

Safety Corner

What is the difference risk appetite and risk tolerance?

Frequently, the terms risk appetite and risk tolerance are used interchangeably, although they represent related, but different, concepts.

Risk appetite is the degree of uncertainty or the amount and type of risk that an organisation is willing to accept in order to meet their business objectives in anticipation of a reward. An organisation would have different risk appetites depending on their needs, business area, culture, and objectives; thus, a range of appetites exists for different decisions and may change over time.

Risk tolerance indicates the degree, amount, or volume of risk that an organisation will or can withstand in pursuing its objectives. It indicates the maximum risk that an organisation can bear with risk management or control in place. Like risk appetite, risk tolerable should not be a fixed number for an organisation.

To understand an organisation's risk appetite and risk tolerance, the organisation must be able to measure or, at the minimum, characterise risks. While it is difficult to directly measure an organisation's risk appetite over a decision, one can establish the appetite by asking how much risk is too much for the management to absorb in making the decision; e.g., the management may consider that they can take a loss of up to HK\$10M over a business decision acceptable. When the risk levels fall outside an organisation's risk appetite range, the performance is sub-optimal.

Similarly, when risk levels exceed the organisation's risk tolerance, the organisation must critically re-evaluate its decision and course of action because there is a chance that the organisation may not survive. The next question is: how does one compare one range compare to another?

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