Five Ways to Manage Business Risk

Risk is a part of any business plan, which is why learning how to cope with it is vital.
Risk is the positive or negative uncertainty arising from a given event.

Risk management is a plan to assure negative uncertainty does not deflect the endeavor from reaching the goals.

The Psychology of Risk

Risk management is painful

→ It’s not a natural act for humans to perform.

→ Be wary of confirmation bias—only finding evidence that supports our desired outcome. Also known as “Fox News/NPR Factor.”

Risk is hard to talk about

→ It bums us out and deflates our entrepreneurial vision.

→ Risk management is a plan to assure negative uncertainty does not deflect the endeavor from reaching the goals.
As an entrepreneur and an insurance professional, I have come to realize I have a unique perspective (not to be confused with a personality disorder) as it pertains to risk management. As an entrepreneur, I am inclined to take A LOT of risks and as an insurance advisor, my job is to prepare and protect my clients from the worst case scenario. Hence, the personality disorder. After 20 years of business ownership much risk management without risk taking stagnates growth. Understanding the best way to identify and manage risk early in a business sets the stage for long term growth and value (and more sleep and less gray hair) and a business discipline second only to surrounding yourself with great people. The good news is that a focus on risk management leaks outside of simply purchasing insurance policies and insurance experience, I have observed many successes and failures in my client’s businesses and my own company. As a result, I have determined that a healthy balance of risk taking and risk management creates the most competitive advantage and sustainability. The bottom line is too much risk taking without risk management causes a company to blow up and too and is a philosophy of business. We are going to explore the five ways to manage risk and examples of how this comes to life in many businesses.

“A healthy balance of risk taking and risk management creates the most competitive advantage and sustainability.”
Five Ways to Manage Risk:

- Insure
- Prevent
- Reduce
- Transfer
- Accept

“One way of looking at this might be that for 42 years, I’ve been making small, regular deposits in this bank of experience, education and training. And on January 15, 2009 the balance was sufficient so that I could make a very large withdrawal.”

Captain Sullenberger
Before we go running off to the insurance agent to buy policies, we should understand our role in risk management. Because even if we choose to have the insurance company take on our risks, we are going to want to prevent, reduce and transfer many of these risks so that we can minimize the amount of claims an insurance company may pay so we can keep insurance costs down and maintain productivity. If you have ever had an insurance claim, you know firsthand that it is disruptive and unpleasant at best--stealing precious time from your life and business.
Examples of *preventing* risk:

- Clear job descriptions and expectations of employees
- Creating and adhering to processes and procedures
- Drug testing and/or post offer physicals, pre-employment testing
- Close monitoring of bank balances, cash flow and checks
- Maintenance of building, equipment, and other physical assets required for business to function without disruption
- Constant recruiting for talent

Examples of *reducing* risk:

- A back up plan in case of a physical disaster to work space
- A business continuity agreement with friendly competitors—you take my orders if I am down and I will do the same for you.
- Backing up of data
- Cross training of key employee’s function
- Having a social media policy—expectations of employee conduct
Examples of *transferring* risk:

- Understand your contracts—read the fine print—know the risk so you can transfer your risk by contract where appropriate
- Use a staffing firm for employees
- Subcontract certain portions of your operation to others and transfer liability to them by contract
- Transfer to an insurance company through the Insure technique

Now that we understand the opportunities to manage risk before or side by side with insurance, we can explore the opportunity to transfer risk to an insurance company by way of an insurance policy. Below is a list of the type of insurance policies often need to protect themselves from catastrophic situations:

- Workers compensation
- General liability (premises and product)
- Professional Liability (also known as errors & omissions)
- Property insurance
- Business income
- Cyber liability
- Employment practices liability
- Health insurance
- Life and disability insurance
- Directors & officers
- Crime
- Equipment breakdown
As a responsible manager or business owner, you need to be aware of your risks. Does this mean that you should try to address each and every risk that your project might face? Probably not – in all but the most critical environments, this can be much too expensive, both in time and resources.

Instead, you need to prioritize risks. If you do this effectively, you can focus the majority of your time and effort on the most important risks.

The Risk Impact/Probability Chart (page 9) provides a useful framework that helps you decide which risks need your attention.

How to Use the Tool

The Risk Impact/Probability Chart (page 9) is based on the principle that a risk has two primary dimensions:

1. Probability – A risk is an event that “may” occur. The probability of it occurring can range anywhere from just above 0 percent to just below 100 percent. (Note: It can’t be exactly 100 percent, because then it would be a certainty, not a risk. And it can’t be exactly 0 percent, or it wouldn’t be a risk.)

2. Impact – A risk, by its very nature, always has a negative impact. However, the size of the impact varies in terms of cost and impact on health, human life, or some other critical factor.

The chart allows you to rate potential risks on these two dimensions. The probability that a risk will occur is represented on one axis of the chart – and the impact of the risk, if it occurs, on the other.
The corners of the chart have these characteristics:

- **Low impact/low probability** - Risks in the bottom left corner are low level, and you can often ignore them.

- **Low impact/high probability** - Risks in the top left corner are of moderate importance - if these things happen, you can cope with them and move on. However, you should try to reduce the likelihood that they'll occur.

- **High impact/low probability** - Risks in the bottom right corner are of high importance if they do occur, but they’re very unlikely to happen. For these, however, you should do what you can to reduce the impact they’ll have if they do occur, and you should have contingency plans Add to My Personal Learning Plan in place just in case they do.

- **High impact/high probability** - Risks towards the top right corner are of critical importance. These are your top priorities, and are risks that you must pay close attention to.
To use the Risk Impact/Probability Chart, follow these steps:

1. List all of the likely risks that your project faces. Make the list as comprehensive as possible.

2. Assess the probability of each risk occurring, and assign it a rating. For example, you could use a scale of 1 to 10. Assign a score of 1 when a risk is extremely unlikely to occur, and use a score of 10 when the risk is extremely likely to occur.

3. Estimate the impact on the project if the risk occurs. Again, do this for each and every risk on your list. Using your 1-10 scale, assign it a 1 for little impact and a 10 for a huge, catastrophic impact.


5. Develop a response to each risk, according to its position in the chart. Remember, risks in the bottom left corner can often be ignored, while those in the top right corner need a great deal of time and attention.
Five Ways to Manage Business Risk
Baker-Hopp & Associates is a leading risk management and insurance firm serving businesses and individuals in the areas of business and personal insurance and employee benefits. Our advisors focus on identifying risks critical to the client that can pose economic loss, develop a plan to control the exposure and implement solution strategies. Our process generates a reduction in insurance premiums, mitigates risk and creates long term partnerships for success.

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