

# Modern Methods of Risk Identification in Risk Management

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## Abstract

Enterprise risk management (ERM) takes a broad perspective on identifying the risks that could cause an organization to fail to meet its strategies and objectives. Many organizations do follow risk management but hardly ever do we get to see an organization following defined techniques to identify risks. There are many techniques to identify risks of which few common methods are listed in this article which can be followed within any company. These methods of analysis help those that practice risk management to use established ways of identifying risk. It also helps them manage risk by either avoiding it, transferring it, reducing the impact of the risk, or by various other alternative solutions.

**Keywords:** risk management, risks, identification, methods

## Introduction

Risk is defined as an uncertain but potential element that always appears in the technical, human, social and political events, reflecting changes in the distribution of possible outcomes and subjective probability values and objectives, with possible damaging and irreversible effects<sup>1</sup>.

Risk management is an important part of planning for businesses. The process of risk management is designed to reduce or eliminate the risk of certain kinds of events happening or having an impact on the business.

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<sup>1</sup> Opran, C., Paraipan, L., & Stan, S. (2004). *Risk management*. Bucharest: Comunicare. ro.



Source: marsh.com

Figure 1. Risk management process

The most important phases of risk management process include: **the risk identification, risk analysis and risk response.**

- a) **The risk identification** is achieved by completing checklists, organizing meetings for identifying risks and analysis of archived documents.
- b) **The risk analysis** uses methods such as: determining the expected value, Monte Carlo simulation and decision trees.
- c) **The risk response** includes measures and actions to reduce, eliminate or risk allocation.

The purpose of risk management is to identify potential problems before they occur so that risk-handling activities may be planned and invoked as needed across the life of the product or project to mitigate adverse impacts on achieving objectives.

Risk management is a continuous, forward-looking process that is an important part of business and technical management processes. Risk management should address issues that could endanger the achievement of critical objectives. A continuous risk management approach is applied to effectively anticipate and mitigate the risks that have critical impact on the project. Effective risk management includes early and aggressive risk identification through the collaboration and involvement of relevant stakeholders. Strong leadership across all relevant stakeholders is needed to establish an environment for the free and open disclosure and discussion of risk.

Identifying risks is the first and perhaps the most important step in the risk management process. If there is a failure to identify any particular risk, then the other steps in the risk management cannot be implemented for that risk.

In order to manage risk, an organisation needs to know what risks it faces, and to evaluate them. Identifying risks is the first step in building the organisation's risk profile. There is no single right way to record an organisation's risk profile, but maintaining a record is critical to effective risk management. The identification of risk can be separated into two distinct phases:

- **initial risk identification** (for an organisation which has not previously identified its risks in a structured way, or for a new organisation, or perhaps for a new project or activity within an organisation);
- **on-going risk identification** (which is necessary to identify new risks which did not previously arise, changes in existing risks, or risks which did exist ceasing to be relevant to the organisation).

In every case, risks should be prioritised in relation to the objectives. Care should be taken to avoid confusion between the impacts that may arise and the risks themselves, and to avoid stating risks that do not impact on objectives; equally care should be taken to avoid defining risks as simply the converse of the objectives. A statement of a risk should encompass both the possible cause and the impact to the objective which might arise.

### **Methods For Identifying Risks**

Risk management uses formulas and templates to narrow in on and to identify risk. Which formulas and templates are used, is often determined by the industry that they are being practiced in. Some common methods of risk identification are: brainstorming, flowchart method, SWOT analysis, risk questionnaires and risk surveys.

### **Brainstorming**

When objectives are stated clearly and understood by the participants, a brainstorming session drawing on the creativity of the participants can be used to generate a list of risks. In a well facilitated brainstorming session, the participants are collaborators, comprising a team that works together to articulate the risks that may be known by some in the group. In the session, risks that are known unknowns may emerge, and perhaps even some risks that were previously unknown unknowns may become known.

Facilitating a brainstorming session takes special leadership skills, and, in some organizations, members of the internal audit and ERM staff have been trained and certified to conduct risk brainstorming sessions. In addition to well-trained facilitators, the participants need to understand the ERM framework and how the brainstorming session fits into the ERM process. The participants may very well be required to do some preparation prior to the session.

In using this technique, one company familiar to the authors noted that, because the objectives were unclear to some of the participants, the process had to back up and clarify the objectives before proceeding. Using a cross-functional team of employees greatly increases the value of

the process because it sheds light on how risks and objectives are correlated and how they can impact business units differently.

Often in brainstorming sessions focused on risk identification, a participant may mention a risk only to have another person say: "Come to think of it, my area has that risk, and I have never thought of it before." With the team sharing experiences, coming from different backgrounds, and having different perspectives, brainstorming can be successful in identifying risk. It is also powerful when used at the executive level or with the audit committee and/or board of directors.

### **Flowchart Method**

The Flowchart Method is used to graphically and sequentially depict the activities of an operation or process to identify exposures, perils and hazards. There are a variety of methods that can be used including: product analysis, dependency analysis, site analysis, decision analysis and critical path analysis. These methods can illustrate interdependency within your organization; they can easily pinpoint bottlenecks and can determine a critical path. They do not indicate frequency or severity, but only show minor processes with major loss potential, they have a limited applicability to liability exposures and in most situations, they are too process-oriented.

### **SWOT Analysis**

SWOT (Strengths-Weaknesses-Opportunities-Threats) analysis is a technique often used in the formulation of strategy. The strengths and weaknesses are internal to the company and include the company's culture, structure, and financial and human resources. The major strengths of the company combine to form the core competencies that provide the basis for the company to achieve a competitive advantage. The opportunities and threats consist of variables outside the company and typically are not under the control of senior management in the short run, such as the broad spectrum of political, societal, environmental, and industry risks. For SWOT analysis to be effective in risk identification, the appropriate time and effort must be spent on thinking seriously about the organization's weaknesses and threats. The tendency is to devote more time to strengths and opportunities and give the discussion of weaknesses and threats short shrift. Taking the latter discussion further and developing a risk map based on consensus will ensure that this side of the discussion gets a robust analysis. In a possible acquisition or merger consideration, a company familiar to the authors uses a SWOT analysis that includes explicit identification of risks. The written business case presented to the board for the proposed acquisition includes a discussion of the top risks together with a risk map.

### **Risk Questionnaires and Risk Surveys**

A risk questionnaire that includes a series of questions on both internal and external events can also be used effectively to identify risks. For the external area, questions might be directed at political and social risk, regulatory risk, industry risk, economic risk, environmental risk,

competition risk, and so forth. Questions on the internal perspective might address risk relating to customers, creditors/investors, suppliers, operations, products, production processes, facilities, information systems, and so on. Questionnaires are valuable because they can help a company think through its own risks by providing a list of questions around certain risks. The disadvantage of questionnaires is that they usually are not linked to strategy. Rather than a lengthy questionnaire, a risk survey can be used. In one company, surveys were sent to both lower- and senior-level management. The survey for lower management asked respondents to “List the five most important risks to achieving your unit’s goals/objectives.” The survey to senior management asked participants to “List the five most important risks to achieving the company’s strategic objectives.” The survey instruments included a column for respondents to rank the effectiveness of management for each of the five risks listed, using a range of one (ineffective) to 10 (highly effective). Whether using a questionnaire or survey, the consolidated information can be used in conjunction with a facilitated workshop. In that session, the risks are discussed and defined further. Then interactive voting software is used to narrow that risk list to the vital few.

## **Conclusions**

Each of these techniques provides a way to help identify possible risks that may occur in your ongoing economic activity. It’s important that you identify all the risks early on. The better job you do of identifying the projects risks at the planning stage, the more comprehensive the risk response plan will be. Risk identification is not an area of project planning that you should really skip, being one of the most important processes in risk management.

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