CRISIS MANAGEMENT VERSUS RISK MANAGEMENT - A PRACTICAL APPROACH

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Abstract
When it occurs, a crisis can have a devastating effect on a company, can even put to risk its own existence. Without proper preparation and precise focus, a company won't be able to deal effectively with the effects of a crisis and recover to its previous state. Based on the principle "Better prevent than treat", the best way to cope with crises is to avoid them.
Business practice showed that crises can really be prevented and avoided. With the right prevention actions and a proper organizational structure, any company can identify and manage in due time any possible risks that can generate a crisis. The ***biggest challenge*** *for the management is to correctly assess the exposure to risk of the company and identify the key points to focus on in order to avoid any possible crisis. My own experience showed me that there is a pattern which appears every time a company faces a crisis. Based on this finding, I decided to create a* ***practical tool*** *that would make a bridge between the risk management and crisis management practices with the purpose of simplifying the job of the managers in assessing risks and, thus, preventing crises.*

Key words: *Risk management, crisis management, risk assessing, crisis prevention*

JEL Classification: *M21, O21*

Crisis management vs. Risk management

Both, crisis management and risk management are part of the general domain of organizational management and they both deal with threats that impact the well running of the organization's systems and the wellbeing of its individuals.

Crisis Management approaches the threats mostly from a **reactive** perspective; it describes actions that need to be put in place in order to reduce as much as possible the negative effects of an event, which is, in general, unexpected.

Risk management approaches the threats from a **proactive** perspective; it is concerned with identifying and correctly assessing of a possible threat.

While **risk management** is treating risks individually, organizational **crisis management** is concerned also with identifying the connections between different individual threats, from different organizational areas and levels that, existing together, might add up to become a an increased threat and generate a crisis. From this perspective, crisis management has a more integrative approach.

On the other hand, **risk management** involves **identifying and assessing potential threats and finding the best ways to avoid those threats to materialize**, while **crisis management involves dealing with threats before, during, and after** they have occurred. In an extended version of the pre-crisis stage of crisis management, the actions are similar to the ones engaged by risk management, as shown in the table below.

Risk management actions	Crisis management actions
	1. Prevention of crisis
1. Identification of risks 2. Evaluation of risks 3. Mitigation of risks	a. Identification of risks b. Evaluation of risks c. Mitigation of risks
	2. Solving the crisis 3. Recovering after the crisis 4. Implementing changes for a better crisis prevention in the future

The process of identifying, assessing and mitigating potential threats as part of the larger crisis management process is called **crisis prevention**. Implemented within an organization as a continuous process, crisis prevention or risk management will diminish considerably the probability for the organization to face a crisis. The exposure to crises will not decrease to zero, as there is always a certain percentage of risks that can never be completely eliminated, but the chances of avoiding a crisis and recovering after a crisis will be much higher when the organization is adopting a crisis prevention/risk management approach.

Therefore, we can say that risk management and crisis management are not competing with each other as practices within an organization, rather, they are working together for the same outcome, which is increasing the capacity of an organization to cope in the most efficient way with any possible threat that might put in danger its functionality or even its existence.

A more practical approach

Following the COSO ERM (Enterprise Risk Management Integrated Framework) theoretical model, I have developed an algorithm based on a matrix which helps assess the level of exposure to risk of a company and prevent crises by identifying the stressing points existing in the organization that can generate possible crises. Based on the cube designed by the COSO ERM model, which is measuring the level of operational risk, I developed another two cubes that help draw a more complete image of the company by assessing its business and financial situation.

The assessment process is using the three cubes matrixes to collect information from three relevant perspectives:

1) **Business**
2) **Financial**
3) **Operational**

The overall assessment of the company, consisting of the three assessment processes made through the three-dimensional cubes – Business Cube, Financial Cube and Operational Cube, will be done as follows:

- Three sets of questions will be applied, each for every assessment process/cube
- The answers for the first two cubes, Business and Financial, will help assess the situation of the company in terms of business and finance and will depict the broader context in which the operational risk exposure will be placed
- The answers to the questions of the operational cube will create the data base for the mathematical algorithm that will calculate the operational risk exposure

a) **Assessment of the business situation - Business Results Cube (BRC)**

Business Results Cube is a matrix which helps the analysis of **the evolution** of the most important six **business indicators,** as identified below, both at **Entity Level** and **Business units' level (a – n)**, categorized in pre-defined stages (Figure 1).

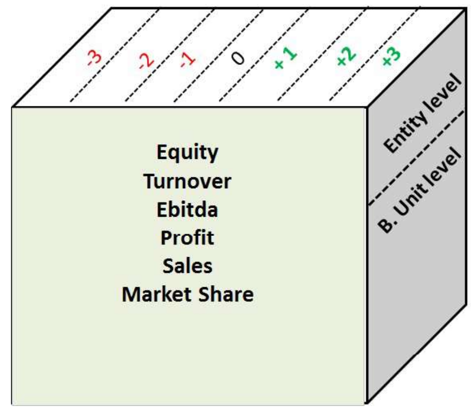

Fig. 1 - Business Results Cube (BRC)

The results of this cube will give the auditors an idea about the business aspects of the company that is under assessment and will help them put in the broader context the operational risk exposure.

b) Assessment of the financial situation - Financial Status Results Cube (FRC)

Financial Status Results Cube is a matrix which helps analyzing the evolution of the most important financial ratios at Entity Level and Business units' level (a – n), categorized in pre-defined stages (Figure 2).

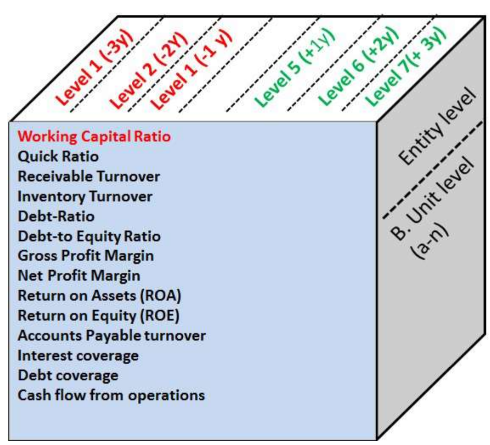

Fig. 2 - Financial Status Results Cube (FRC)

The results of this cube will give the auditors an idea about the financial stability of the company that is under assessment and will help them put in the broader context the operational risk exposure.

The financial indicators used in the financial matrix are the ones that are usually used in the financial analysis by bankers, investors, and business analysts to assess a company's financial status. They are used to identify company's strengths and weaknesses, analyze trends and show its competitive position, or more important to predict future financial crises.

c) Assessment of operational risks exposure - Operational Key Points Cube (OKPC)

Operational Key Points Cube is a matrix which helps assessing the level of exposure to operational risk of a company, taking into consideration the three dimensional vectors presented on the cube (Figure 3).

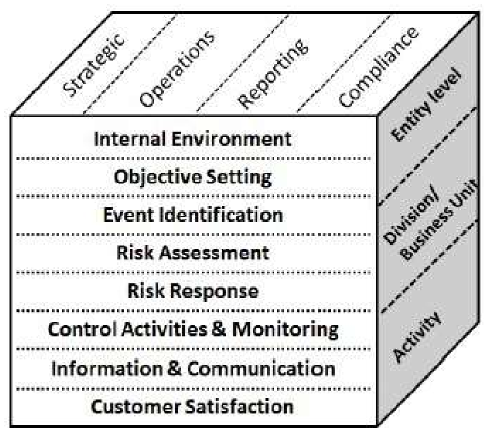

Fig. 3 - Operational Key Points Cube (OKPC)

The components of the cube can be explained as follows: there are four objectives (the top side of the cube), eight perspectives (the front side of the cube) and three organizational levels (the right side of the cube) that interact together in order to make the assessment.

Within the context of a business entity's established mission or vision, management establishes strategic objectives, selects the strategy, and sets aligned objectives. The entity's objectives can be set in four categories:

- **Strategic** – high-level goals, aligned with and supporting the company's mission and strategic guidelines
- **Operations** – effective and efficient use of the resources
- **Reporting** – accuracy and reliability of reporting process and tools
- **Compliance** – compliance with applicable laws and regulations (internal and external) and company's procedures

Every type of objective must be reflected at every level of the organization – entity level, division level or activity level, from the following perspectives:

- **Internal Environment** – it refers to the values of the company, how these values are viewed and addressed by the employees, the integrity and ethical values of the environment in which they operate; also, the tone of an organization, how risk is viewed and addressed by the entity's people, including risk management philosophy and risk appetite.
- **Objective Setting -** management must set objectives and then, chosen objectives must support and be aligned with the entity's mission and are consistent with its risk appetite. Should be analyzed how the objectives are set in order to support the company's strategy.
- **Event Identification -** Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. The ability of the company to identify the positive and negative events, which can affect or bring benefits to the company, must be analyzed.
- **Risk Assessment -** Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. The ability of the company to analyze risks, to understand the impact and to establish how these should be managed.
- **Risk Response** – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite. Should be analyzed if the risk response is according to the company's strategy in relation to risk and the attitude towards this.
- **Control Activities & Monitoring -** policies and procedures are established and implemented to help ensure the risk responses are effectively carried out. The activities engaged and tools used by the company to make sure that overall, the company is following the strategies set, objectives, targets and decisions taken.
- **Information and Communication -** Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity. From accuracy point of view and time wise, the ways of transmitting information across the company is a crucial point to be analyzed.
- **Customer satisfaction** – it shows the degree of satisfaction provided to internal or external clients. The external clients' attitude towards the services received represents a very important indicator for the image and the trust in the company. Also, the relationship with the internal clients is very important; the way they are served by their colleagues is a major

factor for determining the effectiveness of the cooperation between departments.

The mathematical algorithm

Based on the elements of the **Operational Key Points Cube**, I created a mathematical algorithm that is measuring and grading the importance of every element and the interconnections between them, is calculating the level of exposure of the company to operational risks and also is identifying the points of interconnection where the exposure is mostly present and tell us how high it is.

The applicable algorithm is based on:

1) Yes/no key questions project

Relevant questions (based on OKRC) are addressed regarding the existing situation of the company. Each and every question represents a point of potential risk (if the answer is "no").

2) Weighting the significance of the questions

Although the questions are relevant to the majority of business fields and companies, the significance of each and every one of them is different from one company to another and can be changed over time in certain companies. Also, the significance of the questions is measured differently by different persons within the same company, who are operating at different levels and areas (departments). Their assessment of the weight is subjective, reflecting their own view and managerial approach from every different perspective each of them represent.

The average of their evaluation creates the weight.

The mathematical algorithm calculates **the company's exposure to operational risk and maps this exposure in certain activities and levels.**

The algorithm presents the company's exposure to risk as a map. Based on the result obtained through the algorithm, the company receives a percentage of exposure to risk, which will be illustrated in colored alerts, as follow:

- **Red alerts** – high exposure, immediate actions required
- **Yellow alerts** – medium exposure, actions for improvement required
- **Green alerts** – no exposure

The practical result

The practical impact of using the algorithm is illustrated in the table below.

Risk management actions	Crisis management actions	Algorithm actions
	1. Prevention of crisis:	
1. Identification of risks 2. Evaluation of risks 3. Mitigation of risks	a. Identification of risks b. Evaluation of risks c. Mitigation of risks	1. Identification of risks 2. Evaluation of risks
	2. Solving the crisis 3. Recovering after the crisis	
	4. Implementing changes for a better crisis prevention	3. Implementing changes for mitigating the risks and a better crisis prevention

The algorithm is improving the process of risk management and crisis prevention, so that the actions of crisis management are simplified. Due to the measures taken based on the results of the evaluation through the algorithm, the crisis is avoided. Thus, the company will no longer use resources and time to repair the damages caused by the crisis and recover after such an event, but focus on its main business goals and targets. In the same time, it will be more protected in the future from possible dangers.

Author's background

The author has a long experience in assessing risks and managing crisis.

He is a retired Major from the Israeli Navy (served in combat and intelligence positions).

He has almost 20 years of experience of CEO in Insurance and Automotive industry.