

## A Study on Importance of Risk Management

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**Abstract:** Risk management is a structured approach/methodology for dealing with uncertainty related to threats; a range of human activities including: assessing risk, developing strategies to manage it, and mitigating risk through resource empowerment/management. Possible strategies include shifting risk to other parties, avoiding risk, reducing the adverse impact of risk, and adjusting some or all of the consequences of certain risks. Financial risk management, on the other hand, focuses on risks that can be controlled using financial instruments. The goal of implementing risk management is to reduce the various risks associated with the selected area to a level acceptable to the community. This can come in the form of different types of threats caused by environment, technology, people, organizations and politics. The implementation of risk management includes all means available to people, especially the risk management units as a person, staff and organization.

**Keywords:** Risk, Management, Importance, Organizations, Risk Management.

### I. INTRODUCTION

Risk is part of the working life of individuals and organizations. Various risks such as fire hazard, collision with another vehicle on the road, flood hazard in rainy season, etc. can lead to losses if we don't anticipate these risks in advance. Risks are associated with possible events or circumstances that could jeopardize the achievement of company goals. We understand and agree together that the goal of entrepreneurship is to build and expand competitive advantages in the organization. In principle, the activities of a business entity or a company cannot be separated from the activities of risk management. The operation of a business unit or company usually deals with business risks and non-business risks. Imam Ghazali in Kasidy, Risk Management (2010) states that business risk is risk associated with a company's business in order to create a competitive advantage and add value to shareholders. Non-business risk is another risk that cannot be controlled by the company. In general, risk can be interpreted as a situation faced by a person or organization that has the potential to be harmful. What if the opportunities presented can provide tremendous benefits, and even if they suffer a very small loss. For example, buy a lottery. If you're lucky you'll get a very big prize, but if you're not lucky the money used to buy the lottery is relatively small. Is that also a risk? The answer is

that this is also a risk. During a loss, even if it is so small, it is considered a risk. Risks related to this uncertainty arise from a lack of or insufficient information about what is about to happen. Something that is uncertain (uncertain) can have a positive or negative effect. According to Weidman, uncertainty that creates profitable opportunities is referred to as opportunity, while uncertainty that creates adverse consequences is referred to as risk.

In recent years, risk management has become an important trend both in discussions, practices and professional education. This concretely shows the importance of risk management in today's business world. In general, risk can be interpreted as a situation faced by a person or organization that has the potential to be harmful. What if the opportunities presented can provide tremendous benefits, and even if they suffer a very small loss. For example, buy a lottery. If you're lucky you'll get a very big prize, but if you're not lucky the money used to buy the lottery is relatively small. Is that also a risk? The answer is that this is also a risk. During a loss, even if it is so small, it is considered a risk. Why should risks be managed? The answer is not difficult to guess, because the risk involves no small cost. Consider an incident where a shoe company caught fire. Direct losses from these events are financial losses from the burning of assets (e.g. buildings, materials, semi-finished and ready-to-sell shoes). However, there were also indirect losses, e.g. B. a business interruption of several months, which stopped the cash flow. Another consequence is the failure to pay debts to suppliers and creditors due to the loss of cash flows, which will ultimately reduce the company's credibility and good relations with business partners. Risks can be reduced and even eliminated through risk management. The risk management role is expected to anticipate rapid changes in the environment, develop corporate governance, optimize strategic management, safeguard the organization's resources and assets, and reduce reactive decisions by top management.

### II. REVIEW OF LITERATURE

Risk management is the design of procedures and the implementation of procedures to manage a business risk. Risk management is an anticipation of the increasingly complex activities of business entities or companies that are triggered by the development of science and technological

progress (Kasidi, 2010). Another definition that explains the meaning of risk is the possibility of deviations from expectations that can cause harm. Risk is a possibility of an event that deviates from what is expected, but this deviation is only seen when it has taken the form of a loss (Kasidy, 2010). Another opinion was also expressed by Abbas Salim in Kasidy (2010) Risk is uncertainty that may give birth to loss. So from some definitions that have been expressed, it can be concluded that risk is something that is uncertain but if not handled properly will cause harm to the business.

### III. RISK MANAGEMENT PRINCIPLES

**Transparency:** All potential risks in the activity must be exposed openly because hidden risks can be the biggest source of problems.

**Accurate measurement:** Investment must be continuous with various techniques and tools that will be used as a condition of strong risk management

**Quality information on time:** This principle determines the accuracy of measurement and the quality of decisions taken.

**Diversification:** A good risk management system places the concept of diversification as something important to observe, this requires a constant and consistent monitoring pattern.

**Independence:** Discuss the authority and responsibilities of the risk management group and other groups / units in the company, the company's vision and the quality of interaction between risk management groups and other groups / units, as well as between groups / units that carry out transactions by taking certain risks.

**Discipline Decision Patterns:** The pattern of decisions taken must depend on management's efforts in deciding the best way to use certain tools / techniques and understanding the limitations of the tools / techniques.

**Policy:** Require that the objectives and strategies of a company's risk management must be formulated in a clear policy, manual and procedure. The main objective of this is to provide clarity regarding the risk management process, both for internal parties and external parties.

### IV. RISK MANAGEMENT CLASSIFICATION

In the world of insurance referred to risk is, if the risk is interpreted as uncertainty that causes losses (Uncertainty of loss), which referred to here losses in the sense of financial (financial risk), where losses it can be assessed financially or valued with money. Risks can be classified as follows:

**Operational risk:** Namely the type of risk that arises due to the non-functioning of the internal part of the company and several other causes such as human error and a failed system. The cause of this operational risk is claimed to be the most widespread cause compared to other types of risk. Besides being caused by several things mentioned above, there are other causes of operational risks, such as accounting, operational activities (both operational activities for goods and services), management information systems, information technology systems, and human resource management systems (HRM).

**Risk of hazard/risk of danger:** Namely a number of factors that can affect various consequences that arise as a result of an

event. Losses experienced by a company are examples of irregularities that are certainly not desired by all companies. As for some of the factors claimed to be sources of losses experienced by a company, including social risks, economic risks and physical risks. It is very important for risk managers to identify the sources of risk that exist in a company manager managers can immediately take the right steps to handle them.

- **Financial risk:** Namely a risk that is generally experienced by investors. This risk arises as a result of issuers' shares and bonds that cannot afford to pay dividends or interest, or loan principal and interest.
- **Strategic risk:** Namely the risk that usually arises due to a series of events or conditions that are unexpected where the event or event can reduce the ability of a manager to apply his ideas or strategies.
- **Stages in Risk Management:** Establishing context is setting the basic parameters by which a risk must be managed and preparing guidelines for making more detailed decisions in the risk management process. The context includes the internal and external environment of the organization and the objectives of risk management activities.
- **Establish an external context:** This step determines the external environment in which the organization operates and the relationship between the organization and its environment include, socio-cultural environment, regulation, competition, financial markets and political environment and external stakeholders.
- **Establish internal context:** Before the risk management activities at each level begin, it is necessary to understand an organization including:
  - Culture
  - Internal stakeholders
  - Structure
  - Capability of resources such as human, system, process, capital.
  - Targets and targets and strategies for achieving them.

### V. ESTABLISHING AN INTERNAL CONTEXT IS VERY IMPORTANT BECAUSE:

Risk management occurs in the relationship between organizational targets and goals.

- The big risk in almost all organizations is that they fail to get strategies, business goals or projects, or feel frustrated by stakeholders.
- Organizational policies, targets and desires help in determining organizational risk policies.
- The specific goals and criteria of a project or activity must be considered as the overall goal of the organization.

The target, target, strategy, scope and parameters of the activity or part of the organization must be determined when the risk management process is implemented. The process must be carried out by considering the balance costs, benefits and opportunities.

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### A. Risk Management Application Coverage And Limits Include:

- Establish other organizations, processes, projects or activities and determine their targets and targets.

### B. Make Decisions

- Establishing project activities related to time and location.
- Identify the goals and resources needed.
- Determine the depth and breadth of risk management activities carried out.

### C. Risk Management Process

Risk management understanding allows management to engage effectively in dealing with uncertainties with risks and opportunities that relate to and enhance the organization's ability to provide added value. According to COSO, the risk management process can be divided into 8 components (stages).

**1. Internal environment:** This component relates to the environment in which government agencies are located and operating. Its scope is risk-management philosophy (management culture about risk), integrity (integrity), risk-perspective (risk perspective), risk-appetite (taste or acceptance of risk), ethical values (moral values), organizational structure, and delegation authority.

**2. Objective setting:** Management must establish objectives (objectives) of the organization in order to identify, access and manage risks. Objectives can be classified into strategic objectives and activity objectives. Strategic objectives in Government agencies relate to the achievement and improvement of agency performance in the medium and long term, and are the implementation of the agency's vision and mission. Meanwhile, the activity objectives can be divided into 3 categories, namely (1) objectives operations; (2) reporting objectives; and (3) compliance objectives.

Human resources (HR) owned by the organization in all divisions and sections must be involved and understand the risks faced. The involvement is related to the view that each official / employee is the owner of the risk. Likewise, in determining organizational goals, it should use the SMART approach, and determine risk appetite and risk tolerance (variations of acceptable objectives). Risk tolerance can be interpreted as variation in achieving objectives that can be accepted by management. In the implementation of modern tax services such as sending WP tax returns electronically, an estimated 80% of taxpayers (WP) will implement it. If the risk tolerance is set at 10%, in the event that 72% of the Large WP has implemented it, it means that the purpose of providing the facility has been fulfilled. In addition, there is also the activity of an organization such as a manned rocket launch with risk tolerance is 0%.

## VI. EVENT IDENTIFICATION

This component identifies potential events that occur both in the internal and external environment of the organization that affect the strategy or the achievement of the goals of the organization. These events can have a positive impact (opportunities), but can also be the opposite or negative (risks).

There are 4 models in risk identification, namely

- 1.Exposure analysis
- 2.Environmental analysis
- 3.Threat scenario
- 4.Brainstorming questions.

One model, namely exposure analysis, tries to identify risks from organizational resources which include financial assets such as cash and deposits in banks, physical assets such as land and buildings, human assets which include knowledge and expertise, and intangible assets such as reputation and mastery of information.

### A. Discussion

Risk management is an important part of the management strategies of all entrepreneurs. The process by which an organization that matches its method can show the risks that occur in an activity towards success in each activity of all activities. The focus of good risk management is the identification and way of dealing with risk. The goal is to increase the maximum sustainable value of the organization. The main objective is to understand the potential upside and downside of all factors that can have an impact on the organization. Risk management increases the likelihood of success, reducing the likelihood of failure and uncertainty in leading the overall goals of the organization. Risk management should be sustainable and develop processes that work in the overall organizational strategy and strategy in implementing. Risk management should be aimed at overcoming a problem in accordance with the methods used in carrying out activities in an organization in the past, present and future. Risk management must be integrated in the organizational culture with effective wisdom and programmed to be led by several senior management. Risk management must be translated as a strategy in technical and operational objectives, assignment of duties and responsibilities and overall ability to respond to an organization, where each manager and worker views risk management as part of the job description. Risk management supports accountability (openness), performance measurement and reward, promoting operational efficiency of all levels.

### B. Risks Can Be Divided Into Two Groups, Namely

- 1.Non-systematic risk, namely the risk that can be eliminated or reduced through a diversification or risk prevention and mitigation measures.
- 2.Systematic risk, risks that cannot be eliminated or reduced through diversification, usually associated with markets or events that can systematically affect market position (IbanSofyan, 2004).

In addition, Kasidy (2010) divides the types of risk into two, namely:

**1. Speculative Risk:** Speculative risk is a situation faced by companies that can provide benefits and can also provide losses. Speculative risk is sometimes known as business risk. Someone who invests funds in a place facing two possibilities. The first possibility is that the investment is

profitable or even the investment is detrimental. The risks faced like this are speculative risks.

**2. Pure Risk:** Pure risk (pure risk) is something that can only cause harm or nothing happens and may not be profitable. One example is a fire, if the company suffers a fire, the company will suffer losses. Another possibility is that there is no fire. Thus, fires only cause losses, not cause profits unless there is intent to burn with certain intentions. Pure risk is something that can only cause harm or nothing happens and may not be profitable. One way to avoid pure risk is insurance. Thus the amount of loss can be minimized. That's why pure risk is sometimes known as insurable risk. The main difference between speculative risk and pure risk is the possibility of profit or not, for speculative risk there is still the possibility of profit while for pure risk there is no possibility of profit. Actual events sometimes deviate from estimates. This means that there is a possibility of beneficial or adverse irregularities. If both possibilities exist, then the risk is speculative. On the contrary, the opposite of speculative risk is pure risk, that is, there is only the possibility of loss and has no possibility of profit. The risk manager's main task is to handle pure risk and not deal with speculative risks, unless speculative risks force him to face these pure risks. Determining the source of risk is important because it affects how to handle it. Risk sources can be classified as social risk, physical risk and economic risk. Costs incurred due to risk or uncertainty can be divided as follows:

1. Costs of unexpected losses
2. Costs of uncertainty itself

### C. Identify Risk

Risk identification is an analysis process to find systematically and continuously the risks (potential losses) faced by the company. Therefore, a checklist is needed for a systematic approach in determining potential losses. One alternative system for classifying losses in a checklist is; loss of property rights, obligation to compensate others (liability losses) and loss of personnel (personnel losses). Previously built checklist to find risks and explain the types of losses faced by a company. Companies with a complex, diversified and dynamic nature of their operations, a more systematic method is needed to explore all aspects. The recommended method is as follows:

1. Risk analysis questionnaire (risk analysis questionnaire)
2. The method of the financial statements (financial statement method)
3. Flow map method
4. Inspection directly on the object
5. Planned interaction with company parts
6. Record statistics of past losses
7. Environmental analysis

### D. Types of Ways to Manage Risk

**1. Risk avoidance:** That is, decide not to carry out activities that contain risks at all. In deciding to do so, it must consider the potential benefits and potential losses generated by an activity.

**2. Risk reduction:** Risk reduction or also called risk mitigation is a method that reduces the likelihood of a risk occurring or reduces the impact of damage caused by a risk.

**3. Risk transfer:** That is moving risk to other parties, generally through a contract (insurance) or hedging.

**4. Risk deferral:** The impact of a risk is not always constant. Risk deferral involves delaying aspects of a project up to the time when the probability of the occurrence of the risk is small.

**5. Risk retention:** Although certain risks can be eliminated by reducing or transferring them, some risks must still be accepted as an important part of the activity.

## VII. CONCLUSION

Risk management is a process of identifying, measuring risk, and forming strategies to manage it through available resources. Risk management and internal control have the same material and components, and are interrelated with one another. Existing risk management needs to be evaluated for reliability. Meanwhile, control activities will be optimal using a risk approach. Risk management is considered feasible to be applied in Government agencies. All components of the risk management process can be used in the activities of Government agencies. Therefore, the application in the form of a trial (pilot) is time to begin and the concept of risk management needs to be socialized to units within the Government. Risk management is an important part of the management strategies of all entrepreneurs. The process by which an organization that matches its method can show the risks that occur in an activity towards success in each activity of all activities. The focus of good risk management is the identification and way of dealing with risk. Asset management is an activity carried out by management that cannot be separated from risk. Risk-based asset management emphasizes the process of managing physical assets that are very large and associated with the risks inherent in the process by involving the application of risk management processes to the company's main assets to identify and manage the main causes of failure to achieve corporate goals. The application of the risk management process can be carried out on all business activities of the company specifically emphasizing more on the company's asset management activities (every lifecycle asset management activity). Risk-based asset management can be one solution in order to maximize asset management.

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