK MAPPING

TOPIC INTRODUCTION
In this topic you will learn about business risk mapping tools and how to apply them to your small business. You will gain a more detailed understanding of how to rate risks that your business is facing.

TOPIC OBJECTIVES
Upon completion of this lesson you will be able to:

1. Use a risk mapping tool to classify risks that may impact your business.
2. Demonstrate an understanding of the both the impact and likelihood of risks affecting your small business.

RISK ASSESSMENT SURVEYS AND RISK MAPPING TOOLS

WHAT IS A RISK MAP?
A Risk Assessment Survey and the Risk Map (such as the one below) are tools used to identify, evaluate and prioritize a group of business risks which could significantly impact a company’s or business unit’s ability to accomplish its business strategies.

A Risk Assessment Survey is used to identify and measure the significance and likelihood of business risks that occur within a function or specific process. Once the business risk is assessed, a Risk Map is used to plot the significance and likelihood of the business risk occurring. The map allows you to visualize risks in relation to each other, gauge their extent, and plan what type of controls should be implemented to mitigate the risks.
In the sample risk map above, you can see that risks in the upper right hand quadrant (those in red) are considered high risks because they could have a significant impact on the business and are highly likely to occur. Those risks in the upper left hand and bottom right hand quadrant are medium risks while those in the lower left hand quadrant are low risks since both their likelihood of occurring and their impact on the business is low.

**WHAT ARE THE BENEFITS OF USING A RISK MAPPING PROCESS?**

*Benefits include:*

- The survey and risk map link business risk significance and likelihood of occurrence in a clear, effective manner.
- Business risks are rated by overall impact on business strategies and thus, can be addressed accordingly.
- The survey can be used across the company to develop separate risk maps or one collective map.

**WHAT IS A RISK ASSESSMENT SURVEY?**

Another tool is the risk assessment survey.

The graph at the right shows the results of a survey that outlines several business risks which could significantly impact a company’s ability to accomplish its business goals. The kind of survey used will depend on the nature of the business. As a result most businesses that are interested in undertaking a risk assessment survey will create a survey that is suited to their business. The above example illustrates a number of financial and political risks that could impact a business. In this case, the business happens to be a real estate firm so it is clear that a number of the survey risks outlined are directly applicable to the real estate industry (e.g. property prices, regulations, defaults on loans, etc.). The percentages indicate the likelihood that a particular risk will have an impact on the company’s business goals.
In order to design the survey you will need to determine those risk areas that are most likely to impact your business. You can do this by using the SWOT or PESTEL analysis that was discussed earlier in this course.

Here is a process that you can use to rate the significance of business risks that you have identified. Rate the significance of each risk, without regard to the likelihood of occurrence. The rating should be based on the potential negative impact to the company if the situation or event occurred.

1. Only use each ranking number once.
2. After ranking the risk for significance, rank the likelihood that the risk will occur on a scale of 1 to 5, with 1 representing that the risk is unlikely occur and 5 that the risk is certain to occur.
3. At the end of the survey, in the space provided, list any additional significant business risks that have not been identified.

Both the significance and likelihood evaluation should be determined without regard to the processes and controls that the company has in place to manage these risks.

Now let’s consider another approach to capturing risk assessment data.

**THE RISK ASSESSMENT MAP**

The Risk Map prioritizes each risk according to significance and likelihood and maps the risks into four quadrants on a grid such as the one to right.

The scales on the x and y axes in this example range from 0 to 1.0 and are outlined in increments of 0.1. The scale can vary and for ease of use the example provided on the next page uses a scale of 1 to 10. As long as you consistently apply the scale you risk map should result in an appropriate analysis of the risks.
To map the risks your business may be facing into these quadrants, you can use the following steps:

1. For each risk, plot the significance on the vertical axis and the likelihood on the horizontal axis.

   For example, if for your business, you rated Regulatory, Industry and Environment risk as a Significance of 6 and a Likelihood of 2 you would plot it as indicated on the risk map to the right.

2. Once the top 10 risks are plotted, look at the quadrant where the risks are located. Position in the quadrant helps prioritize the risks and indicates the level of concern and attention which should be directed toward mitigating that risk given the potential impact on your company’s ability to accomplish its business strategies.

   With this as an introduction, let’s move on to the next page and consider and consider a step by step approach to risk mapping.
The Risk Map locates each risk in the following four quadrants and based on its location in on the map general recommendations how to manage the risk are provided.

I. “Prevent at Source” risks.

Risks in this quadrant are classified as Primary Risks and are rated “high” priority. They are the critical risks that threaten the achievement of company objectives. These risks are both significant in consequence and likely to occur. They should be reduced or eliminated with preventative controls and should be subject to control evaluation and testing.

II. “Detect and Monitor” risks.

Risks in this quadrant are significant, but they are less likely to occur. To ensure that the risks remain low likelihood and are managed by the company appropriately, they need to monitored on a rotational basis. Effective controls and monitoring procedures should be put into place to ensure that these high significance risks will be detected before they occur. These risks are second priority after Primary Risks.
III. “Monitor” risks.

Risks in this quadrant are less significant, but have a high likelihood of occurring sometime during the business cycle. These risks should be monitored to ensure that they are being appropriately managed and that their significance has not changed due to changing business conditions.

IV. “Low Control” risks.

Risks in this quadrant are both unlikely to occur and are not significant. They require minimal monitoring and control unless subsequent risk assessments show a substantial change, prompting a move to another risk category.

In the risk map example provided earlier, "Regulatory/Industry Environment Risk" falls into Quadrant II, suggesting that this risk should be Detected and Monitored. Although it is significant, it is somewhat less likely to occur. Detective controls should be implemented and periodic audits used to monitor the effectiveness of the controls and measures.

A completed Risk Map should give you a basis for assessing risks and addressing each one in accordance with its potential impact on your business strategies and goals.

Now, let’s take a moment to reflect on what you have learned in this topic on business risk mapping.

**Self-Reflection Questions**

In the last self-reflection exercise you considered the likelihood and impact (significance or consequences) of risk factors that you identified earlier in this course.

1. Which of these risks could be ones that are “prevent at source” risks? Why?
2. Which are “detect and monitor” risks? Why?
3. Which are “monitor” risks and why are they different than “detect and monitor risks”?
4. Which are “low control” risks? Why?

*Write your answers in your personal journal.*
TOPIC SUMMARY
You have now completed this topic which outlined how to employ a risk mapping approach to determine the Impact of different events or activities (also known as significance or consequence) and the likelihood that a particular event or activity will negatively impact your small business.

Now, let’s go on to the last topic in this unit which deals with using scenario building tools as a way of determining business risk.
**TOPIC 3.3 – USING TOOLS TO BUILD SCENARIOS**

**TOPIC INTRODUCTION**
In this topic you will learn about how to build a scenario or story that will help you understand the how current events and trends could potentially impact your small business. You will be presented with a step by step process that you can use to build scenarios and identify strategies that you can use in your risk assessment and management process.

**TOPIC OBJECTIVES**
Upon completion of this topic you will be able to:

1. Build a scenario that reflects current and future trends and events that will impact your small business.
2. Outline strategies that you can use to address risks identified through a scenario building process.

**WHAT IS SCENARIO BUILDING?**
Scenario building can be described as the development of a story which is based on the analysis and understanding of current and historic trends and events. It also includes a description of possible future situations. The development of a set of narrative scenarios will help identify possible pathways towards a vision of the future.

A scenario can be thought of as a story that describes the way the world and your business might turn out in the future. Scenarios are not specific forecasts of the future but rather a plausible description of what might happen.

Scenario building can be used to develop strategies which help businesses reach their goals and attain their vision. Scenarios should be plausible, internally consistent and based on good quality information.

The process of scenario building will help you to become aware of uncertainties, risks, and constraints that you could encounter in the future. Later in this topic we are going to consider a situation involving illegal water use (and other factors) as set out by Moriarty (Moriarty, et al., November, 2005).

Now let’s consider a methodology and the steps needed to build a scenario that will help you assess risk.
In other courses in this program you have developed a business plan which includes a vision for your business or for one that you plan on starting. This work is a necessary part of the preparatory work that you need to do before building business scenarios.

Scenarios are typically built by using a matrix which contains factors that are beyond your control (external factors). Strategies are developed by considering factors that are within your control (internal factors).

A typical scenario building matrix looks like this:

<table>
<thead>
<tr>
<th>Quadrant</th>
<th>Condition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Most important AND Less uncertain</td>
</tr>
<tr>
<td>2.</td>
<td>More important AND More uncertain</td>
</tr>
<tr>
<td>3.</td>
<td>Less important AND Less certain</td>
</tr>
<tr>
<td>4.</td>
<td>Less important and More uncertain</td>
</tr>
</tbody>
</table>

Now let’s consider the steps that are required to build a scenario.

**Step 1: Brainstorm** - Previously you learned how to use various brainstorming techniques. One of these techniques should be used to identify all internal and external factors that will affect achieving the vision that you have for your small business.

**Step 2: Classify** - The next step consists of classifying the factors as outlined in the matrix above. The factors in the upper-right quadrant which are labeled as the most important and most uncertain factors are used to differentiate between possible futures that will be described in the scenario that you write. A reduction of these key factors to two or three helps to keep the number of possible scenarios reasonable.

**Step 3: Identify Future States** - Step 3 involves the identification of different future states for each factor. The results have to be combined in order to come up with the main storyline for each scenario. The less uncertain or less important factors in the other three quadrants can be used to develop a ‘background story’ that is shared by all
of the scenarios. It is also important to brainstorm at this stage to determine which scenarios are high probability and which are low probability.

**Step 4: Write Scenarios** - In step 4, write a series of scenarios in which the factors from quadrant 1 of the matrix provide a common background story to a set of diverging possible futures described by the factors in quadrant 2. Depending upon how detailed the scenarios are, you may want to include factors from quadrants 3 and 4 or you may choose to leave them out.

**EXAMPLES OF DIFFERENT SCENARIOS**

Below are different scenarios.

![Diagram showing different scenarios](image_url)
<table>
<thead>
<tr>
<th>Community Orientation</th>
<th>Management Strategy</th>
<th>Reactive</th>
<th>Proactive</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outward</strong></td>
<td>Reactive Outward ‘Trading with the Known’ Cultural Continuity: high incorporation of external values and cultural aspects. Education system: controlled by Panamanian Government Ocean use: increased fishing for external sale. Land use: increased land use but not for internal sustenance. Land use for export. Local economy: high external trade, less internal management of exchange.</td>
<td>Proactive Outward ‘Global Kuna’ Cultural continuity: adaptive Education system: organized system with both Kuna and external focus. Ocean use: reduced fishing for external sale. Land use: increased land use for both internal use and external sale. Local economy: organized cooperative use of resources, with products remaining in the community and being exported.</td>
<td></td>
</tr>
</tbody>
</table>
SCENARIO CASE STUDY

Next, let’s consider the following matrix that includes factors identified in the Moriarty study (Moriarty, et al., November, 2005). This example was built as a part of a process to improve water supply to a village in Jordan.

<table>
<thead>
<tr>
<th>Quadrant 1</th>
<th>Quadrant 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Old water network</td>
<td>✓ Cooperation among villagers</td>
</tr>
<tr>
<td>✓ Water policies</td>
<td>✓ Inefficient agricultural marketing</td>
</tr>
<tr>
<td>✓ Low pressure in network</td>
<td>✓</td>
</tr>
<tr>
<td>✓ Illegal water use</td>
<td>✓</td>
</tr>
<tr>
<td>✓ High agricultural production costs</td>
<td>✓</td>
</tr>
<tr>
<td>✓ Lack of public awareness</td>
<td>✓</td>
</tr>
</tbody>
</table>

Increasing importance of outcome

Increasing uncertainty of outcome

The details included in the matrix could be used to write narrative scenarios that describe possible future visions of life in the village.

After the different scenarios have been written, strategies are then developed to meet the vision of the business or project. Sometimes it will be necessary to refine the vision since they can be unrealistic. Not every small business, for example, is going to become the next Apple or Microsoft.

Strategies

See the diagram on the next page.

After the different scenarios have been written down, strategies are developed to meet the vision. Sometimes it is necessary to refine the vision since visions, being desired states, tend to be unrealistic. There is often a broad nature of scenarios, so that multiple strategies can lead to the vision. Once the numerous lines of visions, scenarios and strategies have been developed, they are assessed by specialists using analytical or modelling techniques with the aim of assessing the internal logic of the strategy and likelihood of it achieving the
vision. The outcomes of this analysis are reported back to stakeholders leading to subsequent iterations.

Applicability

Scenarios (and visions) can be built at the beginning of any planning process. The scenarios developed are in turn used as a basis for identifying potential strategies and plans to achieve the vision that are feasible and desirable in terms of equity, economic efficiency and environmental sustainability. It is important that stakeholders from all levels are involved in this process. A good facilitator is of utmost importance in this process.

Advantages and Disadvantages of Scenario Building

There are several advantages and some disadvantages to using a scenario building process in your business. The advantages are:

- It improves strategy development and helps make your stakeholders more aware of risks and constraints.
- It helps you to think about a number of possible alternative ways to develop your business.
- It raises awareness concerning possible future situations and helps you as a business owner to be prepared for these situations.
Some of the disadvantages are:

- It can become quite complex so you need to restrict the number of scenarios that you build to 3 or 4 at most.
- Separating internal from external factors may not be easy. It helps to have a facilitator guide you through the process.

To learn more about scenarios and their use in building strategies it is recommended you read the following article:


Now, take a moment to reflect on what you have learned in this topic of the course.

**Self-Reflection Questions**

Answer the following questions bearing in mind the small business that you are thinking about starting or own.

1. What are the most important factors to achieving your business goals? Why?
2. What are the most uncertain factors? Why?

Write your answers in your personal journal.

**TOPIC SUMMARY**

You have now completed this topic on scenario building. This approach can help you with determining where you are likely to be in jeopardy of not achieving your business goals. It can also help you to refine your vision in order to achieve success.

Now, let’s go on to complete the third assignment in this course on risk assessment tools.
ASSIGNMENT 3: RISK ASSESSMENT

Risk Assessment Tools

With your small business in mind, select one of the following approaches or tools and then answer the questions that follow:

1. Risk Mapping
2. Scenario Building

If you selected risk mapping, build a risk assessment map for the top 10 risks that your small business is facing. Place these risks in the appropriate quadrant of a risk map. Write an explanation which outlines:

   a. Why you have selected the risks that you have, and
   b. Why you have placed them in a particular quadrant

If you selected scenario building, follow the step by step process to build at least 3 plausible scenarios for your business that lead to either your current vision for the business or an altered vision for the business. For each scenario outline the strategy or strategies that will lead your business to meet its vision. Your scenarios should be in a narrative form (i.e. in written paragraph form).

Write your response in your personal journal and send a copy of the assignment to your instructor for review and feedback.
UNIT THREE – SUMMARY

In this unit you have learned about different risk management tools and processes. Specifically, you have considered the process involved in creating and using a risk map and those involved in building business scenarios. Using these approaches will enable you to better understand the risks that your business is facing and will help you refine the vision and goals of your business.

NEXT STEPS

In the next unit, you will have the opportunity to learn about risk reduction, mitigation, and control strategies including risk avoidance, risk transfer and risk assumption.

The assignment for this unit will focus on a case study in risk reduction. You will be asked to apply the knowledge that you have learned to this point in the course and others in this and apply it.

REFERENCES


OTHER RESOURCES

If you have access to the internet you may wish to access the following online resources to support your learning:


Now, let’s move on to the next unit in this course on risk reduction, mitigation, and control strategies.
UNIT FOUR – RISK REDUCTION, MITIGATION, AND CONTROL STRATEGIES

UNIT INTRODUCTION

In this unit, you will learn about how to manage risk by using one or more of the following strategies: risk avoidance, risk reduction, risk transfer, or risk assumption.

UNIT OBJECTIVES

Upon completion of this unit you should be able to:

1. Understand when to apply risk avoidance as a strategy when dealing with risk in your small business.
2. Describe ways that you can reduce risk for your small business.
3. Distinguish between two forms of shared risk, namely risk transfer and risk assumption.
4. Demonstrate an understanding of when to apply risk transfer and risk assumption to identified risks in your business.

ASSIGNMENTS AND ACTIVITIES

There are a number of learning activities and assignments throughout this unit. The assignment for this unit involves

As in earlier courses, you will also be asked to complete a self-assessment to help you identify your own strengths and weaknesses. This will help you identify areas that need improvement and strengths that you can build upon.
TOPIC 4.1: RISK AVOIDANCE

TOPIC INTRODUCTION
Today many businesses large and small are facing a crisis of consumer confidence that has been brought on by defective products and services. In recent times we have heard about melamine in milk and pet food, e-coli in spinach, and lead in toys. Businesses are being challenged to create a culture of risk avoidance and accountability. Avoiding crises in the first place is obviously far better than having to endure the costly and disruptive consequences of dealing with such events. Risk avoidance can be thought of as elimination of risk by abandoning or refusing to undertake an activity when the risk seems too costly or will have too great an impact on the business.

In this topic you will learn about what is meant by avoiding risk and the issues that your small business will need to address as a part of its development of a risk avoidance strategy. You may find it useful to refer to the sample risk avoidance checklist in Appendix 3 as you work through this topic.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to understand when to apply risk avoidance as a strategy when dealing with risks in your small business.

WHAT IS RISK AVOIDANCE?
Risk avoidance can be defined as not performing an activity that could carry risk. As a small business owner an example would be deciding not to expand your business to a second location in order to avoid the financial, personnel and legal risks that come with it. Another example would be to not outsource production but to keep it in-house so that you can more closely control the quality of the product. Business owners that try to avoid all risks also miss out on the potential opportunities and rewards that taking risks imply. Not starting a business to avoid the risk of personal financial loss also avoids the potential of earning a profit.

Some risks aren’t worth taking in the first place. You need to think about what activities are core to your business. Is the risk a result of activities within the core business or outside it? If outside and the level of risk is deemed relatively high, then consideration should be given to avoiding that risk or the resultant losses that an event could trigger, by ceasing to undertake those activities that create the risk, or avoid undertaking an activity. For
example, if undertaking a capital expansion project may expose the organization to losses that they wouldn't be able to recover from, then the project may be scrapped. Alternately, consider if there is another way of doing things that will avoid the risk or loss. For example, a company that outsources its non-core activities is avoiding the risk from occurring internally, and dependent on the type of risk, could otherwise be avoiding any loss that may occur if the risk were to crystallize. Outsourcing may also be considered as a way of transferring risk, which as mentioned is another mitigation strategy that is explored further below.

THE IMPORTANCE OF HAVING A RISK AVOIDANCE STRATEGY

The fallout over defective products creates a variety of serious issues and challenges for businesses including lawsuits (individual and class actions), government investigations, media scrutiny, interest from the investment community, and the potential for securities claims and criminal prosecutions. As we know, the financial implications can be staggering. Moreover, the reputation and competitive standing of the company may be on the line.

Despite these high stakes, many businesses do not have a consistent or disciplined approach to risk management and accountability for product safety. That is a mistake. It is critical for businesses to consider how to avoid risk with such measures as a systematic application of "lessons learned," creation of a quality control process or undertaking a review of the critical decision-making processes involved in producing a product.

According to Davey (Davey, 2011) and others, most companies also need to expand their notion of what courts or regulators will regard as "foreseeable" and thus something that should have been prevented or avoided. A checklist for product risk is provided in the reference section at the end of this unit. It includes items that businesses that produce and sell products should pay close attention to. Some of the items on the check list are:

- Product warranties/indemnities.
- Marketing and distribution procedures.
- Ability to track and recall a product.
- Is there proposed or pending federal or state legislation which could impact the company?
- Risk of counterfeit products and or tampering.

Creating a culture of risk avoidance and accountability requires education of employees at every level. It is not always intuitive. One technique is to demonstrate to employees, in a classroom atmosphere, how the words of
people in other industries have been used against their companies in the courtroom. The same goes for internal communications, email, internal plans, etc.

It is all too common for businesses to find themselves in the position of having to explain or contextualize seemingly insensitive language or ill-considered musings in internal e-mails, memos, and marketing reports. The words contained in these documents may have little or nothing to do with the merits of a given case, but ill-chosen words or speculative musings can alter (and have altered) the dynamics of an entire legal case and made a corporate crisis more serious than it otherwise would have been. It would be appropriate to simulate a cross-examination of an employee to illustrate how what they put in writing can be misunderstood and misinterpreted years later. This can be a real eye-opener for employees at every level across the company, and it is a minimum investment which promotes risk avoidance.

In some cases, companies have literally put their products on trial within their internal operations. They will troubleshoot quality control, marketing, scientific and medical issues to determine whether their decision-making process can withstand the rigors and scrutiny of cross-examination. Outside experts can be brought in to challenge your assumptions and examine public assertions about a product.

Another important risk avoidance strategy is to consider the consistency of internal and external communications of the company on a given subject. Ideally, this is performed by independent, objective, and knowledgeable individuals who appreciate how potential claimants will exploit any divergent statements. This is part of a disciplined assessment of risk, since the lack of consistency between external and internal messages can serve as the basis for everything from a consumer fraud class action to a regulatory proceeding and may even lead to the imposition of punitive damages or criminal prosecution. This risk can also be minimized with appropriate training.

As noted in early topics in this course, the particular tools needed to assess risk will depend on the type of business that they are applied to. Regardless of the tools used, it is critical for small business owners to make a conscious effort to create a work culture of risk avoidance. Every employee should be engaged in a continual process of risk assessment and avoidance.

Now, turn to the next page and take a moment to reflect on what you have learned by answering the self-reflection questions.
**Self-Reflection Questions**

Answer the following questions while thinking about the small business that you operate or want to start.

1. Does your company create a product or service that this at risk or could be at risk?
2. What kind of risks (threats) does it pose to your business?
3. Is it possible to avoid the risks that you have identified?
4. If so, how?

**Write your answers in your personal journal.**

**TOPIC SUMMARY**

You have now completed this brief topic on risk avoidance. You learned about the importance of developing a strategy to avoid those risks that it makes sense to avoid. As in earlier topics, the notion of creating a risk aware culture in your company is considered an important strategy for ensuring that risks are identified and dealt with in a consistent and strategic manner.

Let’s move on to the next topic in this unit on risk reduction.
TOPIC 4.2: RISK REDUCTION

TOPIC INTRODUCTION
In this topic you will learn about risk reduction. Risk reduction consists of various methods to reduce the probability that a given event will occur. Although some risks cannot be avoided most can be reduced. The primary control technique is prevention including the use of safety and protective approaches.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to describe ways that you can reduce risk for your small business.

HOW DO ENTREPRENEURS REDUCE RISK?
There are many ways that entrepreneurs in small businesses can reduce risk. Effective management is clearly the best way to reduce the impact of many risks, particularly speculative risks. Careful control of financing, product development activities, production, marketing, distribution, and other management concerns help ensure that the results of most speculative risks will be profits rather than result in loss or failure of the business. Many entrepreneurs control risk by keeping fixed assets to a minimum or by renting facilities rather than using personal funds to purchase land and buildings.

Entrepreneurs do not necessarily seek out risks; they assume risks. You can reduce risk through careful planning and decision-making with activities such as the following:

1. Analysing current and future economic and market conditions.
2. Considering the consequences of alternative actions
3. Making reasonable decisions in response to conditions as they develop and change.

As you learned earlier in this course, there are many types of operational risks faced by businesses. Some of the more common ones that impact small businesses are the effect of natural disasters on supply and logistics, quality problems, supply chain, and financial problems. Risk reduction options include buying insurance protection, tightening credit control procedures, diligently following-up on unpaid invoices and rigorous cost controls.

Let’s take a look at some of the more common risk reduction options for small businesses in more detail.
DEBT REDUCTION
Small business owners should reduce their reliance on short-term and long-term debt. This reduces interest expenses and the risk posed by rising interest rates to cash flow. Debt reduction strategies involve converting debt to equity, which means giving investors a share of the company in exchange for funding; using cash flow from sales to finance operations; and refinancing variable-rate debt to fixed-rate debt to make future interest payments more predictable.

DIVERSIFICATION
Businesses that rely on one product are vulnerable to changes in customer preferences and to new product launches by other businesses. Similarly, relying on a one or two customers for the majority of sales exposes a business to considerable risk. Diversification in terms of products, customers and geographic markets reduces the risk posed by depending exclusively on one or two sources of revenue.

QUALITY CONTROL
Defective products may expose a business to expensive customer lawsuits, product recalls and regulatory action. Rigorous quality control and training are two ways to preserve a company's reputation and protect against lost market share to competitors.

HUMAN RESOURCE PLANNING
Small businesses often hire contractors instead of full-time staff to support the growth of their business. This in the short term reduces compensation and benefits expenses, but it introduces new risks. Contractors are more likely to leave for better paying full-time jobs or long term contracts, especially if the job market is good. The loosing company would then have to allocate additional resources to recruit replacements and bring them up to speed.

MENTORS
Entrepreneurs should bring on technical advisers and experienced management consultants to serve as mentors and board members, who understand the growing pains of a new business start-up. The involvement of senior credible mentors is particularly useful when applying for venture capital funding or small business loans; because it assures potential investors and lenders that the company is in capable hands.

PARTNERS
Collaborating with other small businesses, especially when bidding on large contracts, is another useful risk management tool. However, management must choose the partners with care because incapable or financially troubled partners might increase risk and liability. Businesses with complementary skills and solid fundamentals make good partners.
WALKING AWAY
Entrepreneurs should not be afraid to walk away from customers who are habitually late in making payments or whose requirements change frequently. Projects that require high initial capital investments may also not be worth the risk for a resource-constrained small business.

Take some time now to think about the following questions.

Self-Reflection Questions
Think of the small business that you run or are thinking of starting.

1. Outline the operational risks that you are facing in your business.
2. For each risk, outline a risk reduction strategy. Indicate why the strategies that you have chosen are the best alternatives for your business.

Write your answers in your personal journal.

TOPIC SUMMARY
In this brief topic you have learned about strategies that can be used to reduce operational risk. These strategies can also be used with other forms of risk. The strategies suggested include debt reduction, diversification, enhancing quality control, changing human resource practices, employing mentors, bringing in partners, and simply walking away from customers or suppliers who are not able to pay or meet deadlines.

Now, let’s move on to the next topic in this unit which is on risk transfer.
TOPIC 4.3: SHARING RISK

TOPIC INTRODUCTION
Once entrepreneurs have identified the risks they face, they must decide what to do about them. Some risks are easier to control than others and the actions of the owner will vary with the circumstances faced by individual businesses. In this topic you will learn about risk transfer and risk assumption. Risk transfer means shifting the consequences of a risk to a person or organization outside your business. The best known form of risk transfer is insurance which is the process by which an insurance company agrees to pay an individual or organization an agreed upon sum of money for a prospective future loss.

Risk assumption, also known as risk absorption or risk retention, involves the planned acceptance of the risk of loss. In some instances, reducing certain risks may be too expensive. Generally, a small business owner will assume risks in which losses that occur will not produce significant financial consequences to the business. However, determining the amount of loss that is significant is not a precise science.

TOPIC OBJECTIVES
Upon completion of this topic you will be able to:

1. Distinguish between two forms of shared risk, namely risk transfer and risk assumption.
2. Demonstrate an understanding of when to apply risk transfer and risk assumption to identified risks in your business.

RISK TRANSFER
Risk transfer is the underlying principle behind insurance transactions. Risk reduction consists of various methods to reduce the probability that a given event will occur.

For example, whenever someone purchases home insurance, he or she is essentially paying an insurance company to take the risk involved with owning a home. In the event that something does happen to the house, such as property damage from a fire or natural disaster, the insurance company will be responsible for dealing with any resulting consequences.

In today's financial marketplace, insurance instruments have grown more and more intricate and complex, but the transfer of risk is the one requirement that is always met in any insurance contract.
RISK ASSUMPTION

Risk assumption is basically an acknowledgement on the part of the small business owner that the business will assume a particular risk and deal with the consequences should the risk impact the business and its operations in the future. There are several ways that a business owner while assuming risk can limit the financial impact on the business. Two of the more common ways involve waivers and self-insurance. An example of a waiver form is shown to right.

Let’s briefly review each of these approaches. Consider the following situation. You are the owner of a small corner grocery store and require daily cleaning services after hours. You decide to hire an individual who needs the work but doesn’t have their own company and is therefore not set up to pay for insurance against injury such as worker’s compensation. In this case, you ask the individual to sign a waiver that outlines that your company is not responsible for worker’s compensation and is therefore not liable should the cleaner be injured at your store. In this case, the cleaner has assumed the risk and your company has avoided the risk. Another example would be the operation of a Zip Line company or a Bunge Jumping company where the owner requires the rider or jumper to sign a waiver that removes any responsibility for injury from the ride provider.

Mini Case Study – Sharing the Risk

A personal trainer currently has the professional indemnity insurance required to be a registered fitness professional in your country. However, he has recently completed a course in child and adolescent fitness. His insurer indicates that the current insurance policy would not cover injury to individuals under the age of 14.

In these circumstances, explain what you would do and why.

Write your answers in your personal journal.
Self-insurance involves protecting yourself against loss by setting aside one's own money. This can be done on a mathematical basis by establishing a separate fund into which funds are deposited on a periodic basis. Through self insurance it is possible to protect against high-frequency, low-severity losses. To do this through an insurance company would mean having to pay a premium that includes loadings for the company’s general expenses, cost of putting the policy on the books, acquisition expenses, premium taxes, and contingencies.

In other cases, small business owners simply acknowledge a risk and are prepared to ‘take their chances’ since it is highly unlikely to impact their business or it is of such little consequence that it will not seriously damage the business financially.

**TOPIC SUMMARY**

In this topic you have learned about two forms of risk management – risk transfer and risk assumption.

Now, take a moment to reflect on what you have learned by answering the following questions.

<table>
<thead>
<tr>
<th><strong>Self-Reflection Questions</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Think about your small business and the concepts of risk transfer and risk assumption.</td>
</tr>
<tr>
<td>1. What kind of risks are you prepared to transfer to a third party through insurance?</td>
</tr>
<tr>
<td>2. Why are you not prepared to assume these risks?</td>
</tr>
<tr>
<td>3. Could any of these risks be avoided?</td>
</tr>
<tr>
<td>4. What kind of risks are you prepared to assume?</td>
</tr>
<tr>
<td>5. Why are you prepared to assume these risks?</td>
</tr>
</tbody>
</table>

**Write your answers in your personal journal.**

Now, let’s move on to the assignment for this unit on risk reduction. Turn to the next page and read the case study and then answer the questions that follow.
ASSIGNMENT 4: RISK REDUCTION CASE STUDY