Risk management guide

For small to medium businesses

Risk management is a critical element of operating a successful business. Small to medium businesses are frequently exposed to risks that can directly affect day-to-day operations and trading results. Their impact may be serious enough for the business to fail. Most businesses know instinctively that they should have insurance policies to cover risks to life and property. However, there are many other risks that all businesses face, some of which are often overlooked or ignored.

Every business is subject to possible losses from unmanaged risks. Sound risk management should either reduce the chance that a particular event will take place or minimise its impact. Sound risk management also protects business wealth.

Risk management starts by identifying possible threats and then implementing processes to minimise or negate them.

Sound risk management can produce the following benefits:

- lower insurance premiums
- reduced the probability that the business may be the target of legal action
- reduced losses of cash or stock etc.
- reduce the risk of a cyberattack causing significant damage to the business
- reduced business down time.

This guide is not an exhaustive publication on risk management. You may therefore need to seek external advice specific to your business circumstances to implement suitable risk management strategies for your business.

Identifying risks and how to respond to them

Undesirable events, the probability of their occurring and their possible impact vary considerably from business to business and from industry to industry. How does a business identify and manage such risks?

Possible events should be analysed to determine how likely they are to occur and their possible impact on the business. To identify risks and determine how best to respond to them:

- assess the probability of each event as 'very likely', 'moderately likely' or 'very unlikely'.
- prioritise those events by putting a dollar value on each one (e.g. the replacement cost of a critical piece of machinery; or in the case of potential bad debts, the total value of amounts owed by customers).
- focus on developing responses to risks that are most likely to occur and have the largest financial impact on the business.
- for each possible event, develop procedures commensurate with the level of risk the business is willing to accept.
- once a procedure is established, it should be monitored to ensure it is properly implemented and is effective.

For further information on developing policies and procedures, see Developing policies and procedures for your business or seek expert external advice.

This guide identifies some of the risks and areas where risks may emerge, and it provides a variety of strategies to manage them.

Risks posed by customers

Potential Risk	Identify the Risk	Risk Mitigation Strategies
The business losses a major customer.	Is the business highly-dependent on a small number of major customers? For example, you could have a small number customers that account for over 50 per cent revenue.	• Locking in major customers through long-term service or supply contracts, regularly visiting them, or continually asking their views about your business's products and services • Spreading the risk by developing smaller, existing customers so they become larger customers or share a larger percentage of sales.
Low profitability and productivity due to high maintenance customers.	Do you have customers that take up a lot of your time but are less profitable than other customers?	• Seek new, profitable customers • Finding lower-cost ways of servicing or supplying the less profitable customers • Stop servicing or supplying such customers.

Risks posed by suppliers

Potential Risk	Identify the Risk	Risk Mitigation Strategies
The business is impacted by disruption at a key supplier.	Is the business highly dependent on a small number of key suppliers? For example, do you have one supplier that provides 30 per cent or more of the total product requirements, or is there a supplier whose failure to supply could stop the business?	• Locking in major suppliers through long-term service contracts • Seek alternative suppliers capable of supplying similar items, even if having them as back-up suppliers.

Risks posed by employees

Potential Risk	Identify the Risk	Risk Mitigation Strategies
The business is disrupted by high-employee turnover.	Do employees see the business as a short-term employment option? For example, would they describe it as 'a good place to learn for a while' or 'a nursery for the industry'? If the business is seen as short-term employment option, this will result in high staff turnover, disrupting the business and adding to recruitment and training costs.	• Implementing selection procedures that increase the probability of finding the right employees for the business • Implementing a robust performance development system for communication of performance expectations and goals, monitoring performance and setting remuneration • Using equity interests, profit-sharing or other incentives to help retain key personnel and let them share the success they create for the business. But be careful how such incentives schemes are designed, as they could encourage unintended behaviour.
Sales are lost due to the departure of a key employee.	Are there employees in the business who are critical to its success? If yes, their departure could impact sales or customer relationships. A competitor might benefit from your loss if they can recruit such key personnel.	• Allocating several people to fulfill key tasks and provide backup in the event of illness or sudden departure • Putting in place confidentiality agreements and / or reasonable restraint of trade agreements signed by key employees or where appropriate all employees. Seek legal advice on such agreements.
Fraud risk due to lack of supervision and control over employees.	Are some employees largely free to govern or control dealings with key suppliers or customers? For example, some employees may control who your business sells its goods or services, or pricing. If yes, your business is at increased risk of fraud.	• Provide ongoing training for employees consistent with the needs of the business • Rotating employees through various functions or departments to familiarise them with other areas of the business • Implement controls over critical decisions and engage other senior employees to oversight the implementation of those controls.
Risk of workplace injury or death due to an unsafe work environment.	Do employees face occupational health and safety (OH&S) risks? For example, are they working in a dirty or hazardous environment, or do they have to travel extensively by car? If yes, the risk of workplace injury or worse is higher.	• Working with employees and experts to implement suitable OH&S policies to minimise risks. For example, safe driver training and regular maintenance of vehicles and other equipment • Regularly check to ensure employees are following such policies.

Risks posed by the business premises and location

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Sales are disrupted by moving to a new premises or if access to current site is restricted.	How dependent is the business on its current location? That is, would a move to a new premises have a negative impact on sales, employees and supplier access?	• Identifying several suitable alternative premises which would suit customers, suppliers and employees • Review the business strategy to identify future space requirements early • Only businesses that are established, have good prospects and are growing should consider purchasing a property and then only if the property has sufficient capacity to allow for future expansion, otherwise it is preferable to rent. Renting also helps to preserve working capital for business operations.
Current business premises will not cater for future growth of the business.	Is the business growing strongly at present, or is it relatively stable? If it is growing strongly, can your current premises meet your future needs?	• Where the premises suit the business's long-term needs, consider securing a long-term lease or right of first option when the lease expires • Only businesses that are established, have good prospects and are growing should consider purchasing a property and then only if the property has sufficient capacity to allow for future expansion, otherwise it is preferable to rent. Renting also helps to preserve working capital for business operations.

Threats to goodwill and reputation

Potential Risk	Identify the Risk	Risk Mitigation Strategies
A large-scale product recall, fraud, bad review **or other similar event causes long-term** reputational **damage to the business.**	How exposed is the business to a threat to its reputation or goodwill? For example, what would happen if there were a product recall, or if the business received bad reviews or there was a major fraud?	• Incorporating robust review processes and quality assurance systems to avoid a situation that may damage the business's reputation • Strong marketing that builds brand and reputation • Compulsory training and development programs for staff • Procedures that address customer complaints, including online in a timely manner.

Risks posed by information technology

Potential Risk	Identify the Risk	Risk Mitigation Strategies
A critical system goes down in a peak time.	To what extent does the business rely on information technology (IT)? Have you ever noticed how little work is done in an office when a system is not working? The level of risk created by using IT increases as the business becomes more reliant on it.	• Protecting laptops and desktops • Keeping data safe by performing backups and storing those backups offsite • Using the internet safely • Have appropriate cybersecurity processes in place • Keep systems up to date • Ensuring appropriate IT support is available within an acceptable timeframe • Having an uninterrupted power supply unit • Conducting appropriate IT training for employees • Have a back-up internet connection.

Risks posed by financial transactions

Financial transactions create risks for business. They can be classified as liquidity, foreign exchange, interest rate, commodity price and credit risks. Each will be examined separately below. Skip any which do not apply to your business.

Liquidity risk

Potential Risk	Identify the Risk	Risk Mitigation Strategies
The business does not have enough funds to meet future obligations.	Run regular cash flow analysis to identify when and if your business may have difficulty in meeting future obligations.	• Managing cash flow on a daily, weekly and monthly basis by monitoring the flow of cash in and out of the business • Forecasting cash flow to identify any periods when there is inadequate cash buffer to cover unanticipated events. Good forecasting will include 'what if' analysis; for example, 'What if my sales were to drop by 20 per cent?' • Seek a committed line of credit from a financial institution. It is beneficial to have two possible providers in case one does not provide credit when needed • Maintaining a strong relationship with your banker or financial institution to ensure they understand the business and are kept up to date with potential loan requirements • Monitoring market conditions to anticipate seasonal fluctuations in cash flows • Preparing aged debtor reports to monitor debtor collections (and regularly contacting the slow payers).

For further information read **Tips for managing through tough times**.

Foreign exchange risk

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Where the business pays and/ or receives foreign currency, the exposure to fluctuations in the value of foreign currency.	Does the business use foreign currency to buy raw materials or equipment, or receive it from sales of its products and services to overseas customers? If your business does receive or make payments in foreign currency then it's exposed to a potential risk.	• Consulting your bank for assistance in managing foreign exchange exposure • Buying or selling foreign currency in advance (i.e. at the time of the agreement) to lock in the foreign currency rate • Using financial market instruments provided by financial institutions that either lock in foreign currency rates or minimise the risk of impact of foreign currency fluctuations on revenue and/or expenses.

Interest rate risk

Potential Risk	Identify the Risk	Risk Mitigation Strategies
If the business borrows from a lender or generates income from savings, interest rate movements can impact profitability.	Calculate the impact various interest rate movements will have on your borrowing costs or income generation. In a high inflation environment, interest rates are likely to go up quickly.	• Consult your bank for assistance in managing interest rate exposure • Borrowing or investing at a fixed rate to provide certainty of interest expenses or income • Using financial market instruments provided by financial institutions that either fix interest rates or minimise the risk of impact of interest rate fluctuations on revenue and/or expenses.

For further information read **Tips for managing through tough times.**

Commodity price risk

Potential Risk	Identify the Risk	Risk Mitigation Strategies
If the business buys or sells commodities, price movements can have an impact on profitability.	Calculate the impact of various price movements (say 5 per cent, 10 per cent, 20 per cent and 50 per cent) will have on your revenue and expenses. The risk could be broader than just the commodity; therefore look at historical data to see what happens to the sales of other products or services at various price movements.	• Consult your bank on how they can assist in managing commodity price exposure • Enter into fixed price contracts with suppliers or customers • Using financial market instruments provided by financial institutions that either fix commodity price or minimise the risk of impact of commodity price fluctuations on revenue and/or expenses • See if there are opportunities to diversify into other areas less exposed to sudden price movements.

Credit risk

Potential Risk	Identify the Risk	Risk Mitigation Strategies
If the business sells on credit, the risk that debtors will be unable to pay for them.	Does the business sell its products or services on credit? If so, create an aged debtors report to determine which debts are old. What would happen to your business if such old debts weren't paid?	• Check the credit status of the customer before making the sale • Check publicly available registers to verify that the customer's business is real and to find out who is behind the business • Insisting that customers sign a 'terms and conditions of trade' prior to supplying goods or services to them that includes a 'retention of title' clause for the goods you supply • Impose credit limits to restrict your firm's overall exposure, obtaining personal guarantees where possible • Maintain strong relationships with the customer to ensure their current liquidity status is always known • Contact debtors before the due date for payment • Stop selling to customers with old debts.

Risks posed by competitors

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Current and potential competitors can pose a significant threat to your business.	Do a SWOT analysis of your business. What would happen to your business if a competitor was to take advantage of one of your weaknesses, or is better placed to exploit an opportunity??	• Continue to build relationships with clients and the local community. Providing great service as a way of combating competitors. • Do a SWOT analysis and identify how your business can address weaknesses and take advantage of opportunities? • Keep up to date with local developments to get an early indication of the potential emergence of a competitor.
	Are they likely to be first to market with a new product or service? Are they likely to expand their business or to find new ways of getting their products or servicesto market?	• Research industry trends through reading and travel. Adopt viable new products and services – or ways of delivering those products and services to customers • Invest money in developing new products and services • Protect intellectual property assets by registering them where possible (trademarks, designvns, copyright, patents).
	Are they likely to significantly reduce their prices?	• Continually monitoring competitors, including the prices they charge • Remember, just because a competitor charges a particular price, doesn't mean it's the right price.

For further information read **Tips for managing through tough times.**

Risks posed by the market or the economy

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Changing tastes and trends, or from an economic downturn.	Is the business exposed to risks from changing tastes and trends or from an economic downturn? For example, while the business itself may be relatively immune from an economic downturn, a downturn may impact on your customer base. Are your products or services vulnerable to changes in taste and preference?	• Research consumer trends and tastes so that the business can respond to change • Continually test the market to see what products and services consumers prefer. This provides an understanding of changing consumer sentiment during changes to the economic cycle • Promote products and services that sell better during an economic downturn (these can be determined by testing the market) • Promote stock or services that sell well and are profitable.

Unexpected exit of the business owner

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Death or incapacity of the business owner/s	Ask what would happen to the business if the owner or one of the partners died or became incapacitated?	• Consult advisers who can assist in business succession, wills and estate planning • Prepare a business succession plan and a will that is consistent with the plan • Implement appropriate insurance that provides income or a capital sum in the event of the death or incapacity of the owner or a key employee • Where there are two or more unrelated owners in a business, consider a buy/sell agreement and funding agreement for the eventual transfer of the business • Document key processes and critical information so that other people can continue to run the business • Train employees so that more than one person knows how to perform each task.

Risk posed by natural disaster

Potential Risk	Identify the Risk	Risk Mitigation Strategies
Natural disaster such as flood, fire, pandemic or drought.	What would be the impact to the business if it had to stop operating from its premises for an extended period? What would be the impact on the business if its customers suffered a sharp fall in income?	• Prepare a business continuity plan that identifies how to run the business following a disaster • Ensure that all asset details are kept so replacement can be undertaken if needed • Have an adequate cash buffer that will assist if business operations are interrupted • Have adequate insurance in place.

Other potential risks in business

It's important to have controls in place to protect the business's assets. The controls needed will vary depending on the business's goods and funds, the type of industry it is in and its potential to suffer from loss or fraud.

The business's key areas should be reviewed to ensure that policies and procedures are in place to manage risks such as those listed below.

Key area	Identify the risk
Sales	• What are the procedures for the delivery of goods or services? • Are delivery instructions recorded? • How do you ensure that all sales are recorded? • What are the procedures for handling cash and credit sales?
Purchasing	• What procedures are in place to ensure purchases are in line with what is required? • Are suppliers' details checked on a regular basis to ensure the details (i.e. addresses or bank account numbers) are correct and not an employee's or their associate? • What procedures are in place for checking goods received against good ordered
Accounts payable	• Are payments checked to ensure they are not duplicated or identical? • What procedures are in place to ensure that payment is made on agreed terms? • Can rapidly increasing purchases from one supplier be identified?
Accounts receivable	• Are outstanding payments from customers reviewed on a regular basis? • What procedures are in place to follow up on late payments? • Are procedures in place to check who is receiving early-payment discounts?
Payments	• Does the business have controls in place to ensure that all invoices are appropriately approved before payment? • Who is authorised to make payments? • Are the duties for banking and bank reconciliation separated?

For further information read **Internal controls for small business**.

Insurance

One of the most important ways to protect the business against risks is to carry sufficient insurance. With insurance you can decide which risks you must insure, and which can be covered by the business or its owners. Seeking advice from a business insurance broker can be helpful to determine which insurance are relevant to your business.

Type of Insurance	Insurance cover provided
Building and contents insurance	This insurance should cover the business's buildings as well as contents and stock against loss.
Cybersecurity insurance	Cyber insurance is designed to protect businesses against the costs incurred as a result of a cyber-attack, internal employee threats and a business' liability for a data breach in which personal information is exposed or stolen.
Business interruption or loss of profit insurance	The business should be covered for interruption due to damage to property by fire or other insured perils. The cover should ensure that ongoing expenses are met and that anticipated net profit is maintained through a provision of cash flow.
Public liability insurance	Public liability insurance should cover the owner and business against the financial risk of being found liable to a third party for death or injury, loss or damage of property or economic loss resulting from the business's or the owner's negligence.
Directors and officers liability insurance	Directors and officers (D&O) liability insurance is intended to protect individuals from personal losses if they are sued as a result of serving as a director or an officer of a business.
Key person insurance cover	This type of insurance should help cover the loss of a key member of staff.
Workers' compensation insurance	In Australia, it is compulsory to maintain appropriate accident and sickness insurance for all employees and certain contractors you engage in your business.
Personal accident and illness insurance	This insurance is important for self-employed business operators who are not covered by workers' compensation insurance.
Motor vehicle insurance	It is compulsory to insure all company or business vehicles for third party injury liability in Australia.
Burglary cover	Business assets should be protected against burglary by this type of insurance.
Professional indemnity insurance	This type of insurance is important for businesses giving professional advice.
Fidelity guarantee	Insurance covering losses resulting from misappropriation by employees who embezzle or steal.
Machinery breakdown insurance	Insurance covering the business for any losses incurred if plant and machinery break down.
Product liability insurance	This insurance provides cover for injury or damage caused by goods the business sells, supplies or delivers — even in the form of repairs or services. As the type and level of insurance cover needed requires an assessment of the particular needs of the business, it is necessary to speak to an insurance specialist to ensure your business is adequately protected.

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