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What is 'risk appetite' and why does an organisation need one?

It was suggested (more than once) in the March/April edition of Continuity, that 'risk appetite' was something that was closely linked to the current economic climate and that organisations should now be re-evaluating what their risk appetite is. So, what does this actually mean and what would we expect to see as an output of such a review?

Like many organisations, I suspect that the standard response would be something along the lines of "Oh, well of course in this economic climate/in our industry, we don't like to take too many risks". In fact, this is exactly the sort of answer given to auditors when they ask just this question as part of the BS25999 certification process. Unfortunately, once asked, there is little to suggest that an organisation's response is followed through to a meaningful conclusion.

As someone who works closely with BS25999 Parts 1 and 2, it is interesting to note that these sources of information are unable to provide a consistent approach to risk appetite. Part 1 helpfully gives us a definition of what risk appetite is, describing it as: "The total amount of risk that an organisation is prepared to accept, tolerate or be exposed to at any point in time." However, Part 2 is less forthcoming as it omits this definition and in fact, omits to mention risk appetite anywhere in the Standard. Rather, it refers to 'risk acceptance' ("informed decision to take a particular risk" BS31100:2008 Risk Management Code of Practice). Indeed, if you look even further, the BS31100 definition is extended to include the words 'type' (of risk) and 'seek' (organisation is prepared to seek, accept or tolerate).

So, should we be surprised when organisations don't know what their appetite is?

Let me try and put this concept into words. Risk appetite is a strategic decision taken by organisational planners, as to what they consider to be an acceptable level of risk in various scenarios relevant to their business. In the financial services world this may mean that loans will no longer be granted to corporate borrowers in certain industries (if only!), or for ethical reasons a company will not trade with a particular country. In other words, a tangible yardstick has been deployed to measure appetite and can be easily validated. By adopting this approach, the organisation is attempting to set some ground rules around what they consider to be acceptable trading boundaries.

Having identified their appetite for risk, it is absolutely crucial that the organisation then periodically reviews this to make sure that it remains appropriate to their trading and economic situation. How would it look if a company which traded heavily on their reputation were to take out a contract with a company who employed under age children in their factory?

What prompts this review will vary. It may be that as part of their BS25999 certification requirements, they undertake a formal "Management review of their Business Continuity Management System", or it may just be that as part of the board's risk assessment process they revisit their business strategy from time to time, or when a particular internal or external event triggers the need for such a review. Whatever the driver, to remain valid this process needs to be undertaken to ensure that the organisation's risk appetite continues to be appropriate.

So, next time you hear one of your clients say that their risk appetite is 'conservative' or 'medium', don't just nod and smile, but seek to challenge them on what they mean by this glib statement or better still, give them a helping hand and lead them down the path of enlightenment. You never know, it might just save their bacon!

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