Risk management at the speed of business

By

NG SIEW QUAN
Partner, PwC Singapore

ALVIN CHIANG
Senior Manager, PwC Singapore

Traditional risk management focuses on the likelihood and impact of risks. Increasingly, a crucial third dimension is being recognised and measured: risk velocity or the speed at which an exposure can impact the organisation.

Life is indisputably faster today than it was before. Technology ensures that most of us are continuously "plugged in". The business and regulatory landscapes today have become increasingly complex and fast-paced with the Internet of Things and other disruptive technologies.

In an environment where speed is of the essence, the ability to manage risk and uncertainty is paramount.

But risk is seldom static, and the rate at which a risk can impact an organisation is now considered as another vital element for measuring and responding to risks. Social media has helped raised the velocity and stake in which such risks can occur. An incident can become viral in a matter of hours. Short selling attacks, with support of social media, can lead to immediate plunges in their share price.

Boards today need to prepare themselves to better understand the emerging concept of "risk velocity".

Recognising risk velocity

Traditionally, the measurement of risk is predominantly two-dimensional, looking at the likelihood and the impact of risks. The information is typically represented in the form of a heat map to determine the level and subsequent prioritisation of the risks (see diagram on "Risk Heat Map").

Risk Heat Map

LIKELIHOOD	Insignificant	Minor	Moderate	Major	Catastrophic
Certain	MEDIUM	HIGH	HIGH	EXTREME	EXTREME
Likely	MEDIUM	MEDIUM	HIGH	HIGH	EXTREME
Possible	LOW	MEDIUM	HIGH	HIGH	EXTREME
Unlikely	LOW	MEDIUM	MEDIUM	HIGH	EXTREME
Rare	LOW	LOW	MEDIUM	HIGH	HIGH

IMPACT

While some risks may have similar likelihood and impact ratings, they may nevertheless take varied lengths of time to impact the organisation. The traditional heat map does not account for this.

Thus, it has been suggested that a third element, or dimension, "risk velocity", be added to the risk assessment process.

Risk velocity measures how fast an exposure can impact an organisation. It is the time that passes between the occurrence of an event and the point at which the organisation first feels its effects. For those risks with high velocity, having the appropriate controls in place in the event that the risk does materialise and impact the organisation, is crucial.

Measuring risk velocity

The representation of risk velocity is still in its infancy. Risk practitioners have tried to use different models for measuring and representing risk velocity.

One approach is to consider velocity as a value to be added to a risk score and plotted on a linear scale (see diagram, "Adding Velocity to Risk/ Impact Score"). As illustrated, following an initial scoring based on the product of likelihood and impact ratings, a separate rating will be allocated to velocity and added to the overall scale, i.e.:

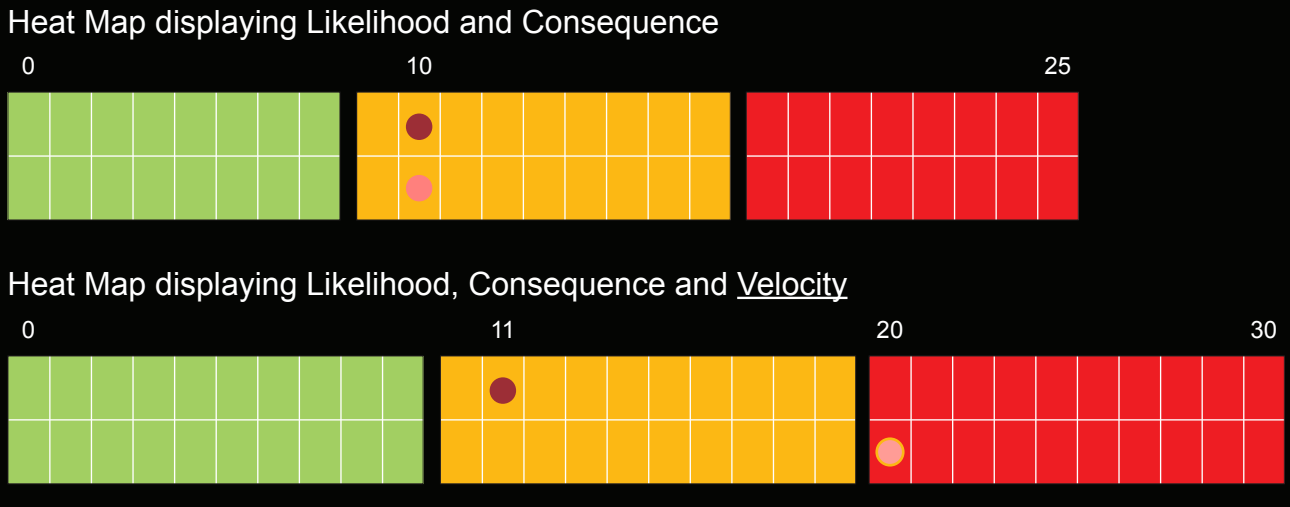
Total Risk Score =
(Impact x Likelihood) + Velocity.

Another approach is to overlay a risk velocity rating to the traditional two-dimensional framework, rather than as an added dimension (see diagram, "Symbol Representation of Velocity on a 2D Heat Map"). As shown, risks are plotted on the traditional heat map, but the velocity of each risk is visually presented by a symbol which can be differently coloured, depicted and sized (with say, larger circles for higher risk velocity).

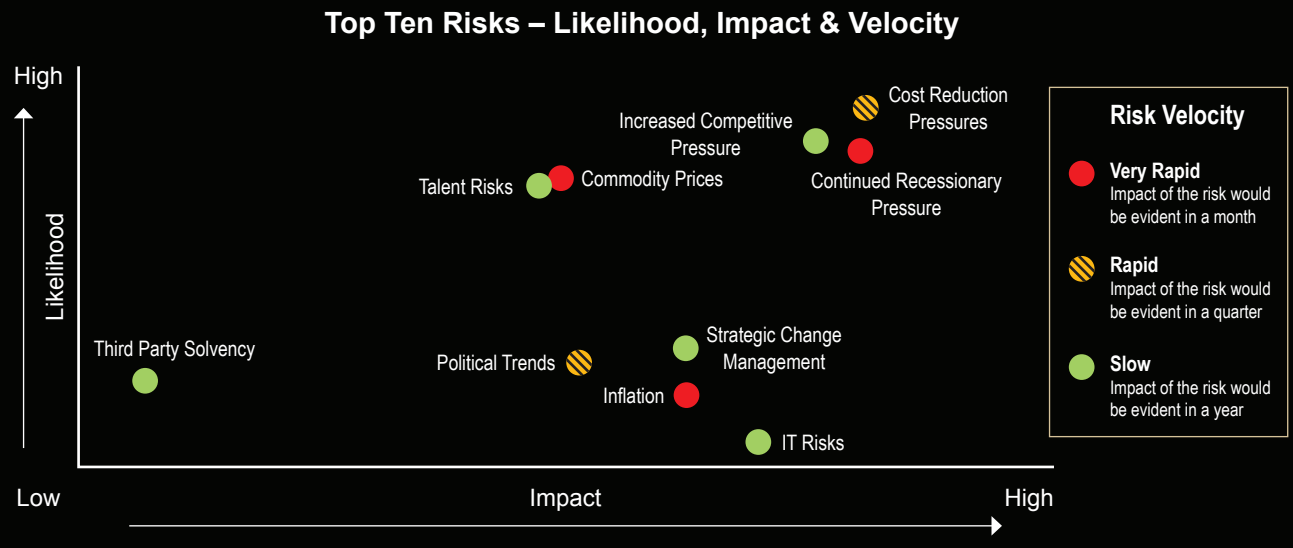
Beware of speed traps

Care should be taken when incorporating risk velocity into the current risk assessment framework, so as not to present something overly-complex to the extent where no one else apart from the risk experts know how to interpret them. The guiding principles of effective risk management should be adhered to, which is that risks should be easily communicated across the board. Thus, everyone should be aligned to understanding how velocity impacts risk.

Adding Velocity to a Risk/Impact Score



Symbol Representation of Velocity on a 2D Heat Map



Source: Corporate Executive Board

Focus should not only be given to those risks with high velocity. Consider a common example of a regulatory risk, where the regulation will become mandatory in, say, five years. Although this risk has low risk velocity, it may actually require actions starting today in order to develop adequate systems and processes to prepare for its impact. It is therefore important that low velocity risks are not overlooked.

When the rubber hits the road

Organisations should add a velocity lens to their regular review of previously identified risks and identification of emerging risks.

A major advantage of assessing the velocity of risks is that organisations can plan ahead to implement pre-emptive and recovery processes today. This is especially in situations where risk velocity is high, and recovery actions need to be swift in order to both reduce the impact to a manageable level and to enable the organisation to return to business-as-usual as soon as possible.

A top-down cohesive and coordinated approach is required to ensure seamless risk management and business continuity planning. The frequency of periodic risk monitoring scans should be congruent with the rate of change of the organisations' business environment. This can be even more relevant for those risks with high risk velocity.

Ready, steady, go

Boards should therefore prompt management to incorporate velocity into their current assessment of risks. The board should be enquiring of management in regard to the existence of disaster recovery plans or business continuity plans for high velocity risks, proper accountability and emergency communication plans in place and the cost/benefits of implementing risk mitigating activities for each risk.

Regardless of the approach adopted by organisations, the consideration of risk velocity will allow for improved preparation and responses to risk. Disruption is the new normal, and organisations that promote and embrace the concept of risk velocity will be better placed to thrive in an environment that is increasingly volatile. ■