

The cost of managing risk

by Dr David Hillson, director, Risk Doctor & Partners

Managing risk is not a cost-free option. David Hillson looks at the issues

Many organisations considering whether to invest in risk management ask an important and valid question: 'What is the Return On Investment (ROI)?'

ROI has two components: the amount invested (cost), and the return achieved (benefit). Calculating ROI is therefore essentially a cost-benefit analysis. While the benefits from effectively managing risk are clear and many (these will be the topic of next month's column!), the cost question is not simple. Risk management is not free, it must be paid for somehow, but is it worth it? There is no 'zero-cost option' for risk management, and the costs to be paid fall into three categories: one-off, ongoing, and occasional.

First are the costs of entry, paid once by an organisation to establish its initial risk management capability. The primary cost here is for the 'Three T's': techniques, tools and training. Any organisation wishing to manage risk has to invest in the necessary infrastructure to support the risk process. Techniques and procedures must be developed and rolled out. Tools to support the process must be bought or developed. And staff must be trained to use the techniques and tools effectively. If the entry cost is not paid, risk management remains merely a good intention, with no capability to deliver.

The second type of costs is for ongoing maintenance, to preserve an effective organisational risk management capability. It is important to keep the risk process fresh and up to date. Without ongoing development of the risk process, there is a danger of losing effectiveness. Risk management is a developing discipline, and new techniques and tools emerge regularly. Even the conceptual basis continues to grow as new ideas become accepted into the mainstream. And staff movements mean that new people join the organisation who may lack the necessary competence or understanding. Effective risk management requires refresher training to maintain and develop staff skills, as well as revitalising the process to incorporate recent developments and new approaches. On average an organisation should aim to refresh its risk process every 2-3 years to stay up to date.

Thirdly there are the costs associated with managing risk on projects. Each unique project faces a unique risk challenge, and managing this challenge incurs costs both for assessing risk and for addressing risk.

● **Assessing risk:** These are the costs of implementing the risk process on the project, including spending time and resources in risk identification workshops or interviews, performing risk assessments and analyses, attending risk reviews, producing and maintaining the Risk Register, writing risk reports etc.

● **Addressing risk:** This covers the cost of executing risk response plans, those actions which were not originally in the project plan, but which are deemed necessary in order to deal appropriately with identified risks. Proactive actions are needed to address both threats and opportunities, and the costs of these actions fall under two headings: 'Spend to save' (avoid or reduce threats), and 'Spend to gain' (exploit or enhance opportunities). Contingency and fallback plans must also be put in place in case risks occur. These costs would not have been incurred if risks had not been identified, but they are necessary to optimise the chances of achieving project objectives.

If an organisation is serious about managing its risk, it must be prepared to pay all of these types of costs. This is particularly true of projects, which tend to have fixed budgets. Risk management will never be effective if it is seen as an optional zero-cost extra. The cost of assessing risk must be included in the overall project management budget, and there must be adequate contingency in the project budget to cover the costs of addressing risks.

In addition to these 'hard costs' which can be measured in cash or effort, there are also 'soft costs' which are an essential part of the cost-benefit analysis for risk management. These include: a top-down commitment to implementing risk management across the organisation and within its projects; a committed and proactive risk-aware attitude which recognises risk and is determined to address it; and a degree of organisational courage required to operate confidently in an uncertain environment in order to gain the rewards available from embracing risk. While these soft costs may be hard to quantify, they form an essential component of the investment required if

an organisation is to gain the full benefit from its risk management process.

Of course there is a cost-benefit relationship from investing in risk management. Risk management delivers a wide range of benefits to the organisation and to its projects, clients and staff. Although it may be hard to measure the Return On Investment for risk management, it is certain that no benefits will be realised unless the organisation is prepared to pay these costs. Indeed, not paying the cost to implement risk management exposes an organisation to another unnecessary cost – the impact of unmanaged risk. This includes avoidable threats which turn into problems, missed opportunities which could have delivered extra value, more failed projects delivering reduced business benefits, dissatisfied clients and damaged reputations, demotivated staff with reduced productivity, and so on.

The answer to the question 'Is risk management worth it?' is a definite yes – if we pay the cost we will reap the benefits.

About the author

Dr David Hillson, PMP, FAPM, 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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