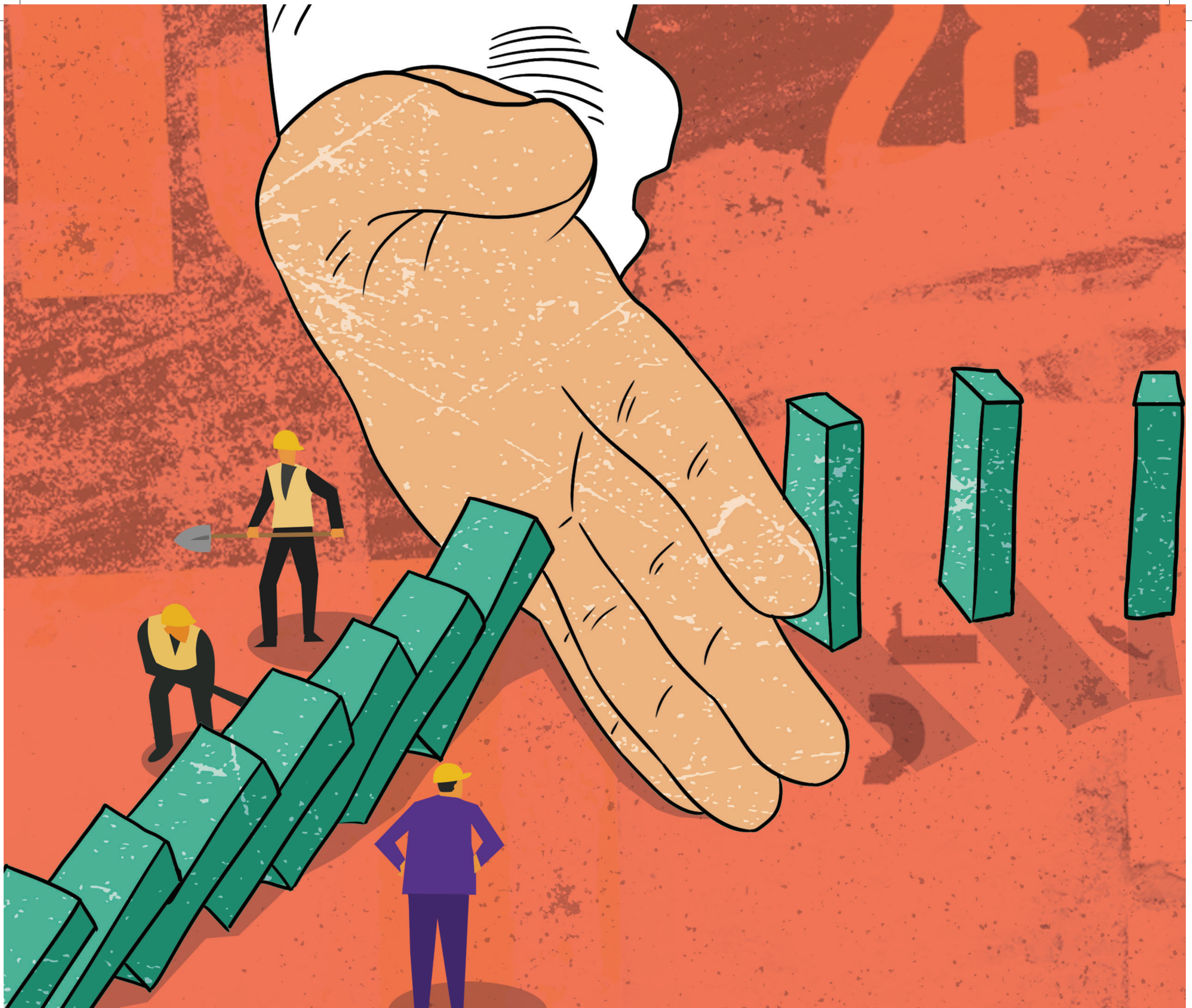
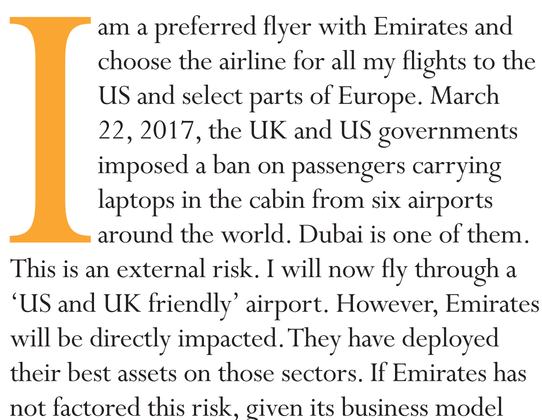


Building resilience

A structured approach that merely complies with regulations is not enough to manage risks. Unconventional thinking is the need of the hour.

✦ K SHANKAR, FEEDBACK BUSINESS CONSULTING



I am a preferred flyer with Emirates and choose the airline for all my flights to the US and select parts of Europe. March 22, 2017, the UK and US governments imposed a ban on passengers carrying laptops in the cabin from six airports around the world. Dubai is one of them. This is an external risk. I will now fly through a 'US and UK friendly' airport. However, Emirates will be directly impacted. They have deployed their best assets on those sectors. If Emirates has not factored this risk, given its business model they will find it difficult to mitigate it. The impact will touch every bit of Emirates—financials, brand image, fleet management, customer loyalty programmes, employees, investors, and many more. This development is a clear indicator of how risk has changed in the last two decades and the speed of its change in the last five years.

The 'risk mix' is changing at a pace of knots. 'Risk mutation' like virus mutation is the new phenomenon that is developing. Most conventional risks have now become 'hygiene' checks for businesses. Companies are redrawing their risk management plans and reviewing it at a higher frequency. It is not being managed in operational silos anymore. Risk management is a high weightage item on the boards' agenda. It sometimes matters a lot more than growth plans. This is primarily because the danger may be in the blind spots caused by the lack of an integrated view of operational activities or in areas not considered to be at risk. The Emirates example is a case in point.

A comprehensive, dynamic, and integrated approach to addressing corporate risk is essential in identifying critical strategic and operational risks that affect enterprise value. This will involve a holistic view of strategic, financial, operational, and external risks. These are the conventional parameters. Additionally, the new and the more compelling pointers of risks that have found their way into the new framework are the tirade against globalisation—popularly known as the anti-globalisation movement, changing international trade dynamics—future of select trade agreements around the world, data piracy, financial crises, environmental disasters, regulatory changes, and obsolescence in product or service caused due to disruption or innovation in conventional businesses. Risks have an upside and a downside. Both extremes cannot be ignored as they have a direct bearing on the future value as well as net present value of a corporation.

When global economic buoyance dampens and countries begin to look inwards for more predictable markets, the regulatory bodies and investors begin to exercise their responsibilities more seriously and start scrutinising companies for their risk-management policies and the exposures they have in the business ecosystem. The procedures are measured and a certainty is established. This can be substantiated by the continuous increase in responsibilities of independent directors on the board. Till a year ago, in India, independent directors were responsible for small investors' interest and the overall compliance of the company on statutory issues. The responsibilities have moved beyond that and accountability has gone up. This is primarily because board of directors are required to review and report on the adequacy of risk-management processes in the organisations they administer. It was always important and it now is a massive strategic imperative.

A strategy is generally designed to push hard a desired outcome and with high expected returns.

Conventional risk management is dealt with in a simple templated framework. Risk issues are divided into three clusters:

- **Known risks:** These are risks that are predictable, and a policy can be architected to manage each of these. These are primarily internal issues (employee, safety, quality process, compliance, etc.) and a few external issues (monetary, fiscal, customer, etc.). These risks can be closely measured, controlled, or in some cases eliminated.
- **Strategy risks:** Strategy risks are quite different from known risks because they are not inherently undesirable and they emerge as a result of the 'gamble' or market-driven endeavour a company exposes itself to. A strategy is generally designed to push hard a desired outcome and with high expected returns. This generally requires the company to take on significant risks, and managing

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Risk teams should look at both the upside and downside of a particular risk.

those risks is a key driver in capturing the potential gains. The most highlighted example quoted around the world on strategy risk is British Petroleum. The high-risk strategy of drilling several miles below the surface of the Gulf of Mexico resulted in 11 deaths and a loss of many million barrels of crude. BP settled with the US authorities by agreeing to pay close to $18 billion in penalties! A lot of small and medium companies fall victim to this category of risk primarily when they raise finances for business expansion, product introduction, etc., without proper assessment of downside risk.

- **Ecosystem risks:** These are usually referred to as external risks or outside risks. In a globalised world, there are a lot of risks that arise from events outside the corporation and are beyond its influence, control, or predictable canvas. Sources of these risks include natural disasters (depleting ozone, shrinking glaciers, etc.), political developments (Brexit, Trump election, etc.) and major macroeconomic shifts (impact of Chinese economy). Ecosystem risk management requires a different approach to deal with. This is primarily because companies cannot prevent such events from occurring, their management must focus on hypothesising about potential risk, identification of these risks, and picking up early signals. This usually becomes a corner-room activity or a board- sponsored activity that runs independent of the corporation's daily management rigmarole.

Corporations that tailor their risk-management processes as per the above mentioned categories and manage them are found to be less impacted than the others. While a compliance-based or a rule-based approach is effective for managing known risks, it will not be effective to manage strategy risks or external risks. These require a fundamentally different drive based on open, fungible, explicit, and unstructured approach. It will involve lateral thinking and working with a variety of stakeholders. Here are some suggestions:

Risk management needs recognition and investment

Investment-led approach: Organisations need to look at risk management as an investment and not expenditure. This requires a mindset change. Boards should drive this change through the CEO. This would also mean the CEO having a risk mentor in the board or an external risk mentor. This will be a clean indication to investors and employees that risk has received recognition as an area of importance. Companies that are dependent on data have to invest in securing it from theft, loss, and neglect by eliminating all insecure practices and investing in layers of security with predefined access rights. Data should be made available on a need basis. This infrastructure will call for investments.

Independent teams: Risk management will need separate attention. This team should be independent of the strategy team and report directly to the CEO. Issues such as data piracy risk, regulatory, and policy risks can be best handled through this operating model. Large companies with complex operating structures and geographies should appoint risk advisors on compliance, monetary issues, etc. External advisors will also report directly to the CEO. This will mean the CEO will have three independent views from teams on strategy, routine risks, and business and external risks. This simplifies mitigation mechanisms. The review frequency has to be high.

Bulls and bears debate: Risk teams should look at both the upside and downside of a particular risk. The approach to mitigation is best decided if the risk team can assume

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roles of debaters —for and against a particular action. US corporations are very adept at this. This is similar to a bulls and bear approach when acquisition strategy is debated by management teams.

Risk scorecard is mandatory

Measuring risks and linking it to performance: Companies that have multi-country, multi-product, multi-market footprints should invest in a cost centre that not only measures risks but also articulates it ahead of time. Metrics can be put in place to measure risks in a way that performance assessments is possible. Risk management deliverance should be made a performance measurement parameter.

Setting thresholds: Risk is like friction. It can be minimised but not eliminated. In view of this, it has to be part of the core operating principle and a threshold for risk needs to be indicated. It becomes a brief to the risk management team. Provisioning in the budget plan has to be made to deal with the threshold levels.

Risk is like friction. It can be minimised but not eliminated.

Involve insurance: Insurance will have a big play in risk mitigation going forward. Companies need to insure themselves adequately to deal with eventualities of litigation or otherwise.

Embedded thinking on risk

Derisking at the core of strategy—every strategy should have a derisking plan mandatorily conceived. This will take care of all the known risks and strategy-related risks that will affect customers, market, and finance. It will also 'roll in' policy change issues and regulation.

Derisking should be addressed through a 'scenario building' approach so that the path to a derisking strategy is well laid out and all variables are adequately identified. These scenario building approach methodologies will include all the possible natural disasters, international developments, politics, and war. The most successful companies that handled the Brexit situation were those who embedded it into their plans.

Planning contingencies and making appropriations: Like any good planning annexure, risk planning should have alternate plans that can address various combinations of risks. Contingency plans work best in case of unstructured scenarios.

Insulate core assets, capital and people: While these come under the known risk categories, they can behave differently in response to external risks. They have to be protected and taken care of on a continuous basis. Multinational corporations can operate through a limited liability approach when they expand globally. It will also help them deal with the anti-globalisation narrative.

The quantum of risks is increasing by the day. Risk audits alone will not be the way forward. A lot of unconventional thinking is required to deal with risks. New-age businesses tend to become obsolete in terms of their core offerings in a time period of 5-7 years with the way technology is invading businesses. Good risk management practices will help corporations tide over these cycles consistently. IM