

Assessing Risk Appetite of an SME Business

A Step-by-Step Guide

1. Define Business Objectives

- **Strategic Goals:** Identify and clearly define the business's short-term and long-term strategic goals.
- **Key Performance Indicators (KPIs):** Determine the KPIs that are critical to achieving these objectives.

2. Identify Key Risks

- **Internal Risks:** Evaluate internal risks such as operational inefficiencies, employee turnover, and technological vulnerabilities.
- **External Risks:** Assess external risks including market volatility, regulatory changes, and competitive pressures.
- **Emerging Risks:** Consider potential future risks that could impact the business, such as industry disruptions or economic downturns.

3. Engage Stakeholders

- **Management Input:** Involve senior management in discussions to understand their perspectives on acceptable levels of risk.
- **Employee Insights:** Gather input from employees at different levels to get a comprehensive view of risk tolerance across the organization.
- **Board of Directors:** Ensure that the board of directors is aligned with the risk appetite and is involved in the decision-making process.

4. Evaluate Financial Capacity

- **Financial Resilience:** Assess the business's financial health, including cash flow, liquidity, and capital reserves.
- **Risk Tolerance:** Determine the financial thresholds that the business can withstand without jeopardising its stability.

5. Analyse Past Performance

- **Historical Data:** Review historical data on how the business has managed risks in the past, including successes and failures.
- **Lessons Learned:** Identify lessons learned from past experiences to guide future risk-taking behaviours.

6. Establish Risk Categories

- **Risk Levels:** Define different levels of risk (e.g., low, moderate, high) and categorize them according to their potential impact on the business.
- **Risk Appetite Statements:** Develop clear risk appetite statements for each category, outlining the acceptable levels of risk.



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7. Quantitative and Qualitative Assessment

- **Risk Metrics:** Use quantitative measures such as risk-adjusted return on capital (RAROC) to assess risk appetite.
- **Qualitative Assessment:** Incorporate qualitative assessments through surveys, interviews, and scenario analysis to capture the broader context of risk tolerance.

8. Develop Risk Management Framework

- **Policies and Procedures:** Establish policies and procedures that align with the defined risk appetite.
- **Monitoring and Reporting:** Implement a system for ongoing monitoring and reporting of risk exposures relative to the risk appetite.

9. Communicate and Implement

- **Stakeholder Communication:** Clearly communicate the defined risk appetite to all stakeholders, including employees, investors, and partners.
- **Training and Awareness:** Provide training and resources to ensure that everyone understands and adheres to the risk appetite framework.

10. Regular Review and Adjustment

- **Continuous Monitoring:** Regularly review the risk appetite to ensure it remains aligned with changing business objectives and external conditions.
- **Feedback Loop:** Establish a feedback loop to continuously improve the risk appetite assessment process based on new insights and experiences.