

# What Risk Management Is and Why It's Important

---

7 min read



In life, we encounter and assess risk all the time. In fact, for human beings, risk assessment and risk-taking are somewhat second-nature since we constantly evaluate situations and play-out potential futures in order to make decisions.

## Key Takeaways

- **What Is Risk Management?:** Risk management is the practice of identifying, evaluating, and taking action to control or mitigate the risks that could potentially...
- **How to Manage Risk:** Once a potential risk has been identified, the next step is to analyze and assess the potential threat to your...
- **Always Be Prepared to Safeguard Your Business From Risk:** To help protect your business and ensure that risk-related losses cannot seriously harm your business, you should always...

For example, should you choose a high-deductible healthcare plan? Should you fasten your seatbelt if you're just driving around the corner? Should you use the last of the milk even though it's a few days past its expiration date?

Like life, business is risky, too. In business, risks range in degree of severity from pure risk (i.e. lose everything or lose nothing at all) that can occur during events like natural disasters [1] to smaller risks such as displaying products of minimal value in a location that's blind to security cameras.

In and of itself, the very act of choosing to open a business requires a significant amount of risk, but the risks certainly do not stop there. During every day of a business's operations, it will be at risk because countless things could go wrong and subsequently endanger the business's capital, earnings, reputation, and safety.

For this reason, risk management is essential to successful business operations (and successful living, as well).

## What Is Risk Management?

**Risk Management Definition:** Risk management is the practice of identifying, evaluating, and taking action to control or mitigate the risks that could potentially impact an organization. This includes foreseeing a wide variety of potential types of risks including financial, strategic, legal, and security-related. <sup>[2]</sup>

# How to Manage Risk: The Risk Management Process

## Risk Identification

The risk management process begins with identifying risks. For example, an accounting controller might notify you of issues with your back-office processes where there is not adequate separation of duties to prevent fraud.

## Risk Analysis and Assessment

Once a potential risk has been identified, the next step is to analyze and assess the potential threat to your business, workforce, and operations. Consider the likelihood or probability that the event might occur and do your best to forecast the potential outcome of that event. The purpose of this step is to evaluate the magnitude of each risk and then rank these risks in terms of their plausibility and consequences.

**Read More:** [How Do Outsourced Bookkeeping Services Reduce Risk in My Business?](#)

## Risk Mitigation and Monitoring

Risk mitigation and monitoring is the final step in the risk management process, and this step involves planning, developing, and implementing strategies to reduce or avoid the risks you have identified in your business in addition to monitoring for these risks. Risk mitigation should also outline the actions that should be taken should these potential risks affect your business.

# 5 Basic Types of Risk Management for Business (and Life)

When you look at risk management strategies, you'll see a pattern of five very basic types of risk management which include avoidance, retention, sharing, transferring, and loss prevention and reduction.

## 1. Avoidance

The method of risk management is avoidance. This fairly simple method simply uses the practice of avoiding or not participating in activities that could adversely affect your business.

## 2. Reduction

This type of risk management is used when risk cannot be completely eliminated. As a result, the strategy is to minimize loss (instead of completely avoiding it) while also preventing it from spreading or worsening.

## 3. Sharing

Another type of risk management is risk sharing. By sharing risk, the loss potential spreads out across a group rather than falling on an individual (or a single business).

**Read More:** [In Service Businesses, Strategy is Different. Here's How to Leverage It...](#)

## 4. Transferring

In business, risk can also be managed by transferring it to a third party. For example, the risk of a natural disaster to your commercial property can be transferred to an insurance company.

## 5. Acceptance, Retention, and Loss Prevention

No matter how thorough your risk management program may be, your business will always retain some risk. This remaining risk is known as residual risk. As your business always

retains some portion of the risk, you can accept risk as a fact of doing business and do your best to prevent and/or minimize losses from occurring as a result of residual risk.

## **Risk Management Examples to Use in Your Business**

There are countless ways business owners can use risk management to protect their businesses from losses and damage. A few examples include:

- Institute security procedures for your business and security training for your employees to mitigate physical security risks on your commercial property.
- Additionally, you should have a natural disaster plan in place so that all employees know what to do in the event of a disaster or fire during work hours.
- Implementing internal controls and separation of duties to prevent workplace fraud.
- Make sure your business has all the proper licensing and insurance to transfer risk.
- Implementing a thorough, forward-looking compliance department and hiring additional third-party consulting or management, if necessary.
- You should also have a solid IT security department or third-party consultant working with you to protect your business from cybercriminals. Additionally, you should also implement IT security training, policies, and procedures for your entire staff including the c-suite.
- You can assess and mitigate the risk of cash flow shortages by actively forecasting your company's cash flow and implementing strategies to avoid shortages before they occur.
- Protect your business from the risk of rising inflationary costs by using inflation accounting and worst-case scenario budgeting.
- Keeping an ample cash reserve on hand in your business can safeguard you from a whole host of potential risks.
- Testing the marketing before investing in new products or services will help you ensure that there is actual demand for your new potential revenue stream.

## **Risk Management: Always Be Prepared to Safeguard Your Business From Risk**

If you want to avoid all risks associated with business, then you probably should not start a business in the first place. Running a business is inherently risky, and no matter how many precautions you take, you will always be operating with some degree of risk. To help [protect your business](#) and ensure that risk-related losses cannot seriously harm your business, you should always operate with caution. This means considering and being prepared to handle worst-case scenarios in addition to always being aware of the ever-changing landscape of your business, industry, market, regulations, competitors, and environment.

1. <https://www.investopedia.com/terms/p/purerisk.asp>
2. <https://www.ibm.com/topics/risk-management>