

Strategic Management

Lecture Eleven: Risk Management and Crisis Strategy

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Introduction

In our previous lecture, we emphasized the importance of evaluating and controlling strategy to ensure it remains aligned with a rapidly evolving environment.

Yet, even with diligent evaluation, unforeseen disruptions can emerge. That's where the current lecture—Risk Management and Crisis Strategy—comes into play.

Risk is an inherent element in every strategic decision, and organizations must be prepared not only to anticipate but also to respond when crises strike.

Effective risk management bridges strategy and resilience, ensuring continuity amid uncertainty (Morris & Hodges, 2019).

Learning Outcomes

1. Define risk management and differentiate it from crisis strategy.
2. Identify common strategic risks faced by businesses.
3. Evaluate frameworks and tools for managing strategic risks and crises.
4. Apply principles of risk and crisis management to personal scenarios.

Case Study: British Petroleum (BP) and the Deepwater Horizon Disaster

In 2010, BP's Deepwater Horizon oil rig explosion became one of the most devastating environmental disasters in history. Investigations revealed that cost-cutting measures, ignored safety warnings, and lack of crisis protocols amplified the damage. The company's strategy prioritized rapid deep-sea drilling but had weak contingency planning. The

aftermath included billions in losses, environmental lawsuits, and a damaged global reputation (Ingersoll, Lockie, Reavis, 2012).

Lessons from BP:

- Strategic ambition must be matched with a comprehensive risk assessment.
- Ignoring early warning signs can lead to catastrophic outcomes.
- Crisis response plans are as vital as growth strategies.

Risk Management

Strategic risk refers to potential events or conditions that can disrupt an organization's ability to achieve its strategic objectives.

These can stem from internal factors (e.g., poor planning, leadership changes) or external forces (e.g., economic downturns, technological disruptions).

Risk management, on the other hand, is the systematic process of identifying, assessing, and responding to risks that could impact an organization's ability to achieve its strategic objectives.

It is a **proactive** approach to managing uncertainty and minimizing negative consequences.

The purpose is to safeguard strategic goals, reduce uncertainty, and enable organizations to act confidently despite volatility.

A crisis on the other hand is a sudden unexpected event that poses a serious threat to a firm's operation. A crisis requires immediate high-level decision making and may force a change in business strategy. We therefore say risk is a possibility crisis is the reality.

Key aspects of Risk Management Process

1. **Identification:** Recognizing potential internal and external risks (e.g., economic changes such as inflation, system failures, reputational threats).

2. **Assessment:** Evaluating the likelihood and impact of each risk using qualitative or quantitative methods. What is the possibility that it will occur and when it occurs what will be the effects.
3. **Mitigation:** Taking steps/actions to reduce the likelihood of risk occurring or lessen its impact if it does.
4. **Monitoring:** Continuously tracking known risks and identifying emerging ones as conditions change.
5. **Response Planning:** Developing clear action plans for managing risks that materialize, often through contingency or continuity plans.

Frameworks and Tools for Risk Management

1. **SWOT:** We looked at this in our previous lectures. Of interest here is the T for threat. The firm must adequately and keenly look at every possible threat that is likely to affect its competitiveness in the industry now and in the future.
2. **PESTLE:** This framework emphasizes the need for the firm to map out and monitor macro-environmental risks by categorizing them from political to ecological. The framework requires the firm to identify the trends or likely changes in each of the categories thereby planning appropriately.
3. **Risk Heat Maps:** These are visual tools that plot risks on a grid based on two criteria—likelihood of occurrence and potential impact. They help prioritize which risks need immediate attention and which can be monitored. For example, a high-impact, high-likelihood risk falls in the "red zone" and requires urgent mitigation.

To be able to use this tool here are the steps to follow;

- Identify the potential risks that might affect your operations
- Assess their likelihood of occurrence, by assigning likelihood score from 1 to 5
- Assess the impact of the risk, assign an impact score from 1 to 5
- Calculate risk score by multiplying likelihood with impact
- Plot on a heat map by placing each risk on the matrix based on its scores
- Prioritize the response, focus much attention on high-risk areas
- Implement controls to reduce either the likelihood or the impact
- Monitor and update, regularly revisit the heat map and update.

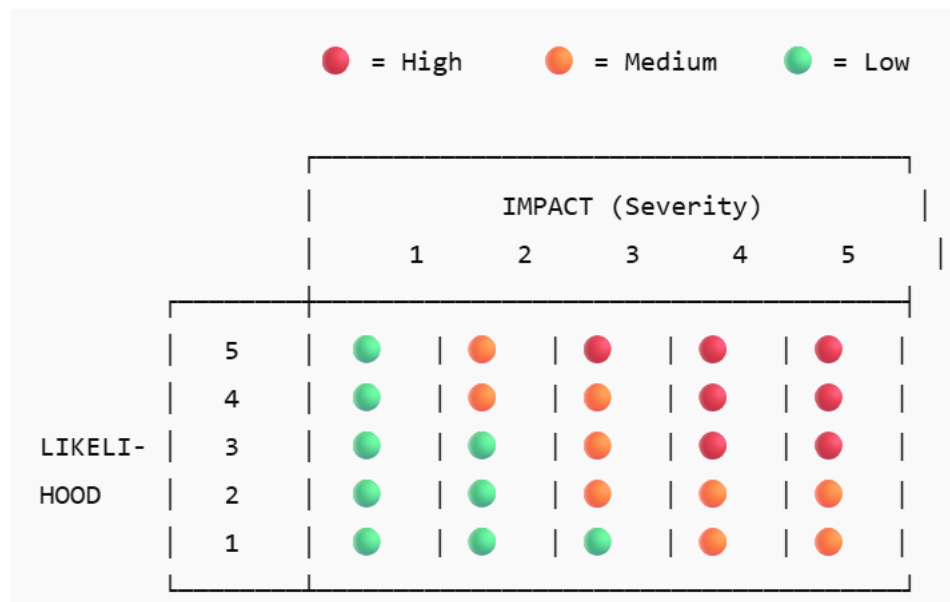
Here is a sample for a coffee shop

Table 1: Risk- Impact Matrix

| Risk | Likelihood (1-5) | Impact (1-5) | Risk Score (L×I) | Priority |
|--|-------------------------|---------------------|-------------------------|-----------------|
| Staff absenteeism | 4 (Likely) | 3 (Moderate) | 12 | High |
| Power outage | 3 (Possible) | 4 (Major) | 12 | High |
| Customer injury (e.g. slipping) | 2 (Unlikely) | 5 (Severe) | 10 | Medium-High |
| Theft or break-in | 2 (Unlikely) | 4 (Major) | 8 | Medium |
| Coffee bean supply delays | 3 (Possible) | 3 (Moderate) | 9 | Medium |
| Negative online review | 4 (Likely) | 2 (Minor) | 8 | Medium |
| Equipment failure (e.g., espresso machine) | 3 (Possible) | 4 (Major) | 12 | High |
| Health inspection non-compliance | 1 (Rare) | 5 (Severe) | 5 | Low |

Table 1 shows possible risks and their impact on the operations of the coffee shop. Those with the highest scores, such as 12, should get the attention of the management. To have a better visual of the above information, we can generate a heat map that makes it much easier to see where attention should be drawn. Where the red is, that signifies danger and therefore immediate action is needed.

Map 1: Risk Heat Map



4. **Business Continuity Planning (BCP):** BCP ensures that essential functions continue during and after a crisis. It includes identifying critical operations, creating backup systems, securing communication channels, and outlining step-by-step procedures for maintaining service levels under stress. BCP is especially useful in industries like healthcare, finance, and logistics. Here are the steps to implement BCP
 - a. **Risk assessment-** Identify the threats and vulnerabilities by asking questions such as what could go wrong? What are the chances?
 - b. **Business impact analysis-** how the disruptions affect business operations. Ask questions such as, what are our critical processes? How long can they be down?

- c. **Strategy development**- develop strategies to maintain or quickly resume operations of critical functions. Ask, what resources do we need to stay running?
- d. **Plan development**- come up with a detailed continuity plan with procedures and contact list. Pause questions such as who does what when disaster comes.
- e. **Training and awareness** – staff must be educated about the plan and their roles. Ask, does everyone know what they are supposed to be doing?
- f. **Drills**- Carry out simulations to test the plan, this will validate whether the plan works under pressure.
- g. **Maintenance and Review** – keep your plan updated reflecting changes in your business environment.

The following are important things to include in your BCP

- Emergency contacts
- Alternative suppliers
- Alternative workspace
- Data recovery plan
- Communication protocol

For the coffee shop this would be BCP, if it was hit by power black out

- **Risk Identified:** Power failure.
- **Impact:** Coffee machines go down, lost revenue, food spoilage.
- **BCP Strategy:** Install a generator, use manual brewing equipment, and notify customers via social media.
- **Prepared Plan:** Manager initiates power-loss protocol, staff follow printed checklist, and operations resume within an hour.

Application at personal level

Applying risk management and crisis planning at a personal level helps you become more resilient, better prepared, and less reactive when life throws unexpected challenges your way. Here is a sample of Personal Risk Management

- **Identify personal risks:**
 - Job loss (if employed) or business closure if self-employed
 - Illness or injury
 - Theft or cyber threats (now that we are heavy on technology gadgets)
 - Poor financial decisions

- Time mismanagement
- **Assess likelihood and impact:**
 - How likely is this to happen?
 - What would the personal, financial, or emotional cost be?
- **Mitigate risks:**
 - Build an emergency fund (be setting aside monthly some money for this)
 - Get health or life insurance
 - Live a healthy lifestyle (eat well, exercise regularly)
 - Use strong passwords and backup data
 - Maintain strong relationships and networks
- **Monitor and review:**
 - Regularly review your finances, health, and personal goals
 - Adjust strategies as your life changes

References

- Ingersoll, C., Locke, R. M., & Reavis, C. (2012). *BP and the Deepwater Horizon disaster of 2010*. MIT Sloan School of Management. <https://mitsloan.mit.edu/teaching-resources-library/bp-and-deepwater-horizon-disaster-2010>
- Morris, J., & Hodges, T. (2019). *Strategic management*. Oregon State University. <https://open.oregonstate.education/strategicmanagement/>