Risk Modelling

Context

The one thing we know about any forecast is that it will not be right. Uncertainty, and the existence of risk, mean that a project will not complete on the predicted day; it might be sooner or it might be later. A new product will not hit its anticipated sales exactly; they might be more, they might be less. And the new product might be hit by a disaster such as a product recall as a result of a regulatory intervention.

This prompts obvious questions. How much sooner might the project complete? How much later? How much lower might sales reasonably be? And how likely is the product recall and what impact might it have on profits?

Purpose

The purpose of risk modelling is to provide a quantitative indication of the potential range of outcomes of an enterprise, initiative or project. The outcomes might be the cost or duration of a project, the profit in a business plan or the possibility of running out of cash. The ranges are represented in practice by probability distributions.

Benefits

Risk modelling:

- allows managers to improve their decision making by providing an insight into the full range of possible outcomes
- enables them to embark on a proposed activity with a better understanding of the balance of risk and reward
- provides a starting point for business-as-usual risk management.

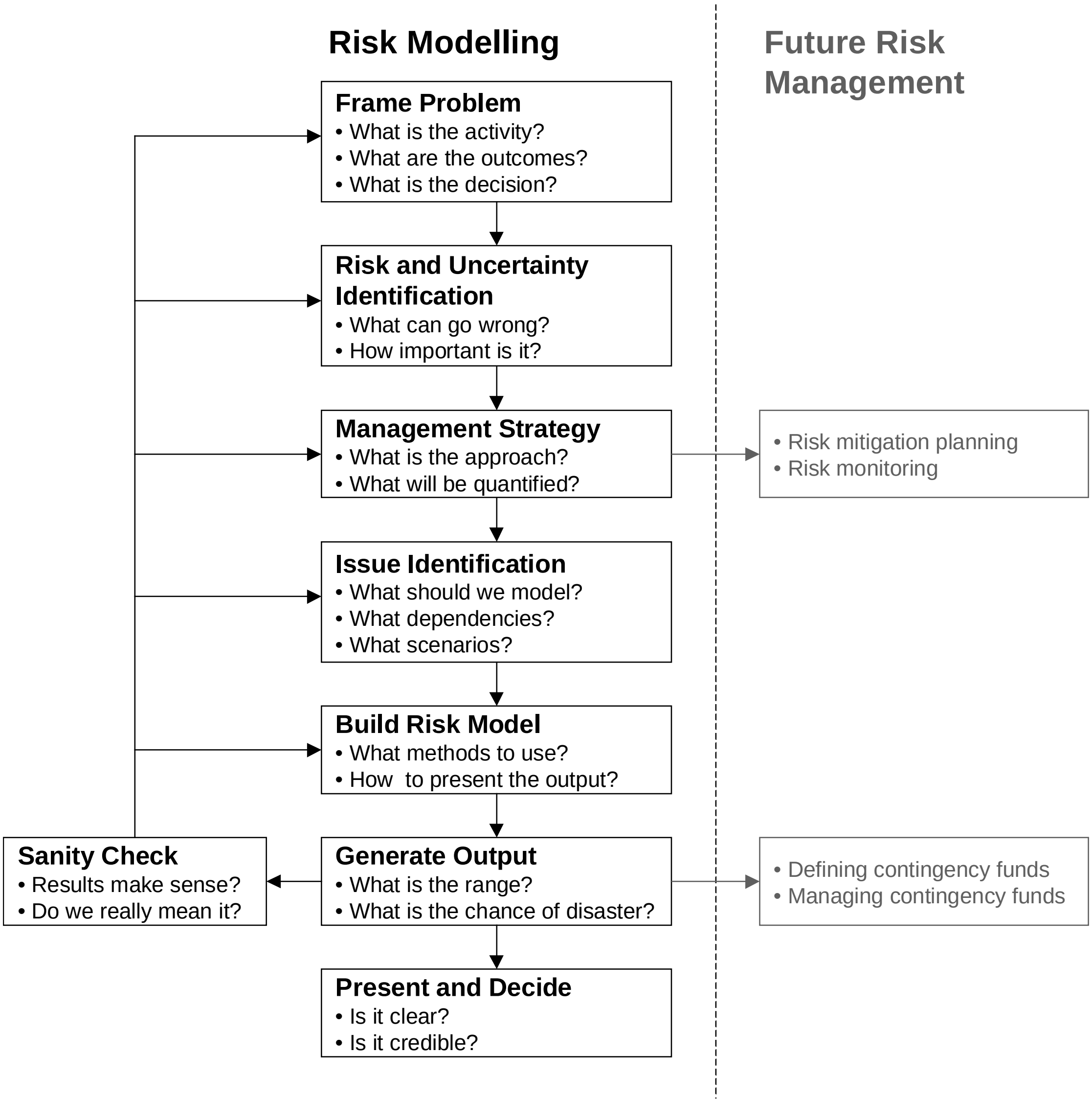
Approach and Features

Our generic approach to risk modelling is shown in the chart on the following page. The specific features of the Risk Agenda approach are:

- clear, up-front specification of the problem to be addressed so that the generic approach can be customised to the management challenge
- open identification and discussion of key risks and uncertainties in workshops and management interviews
- clear risk management strategy to ensure that only the issues which need to be are quantified
- interface with business-as-usual risk management to support risk management planning, risk reporting, risk monitoring, and the definition and management of contingency funds
- detailed analysis of the risks and uncertainties to generate the issues to take forward to the model, avoiding mechanical quantification of the risk register
- identification and modelling of interdependencies and correlated effects
- both these previous points supported by our innovative new approach to risk mapping

- use of scenarios to deal with an unfolding future in the most realistic way
- full range of modelling capabilities and tools, including Monte Carlo, but also simpler, more direct techniques
- avoidance of common pitfalls and howlers
- emphasis on explanation and sanity checking to promote clarity and credibility, and to avoid the imposition of black box output
- clear presentation and interpretation of the results.

Generic Process Flow Chart



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