

## **Risk Management for Small Businesses**

Legal risk management has always been important for individuals, businesses and non-profit organizations. What has changed is this. In the current economic climate, when having to pay out of pocket for an uncovered claim, legal defense costs or a settlement or judgment may mean the difference between survival or failure, what has always been important has now become necessary and imperative. But it's not all about survival. Effectively managing risk now will better position any business owner or business organization for greater success when the economy turns around.

While there has been a lot of news chatter on the internet and in business and insurance publications about risk management since the 2008 stock market meltdown, it has for the most part been without the benefit of a definition of the term. Most of the buzz has been about enterprise risk management and insurance underwriting in the context of the insurance and banking/financial industries. Given the fact that economic risk taking is the topic du jour, this may be interesting stuff, but not what those managing smaller organizations' risks deal with from day to day.

What we are really interested in is trying to protect individual entrepreneurs, small businesses, non-profit organizations and their members, from bad things that could happen. Or, at least, from the consequences (generally financial) of those bad things. We can get that accomplished without a lot of Wall Street mumbo jumbo, right? I mean, look where that sort of thing has taken us.

That said, any effective risk management program should start from academic risk management theory boiled down to its basics, because they make a lot of sense and provide an excellent roadmap. A good "academic" definition of legal risk is as follows:

*Legal risk is risk from uncertainty due to legal actions or uncertainty in the applicability or interpretation of contracts, laws or regulations.*

Depending on your type of business or organization, you face certain specific legal risks, but in a general "big picture" sense, businesses and organizations all face the same two general categories of legal risks:

1. Contractual risks. (Are your contracts legally binding and enforceable? How do they allocate legal responsibilities? Specifically, what responsibilities do you have? What responsibilities do your customer or clients have? If your customers or clients do not fulfill their responsibilities, what are your options?)
2. Operational risks (defined by the Basel Committee, an international committee that has played a leading role in standardizing bank regulations across jurisdictions, as "the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events").

So, as long as you don't have any relationships with any other parties in which you have any contractual responsibilities, all of your internal processes and systems are flawless, and neither you nor your employees, subcontractors or vendors ever make a mistake, you

don't have to ever worry about risk management. (That's said tongue in cheek, of course.)

In its purest form, risk management is simply the process of:

1. Identifying risks.
2. Identifying the potential impact of those risks.
3. Deciding how to eliminate or minimize the potential impact of those risks.

So, when I am helping a client manage legal risks, I have two general goals in mind. They are (a) to avoid legal liability so that my client isn't taking any risks he/she/it does not need to (through risk shifting provisions in a contract, for example) and (b) to make sure that my client can survive the potential detrimental impact of those legal liability risks which cannot be avoided (through adequate insurance coverage, for example).

Large corporations have their own in-house risk management staff and in-house attorneys to deal with the minutia. Individual entrepreneurs, small businesses and community organizations don't have any of that support. Which may leave you feeling like "tag, you're it".

Sometimes handling your own risk management is a simple task. You're going sky diving, which involves the risk of hurtling to the ground from a great height, striking it and becoming a human pancake, so you use a parachute, making sure that it has been folded and packed correctly, that you are wearing it securely, and that you have a backup chute. There, that risk is managed pretty easily. But that's only because (a) there's no uncertainty about the nature of the risk or its potential magnitude and (b) there is really only one way to minimize it. (To tell you the truth, if it were me this risk would be avoided altogether, since I would simply not jump - or better yet, I would simply not get in the plane - but hey, that's just me, and anyway, that would have been a lousy example for this article.)

Most business activities involve more uncertainty about the legal risks involved, which in turn means that deciding how to eliminate or minimize the potential impact of those uncertain risks will necessarily involve a combination of interlocking legal mechanisms, so require the assistance of a business attorney. These mechanisms, including business entity creation, contractual risk allocation (such as hold harmless, indemnity and/or warranty provisions) and implementation of effective business systems to manage operational risks such as potential employer liabilities, work together to provide the maximum available protection for you individually, and for your business or organization. And like a puzzle, when it all fits together right, it's a pretty picture, and it makes sense.

If it doesn't all fit, if it doesn't make sense, if you are left with a feeling of vulnerability to the shifting sands of the legal liability risks you face, it is time for you to consult an experienced business attorney to get the mechanisms in place, or implement the systems you need, to provide that protection so that you can keep your eye on the future without having to worry too much about the past.

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