

# Risk Management for Project Driven Organizations

A Strategic Guide to Portfolio,  
Program and PMO Success



ANDY JORDAN, PMP

## **Risk Relationships**

In the previous chapter, we looked at the different categories of risk from both inside and outside the organization. This gives us foundation knowledge, a basic understanding of the risk source, and potential impact on the organization. However, this understanding is still far too basic to be able to effectively manage the risks with any expectation of success. Effective risk management requires a detailed understanding of how the risks relate to one another; how they will respond to different management approaches; and how much time, effort, and money will need to be invested before a meaningful impact on the risk is achieved.

The first step is to understand how each individual risk and risk category interacts with others—the relationships between risks. As an example, think about a change that occurs within an organization—say the retirement of an executive. That single act will have a lot of impact—maybe a new executive will be brought in from outside who will want to bring some people with him or her and that will cause moves and changes. They may decide to reorganize, which will drive some other changes. Some of their staff may not like the changes and leave, creating openings for others to be promoted and in turn for someone to be hired to fill their old position. That one single act—the retirement of a senior individual—can create a cascading impact that ultimately results in the hiring of someone new in the mail room.

The same situation occurs with risks. A change in one risk can have a wide-ranging effect elsewhere in the organization, and if we don't understand that those relationships exist and the potential impact they may cause, then we will never be able to develop an effective risk management

strategy. There are two types of relationship between risks that we need to consider:

1. *Risk driven relationships*. In these cases the risk itself is driving associated risks. As one risk changes its profile, it drives change in associated risks.
2. *Action driven relationships*. In these cases, the actions that we take to try and control the risk drive changes to related risks. This effectively requires a compromise in our risk control activities.

Of course, both situations may exist for the same risk. In fact the risks that have the most risk driven relationships are often the most serious. Therefore, they are the ones that are in the most need of actions being taken, even if those actions themselves drive additional risk exposure. Consider also that the relationships are not always negative. By taking actions to manage one risk we may be creating or increasing an opportunity (positive risk) elsewhere, or we may be mitigating a related threat (negative risk).

### **Risk Driven Relationships**

Let's start with an example of this type of relationship to help us recognize it. Suppose that an organization is having problems with a systems upgrade that will deliver new regulatory reporting—the system is failing quality assurance, and the schedule is being delayed. As a result there is a high likelihood that the organization will fail to make the deadline for the new reporting requirements (increased compliance risk). The regulator will then have the option to impose fines on the company for noncompliance (increased financial risk), lower the company's rating (reputational risk), and subject the company to increased monitoring and audit requirements (increased regulatory risk).

We can clearly see here that the impact of one risk becoming real can have a significant effect elsewhere in the organization and can cause problems that go far beyond simple problems with a reporting system. We need to understand these relationships and how the impacts can spread out from the central issue if we are going to make intelligent risk management decisions.

If we don't understand the connections between the risks, then we may not be that concerned about a slight delay in the schedule beyond the deadline. We may have a sense that not being ready by the time that the

regulator requires the change to have been implemented is a bad thing, but understanding the full extent of the impact will help us to decide whether the delay is acceptable or whether we need to invest more in trying to avoid the risk from triggering.

It's also important to understand that the increased risk impact does not require the first event in the chain to become real. This can be a difficult concept, but it's key to understanding risk exposure. In the example that we used, let's look at nothing more than the levying of a fine if the deadline is missed. This is a fairly black and white situation—meet the date and don't incur a fine, miss the date and be penalized.

However, from a risk standpoint it's not that simple. If the fine is \$100,000 and we originally estimated the likelihood of missing the date at 10%, then we needed reserves of \$10,000 to cover this risk. If we do the project ten times, then we will miss the deadline once (10%) and incur a total fine for the ten projects of \$100,000—\$10,000 per project. The reason that we allocate reserves of \$10,000 for the risk even though the actual impact will always be \$0 or \$100,000 is that the \$10,000 contributes to an overall reserve pool for all of the risks—the reserve for the risks that don't become real problems offsetting those that do.

Suppose that challenges on the project require us to re-assess the likelihood of missing the date at 50%. Now we need reserves of \$50,000. If we do the project ten times, then we will miss the deadlines five times (50%) and incur a total fine of \$500,000 or \$50,000 per project. We still don't know whether the project will deliver on time or not, but the risk profile has already changed. The reserve requirement has increased because of a change in circumstances on the project.

We'll look at these concepts of reserves in much more detail later in the book.

## Action Driven Relationships

Anyone familiar with project level risk management understands the trade-offs that occur when we manage risks. We choose to invest time, effort, and money into various risk management strategies in order to reduce the likelihood of a risk occurring, the impact that the risk has on the project if it is triggered, or both—a trade-off of some managed impact now to reduce the chances of a more significant, less-controlled impact later.

Action driven risk relationships are an extension of this concept. They involve the acceptance of additional risk in one area to reduce the

risks elsewhere. As a simple example, suppose that the organization in our regulatory reporting scenario is not prepared to accept the increased risk of late delivery of the new regulatory reporting. Instead they decide to move resources from other projects in order to try to recover from the delays and deliver on time.

Our project management training would tell us that this is a cost increase—we are sacrificing budget in order to try and preserve schedule, and for the regulatory reporting system project, it is indeed a cost increase. However, from an organizational standpoint the change is cost neutral. We still have the same number of people working on the portfolio; we have simply diverted some of them from one initiative to another.

From an organizational standpoint, this is a risk play. We are creating an action driven risk relationship by increasing the likelihood of problems with scope, quality, schedule, etc., in some projects as a direct result of trying to protect the schedule in the project that poses the most organizational risk impact. Generally speaking, we should be looking to generate an overall improvement in risk exposure—the total amount of risk that the organization faces as a result of creating these action driven risk relationships is less than the total amount of risk faced before we created the relationships, but that's not a hard and fast rule. In our regulatory reporting example we are likely to accept additional risk exposure if it means avoiding being in breach of the regulatory framework that we operate under—a case of the type of risk being important. There are other situations where we might consider a higher overall risk exposure if it means that we can move risks away from critical areas—protecting a revenue generating project at the potential expense of a project that is designed to drive operational savings, protecting costs by accepting increased schedule risk in exchange for reduced financial risk, etc. Your organization likely makes many of these decisions already, just based on a less structured, more gut-feel approach that we should move people from one project to another to try and keep things on schedule.

### Managing Relationships

Risk driven relationships are predictable. We can follow the logic that says if event A occurs, then events B, C, and D are more likely to occur. This still requires detailed analysis. The connections aren't always obvious, but they do at least follow a logical flow. Managing these relationships consists of a proactive approach to understanding the relationship itself, the significance of the impact that the relationship can create (i.e.,

how substantial a problem can a triggered risk cause), and the work that can be done to manage those interconnectivities—either minimizing or eliminating the connection or ensuring that the impact is acceptable. This becomes part of risk analysis that we will look at in Section 2 of the book.

Action driven relationships are much harder to predict because they don't flow from the risks themselves, but rather from how the risks are addressed. As a result, a shift in the management approach can cause significant change in the action driven relationships—breaking some connections completely, creating new ones, and changing the impact in others. On the positive side, they are a lot easier to manage than risk driven relationships because we make conscious decisions to accept increases in risks 1, 2, and 3 in order to reduce risk 4. We control the impact.

Action driven relationships leverage work that is already being undertaken further down within the organization where project managers are undertaking risk management on their individual projects. This provides the organization with a solid understanding of the impact on a project of losing a resource for a period of time, diverting budget to another project, increasing scope, shortening the timeline, etc. Because most of our action driven relationships are a combination of these project level risks we can, as long as the risk management is effective, make quick assessments of the impact. This analysis is largely reactive from the organizational perspective. It is in response to a situation that requires us to take the initial action that triggers the action driven relationship.

Understanding the relationships is a vital part of an organizational risk management process. Our overriding focus, and something that will become a recurring theme, is to ensure that the portfolio delivers the organizational goals and objectives that have been established. If that means sacrificing one or two portfolio elements (projects) to preserve the ability to deliver the greater goals, then that's an acceptable strategy and that may be the impact of some of our risk management. In most situations, we will have limited capacity to add additional resources (people, time, or money) to the overall portfolio, and even if there is some capacity for these additions, there will generally be some delay between the addition and the impact being felt. As a result, organizational risk management frequently becomes about making trade-offs—choosing the least unacceptable approach, sacrificing the project with the least impact, or accepting the risks with the lowest chance to derail the portfolio. The only way that those decisions can be made with any degree of confidence is with a solid understanding of the relationships between the risks.