



Boom, bust and risk management

By David Hillson

The media have been full of gloom and doom for many months now, arising from massive and continuing volatility in the world's financial markets, coupled with steeply rising energy and food prices. New phrases have entered the popular vocabulary, such as 'credit crunch', 'subprime mortgages', and even 'synthetic collateralised debt obligations (CDOs)'. Banks and building societies previously thought to be invulnerable have experienced balance-sheet shocks leading to huge write-downs in value, with knock-on effects into the wider stock markets. Commentators are openly using the R-word, suggesting that the UK economy is about to enter a recession that may be as bad as the Great Depression of the 1930s. A recent Ernst & Young ITEM Club report spoke of the likely future for the UK economy resembling a horror movie. Political and business leaders seem unable to exercise any positive influence on events, and appear to be mere bystanders as the situation unfolds. Some believe we are seeing the re-emergence of the infamous boom-and-bust cycle from The Bad Old Days.

The response to these conditions has been both predictable and flawed. In the light of the serious economic situation and general downturn in business and the markets, organisations are calling for severe and radical cost-reduction measures, using a range of euphemisms such as belt-tightening, efficiency savings, and re-engineering the cost base. All non-essential costs are being identified and cut in an attempt to reduce the pain being felt by organisations large and small, in the hope of increasing their 'survivability' in these difficult times. And the list of so-called non-essentials includes all the usual victims: recruitment is 'on hold' or staff are being 'let go', new investments in product development or R&D are being delayed or shelved, budgets for training and other forms of staff development are being reduced, and so on.

While these cost-cutting measures may be effective in the near term, they are, of course, short-sighted, since recruitment, research and staff skills are vital contributors to the ongoing health and performance of any organisation. It is only a matter of time before businesses have to return to these practices, since they represent necessary investments rather than avoidable costs.

There is one new entry on the list of potential cost savings, which some suggest is a natural candidate for removing unnecessary cost from any organisation, namely risk management. Several potential clients have told us recently that they would like to establish or improve their approach to risk management, but they were being hampered by budgetary constraints. The argument is that since risks are merely uncertain future events that may never happen, there is no need to spend time and effort (and therefore cost) on identifying, assessing and managing them. Instead, the organisation should ensure that its fundamental structures and processes are sound and resilient, and should only react when it is absolutely necessary to do so, if risks materialise into actual events. Reducing the effort spent on risk management produces cost savings in two ways. Firstly, staff are not spending time on the risk process, attending risk workshops, producing risk registers or reports, or reviewing risk assessments to keep them up to date. Secondly, time and money will not be spent on new actions which are deemed necessary to respond to identified risks. Cut risk management and you can remove the dual costs of assessing risks and of addressing risks, or so the argument goes.

As a risk specialist, you might expect the Risk Doctor to object to this approach! But are there any valid reasons for keeping risk management in straitened times when all non-essential costs are rightly being removed wherever possible? Fortunately there are several.

Firstly, risk management should be seen in the same light as many of the other so-called 'non-essential costs', such as recruitment, research or training. Risk management is an investment in an organisation's ability to cope with an uncertain future. It is not a pure cost, since the goal of risk management is to provide sufficient advance warning of significant risks to allow threats to be avoided or minimised, and to exploit and maximise opportunities. Time and effort allocated to managing risk in advance should be seen as 'spend to save' (by stopping potential bad things from happening so we don't have to deal with them later), or as 'spend to gain' (by capturing additional benefits and creating value).

Secondly, a proper understanding of risk exposure will allow an organisation to set aside appropriate levels of contingency to cope with the effects of likely future uncertainties. Instead of hoping to muddle through and cope with any unexpected crisis 'if and when it occurs' (as it surely will), targeted resources can be pre-positioned ready to be used when the need arises. This will contribute to the flexibility and resilience which are so vital to organisational survival in these turbulent times.

Finally, for the organisation that is serious about cost reduction and efficiency savings, risk management offers analysis and actions which aim to reduce waste, cut rework, maximise productivity, and support successful delivery. Avoiding and minimising threats naturally cuts out additional costs, by proactively dealing with potential problems before they have a chance to have any negative effect. And a risk process that includes opportunity management will automatically result in performance that is faster, smarter and cheaper.

There is no doubt that all sectors of industry and society are facing real challenges in coping with the current fallout from the credit crunch. But risk management should not be regarded as a non-essential cost to be cut in these difficult times. Instead, organisations should use the insights offered by the risk process to ensure that they can handle the inevitable uncertainties and emerge in the best possible position in future. With high levels of volatility surrounding us on all sides, risk management is more needed now than ever, and cutting it would be a false economy. Rather than treating risk management as part of the problem, we should see it as a major part of the solution.

About the author

Dr David Hillson, PMP, HonFAPM, FIRM, is an international risk management consultant, and Director of Risk Doctor & Partners (www.risk-doctor.com). He is a popular conference speaker and award-winning author on risk. He is recognised internationally as a leading thinker and practitioner in the risk field, and has made several innovative contributions to improving risk management. David is an active member of the global Project Management Institute (PMI) and received the PMI Distinguished Contribution Award for his work in developing risk management over many years. He is also a Fellow of the UK Association for Project Management (APM) and a Fellow of the UK Institute of Risk Management (IRM).

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