Why Enterprise Risk Management Is Critical for Small & Mid-Sized Businesses

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As we discussed in a recent article, it is critical for Los Angeles and Southern California business owners and entrepreneurs to find the right balance between the financial and operational sides of their companies. It is especially important that the goals and objectives of finance and operations be linked together and compatible with each other.

Enterprise risk management, or ERM, can play a critical role in finding this balance and making these links. Companies use ERM to methodically and strategically evaluate the various risks that could impact the results of their financial or operational goals.

What Exactly is ERM?
The Institute of Risk Management defines enterprise risk management as follows:

> *"The systematic process of understanding, evaluating and addressing these risks to maximize the chances of objectives being achieved and ensuring organizations, individuals and communities are sustainable."* [1]

Traditionally, ERM was used primarily by larger organizations. However, many small and mid-sized companies today are using ERM to help them view their business from a broader perspective. In doing so, they are reaping many benefits — including improving or sustaining their ability to compete in today's dynamic and ever-changing marketplace.

The fact is, ERM is probably more important for small and mid-sized businesses than it is for large corporations. This is due to the simple fact that smaller firms typically experience much higher failure rates than do large businesses. This makes enterprise risk management an absolutely essential task for these business owners, executives and entrepreneurs.

Frequency and Magnitude of Risk Events
Generally speaking, risk is measured by two variables: the frequency of a specific risk occurring, and the magnitude of the negative consequences if the risk actually does occur. In other words, how often is it likely that your business could be impacted by a particular risk? And what is the worst-case scenario for your business each time this risk event comes to pass?

Businesses today face a variety of risks, both internally and externally. The former include operating, production, supply chain, financial and pricing risks, while the latter include regulatory, environmental, technological and societal risks. Some of the most serious risks faced by small and mid-sized businesses today include:

- Cybercrime
- Fraud and embezzlement
- Business interruption

- Interest rate changes
- Foreign currency exchange volatility
- Merger and acquisition upheavals

Your ERM challenge is to methodically identify the specific risks that pose the greatest threats to your business, and then take steps to minimize the chances that they could occur and/or the damage that could result if they do occur. Not doing so can lead to inefficient production, outdated processes, pricing inefficiencies, lost customers and market share, inventory mismanagement and product outages, and missed business opportunities.

The Strategic Risk Assessment and Plan

The best way to go about the process of enterprise risk management is to start with a strategic risk assessment and plan. This will help you evaluate and assess your priorities with regard to ERM and create ongoing monitoring and control activities. It may also uncover tax-planning strategies that can help you take advantage of tax-related ERM risks and opportunities. Doing so may result in a number of positive outcomes:

- Less uncertainty in the corporate enterprise
- Ensured continuity in production
- Decreased risk of business failure or product launch
- Better allocation of limited corporate resources
- Higher profits and lower costs
- Establishment of a foundation for continuous process improvement

Concluding Thoughts

Businesses today face a variety of risks, both internally and externally. Many are using enterprise risk management to methodically and strategically evaluate the various risks that could impact the results of their financial or operational goals. ERM was traditionally used primarily by larger organizations, but many small and mid-sized companies today are using ERM to help them view their business from a broader perspective. In fact, ERM is probably more important for smaller businesses than it is for large corporations. This makes ERM an absolutely essential task for all business owners, executives and entrepreneurs.

1 The Institute of Risk Management: https://www.theirm.org/about/risk-management/

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we are passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.