



THE INSTITUTE OF
LEADERSHIP
& MANAGEMENT

No.11

Leadership Essentials

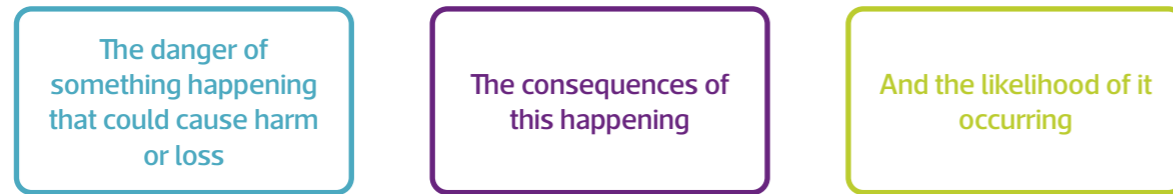
Evaluating Risk

Visionary leaders identify and evaluate risk



Understanding Organisational Risk

Any innovation within your organisation will carry some element of risk of failure. Risk is:



Often there is a culture within organisations where failure is hidden or punished and there is a danger that employees, and therefore the organisation itself, can become risk averse as a result. In order to keep improving and developing there is a need to take some risk, but it is important that this risk is managed effectively (Kahneman, 2011)

What are the benefits of taking risks?

Fear of failure and the repercussions of this – the damaged reputation of the organisation, for example, or the impact on an individual’s career prospects – inhibit risk taking. However, research demonstrates a relationship between failure and high performance, with the best performers having a low fear of failure, and being comfortable with risking failure as a necessary part of growth. If you and your team are going to embrace risk, you need to be able to convince them that taking a risk is worthwhile. One way of doing this is to outline the benefits of taking risks (Cannon & Edmondson, 2005; Heath, 2009):

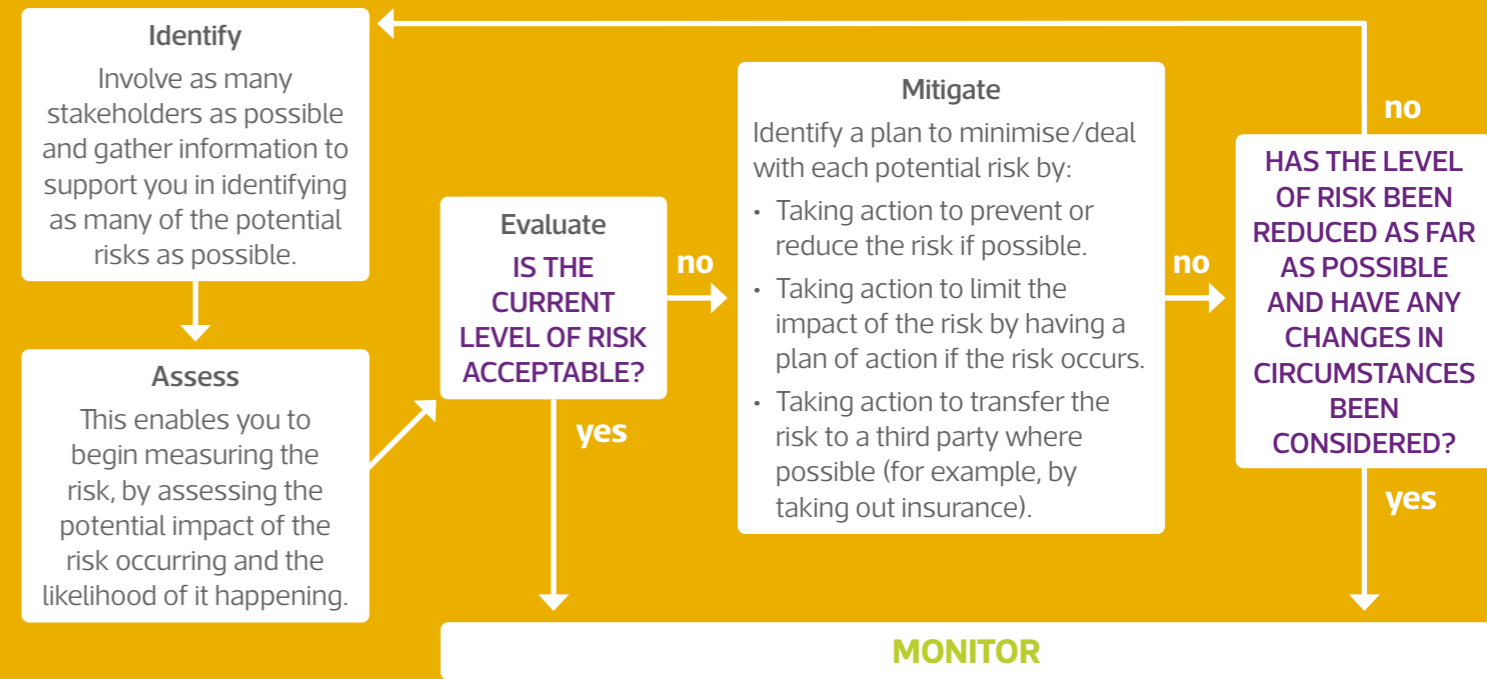
- Risk presents new challenges, opportunities and experiences, supporting learning and the development of new skills.
- Risk pushes the boundaries of what team members feel they can achieve. This can improve confidence and enable employees to perform at a higher level.
- Taking risks also encourages creativity, by pushing team members to think in new ways and identify new solutions to problems.
- The willingness to take risks can help members of your team to focus on their own goals, such as developing new skills or pursuing a promotion, motivating them to accept the possibility of failure because of the clear potential for gain.

The ability to identify, understand and analyse risk is an essential part of effective leadership. The categories of organisational risk are:

| Risk category | Type of risk | Examples of risks |
|--------------------|---|---|
| Strategic | Risk associated with the business environment and the particular sector or industry it is situated within | The ability to keep pace with changes in the sector and have new systems and processes 'ready to go' |
| Financial | Risks around financial transactions and the financial structure of the sector | Investment/recruitment based on future projected growth in income is a risk if the reality doesn't match the projection |
| Operational | Risks around the operations and administrative practices of the organisation | Reliance on one supplier for essential supplies could present risk if things go wrong |
| Compliance | Risk associated with adhering to legal regulations | Failure to adhere to Health and Safety regulations or the Equality Act |
| Other | 'Other' risk could be due to situations that are difficult or impossible to predict | Severe weather conditions could present a risk |

Managing Risk

Risk management is about understanding and evaluating risk, taking the necessary action to minimise the likelihood of it happening and reducing the impact it has if it does occur, so that the organisation can achieve its objectives. In order to do this, you need to apply a risk management process. There are five major steps in managing risk – identify, assess, evaluate, mitigate, monitor. (Webb, 2003)



Contingency planning can help you to deal with exceptional risk that, whilst unlikely to occur, would have a huge impact on the organisation if it did. An example of such an exceptional risk occurring could be the entire team in one department being off-sick for a substantial period with food poisoning following a team-building meal. Contingency planning is sometimes referred to as 'Plan B'. A contingency plan should:

- Set out actions to minimise the impact of such a catastrophic event**
For example, ensuring a certain number of staff have the experience to work across departments
- Ensure that the organisation can continue to operate**
For example, have robust training plans in place to upskill short term temporary workers

Measuring risk

Having identified the possible sources of risk, you will need to measure the risks. You can do this by looking at the level of impact each risk would have and the probability of it occurring. This can be done by making qualitative statements, for example 'the risks we most want to avoid are staff shortages and disruption to the delivery of production targets'. However, it can be very effective to analyse this in a quantitative way which allows you to assign a score to each risk and to rank the risks in order of significance:

Remember, though, that you need to keep monitoring your measurement of risks and reviewing this as the situation changes or new information becomes available.

| Impact | Likelihood of adverse outcome | | |
|-------------|--|--|---|
| | Low | Medium | High |
| Significant | Considerable management required Risk Level 7 | Must manage and monitor risks Risk Level 8 | Extensive management essential Risk Level 9 |
| Moderate | Risks may be worth accepting, with monitoring Risk Level 4 | Management effort worthwhile Risk Level 5 | Management effort required Risk Level 6 |
| Minor | Accept risks Risk Level 1 | Accept but monitor risks Risk Level 2 | Manage and monitor risks Risk Level 3 |

(Diagram reproduced with the permission of the Office of the Auditor General of Canada)

Risk Top Tips

- Involve as many stakeholders as possible in identifying risks
- Commit adequate time and resources to assessing and managing risks
- Plan to minimise or deal with anticipated risks, including contingency planning where possible
- Set regular points to monitor risk status and assign responsibility
- Update plans where the situation changes
- Continually reassess risks
- Create a culture in which risk is accepted but minimised through effective planning

References

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Teale, D (2003). *Project Risk Assessment in a Week*. 2nd Ed. Hodder & Stoughton

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