

The Risk and Governance Interplay



The interaction between risk and governance is of utmost importance for the sustainable growth and success of Small and Medium-sized Enterprises (SMEs). Both risk management and governance are essential components in effective corporate management, and can significantly impact an SME's capacity to attain its objectives while minimizing potential setbacks.

Understanding the interdependence and synergy between these two concepts is paramount for organisations aspiring to establish a business that thrives in the face of uncertainty. This section explores the correlation between risk and governance, the concept of a risk-enabled business, underscores the significance of a risk register and risk appetite statement, and outlines strategies for striking the right balance in risk management.

Risk and governance: Working together

Risk management and governance are intrinsically connected as effective governance serves as the foundation upon which a robust risk management framework is constructed. Governance encompasses the set of rules, practices, and processes that steer a company's direction and control. It encompasses the decision-making structure, corporate culture, and ethical guidelines that govern an organization's operations. On the other hand, risk management involves the identification, assessment, and mitigation of potential threats and opportunities that may affect an organization's ability to achieve its objectives.

A strong governance framework enables an organization to make well-informed decisions



concerning risk, ensuring that risks are kept within acceptable limits and aligned with the organization's strategic objectives. Effective governance fosters transparency, accountability, responsibility and fairness, thereby facilitating the identification and management of risks across the organization. By seamlessly integrating risk management into governance processes, companies can make more informed decisions, enhance their resilience, and generate greater value for their stakeholders.

Embracing Uncertainty: The Essence of a Risk-Enabled Business

A risk-enabled business acknowledges the inherent unpredictability in the business environment and actively manages risks to capitalize on opportunities that support its growth aspirations. By cultivating a culture of risk awareness and integrating risk management into its decision-making processes, a risk-enabled business can navigate the complexities of the business landscape, anticipate potential threats, and exploit emerging opportunities.

The Critical Role of a Risk Register

The board holds the responsibility for overseeing risks and, as such, should maintain a robust internal control system to safeguard the company's assets and the long-term interests of its stakeholders. The board's role includes identifying the primary risks, including emerging risks, facing the company and ensuring that significant risks are being managed appropriately. It is, therefore, beneficial to create a fundamental risk register—a tool designed for this purpose—that the board regularly reviews. This risk register should include:

- A description of the primary risks.
- The potential impact if an event materializes.
- The likelihood of its occurrence.
- A summary of the planned response.
- A summary of mitigation measures to reduce the probability or impact of these risks.

Defining Boundaries with a Risk Appetite Statement

A risk appetite statement is a formal document that outlines an organization's willingness to embrace risk in pursuit of its strategic objectives. It provides a clear understanding of the organization's risk tolerance and guides decision-making processes throughout the organization. To ensure that the risk appetite statement aligns appropriately, organisations should consider factors such as their industry, competitive landscape, regulatory environment, and strategic objectives. A well-crafted risk appetite statement should align with the organization's overall risk management framework, ensuring that risks are maintained within acceptable limits while enabling the pursuit of growth opportunities.

Striking the Right Balance

Achieving the right balance between risk and governance entails aligning risk management efforts with the organization's strategic objectives, proactively managing risks, and fostering a culture of risk awareness. To ascertain the appropriateness of this balance, organisations should take into account the following factors:

Risk Identification and Assessment: Governance processes in organisation such as establishing a board of directors or an advisory board, can effectively identify and assess risks. These governing bodies often comprise individuals with diverse expertise who can offer insights into various risks the SME may encounter, including strategic, operational, financial, and compliance risks.

Risk Appetite and Strategy: Governance frameworks play a pivotal role in defining an SME's risk appetite and risk tolerance. This entails determining the extent of risk the organization is willing to accept to achieve its strategic goals. Governance structures can establish clear guidelines and boundaries for risk-taking, which subsequently inform the company's risk management strategies and decisions.


Risk Management Framework: Governance involves the establishment of policies, procedures, and internal controls. These elements



are vital for establishing a risk management framework within an SME. Effective governance ensures that risk management processes are seamlessly integrated into the organization's daily operations and decision-making.

Accountability and Compliance: Governance mechanisms, such as regular reporting to stakeholders and shareholders, foster transparency within an SME. Transparent communication regarding risks and risk management strategies builds trust and confidence among investors, customers, and partners.

Decision-Making: Boards and committees play a significant role in major decision-making processes, especially those related to risk. They help SMEs in making well-informed decisions by considering risk assessments and aligning them with the organization's strategic goals.



Resource Allocation: Governance facilitates effective allocation of resources, including financial and human resources, to support risk management initiatives. This ensures that the SME possesses the necessary resources to address and mitigate risks.

Adapting to Change: SMEs operating in dynamic environments may encounter new risks as their business landscape evolves. Governance structures can help the organization adapt to these changes by periodically reviewing and adjusting risk management strategies.

Continuous Improvement: Effective governance fosters a culture of continuous improvement, including in risk management. SMEs can learn from past experiences and utilise governance processes to refine their risk management practices over time.

Critical Components: Effective governance and risk management rely on two critical components: risk oversight and internal controls.

Risk Oversight: SMEs could establish an advisory board to provide oversight on risk-related matters. The advisory board may include individuals with diverse expertise who can help identify and evaluate different types of risks, such as strategic, operational, financial, and compliance risks. It may be appropriate to establish a risk committee within the governance structure, exclusively focused on risk oversight and making recommendations to the board. The board should regularly receive reports on the organization's risk profile, including emerging risks and the effectiveness of risk mitigation measures.

Internal Controls: SMEs should implement well-defined policies and procedures to govern their operations. These policies should establish standards of conduct, delineate responsibilities, and offer guidance on risk mitigation. Internal controls often include segregating duties to

prevent fraud and errors. For example, the person responsible for approving expenses should not be the same person responsible for paying them. Clear processes should be in place for authorise and approving transactions, contracts, and financial activities to ensure that only legitimate and approved activities occur. SMEs may consider internal audits or external audits to periodically assess the effectiveness of internal controls and identify areas requiring improvement. Mechanisms should be in place to monitor compliance with relevant legal and regulatory requirements. Internal controls should be reviewed and updated regularly to adapt to the organization's growth.

In summary, the relationship between risk and governance in SMEs are interlinked, with governance providing the structure and processes essential for effective risk management. By integrating risk management into their governance frameworks, SMEs can enhance their resilience, ensure compliance, and make informed decisions to achieve their business objectives while mitigating potential risks.

Achieving the right balance between risk and governance is an ongoing process that necessitates continuous assessment, monitoring, and adjustment. By actively involving the board and senior management in risk management, incorporating risk considerations into decision-making processes, and regularly evaluating the effectiveness of their risk management efforts, organisations can optimize their risk management approach and drive long-term business success. By implementing effective risk oversight and internal controls, SMEs can enhance their ability to manage risks, safeguard assets, maintain financial integrity, and operate in a compliant and ethical manner.