

RISK MANAGEMENT FRAMEWORK

A) Introduction

Every business organization has its own objectives to achieve. Uncertainty of the future is the main problem faced by the organization. Business organizations may fail to achieve their pre-set targets because of the unexpected future events.

For a business organization, risk is the **possibility that actual results will differ from what was expected, and that will affect the ability of the organization to achieve its objectives.** Some risks are significant and cause considerable losses and even have the ability to threaten the going concern of the organizations.

Therefore, business risks should be managed well as organizations can not completely avoid risk. For that purpose, organizations should have a well-defined mechanism to identify risks pertaining to organization.

Therefore, Risks can be segregated into two main segments

- 1) Internal Risks
- 2) External Risks

1) Internal Risks

Internal Risk generates within the organization. As a result, management has more control over internal risks. These risks are generally connected with the operational risks of the organizations. Therefore, Internal Risks can be mainly divided into 04 segments

a) Operational Risk

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b) Fraud Risk

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c) Compliance Risk

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d) Reputational Risk

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2) External Risks

Some risks arise from events outside the company and are beyond its influence or control. As external risks cannot be prevented, their management must focus on identification and mitigation. There are various tools which can be used by companies to identify their external risks.

External Risks can be divided into two main segments

- a) Risk in the general business environment
- b) Risks in the industry environment

Risks in the General Business Environment

This includes the unfavourable impacts coming from external environmental factors as follows.

1) Political and Legal Environment

Eg: Change in Government Regulations in the areas of taxation, labor laws, interest rates, international trade, new trade agreements etc.

Eg: Instability in the country resulting from changes in government policies

2) Economic Environment

Eg: Change in inflation rate, interest rate and exchange rates

Eg: Economic recessions

3) Social and Cultural Environment

Eg : Change in attitude of majority of the population which adversely affect the business

Eg: Religious beliefs which adversely affects business opportunities

4) Technical Environment

Eg: Introduction of new technology which organizations cannot afford or compete with

Eg: Products become obsolete due to latest technology in industries such as mobile phones

Risks in the industry environment

This refers to industry specific risks affect the organizations in that particular industry.
Eg: Banks are facing high regulatory compliance requirements specific to its industry

B) Risk Management Framework.

Risk Management Framework consists of Three Main Sectors.

- 1) Risk Assessment
- 2) Risk Response/Risk Treatment
- 3) Monitoring and Review

Risk Assessment

Risk Assessment Segment is further sub-divided into three components, such as Risk Identification, Risk Analysis and Risk Evaluation,

Under the Risk Identification, the business organization should identify each and every risk and to segregate in between Internal and External risks

Upon the identification of the risks, those risk should be analysis in detail depending on the Impact of the Risk and the Possible Occurrence of the Risk, which is referred as the Risk Analysis. The main objective of the Risk Analysis is to establish the potential impact to the organization and the achievement of the organization objectives.

Upon Identification and Analysis of the Risk, the Business Organization should decide which risk is more important than others and identify those which should be treated or managed. This is referred as Risk Evaluation.

Risk Response/Risk Treatment

For each identified significant risk, business organization should make appropriate responses to manage the risk. The response is depending on the risk appetite, which is referred as the "Willingness to Accept the Risk". Business organization should decide the most appropriate way of managing the risk and implement risk treatment measures

Monitoring and Review.

Under the monitoring and review segment, business organization should revisit the entire process at regular intervals, to check whether the implemented actions/responses are effective or not.

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Eg:

ABC Company is a Company which operates in the apparel industry and the Managing Director (MD) of ABC, devoted the attention for the following key points in the recent Board Meeting.

- As a result of the economical policy which as been taken by the government, the prices of the apparel which the Company currently exporting to the European Market is increased significantly and further MD stated that, at present the Company prices are much higher than the its competitors which is located at India and China. Further MD stated that, as a result of the prices increase, the Company is experiencing a significant decrease in the current export quantities, compared to previous quarters.
- Company IT system faced several breakdowns during the last three months and the system has been repaired by the system vendor and they have provided a warranty period of 2 months.
- A local competitor is trying to attract Company's most senior and experience employees while providing a higher salary and MD further stated that, the replacement of these vacancies are much more difficult in the current business context
- A minor supplier who supplies material to the Company has requested a price increase and the Company is having the ability to accept the price increase. Further, MD stated the Company is in the position to find new suppliers as well, if it wanted.
- Few of the Minor Employees are already resigned from the Company and several employees are going to resign as well in the near future. However, as per MD, the Company is having the ability to recruit new staff under that capacity if the situation demands.

Assume, you are the Finance Manager of ABC Company and based on the above mentioned senarios, you are expected to carry out the Risk Identification and Risk Response from the Risk Management perspective.

C) Risk Management Strategies /Techniques used to mitigate the Risks

a) Risk Avoidance

Risk avoidance is the elimination of hazards, activities and exposures that can negatively affect an organization's assets. Whereas risk management aims to control the damages and financial consequences of threatening events, risk avoidance seeks to avoid compromising events entirely.

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b) Risk Acceptance

Risk acceptance or risk retention means the fact of accepting the identified risk and not taking any other action in order to reduce the risk because we can accept its impact and the possible consequences. This strategy is mainly using;

- 1) When the potential impact of the risk is low
- 2) The likelihood of an adverse risk is low
- 3) The residual risk is within the organizational risk tolerance level

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c) Risk Transfer

Risk transfer is a risk management and control strategy that involves the contractual shifting of a pure risk from one party to another.

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d) Risk Reduction

Management may decide that a risk should be reduced because it is currently too high and so unacceptable. Methods of reducing the risk depend on the nature of the risk. The following methods are used to reduce the risk to an acceptable level.

- 1) Implementation of proper Accounting and Internal Control System within the organization

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- 2) Operational Diversification

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3) Business Contingency Plan

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4) Risk Sharing.

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