Thoughts on Risk Management

By James J. Venezia

Imagine that you have built a brand and now it's literally under attack by forces that you did not even consider. Now what? How can you protect your brand from these exposures and how will you finance the ultimate loss?

Our topic, risk management, will address this question and this often overlooked subject which provides an important value with regard to maximizing an organization's return on investment (ROI).

Risk management is a disciplined process of risk identification, risk analysis, risk evaluation and the implementation of risk control and risk financing measures that protect working assets/resources from financial loss or restore these assets (and the organization) to productivity following a loss. It is the goal of the risk management process to enhance the viability and value of an organization under virtually any circumstances that the organization may be subject to – from liability created by products and services, disruption of income streams related to property damage from terrorism and natural disasters, to the effects of information theft and media exposures.

The Risk Management Process

1. Goal setting
2. Identification
3. Analysis
4. Evaluation of options
5. Implementation of "best" risk management options
6. Monitoring of the process

Goal setting establishes the vision for the risk management process within a specific organization.

Identification of loss exposures is where the risk management process begins through the use a various evaluation techniques including questionnaires, flow charts, financial statements, brainstorming and more. It requires creativity and patience as it drills down to the core of the organization to understand the organizations vulnerabilities to risk.

Analysis of identifiable risk is the next step in the process. Teamwork and input from various members of the organization are critical here. This includes an open dialogue with team members at all levels of the organization, particularly those employee positions with direct client contact.

During the evaluation phase the risks will be prioritized for their potential impact to the organization, and protective measures will be reviewed. Since risk management recognizes the scarcity of resources, the process is sensitive to utilization of resources/options in the most effective manner possible to achieve the most favorable ROI.

The implementation section of the process puts specifically evaluated measures/options in place to fulfill the risk management goals of the organization. Beyond the mechanical process of these specific action items is the human process of creating a culture that assures continued success in implementation and the final stage of monitoring.

Organizations change, industries change, the world changes and this dynamic environment requires continuous monitoring, which is the final step in the process.

Areas of Resource Risk

1. Human resources/employees
2. Stream(s) of income
3. Property
4. Product/service liability
5. Executive liability

Organizations are faced with a variety of resource-specific risks and perils. Some of these are independent, while others are interdependent and cross the line between various resources.

The number one risk consideration is related to human resources which are generally an organization's most important and most costly asset in terms of maintenance, effectiveness and peril. Loss considerations must be evaluated in areas including but not limited to:

- Employee fidelity with regard to both tangible and intangible assets such as confidential information and trade secrets
- Employment practices ranging from process and procedure to culture with emphasis on risks related to discrimination, harassment and wrongful termination
- Physical workplace and environmental issues as they relate to potential workers compensation, employee benefits and workplace effective matters
- Training and knowledge management with consideration to service-related errors and omissions as well as employee motivation and personal growth
- Liability issues as they relate to specific business systems, including technology and data management
- Other issues as developed during the various phases of the risk management process

Consider the organization's "stream(s) of income" as the next critical area of concern and evaluation. What are organizations sources of income and/or funding? In simplified terms, what are the perils that can impair this income stream? Thinking broadly, examine risk associated with nature perils, human perils and employee-related perils from hurricanes and computer hackers to employee errors and poor judgment.

Executive risk is an often overlooked discussion in the process, particularly since management is generally driving the evaluation. Errors and omissions in the management process; breech of a fiduciary duty; and failures to meet the expectations of trading partners, employees, clients, creditors or beneficiaries of the organization's operations are areas where detailed analysis can reveal unexpected risks.

What about property risk? The organization's industry or business discipline plays an obvious role with regard to the amount of tangible property that an organization employs to generate income. Less obvious is the value of intangible property and the potential liability created by its destruction or breech.

Finally, consideration must be given to potential liability created from products and services. This area necessitates an evaluation of past, present and future risks with an assessment of overlooked areas, such as the potential for product pollution liability and environmental damages. With specific regard to professional service organizations, a focus on the organization's evaluation of employee professional qualifications and communication skills is valuable.

During the process of risk/peril identification and analysis in the areas outlined above, a simple set of categories will branch out into a much more complex structure that will provide a more complete picture of the organization.

Risk Management Options

After a thorough process of risk/peril identification and analysis with respect to the above resources has been completed, it is time to evaluate the various risk management options in terms of costs, benefits and limitations.

Loss Control

- Loss reduction/prevention – Various efforts used to prevent or reduce the frequency (number of) and severity (dollar amount) of financial losses attributable by factors which the organization "is aware of" and can control.

- Duplication – The creation of duplicate services or operations in separate geographic areas, the goal of which is to distribute risk.

- Separation of exposures – Unlike duplication, exposures are separated into parts to protect a portion of the organization's operations or services.

- Avoidance of exposures – The exposure is avoided along with any potential financial rewards.

The options above have a cost. Those that offer greater certainty have a more significant cost, thus priorities and goals become driving factors in the decision.

Loss Financing

If a loss situation cannot be prevented, then the organization will need to plan on addressing the consequences of the loss. This will require financial resources, physical effort and managerial expertise. Loss financing is the planning phase that addresses the question, "where will the dollars to pay for claims come from?"

- Cash Flow Financing/Risk Retention – Pays for losses from the existing cash flow of the organization and may involve the use of previously established lines of credit.

- Contractual Risk Transfer – The use of contracts to transfer the payment of losses to another party.

- Insurance – Using limited dollars in the form of premium to purchase various levels – financial and contractual – of protection from an insurance company.

For most small to middle market organizations, insurance is the logical and cost-effective choice, bringing both the dollars necessary to finance a loss as well as important insurer expertise into the situation at a critical time.

As the tool of choice it deserves special attention with regard to the evaluation and procurement process.

Insurance

- Insurable exposures – Insurance programs can be designed to provide protection for a wide variety of exposures, but not all exposures are insurable. Weighing the cost and benefits of insurance within the context of a complete risk management plan is necessary.

- Insurance as a contract – Insurance is a contract and it requires the same amount of attention as other contracts. This is the most important point to keep in mind as price is not a fair measure of the value of an insurance program. It is solely one component.

- The broker client relationship – Brokers add value and you need to understand the value proposition prior to engaging in a relationship. Any substandard relationship is costly, thus expectations must be discussed and agreed to upfront.

- The procurement process – Purchasing agents in any industry add value by clearly understanding their client's mission and the market from which they secure products. This is equally important in the insurance transaction. A trusted professional relationship is another component made more important by the matter in which agents and brokers are compensated.

- Policy management – Insurance contracts typically have two coverage triggers; retaining and managing past insurance policies is based upon the coverage trigger concept (i.e. claims made or occurrence.)

- Insurance in contracting relationships – Engaging in contracts whether you are the lead or general contractor or a subcontractor requires careful evaluation of the organization's insurance coverage as well as the coverage provided by your business/project team/partners.

- Claim management – At that critical time of a claim, what's the "drill" and the involvement of the insurer, the broker and/or any third party adjusters?

Monitoring

The risk management process is never complete. It is a dynamic process that requires awareness and monitoring of expected vs. actual results and the various changes that require activity throughout the year. Change comes in many ways:

- Economic
- Financial
- Systems
- Strategic
- Legal
- Succession related

Creating a risk management and a risk-oriented organizational culture will offer a higher degree of certainty that your organization can weather any storm and, in the worst case survive, but in the best case continue to operate profitably.

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