If you can't manage risk, you can't control it. And if you can't control it you can't manage it. That means you're just gambling and hoping to get lucky.

(J. Hooten, Managing Partner, Arthur Andersen & Co., 2000)

Introduction

- The increasing pace of change, customer demands and market globalization all put risk management high on the agenda for forward-thinking companies.
- It is necessary to have a comprehensive risk management strategy to survive in today's market place

The concept of risk

- The term risk is variously defined as:
  - The chance of loss
  - The possibility of loss
  - Uncertainty
  - The dispersion of actual from expected results
  - The probability of any outcome different from the one expected

Complete definition of risk

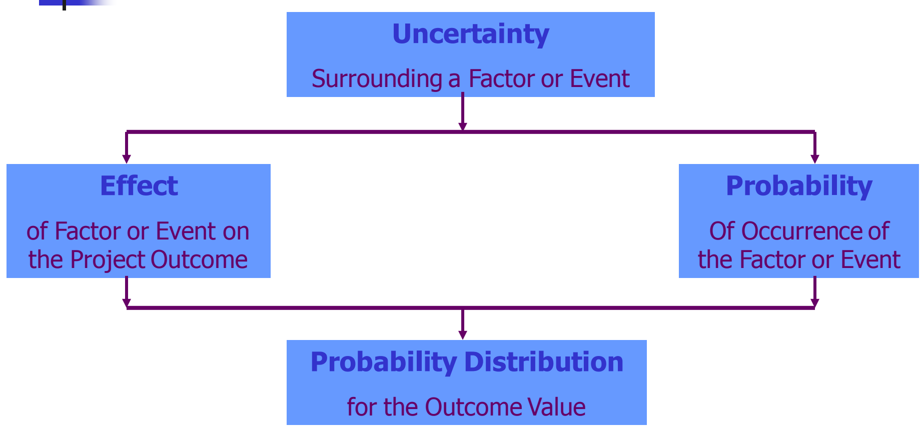
- Risk is a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for
- Risk can be defined as any issue that impacts an institution's ability to meet its objectives

Uncertainty

- Refers to a state of mind characterized by doubt, based on a lack of knowledge about what will or will not happen in the future.
- Psychological reaction to the absence of knowledge about the future

Risk management should consider not only the threats (possible losses) but also the opportunities (possible gains)

The concept of risk



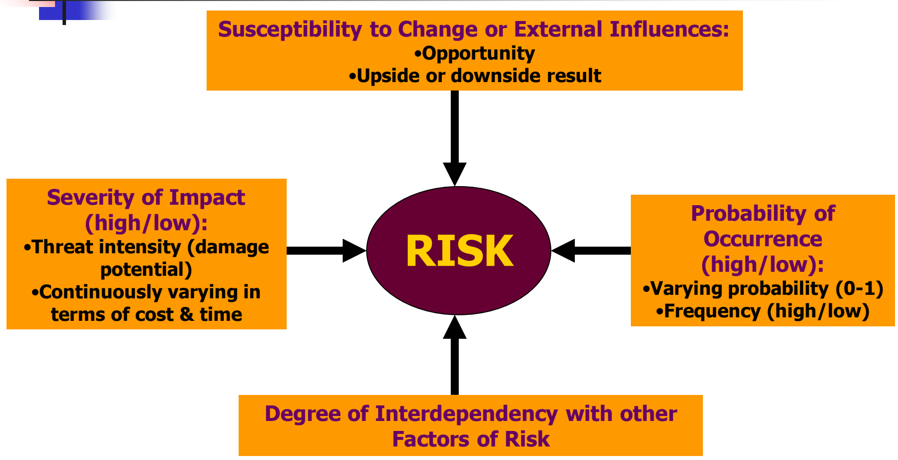
(Merna and Smith, 2996)

Risk and Uncertainty

Bussey (1978) and Merrett and Sykes (1983)

- **A decision is said to be subject to risk when there is a range of possible outcomes and when known probabilities can be attached to the outcome.**
- **Uncertainty exists when there is more than one possible outcome to a course of action but the probability of each outcome is not known**

Typical Risk Parameters



Risk versus peril and hazard

- A peril is cause of a loss
- A hazard is a condition that may create or increase the chance of a loss arising from a given peril

Hazards are classified into three categories

- Physical hazards
- Moral hazard
- Morale hazard

Physical hazards

- Consist of those physical properties that increase the chance of loss from the various perils
- Example:
  - The location of the property
  - The occupancy of the building

Moral hazard

- Refers to the increase in the probability of loss that results from dishonest tendencies in the character of the individual.

Morale hazards

- Because of a different attitude toward losses that will be paid by insurance
- Example:
  - When people have purchased insurance, they may have a more careless attitude toward preventing losses or may have different attitude toward the cost of restoring damage.

Classifications of risk

- Financial and non-financial risks
- Static and dynamic risks
- Fundamental and particular risks
- Pure and speculative risk

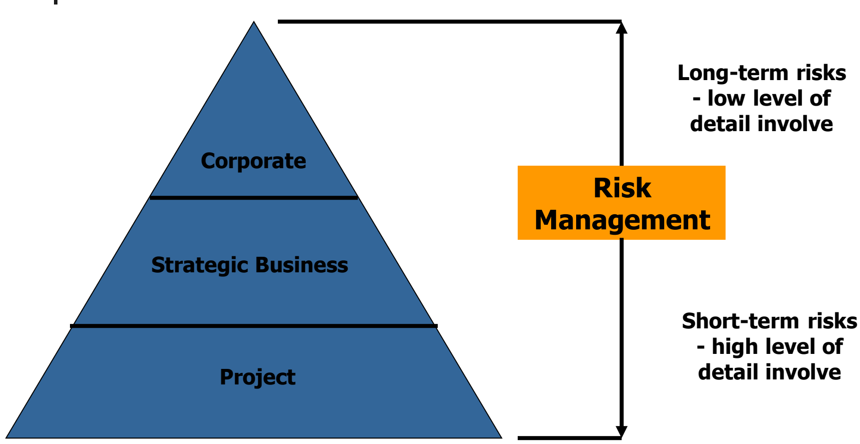
Risk management

- Is a scientific approach to dealing with pure risks by anticipating possibility accidental losses and designing and implementing procedures that minimize the occurrence of loss or the financial impact of the losses that do occur

Risk Management

- Balancing **Risk** and **Reward**
- Balancing **Art** and **Science**
- Balancing **Process** and **People**

Risk Management & Level of Organisation



Risk management tools

- The techniques for dealing with risk are grouped into two broad approaches:
  - Risk control
  - Risk financing

Risk control

- Consists of those techniques that are designed to minimize, at the least possible costs, those risk to which the organization is exposed.
- Two techniques:
  - Risk avoidance
  - Risk reduction

Risk financing

- Consists of those techniques that focus on arrangements designed to guarantee the availability of funds to meet those losses that do occur.
- Two techniques:
  - Risk retention
  - Risk transfer

The risk management process

- Determination of objectives
- Identification of the risks
- Evaluation of the risks
- Considering alternatives and selecting the risk treatment device
- Implementing the decision
- Evaluation and review

Enterprise Risk Management (ERM)

- includes the methods and processes used by organizations to manage risks (or seize opportunities) related to the achievement of their objectives
- described as a risk-based approach to managing an enterprise, integrating concepts of strategic planning, operations management, and internal control.

ERM (2)

- is the culture, processes and tools to identify strategic opportunities and reduce uncertainty.
- is a comprehensive view of risk from both operational and strategic perspectives and is a process that supports the reduction of uncertainty and promotes the exploitation of opportunities.

[by Risk and Insurance Management Society (RIMS)]

ERM (3)

- Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives. (COSO)

ERM (4)

- Enterprise risk management is:
  - A process, ongoing and flowing through an entity
  - Effected by people at every level of an organization
  - Applied in strategy setting
  - Applied across the enterprise, at every level and unit, and include taking an entity-level portfolio view of risk
  - Designed to identify potential events that, if they occur, will affect the entity and to manage risk within its risk appetite
  - Able to provide reasonable assurance to an entity's management and board of directors
  - Geared to achievement of objectives in one or more separate but overlapping categories

ERM (4)

- Components:
  1. Internal environment
  2. Objective setting
  3. Event identification
  4. Risk assessment
  5. Risk response
  6. Control activities
  7. Information and communication
  8. Monitoring

Reasons of Risk Management

- Managing risk is management's job
- Managing risk can reduce earnings volatility
- Managing risk and maximize shareholder value
- Risk management promotes job and financial security