Business Risk

Specification requirement— risk taking in business—the inevitability of risk, quantifiable and unquantifiable risks, the management of risk.

What is Risk?

Business risk is a circumstance or factor that may have a material (large), and negative impact on the operation or profitability of a given firm . The business risk can result from internal conditions, as well as external factors that may be present in the wider business world.

Risk can also be expressed as "uncertainty." It means the possibility of incurring losses due to problems and circumstances, expected or unexpected.

Risk is inevitable, nothing is entirely predictable in business, and there will always be a level of probability that things will not work out as expected or hoped for. Some of the risks facing firms are entirely predictable and the likelihood of these risks occurring and the impact of these risks on the business can be measured. This type of risk is known as a **quantifiable risk**. An example of this type of risk might be 'the probability that one of our major customers goes bust and does not pay us the money owed', - a financial risk. A second type of quantifiable risk is an operational risk for example, 'the breakdown or theft of key equipment'. Other types of quantifiable risk include

- **strategic**, for example a competitor coming on to the market
- **compliance**, for example responding to the introduction of new health and safety legislation, or managing computer and client security within the firm

The types of risk described above can be planned for, and measures can be taken to minimize the effects of the risk on the business. For example insurance can be taken out against the failure of a major customer, and a service contract arranged for the machine.

A more difficult type of risk to manage is the **unquantifiable risks** that exist, the thing around the corner that is totally unexpected, or as sometimes described, the' unknown unknowns'. This type of risk is likely to include environmental risks, including natural disasters, and political and economic instability in foreign markets. Unquantifiable risks can also include the human element. Senior managers can lead businesses down paths that lead to disaster, they may be willing to take extreme risks, and a culture of risk taking may grow within firms.

Risk Management

Risk management are the activities undertaken by a firm, which are designed to control and minimize threats to the continuing efficiency, profitability, and success of its operations. The risk management process includes

- the identification and analysis of risks to which the organization is exposed,
- a measurement of the likelihood of the risks occurring

- an assessment of potential impacts on the business,
- deciding what action can be taken to eliminate or reduce risk

At the end of this risk management process the firm should have a comprehensive list of risks attached to the business. This list will form the basis for of a risk register (the formal record of risks and their potential impact etc.). The next step is to analyze and treat the risks. Within large firms specialist risk managers have a role in measuring risk and putting in place systems that reduce chances of negative outcomes occurring.

Risk management strategies include taking out insurance against financial loss or legal liability and introducing safety or security measures. Sometimes external bodies are involved in measuring and managing risk. We have recently seen this in the banking crisis where various government regulatory organizations such as the Bank of England and the Financial Services Authority have taken a great deal of interest in the levels of risk carried by banks.

A contingency plan can be used to manage the unquantifiable elements of risk, in this case a plan of action is put into place that comes into play when the business suffers major disruption to its normal working practices for whatever reason. The contingency plan will provide a strategy for continuing production, sales and other important business functions.

Notes.