Don’t Confuse Risk Management with Risk Elimination when Making Decisions
By Jeff Fahrenwald, November 2010

Managing risk is one of the more important management functions, especially in today’s every changing business environment. It can take great skill to assess the risk of one decision over another in order to make a good decision. Where managers and business owners can get themselves in trouble is when they confuse risk identification and risk management with risk elimination during important decisions.

There really is no way to eliminate risk in decision making. Since what you are making a decision about is something that has yet to happen or something where we don’t know all the facts there will always be risk. If the manager does a good job at identifying the potential outcomes of a decision and makes a decision that seems reasonable, there is still a chance that decision could end up being wrong. In other words there is still risk.

It is also important for managers to understand that eliminating the risk of making a wrong decision one way ends up increasing the risk of making a wrong decision another way. For example, if you wanted to develop a criminal justice system that never let a guilty person go free it could be done, however you would also end up convicting more innocent people. On the other end, if you wanted to never convict an innocent person you would end up letting many guilty people go. Statically speaking these are called type one and type two error – the probability of accepting something that is bad or rejecting something that is good. As you try to eliminate one of these risks the other grows.

You can see these in business also. If you want to make sure you don’t put your business in more of a growth mode until you are certain the time is right, you will most likely end up behind many of your competitors and be late in pulling the trigger. On the other hand if you move too quickly in reaction what you believe is a trend you may actually be too far ahead and again be at a disadvantage when compared to your competition.

Where I see managers and organizations getting in trouble are when they think there is a “sure thing,” don’t understand there is risk, and don’t take the correct steps to plan for outcomes that may or may not happen. Organizations may be able to operate for years without a disaster recovery plan, a data back-up system, a succession plan, an understanding of economic cycles, or a plan if their major customer were to go somewhere else. These managers or organizations end up believing there is not a risk when indeed there is. Then when something happens and the world changes, the results can be disastrous! We saw this way too often as we entered the recession and we’ll see it again as we leave the recession.

Decision making is about identifying, understanding and managing risk. It is not about risk elimination. Good managers know there is no way to eliminate risk completely, understand the concepts outlined in this article
and learn to cope with uncertainty. They are not blindly optimistic their decisions will always come out right, but instead manage the risk by taking reasonable precautions being flexible and understanding the nature of risk.

Jeff Fahrenwald is Director of the MBA program at Rockford College and an Associate Professor of Business. He teaches courses on Leadership and Management. Jeff is also an active volunteer in the community serving on local boards and committees. He is also a trainer and consultant for many local organizations.