

Risk Management Factors: Increasing Relevance



It is desirable to understand and appreciate the forces of globalisation in 21st century for commercial organisations. Geo-political scenario, exchange rate fluctuations, impact of culture, human capital, technology, materials, natural resources, regulators, local politicians, behavior of financial markers, negotiations at WTO, natural calamities, etc. are some of the challenging factors. Senior management's role is very crucial in the implementation of right risk management practices to avoid unpleasant scenarios and outcomes. India has great potential to excel in global market because of its talent pool. But one has to adopt a system and process-oriented approach, even for small and medium enterprises i.e. with definite guidelines to fix the responsibility and minimise the risks. This will ultimately help in building a great, resilient and reputed organisation which is brand-trusted, reliable and sustainable with an emotional bonding with the stakeholders. This article discusses multiple factors, internal and external, which are to be considered by the management in assessing and managing various risks associated with the organisation. Read on...

An Overview

Risk management is a central part of any organisation's strategic management. It is a process by which organisations methodically address the risks attaching to their activities with the goal of

achieving sustained benefit within each activity and across the portfolio of all activities.

The focus of good risk management is the identification and treatment of these risks. Its objective is to add maximum sustainable value to all the activities of the organisation. It should be a continuous and developing process which runs throughout the organisation's strategy and implementation of that strategy. It should address methodically all the risks surrounding the organisation's activities in the past, present and in particular, future. It must be integrated into the culture of the organisation with an effective policy and program led by the senior management. It should



CA. Bimal R. Bhatt

(The author is a member of the Institute. He may be reached at hitabhhatt@gmail.com.)

Management

also translate the strategy into tactical and operational objectives, assigning responsibility throughout the organisation. With the involvement of all concerned, it supports accountability, performance measurement and reward and therefore, promoting operational efficiency and effectiveness.

From practical point of view, risks can be identified into “*external factors*” and “*internal factors*” for an easy understanding:

External Factors	Internal Factors
<ul style="list-style-type: none"> • Macro-economic scenario • Exchange rate fluctuations • Political environment • Competitive environment • Concentration of revenues • Inflation and cost structure • Immigration regulations • Security and business continuity • Technology obsolescence 	<ul style="list-style-type: none"> • Culture, values and leadership • Financial reporting • Liquidity and leverage • Contractual compliance • Compliance with local laws • Intellectual property management • Engagement execution • Integration and collaboration • Human resource management

External Factors

i. *Macro-economic scenario*

One of the most important aspects is to visualise the movement of various countries and their economy in view of the new color of globalisation. The developments of World Trade Organization (WTO), General Agreement on Trade and Tariff (GATT) and General Agreement on Trade and Services (GATS) have aroused new interest in economies. The great amount of bargaining is taking place among countries at the WTO dialogue. Some of the developing countries like India have started pressurising the developed countries for getting necessary and desirable concessions and benefits. The recent case is our strong objection to agriculture subsidy looking to the fate of billions of farmers. All of a sudden, India is being talked in the world economy. A new dimension is provided to the business and political scenario. It could be a tactical move to pressurise developed countries.

People are looking to the policy matters of countries like USA, UK, Japan, Germany,

France, China, Russia, South Africa, Saudi Arabia, *etc.* more closely and trying to visualise a scenario in couple of years. For example, present as well as future increase in federal rate structure has a bearing on other countries’ rate structure and financial stability but may not be relevant in the years to come. Similarly, it is no longer a scenario where multinational companies can dictate their terms in India. The change in the habits, family structure and economic supremacy will have a strong impact on the commercial life of a citizen.

ii. *Exchange rate fluctuation*

Movement of Indian Rupee against US Dollar, Japan Yen, UK’s Pound, Euro, Chinese Yuan, *etc.* will have a major impact on export-import of natural resources, goods and services. How this will behave in short to medium term is a big challenge for a business person to visualise. How is this to be hedged? The problem is more acute where either export or import is substantial for any commercial entity. Should we think about natural hedge by paring export-import? They have to be extra vigil in their risk minimisation exercise. The selection of a right financial advisor to minimise fluctuation risk is a point for consideration. One single bad decision can create havoc for the industry, organisation and stakeholders.

iii. *Political environment*

Our own political environment and the countries in which we deal have a tremendous impact. The fight between democrats vs. republicans in the USA has bearing on the future of our products and services. Similarly, for the last couple of years, we were used to coalition politics at the Central as well as State levels. But after a long gap of almost thirty years, we have a stable government at New Delhi. A new approach, methodology and action plan is going to be visualised. A new hope is being talked at every corner of society. In a


The selection of a right financial advisor to minimise fluctuation risk is a point for consideration. One single bad decision can create havoc for the industry, organisation and stakeholders.


general sense, as the days pass, economics and politics seem to be independent of each other which can be visualised even in the budget proposals of the Central Government of India. The approach by various State Governments will also have a bearing on the development and success of commercial organisations apart from competitiveness of the industry magnates. The question is should an entrepreneur remain too close to the political parties or no? The role of independent directors is going to be crucial on this issue. The appointment of shareholder and government nominee directors under The Banking Regulation Act, 1949 in public sector banks is a classic case for political interference.

iv. Competitive environment

As we realise the free flow of human resources, financial capital, technology and also physical goods across the globe, goods and services are bound to witness new designs, products, lay out, benefits, *etc.* This will lead to more competition, may be a threatening lifecycle for some of goods and services because creativity and innovation will be rewarded and looked after by the management as a major source of inputs. Particularly in our country, we will face new marketing scenario because of the existence of large number of youths and also shifting the trend from pure socialist country to capitalism, naturally with pitfalls. More and more ideas will find support from angel investors with new business culture and life. Apart from this, lifecycle of some of the products is drastically shrinking because of change in preferences, tastes and attitude of the young generation. Should we balance management and advisory team by giving more opportunities to young and dynamic youths?

v. Concentration of revenue

High concentration in any single business segment exposes to the risks inherent in that segment. Management has to look into the


High concentration in any single business segment exposes to the risks inherent in that segment. Management has to look into the undesirable concentration in a particular geography, industry, service, customer or client.


undesirable concentration in a particular geography, industry, service, customer or client. Concentration of revenue from any country exposes to the risk specific to economic condition, global trade policies, local laws, political environment with work culture and issue of ethics. New markets have to be found or even created by constant monitoring and assessment. We have a classic case of developing new markets by some of the well-known spiritual leaders of our country in the entire globe. It affects the life of millions and billions over a period of time and how to convert that new emerging market into a business proposition will be a big challenge.

Similarly, revenue concentration is to be closely monitored to ensure that the cyclical behaviour of any one industry or sudden changes in industry characteristics do not adversely impact the business. Industry segments have different business cycles, competitive structure and price points.

The contribution of service industry as compared to manufacturing and agriculture is rapidly increasing in the Indian economy. There are a number of sectors involved in providing superior services to the entire world such as business process outsourcing, knowledge process outsourcing, contract research in pharmaceutical area, auto components industry, medical, tourism, *etc.* The contribution from each service within the main segments has to be monitored closely to avoid drastic cut in the business. Similarly in some of the industries, we may get repetitive orders from year to year because of superior services and quality of products. This is good for both the sides because of the confidence and trust for each other. But changes and new competitive scenario may put pressure to perform and provide service at a cheaper rate or to lose a customer or client. It may prove to be a disaster with all the results within short time. However, some of the industries are going for long term contract, say three to five years for having confirmed business as well as getting the benefits of long term relationship.

vi. Inflation and cost structure

Cost structure has a direct bearing on the operations of an industry in the long term. For

Every business environment is characterised by swift changes in technology, rapid obsolescence and also shifts in customer/ client choices and selection which may lead to revenue volatility. The business has to re-invent in such a scenario and make efforts for new initiatives on marketing, research and development, strategic buy outs, etc.

some of the industry segments, we are observing cost advantage at present but not necessary that it will hold well in the long term. Creativity and innovation always have a bigger price tag. It could be human being or a product or a service. Also as the economy is in the development stage, there will be demand of money and it has a direct impact on inflationary trend. In India, we have observed drastic changes in interest rate structure for deposits and naturally for lending also in the last decade. At present, we are observing inflationary impact in our country. There is a fight between inflation and growth related factors. The monitoring by the Reserve Bank of India (RBI) with a microscopic eye is worth appreciating. There is another relevant issue of how to take maximum advantage from a cost auditor to improve our costing structure and data analysis.

vii. Immigration regulations

Immigration laws in various countries are subject to legislative change as well as to variations in standards in application and enforcement due to political reasons, security aspect and economic conditions. Naturally, it is very difficult to predict the political and economic events that could affect immigration laws and regulations. The availability of H-1B visa with fee structure for information technology companies is worth to understand and analyse. Companies have to keep good liaison with embassy offices and their persons.

viii. Security and business continuity

In order to ensure business continuity in the eventuality of a disaster and also to guard the security of business operations, comprehensive disaster recovery and business continuity plans are to be implemented. This is more required after the emergence of new terrorism in the entire world which we are observing by way

of bomb blasts in Mumbai local trains, Paris, London, attack on World Trade Centre, Taj and Oberoi Hotels which are the biggest case studies of terrorism and its subsequent impact in different parts of the world. There is a great loss of human life and also destruction of physical properties. The smaller economy and business cannot sustain such losses and naturally, its people. The recent fight in Syria and Yemen is a point to be closely monitored. Some of the EPC companies from India have suffered huge losses.

ix. Technology obsolescence

Technology innovation and better products and services are the rules of business. The life cycle of a product is shrinking. The purchasing style of a consumer is rapidly changing. Consumer products like vehicle or electronic equipment or even clothes are witnessing a fast churning of design and style. In such a scenario, pricing and positioning of a product have great relevance. The rules of marketing including advertising are taking a 360 degree turn. There is a need for industry-wise innovation laboratory in our country where ideas will be nurtured and tested for better results at a later stage. The rapid development in technology platforms and emergence of new e-commerce wizards are a real threat to the large number of other traditional players if such changes are not visualised. The thought process should be how to co-create with these new emerging entrepreneurs.

Internal Factors:

i. Culture, values and leadership

Every organisation has distinct culture which is reflected in their value system and recognition of their leadership. The question arises as to why N. R. Narayana Murthy, Azim Premji, Ratan Tata, N. Vaghul, Kumar Mangalam Birla, Deepak Parekh, K. V. Kamath, Chanda Kochhar, Kiran Mazumdar Shaw, Naina Lal Kidwai are well recognised in international business communities? Whether their behaviour and attitude matches with the output of their services and products? The big question is relevance of DNA, a most vital issue for the survival and growth of any industry in the days to come. How the code of ethics and whistleblower policies are adopted? If adopted, is it implemented in right

spirit or not? How leadership is being developed even for a smallest of small activity? Whether employees are treated as partners in progress or merely a tool for achieving the results? These questions are not easy to answer and require tremendous learning and discussions at various forums. Because of demographic situation in India, adherence to ethical behaviour is the biggest challenge faced by the commercial organisations. It could even impact the entire industry like banking, insurance, natural resources, exchange operations, *etc.*

ii. **Financial reporting**

The debacle of Enron, WorldCom, Arthur Anderson, Satyam, *etc.* over a period of time has invited stringent reporting and disclosures by the corporate sector in the USA and now in India. This scenario has invited to create Sarbanes-Oxley Act, 2002 for strict reporting. Also in India, we are observing amendments in Clause 49 of the Listing Agreement for better and stricter adherence to reporting and disclosure norms. Requirement of announcing quarterly unaudited financial results with adherence to new mandatory accounting and auditing standards have put pressure on the management and accountancy profession. We will visualise a day where investor community is taking legal actions against the management for incorrect or misleading reporting or disclosure with the support of new provisions of The Companies Act, 2013.

iii. **Liquidity and leverage**

Every business environment is characterised by swift changes in technology, rapid obsolescence and also shifts in customer/client choices and selection which may lead to revenue volatility. The business has to re-invent in such a scenario and make efforts for new initiatives on marketing, research and development, strategic buy outs, *etc.* There has to be a mix of equity and debt financing. Even if money is not required immediately, it is to be parked in most judicious financing instruments so that at an appropriate time, the same can be utilised without any hassles and also to minimise losses. Infosys is facing the issue of protecting its cash since years as it is holding more than ₹29,000/- crore in cash and cash equivalents as on 30th

September, 2015. Are they too conservative to miss a great opportunity by not deploying the same in a right direction?

iv. **Contractual compliance**

The commercial entity, depending upon the nature of business, generally involves numerous contractual obligations for performing agreed jobs. Therefore, contract management requires focus on the legal risks, ascertaining legal responsibilities under the applicable laws, restricting liabilities under the agreement and covering the risks involved. Insurance management is important area for covering possible liabilities arising out of non-performance of contracts.

v. **Compliance with local laws**

As a part of global community, an entity may be operating in various countries. Adherence to the respective countries' laws is very vital to avoid possible litigation. The laws could be for employees, security, environment protection, marketing commitments, manufacturing standards, *etc.* Adoption of regular and genuine mechanism of monitoring is the need of hour. A dedicated team and/or with the support of legal counsel should be constituted. Our pharmaceutical, agriculture and software industry is facing this problem in one or other way and drawing the attention of large business community across the globe. It could be related to the competitor's action and even due to political mileage in developed countries.

vi. **Intellectual property management (IP)**

Knowledge is the power which is gaining importance and therefore, important resource and component for products and services. This is more so for service industries like pharmaceutical sector, information technology sector, *etc.* Unauthorised usage of design,

Contract management requires focus on the legal risks, ascertaining legal responsibilities under the applicable laws, restricting liabilities under the agreement and covering the risks involved. Insurance management is important area for covering possible liabilities arising out of non-performance of contracts.

product services, proprietary information, etc. will lead to infringement. An entity has to rely on a combination of patent, copyright, trademark and design laws, trade secrets and contractual provisions to protect intellectual property (IP). A comprehensive approach to manage IP for the entity, clients or customers and also to third parties is to be properly placed. If it is not managed properly, the survival of the organisation will be impacted. Some of the Indian pharmaceutical companies are paying huge money in developed countries on this issue including settlement with regulatory authorities.

vii. *Engagement execution*

In a knowledge-base economy, various clients and customers are involved with varying degree of processes to satisfy their needs. Each transaction or contract has its own uniqueness and issues to tackle so it requires a distinct capability model to achieve or to satisfy their needs. A robust engagement process depending upon the quantum should be at place to avoid litigation at a later date. Constant evaluation is the need of the hour of this relationship.

viii. *Integration and collaboration*

When an organisation has one business place only, the problems will be less and can be tackled easily. But as the business is expanding into newer geographical areas within and outside India, problems will crop up. This is more so when takeover takes place, new cultural issues and other related issues will come into force. Similarly, joint venture arrangement created with different ideology will require tremendous patience and guts to be a winner in the long run. Successful integration of Tata Group with Corus Steel, Jaguar Land Rover, and Tetley on a world map is a classic case to understand for a win-win situation. Similarly, we must appreciate the successful take-over of the Bank of Rajasthan, the Sangli Bank and the Bank of Madura by the ICICI Bank in the last decade. The credit goes to their leadership teams.

ix. *Human resource management*

The biggest challenge in a knowledge-based environment is to attract, train, motivate, empower and retain the best people. There

As a part of global community, entity may be operating in various countries. Adherence to the respective countries' laws is very vital to avoid possible litigation. Adoption of regular and genuine mechanism of monitoring is the need of hour.

is a definite price tag for smart and intelligent people as they are the real source of achievement for an organisation. Without such people, the question of survival comes true even for small and medium scale enterprises. There is talent shortage everywhere. The leader's vision is very crucial at every point of time and function. The large organisations have to be in constant touch with the established educational institutions across India for attracting young breeds. With structured education pattern, Bank of Baroda, ICICI Bank and other banks have tied up with Manipal University to develop young officers, executives and managers for their requirements. Another classic case is the world's largest Institute of Leadership which is established by Infosys at Mysore. Other industry players have to accept the harsh reality about youth and their aspirations in the new socio-economic order.

Conclusion

Every commercial organisation is facing challenges and difficulties each day. Nobody can eliminate all the risks but can always minimise it through the right blend of policies, structures and monitoring. Few risks are also required to keep ourselves on alert radar because complacency has no place. Considering the above referred factors, the audit committee along with executive management has to play a decisive role for risk assessment and management. Also, the biggest issue is-should internal auditors and statutory auditors be the great supporters to guide, monitor, control and comply? Let us build together our knowledge bank on risk management for an exciting future to survive, grow and develop *i.e. build sustainable organisation to help society. Ultimately, one should keep in mind the "reputation risk" for one's own actions.*

References:

- i. "Corporate Governance" by CA. Bimal R. Bhatt.
- ii. Annual Reports of Infosys Technologies, ICICI Bank, Tata Steel, Hindustan Unilever, L & T, Wipro, Tata Motors and other companies. ■