What is risk?

Towards a common definition

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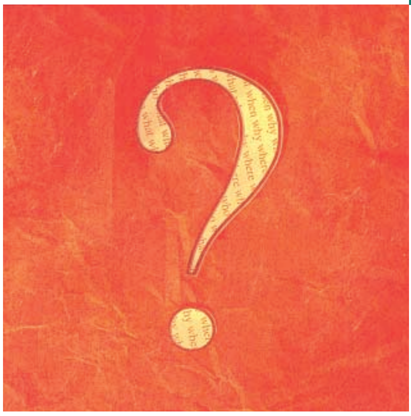
An article by Margaret Davis FIRM in the *June/July 2001 issue of InfoRM* (pages 16-19), addressed the important question "What is Risk?", concluding that there does not appear to be a single definitive answer, with the author describing six different ways of using the word "risk"! The article ended by raising several issues to be resolved by the risk management community, including :

- Risk management professionals must get the terminology right
- We must clarify whether or not risk includes upsides (opportunities) as well as downsides (threats)
- The scope of the risk management process must be defined
- The role of the risk manager should be better understood

Perhaps the first two of these issues are easier to deal with, and certainly they need to be right before we can proceed to the other two. So where do we stand on the question of terminology and definitions?

As risk management practitioners and professionals, we think we know what we mean when we talk about risk. And when we're talking to others, whether they are clients, colleagues or friends, we assume that they share our understanding of the term. After all it's a common word, so surely it has a commonly accepted meaning? But maybe the question isn't so simple after all. Many different professional bodies and standards institutions have attempted to create a definition of risk which will be widely accepted. Of course these perspectives differ, but there seems to be a trend towards a common view, as examination of some key sources reveals.



There is no doubt that common usage of the word "risk" sees only the downside. Asking the man in the street if he would like to have a risk happen to him will nearly always result in a negative response - "Risk is bad for you". This is reflected in the traditional definitions of the word, both in standard dictionaries and in some technical documents. But what about the professional bodies, who may have a different view from the layman?

The Institute of Risk Management (IRM) rather surprisingly appears to have no official definition of "risk", although IRM documents use phrases such as "chance of bad consequences, or exposure to mischance". IRM seems to take the unequivocal position that risk is wholly negative. Some other national standard-setting bodies also use a negative definition of risk, including the Norwegian Standard NS5814:1981, British Standard BS8444-3:1996, and National Standard of Canada CAN/CSA-Q850-97:1997.

More recently other professional bodies have taken a neutral view of risk, such as the UK Association for Project Management (APM), whose Project Risk Analysis & Management Guide (PRAM Guide, 1997) defines risk as "an uncertain event or set of circumstances which, should it occur, will have an effect on achievement of objectives". The nature of the effect is undefined, so implicitly this could include both negative and positive effects. The British Standards Institute (BSI) echoes this general view in BS6079-3:2000, which says that risk is "uncertainty … that can affect the prospects of achieving … goals". The joint Australian/New Zealand risk management standard AS/NZS 4360:1999 also has an open definition that could implicitly encompass both opportunities and threats. And project risk management guidelines in IEC62198:2001 also define risk without specifying whether its consequences are positive or negative.

Other recent guidelines explicitly introduce the concept of including upside effects in the definition of risk. For example the Risk Analysis & Management for Projects Guide (RAMP Guide, 1998) produced by the Institute of Civil Engineers (ICE) states that risk is "a threat (or opportunity) which could affect adversely (or favourably) achievement of the objectives". Similarly, the Guide to the Project Management Body of Knowledge (PMBoK® 2000) produced by the Project Management Institute (PMI®) defines risk as "an uncertain event or condition that, if it occurs, has a positive or negative effect on a project objective". Most recently, the Draft ISO Guide "Risk Management Vocabulary – Guidelines for use in standards" ISO DGUIDE73:2001 defines risk as "combination of the probability of an event and its consequence", noting that "consequences can range from positive to negative", and recognising that "increasingly organisations utilise risk management processes in order to optimise the management of potential opportunities."

There is no doubt that businesses, like everything else in life, are subject to uncertainty. It is also clear that some of that uncertainty might be harmful if it came to pass, whereas other uncertainties might assist in achieving our objectives. The issue is whether we could or should include both types of uncertainty in our definition of "risk", and whether both could or should be handled by a common "risk management process". There appear to be two options :

1. "Risk" is an umbrella term, with two varieties:
   - "opportunity" which is a risk with positive effects
   - "threat" which is a risk with negative effects
2. "Uncertainty" is the overarching term, with two varieties :
   - "risk" referring exclusively to a threat, i.e. an uncertainty with negative effects
   - "opportunity" which is an uncertainty with positive effects

The evolution of risk definitions in the various standards and guidelines suggests that the risk community is moving towards the first option, with the single term "risk" covering two subsets called "opportunity" and "threat".

Does this matter, since as Shakespeare said "that which we call a rose, by any other name would smell as sweet"? It matters because encompassing both opportunities and threats within a single definition of risk is a clear statement of intent, recognising that both are equally important influences over business and project success, and both need managing proactively. Opportunities and threats are not qualitatively different in nature, since both involve uncertainty which has the potential to affect objectives. As a result, both can be handled by the same process, although some modifications may be required to the standard risk management approach in order to deal effectively with opportunities.

There are definite advantages in including both types of uncertainty together under a single heading of "risk" covering all uncertainties that can affect objectives. The only difference is in the nature of the effect. One category has potential effects which are negative, unwelcome, harmful, adverse - these can be called "threats". The other group have positive, welcome, beneficial effects - these are "opportunities". Defining a risk as "any uncertainty which can affect achievement of objectives either positively or negatively" allows both opportunities and threats to be encompassed in a single definition.

The objection that common current usage of the word "risk" is exclusively negative can be met by two arguments. Firstly, words change their common-use meanings over time; and secondly it is quite acceptable for a profession to adopt a technical usage which differs from the layman's definition. And both opportunities and threats can be handled by a common "risk management" process, with clear advantages. Extending the existing threat-based process to cover opportunities will mean that there is no need to introduce a new process, with all the resistance that is likely to be encountered when another overhead is added. There is clear synergy in extending the same process to cover both types of uncertainty - if the management team are already setting aside time and effort to deal with threats, why not use the same time to identify and proactively manage opportunities as well?

It is clear that the risk management process as commonly implemented does not include a structured framework for proactively addressing opportunities, since it focuses almost entirely on threats. If a broadened definition of risk is used which includes both opportunities and threats, and if an extended approach is implemented to address both together, the organisation will be able to take full advantage of those uncertainties with potential upside impact. The alternative is a failure to implement proactive opportunity management strategies, which will guarantee that only half of the benefits of risk management can be achieved.

There seems to be increasing momentum towards a broadened definition of risk which includes both upside opportunities as well as downside threats. This remains an issue of current debate among risk management professionals, but the trend appears to be towards an inclusive view of risk. If this becomes widely accepted in the risk management community and beyond, then other issues concerning the scope of the risk process and the role of the risk manager will also become clear.

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