



How hungry are you for risk?

“As it’s a high risk project we’re going to push the boundaries really hard”

“...but as we’re risk averse we’re going to make sure that those boundaries are absolutely fixed and solid!”



Risk appetite is one of the many areas of risk management that needs to be dealt with by organisations if good decisions are to be made in risky and important situations.

So what is risk appetite? And how is this different from risk attitude - a subject that was touched upon in Lucid Thought 34 (see also www.risk-attitude.com)

Unfortunately, practitioner guides and standards are not that helpful on the subject - either describing one and not the other, or mixing them up. This is work in progress for us, and along with our colleague David Hillson, we will tackle this by writing a guide to the various terms used. However in advance of this being ready, and because so many of our clients have asked us questions recently, we decided to address this question in a (hopefully simple) Lucid Thought.

To keep it simple let’s think about **risk appetite as your hunger for risk**. Just as with food - a large appetite likes to be fed with lots of food - a small appetite with more meagre portions. So in organisations a large risk appetite indicates a willingness or tolerance to proceed with investments that are more risky than for an organisation with a small risk appetite.

But how does that work in practice? Here’s a story from one of our clients, which you may be able to relate to.

In the past we didn’t consider risk appetite for our projects. We would do a plan for the work that took into consideration the assumptions we were making, and the specific risks to our objectives. We would rank the risks as ‘red’, ‘amber’ or ‘green’ based on our judgements of probability and impact, using words like ‘critical’ to signify a red impact, significant for an amber impact and minor for a green impact. It was all very arbitrary. People argued the ranking up or down depending on their perspective. We had no way of using this crude analysis to support our decision-making about what was really important to the project. Leaders had a vague sense of how much risk they were prepared to take, but we had no way of communicating this to the wider team and so we didn’t have a means to gain a shared perspective.



Fixing it was pretty easy though. We introduced a little process at each of our decision-gates (starting with the review that proceeded making a bid for work to our clients). We agreed the project drivers e.g. delivery speed, quality/specification, margin, brand protection, relationship, health & safety. We then talked about the relative priority of those drivers based on our perspective and the perspective of the client and other stakeholders. We then described a 'critical', 'significant' and 'minor' impact on each of those objectives, e.g. a critical impact on time would be a delay of 4 weeks or a saving of 2 weeks, significant - 2 weeks delay or 1 week saving, minor - 1 week delay or <1 week saving (remember risks can be good as well as bad). In the same way, a critical impact on brand would be international press coverage or client cancelling the project, significant would be national press coverage or the client making a formal complaint or commendation, minor would be client feedback to the project manager. I guess some people would say this was defining project specific impact scales with defined thresholds. Those thresholds were our simple way of communicating across the team the amount of risk that the project was prepared to stand - the hunger for risk, or in formal terms - our risk appetite.

Doing this allowed us to prioritise risks much more objectively and focus on those risks that we really needed to manage to contain the actual risk on the project within our defined risk appetite.

We wanted to share this, because often the labels that are used in risk management seem more complex or difficult to implement than they really are. Project specific impact scales are a really good way of getting the team to agree on the relative priority of objectives and in doing so express the appetite for risk for each of those objectives.

So how is risk attitude different to risk appetite?

Our simple response is that risk appetite applies to the project - it represents the tolerance for overall or aggregate risk on the project.

Defining risk thresholds as described above helps to prioritise individual risks, but it also helps teams to take a view on the overall 'riskiness' of the work.

In contrast, risk attitude does not apply to the project - it applies to individual people, or to decision-making groups - it refers to the choice of how to deal with a risk based on the level of comfort with the uncertainty. A risk-averse attitude seeks to reduce uncertainty and risk and would be motivated to actively manage risks rather than leave them to chance. A risk-seeking attitude is comfortable with uncertainty and risk and would be happy to leave things to chance.

You might be thinking - well if the project's appetite for risk is low, it would be really useful if the risk attitude of the people in the team was risk-averse - that way the whole team would be motivated to act to reduce risk. That's true - but it's not how it works in practice. Why?

The factors that influence risk attitude are many and varied and tend to reflect personal objectives and motivations, not necessarily project objectives. If risk attitudes happen, by chance, to align with the project's risk appetite that is fantastic. If they're not, then that's a problem that needs to be managed.

So the things that need to happen to understand and manage risk attitude and to understand and manage risk appetite are different and we would urge you to spend some time working through those differences. We'll write more about the factors that influence risk attitude next month. But for now, maybe you could think about how effective your practices are at defining the risk appetite for your project. **Do you and your team members know how hungry your organisation is for risk? Do you know how to prevent starvation, or indigestion?**

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