

## Briefing Note (draft) Risk Management

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### Risk Management

With the current global debate on making international development more effective, risk management is becoming increasingly important.

This briefing note provides a view on risk management within the broader MfDR agenda. It should contribute to more effective (and efficient) management of risks and as such to increased effectiveness of development interventions.

The document provides definitions of risk management, presents some key characteristics and explains a framework for risk management.

### Defining Risk Management

From literature<sup>1</sup>:

'Risk management is the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events. Risks can come from uncertainty in financial markets, project failures, legal liabilities, credit risk, accidents, natural causes and disasters as well as deliberate attacks from adversary.'

From the OECD/DAC, but focused on risk analysis:

Risk analysis constitutes an analysis or an assessment of factors that affect or are likely to affect the successful achievement of an intervention's objectives. A detailed examination of the potential unwanted and negative consequences to human life, health, property, or the environment posed by development interventions; a systematic process to provide information regarding such undesirable consequences; the process of quantification of the probabilities and expected impacts for identified risks.

In essence, the management of risks enables to limit the negative impact surrounding interventions, while maximizing the expected results. Risk management as such proves to be both

crucial and vital to manage for development results. The concept of risk management in itself is not new. Recognizing that risk is everywhere and is substantially unavoidable, it follows that management of risk is something not too different from management of other aspects of a program or organization.

All managerial decisions made have risk implications of some sort. Risk management starts from elaboration and choice of interventions (project, program, policy) during budget elaboration and goes on until final evaluation to ensure an efficient and relevant delivery of the results. It is therefore best to be considered as integral to good management practice, and not as a separate activity.

The heightened attention for risk management within MfDR can be best explained in the context of the need to produce and account for tangible and clear results, while the nature of development interventions are becoming 'less predictable' and development partners deliberately are shifting away from a relatively high degree of control.

Risk management encroaches indeed on at least 4 of the 5 central pillars of MfDR (keeping 'leadership' open for debate). Monitoring & Evaluation clearly holds a great deal of risk management attention, while in planning and budgeting the focus is on the identification and systematic evaluation of all risks to achieving the outputs, outcomes and impact.

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<sup>1</sup> Source: Douglas Hubbard "the failure of risk management: Why it's broken and How to fix it" pg. 46, John Wiley & sons 2009.

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Defining only one 'good practice' or standard of risk management for development interventions is nevertheless not attainable. This is because the methods, definitions and goals vary widely intrinsically and according to the context in which risk management is applied. In the private sector alike, several risk management standards have been developed over the years.

### Some key characteristics of risk management

**Use:** it helps managers and policy makers in the process of identifying and controlling the exposure to risk of an intervention or activity. It also helps in the communication about risks, either to raise concern or to prompt action;

**Strength:** is the systematic evaluation of risks relating to planned activities in terms of probability (of a threat or event actually happening) and its impact. This makes informed choices about taking risks possible. It puts off a general tendency of not admitting that risk is involved. Identified risks can be allocated to the individual/entity best placed to deal with it, so that prompt action can be undertaken in the event of;

**Risk Measurement:** Risks are generally measured by impacts times (x) probability. Some types of risk, such as financial, can be evaluated in numerical terms. Many others can only be evaluated in subjective ways. Also, any interdependencies or other factors outside the immediate scope of the risk analysis should be taken into consideration;

**Limitations:** are that risk management is to a large extent based on human estimates and decisions (and therefore often lacks consistency). When deficient knowledge or experience are applied to a situation, a risk may be entirely overlooked or under-, overestimated. Also, if risks are improperly assessed and prioritized, time

can be wasted in dealing with risk that is not likely to occur. Spending too much time assessing and managing unlikely risks can divert resources that could be used more beneficially. Prioritizing the risk management processes too highly could keep an organization from ever completing a project or even getting started. This is especially true if other work is suspended until the risk management process is considered complete.

**Pre-conditions:** the following successful applications prevail:

- a demonstrated commitment to public accountability;
- limited political interference in management decisions;
- an incentive structure that encourages public servants to operate in the public interest;
- a degree of stability in staffing.

**Cultural aspects:** International studies point to the fact that differences in culture, national as well as organizational cultures, do matter.

Some societies or organizations are strongly avoiding uncertainties. Uncertainty avoidance is the extent to which the members of a society feel threatened by uncertainty or unknown situations. Societies with strong uncertainty avoidance tend to avoid or prevent risks. Societies with low uncertainty avoidance often promote taking risks and challenging activities are highly appreciated.

High uncertainty avoiding organisations are very much process oriented and function like a closed normative system. Managers should have all the answers, emotional need for rules, inner urge to work hard, resistance to innovation, motivation by security and esteem or belongingness, belief in experts and specialisation.

While the organisations with weak uncertainty avoidance are more result oriented and function as an open pragmatic system. Managers may say they don't know the answer; there should be no more

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rules than strictly necessary, hard working only when needed, tolerance for deviant and innovative ideas and behaviour, motivation by achievement and esteem or belongingness, belief in generalists and common sense. (Geert Hofstede, 1991. Cultures and Organisations: Software of the mind. McGraw-Hill, London)

These cultural dimensions are of course critical in considering Managing for Development Results in general and management of risks in particular.

**Capacity:** Another significant factor seems the level of capacity, particularly at mid and lower management levels to identify and analyse risks as well as to manage the relevant risks properly.

### Guiding principles how to manage risks

Obviously, as explained above, risk management should be an integral part of Managing for Development Results. Coming to effective risk management, a series of well defined steps are developed to support better decision making regarding risks, the so called **Risk Process**.

1. The first phase in this process is about identifying risks and making a **Risk Analysis**. It involves the identification and systematic evaluation of all risks to prevent the achieving of the results. Risk analysis is carried out during the planning stage or so-called design phase of an intervention.
2. Once identified and assessed, risk can be managed. This second phase in the process is called **Risk Management**. It is about identifying and implementing ways to ensure that the risks identified do not prevent or adversely impact the outcome of the activity. Important is to be aware that risks may change over time and new risks may occur. So risk management should be regarded as a continuous process. However, it is important to ensure that an organization

makes cost-effective use of its risk process.

3. For the effective management of risks a **Risk Management Framework** needs to be developed. The framework provides decision making processes that are understood by all involved and which are supported by the framework of risk analysis and evaluation. The framework sets out the 'rules' for: In the box below details are given about the risk management framework.

A.	Identifying risks and categorizing risks
B.	Assessing their probability and potential impact
C.	Quantifying risks (not necessarily financially)
D.	Deciding on how to deal with risks
E.	Making decisions on risk management, such as further risk reduction
F.	Implementing decisions about risk
G.	Evaluating how effectively risks are managed
H.	Communication about risks
I.	Engaging stakeholders throughout the process

A framework for management of risk sets the context in which risks will be identified, assessed, controlled, monitored and reviewed. It must be seamlessly integrated with everyday management and operational practices.

Below the different practical steps of the Risk Framework will be further elaborated:

### A. Identifying and Categorizing Risks

**Risk identification** means establishing exactly what *is at risk* – for example, agreed activities cannot be completed within the planned timeframe or budgets are at risk of being overrun or withdrawn. Risk has to be considered in a variety of forms during the life cycle of an intervention.

A risk analysis or assessment is generally comprised of two separate parts, that of **Framing** and **Forecasting**.

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**FRAMING:** The purpose of framing is to capture the variety of issues that may be associated with a certain risk. The identified risk may be different for the different stakeholders in the intervention. Framing places importance on the need for all interested parties to share a common understanding of the risk being addressed. During this process the stakeholders need to elaborate major assumptions, conventions and procedural rules for the forecasting of risks.

**FORECASTING:** The objective of risk forecasting is to provide the knowledge base for decisions to be taken for instance whether a policy decision should be taken in the face of risk and, if so, how the risk can be reduced or contained. Risk forecasting is a scientific assessment of the risk and questions concerning its economic implications. A key component of this process is the “do no harm” principle. What if the risk occurs, how much harm would it do?

There are **3 types of risk**:

1. Risk that arise from factors actually or potentially under your control (e.g. poor design, ineffective management systems, poor performance by contractors).
2. Risk that arises from factors in the wider policy and institutional environments and controllable by decision makers elsewhere (e.g. poor policy environment, lack of political wills institutional weaknesses).
3. Risk that are uncontrollable (e.g. natural disasters, political instability, world markets).

Risks are affected by a range of factors and are highly dependent on the country, policy, and institutional context etc. in which the development intervention is implemented. Interventions in a more difficult, less predictable environment like, generally, in fragile states, are likely to be of higher risk. One should take in to consideration that there may be complex interactions between risks. A seemingly ‘small’ risk may give rise to several negative effects. Also, the overall impact of risks may be greater than the sum of the individual risks. It remains important during the process of the identification of risks to consider the relation of the risks to the achievement of the results.

There are many ways in which risks can be identified. Some of the most common techniques are cause-and-effect diagrams, decision trees, critical path analysis, scatter diagrams/radar charts and risk identification workshops. Especially these workshops have proven to be very effective because they gather the necessary fields of expertise together, involve relevant stakeholders throughout the process, and speed up the process of risk identification and reaching agreement by consensus.

The box offers a summary of the most common categories of risks with examples of the nature of the source and effect issues. It is not comprehensive: different activities and interventions will need to take into account different categories of risk.

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Areas/categories where risk can be encountered and needs to be managed

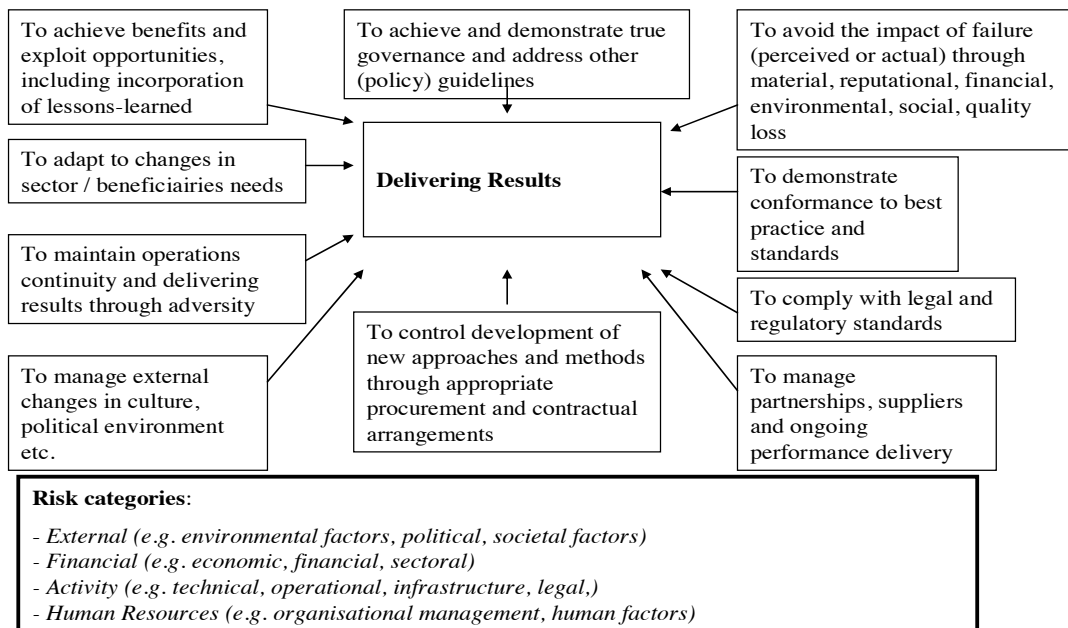


Figure 1: Areas/categories where risk can be encountered and needs to be managed

### B and C. Assessing and quantifying risks: probability and impact

The output of the identification process (A) should be a list of the key risk factors that could affect the success of the development intervention. The next step is to estimate their potential **impact** and **probability**.

- Probability means the evaluated likelihood of a particular threat or event actually happening, including a consideration of the frequency with which this may arise.
- Impact in this respect means an evaluated effect or result of a particular risk actually happening. The estimate should assess their individual and collective potential for causing damage.

The results of the assessments can be presented in a **risk assessment matrix**. All risks evaluated as high probability and high impact should be addressed during the intervention. The result of addressing risk internally and externally as an integral part of the activity design is to create a '**risk environment**'. The risk environment for almost all development interventions includes for example political change (e.g., commitment to agreed tasks, financial support for the work to undertake), economic change (the ability of the donor to fund development activities), and environmental change (the scale and frequency of humanitarian crisis).

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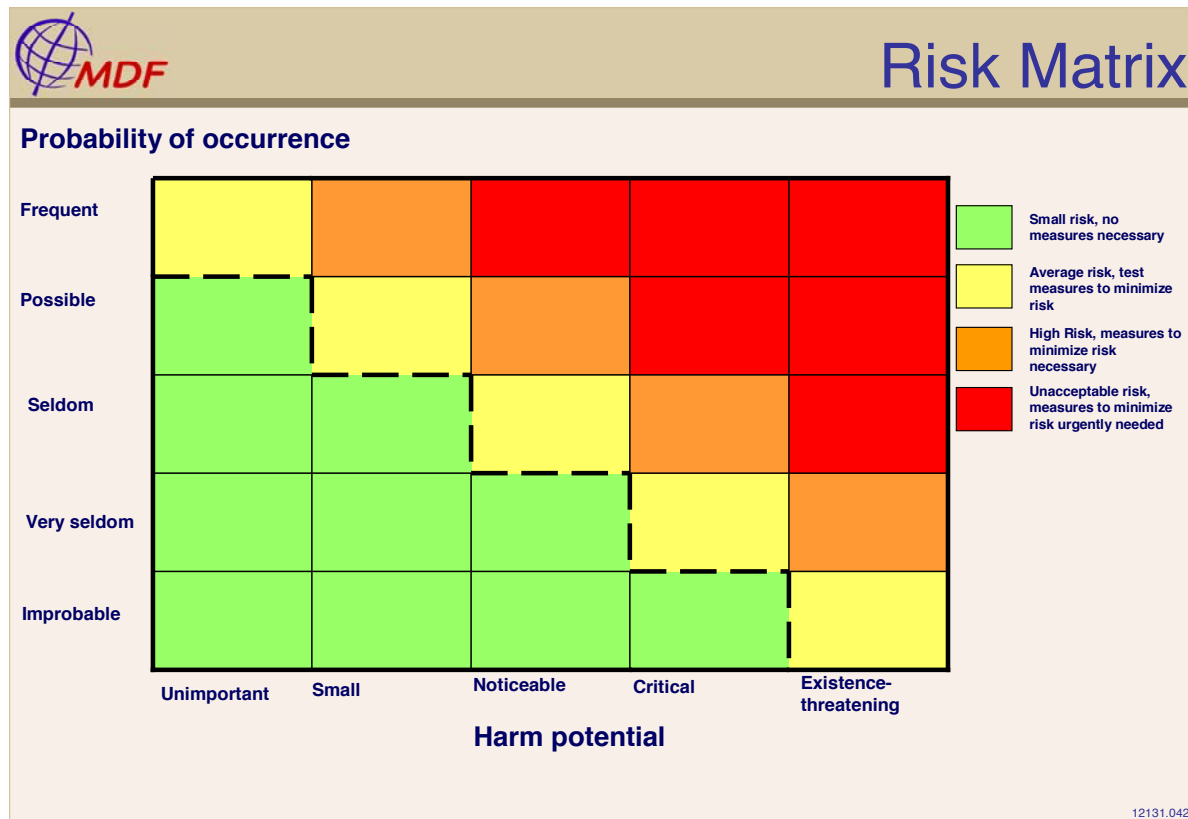


Figure 2: Risk matrix

### D and E. Deciding on how to deal with risks / risk response planning

Once a risk assessment has been undertaken, or when it is being reviewed, it is important to develop actions that will be put in place on how to best respond to risks that have been identified. Responses can be developed in four ways:

- **Transfer** the risk or some aspect of risk to the party best placed to manage it. This might be conventional insurance, or by supporting a third part to take the risk in another way.
- **Tolerate** the risk, because the ability to do anything about some risks may be limited or nothing can be done at a reasonable cost to mitigate it. This course of action is common for large external risks, but they must continue to be tracked. Tolerance levels determining how much risk can be taken need to be set out and should inform the decisions made.

- **Treat** the risk by taking corrective actions to reduce the probability or impact of the risk. By far the greater number of risks will belong to this category. The purpose of treatment is not necessarily to obviate the risk, but more to contain it at an acceptable level.
- **Terminate** the risk by doing things differently thus removing the risk where it is feasible to do so.

For each risk it is to be decided which response is most appropriate. Criteria that are used to assess the responses are: effectiveness, efficiency, minimization of external side-effects, sustainability etc. For this phase the term '**Risk appetite**' is relevant.

Risk appetite is the amount of risk to which the organization is prepared to be exposed before it judges action to be necessary. All identified risks have to be documented in a so called **risk register**. It provides the

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basis for prioritization, action, control and reporting. The Risk Register must be continually updated and reviewed throughout the lifecycle of a development intervention.

### F. Implementing decisions about risk

One of the most important steps of implementing risk management is the definition of the roles (and, if possible, named individuals) who are responsible, called **Risk owner**. A risk owner is a role or individual who is in a position to manage the risk and ensure its control. Risk owners can be internal or external to the intervention

When managing risk one should also consider the **cost** implication. The cost should be accounted for separately from the main program, setting aside a so-called risk allowance. This is a budget specifically for the cost of managing risk, which includes: Development, maintenance and dissemination of the risk policy, creation and maintenance of the supporting infrastructure for use across the organization, development and/or acquisition of relevant skills (including training) and loss of capability while implementing.

### G. Reviewing and evaluating how effectively risks are managed

A crucial component of effective risk management is the review and the evaluation. The regular reviewing and evaluation of the risks should be an integral part of each monitoring and evaluation system of the intervention. Risk management strategies should be assessed to determine how well risks have been managed, whether risks have actually been identified and how effectively they were treated. Recent studies have shown that there may be tendency to neglect the proper management of risks. In risky situations there is often need to rush to find quick solutions. There is a crucial need for more systematic ex post evaluation, so that lessons learned can put in place new intuitions and methodologies for risk assessment and management. A properly maintained risk register should help here. The details in the register can be used to track and monitor the successful management as part of the activity to deliver the required, anticipated benefits. Also quality assurance arrangements need to be established to ensure that risk management reflects current good practice.

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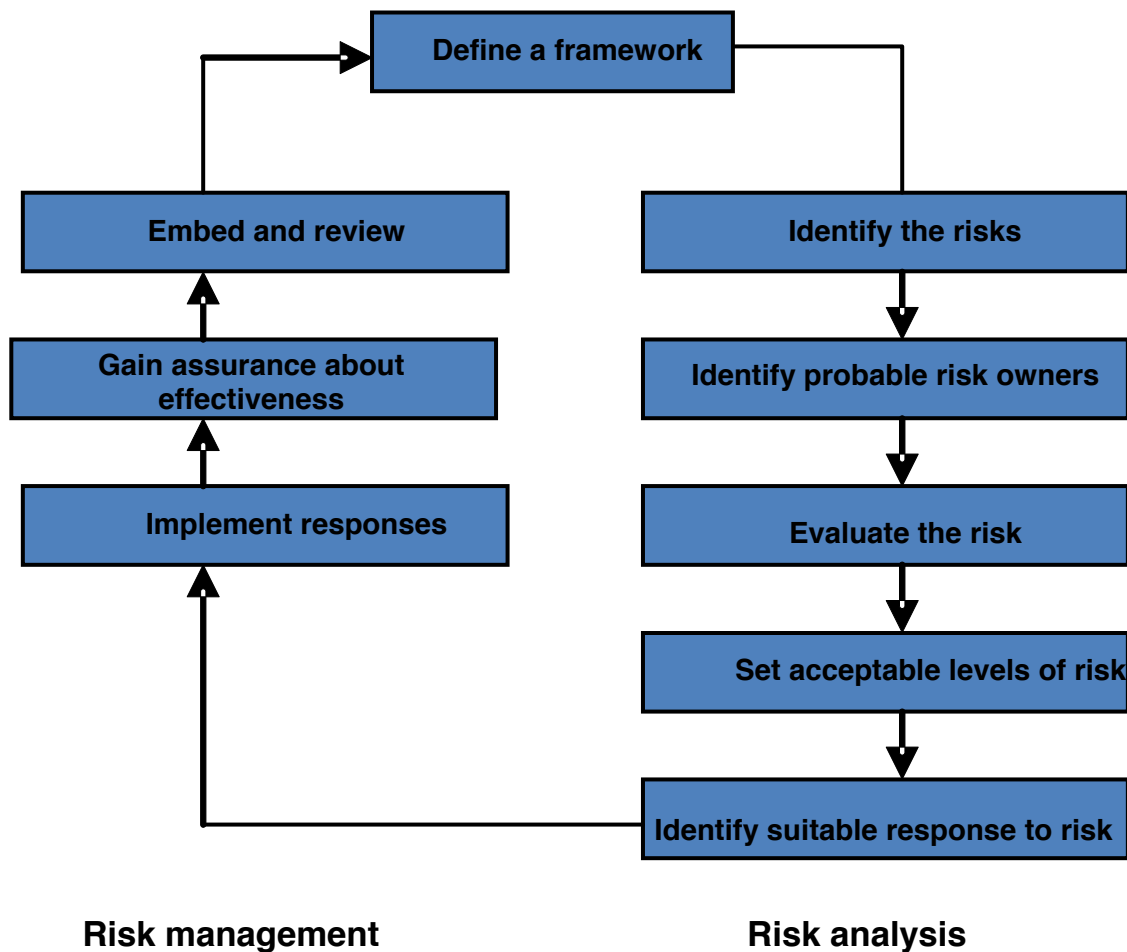


Figure 3. The Risk Management Framework

### H and I. Risk communication

As MfDR includes proper communication around results, proper communication around risks is important throughout the entire life cycle of interventions. It should enable the stakeholders, which are not formally part of the process, to understand the rationale of the results and decisions from the risk framing and risk forecasting phases. Moreover, it needs to help them to make informed choices about risk – balancing factual knowledge about risk with personal interests, concerns, beliefs and resources – when individuals or groups are themselves involved in risk-related decision-making.

Effective risk communication can foster tolerance for conflicting viewpoints and provides the basis for their resolution. Ideally, risk communication, based on an shared understanding of risk, can have a major impact on how well all involved are prepared to cope with risk and react to crises and disasters. Information on risk management further needs to flow within the program, to partners and other interested parties. Ensure that all involved are aware, informed and understand their part in managing risk.

Risk communication should therefore be part and parcel of accountability mechanisms!



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### Risk Management: Who's involved?

1. Senior managers and members of the organization's management board to whom governance is an important priority. Governance is linked to the accountability for the organization's actions, for which it must demonstrate proper practice, procedures and planning.
2. Staff involved in strategic planning who will make deliberate choices about risks. They will appraise different options for meeting objectives by making trade-offs about the mix of costs, benefits and risks.
3. Staff involved in policy/program/project implementation who is managing the intervention in the day to day routine. The focus here is on managing the program risks that have already been identified, together with continually scanning for emerging risks as they develop and managing those as well.

### Conclusion:

Risk management is a crucial element of MfDR. It enhances the partners in development interventions to assess risk and put in place strategies to cope with these risks. It enables the partners to take evidence based and informed decisions about the interventions success and its aim to achieve results.

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### Annex risk management checklists

#### 1. Control questions

- What are the key external and internal risks to our objectives?
- What is the impact and probability of each risk?
- Do we understand the interdependencies between risks?
- Have we taken a long-term view, to identify possible future risks?
- Who is the risk owner for each risk?
- How much of this risk can be tolerated?
- Have we a clear way to report on the risk especially if it starts to escalate?
- Have new risks emerged that should be added to the risk matrix (and added to the risk strategy)?
- Has the probability of the risk occurring changed?
- Has the likely impact of the risk on the policy altered?
- Should any changes be made to plans or management strategies to address the risk?
- Should the risk category of the policy be altered?
- What is our overall exposure to risk?

#### 2. Action steps

- Identify the risk you are or expect to encounter.
- Break the risks into different categories (such as external, financial, activity, human resources and also internal and external)
- Set the risks into a risk matrix.
- Set the risks in a context of opportunity so costs and benefits or payoffs can be examined together.
- Sort the risks according to their importance (criticality).
- Evaluate the risks to establish 1) the probability of those risks occurring, 2) their potential impact and 3) your attitude to those risks in terms of willingness to accept them or not.