Risk management under the conditions of globalization

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Abstract. The important place in European society structure is occupied by the group of people carrying out similar activity, which could be called an enterprise (business) stratum. The social and economic approach requires to consider within scientific research not only the business activity, but also the subject of business activity, namely a figure of the businessman.

The essence of business activity in all the contents is filled with risks of various characteristics. The risk as the phenomenon of the enterprise represents a part of its usual activity. The capital investments possibility, the employment of the new employee, the realization of the goods and services in the market, the formation of the price or signing of the sale agreement could involve business risks.

The experience of development in many European countries shows that ignoring, underestimation and the small accounting of the specifics of enterprise risks when developing tactical and strategic tools of economic policy of enterprise subjects definitely restricts the development of modern society and puts the economic system on lower levels.

Risk management is a new phenomenon for the development of European members' economies which arose upon economy transition to market system of managing. The majority of “newcomers” in European business do not yet understand up to the end and estimate inevitability of risk and importance of its account in business activity.

In the article, according to the considered directions of the globalization processes influence the risks of business activity having paramount value for competitiveness of the companies in the conditions of globalization were considered.

Keywords: risk, risk management, globalization, European experience, entrepreneurship, business risk, business activity.

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1. Essence and evolution of risk management

Historically in financial institutions, risk functions like legal, compliance, audit, credit risk and market risk were managed in separate organisational silos. Operational risk was generally the responsibility of business units as part of their daily activities. Risk management was focused primarily on financial, predictable and quantifiable risks related to loss prevented corporate governance, alignment to strategic objectives, capital adequacy and stakeholder value. Additionally, regular discussions on risk management started appearing on corporate board agendas.

Risk management is a rapidly developing discipline and there are many and varied views and descriptions of what risk management involves, how it should be conducted and what it is for.

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According to ISO/IEC Guide, risk can be defined as the combination of the probability of an event and its consequences. In all types of undertaking, there is the potential for events and consequences that constitute opportunities for benefit (upside) or threats to success (downside).

One should keep in mind that risk management is increasingly recognised as being concerned with both positive and negative aspects of risk.

In putting together ERM initiatives, companies are supposed to focus not only on the downside of risk but the upside as well. The traditional approach was to focus on the downside - the losses from currency or interest rate trades in financial markets, for instance, or financial losses that might be caused by a disruption in a supply chain or cyber or terrorism attack that impairs a company's information technology.

In thinking about the upside, companies are supposed to consider competitive opportunities and strategic advantages that might arise out of deft management of risk. Some of these "better decisions" involve items like where to locate a plant or office abroad based on a risk analysis that would look at the political environment in a country (Quinn 2008).

Risk management is a central part of any organisation’s strategic management. It is the process whereby 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.

Previously companies have been managing risk by buying insurance, than more recently, many companies have shift to the capital markets with "derivative instruments" that help to manage the ups and downs of moment-to-moment movements in currencies, interest rates, commodity prices and equities. From a mathematical point of view, all of these risks or "exposures" have been reasonably easy to measure, with resulting profits and losses going straight to the bottom line.

Now the situation's poised to change as rating companies start to factor in a company's ability to manage ERM. Stakeholders will start to gain a plethora of new risk-related data and information available to them. This story of risk management is likely to expand greatly over the next decade. Where enterprise risk management comes in is where companies manage the risks that defy easy measurements or a framework for management. These include crucial risks such as reputation, day-to-day operational procedure, supply chain, legal and human resources management, financial control, and overall governance.

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 marshals the understanding of the potential upside and downside of all those factors which can affect the organisation. It increases the probability of success, and reduces both the probability of failure and the uncertainty of achieving the organisation’s overall objectives.

Risk management protects and adds value to the organisation and its stakeholders through supporting the organisation’s objectives by:

- providing a framework for an organisation that enables future activity to take place in a consistent and controlled manner;
- improving decision making, planning and prioritisation by comprehensive and structured understanding of business activity, volatility and project opportunity/threat;
- contributing to more efficient use/allocation of capital and resources within the organisation;
- reducing volatility in the non essential areas of the business;
- protecting and enhancing assets and company image;
- developing and supporting people and the organisation’s knowledge base;
- optimizing operational efficiency.

All the objectives' attainment can be portrayed schematically in the following way (see Fig. 1).
2. Risk management as a competitive advantage

2.1. Corporate investment image

Studying how corporations manage the incredibly diverse number of risks they face - everything from movements in currencies, interest rates to public perceptions of their reputations is playing an extremely important role in the investment process. Knowledge of individual corporate “risk profiles” might lead to investing in companies with the confidence that they could meet corporate objectives and investor expectations (not only in good times, but also in bad). Knowledge of these profiles might help to identify up- and-coming organizations for investment - or to better understand which companies to let into community through a new plant or office, believing that they would do everything possible to avoid environmental damage and to treat employees well (Quinn 2008).

The ERM strategy significantly improves business risk assessment and subsequent management processes. The purpose of further evolving strategy is to provide a uniform corporate-wide visibility on risk, thus giving internal stakeholders an understanding of how risks impact the whole of the organisation, rather than on the previous held division by division basis. The strategy establishes a common standard for identifying and measuring risks across all functions and business units and prioritises the primary risks to be collectively managed while encouraging a common risk management culture.

Thus, risk management system is part and parcel of building sustainable competitive advantage (see Fig. 2).
The continuous interaction between risk and stakeholders provides the means for a dynamic corporate strategy that drives sustainable competitive advantage. The risk management strategy focuses primarily on managing prioritized risk scenarios and reducing cost supported by adding value through implementation of development opportunities. The engagement process addresses and gauges stakeholders’ sensitivities and the application of cost-effective measures to enhance performance.

2.2. Risk management significance for the European enterprises

To say that the current economic and financial crisis is a decisive and testing time for the European single market is an understatement. Since the crisis broke in late 2008, the institutions of the European Union (EU) in Brussels have lost little time in developing measures to restore confidence to the financial markets and reassure EU citizens and businesses alike. The European financial services industry has witnessed a relentless stream of draft legislation from the European Commission (EC) and European Parliament introducing greatly strengthened and rigorously applicable regulations covering not only the financial markets but also the key market actors.

Survey, conducted by FERMA, has found that a majority of European companies have established policies, charters, and defined processes related to risk management. Companies are continuing to enhance their risk management fundamentals and narrow the execution gap that occurs from knowing the risk and determining how to handle the risk. The goal is to have risk management practices embedded in the day-to-day operations so companies can be better prepared when a risk issue occurs. European companies have realized that good internal practices can also help them meet external guidelines as well. By having risk management intertwined with operations, companies will now be able to respond to real-time situations more effectively and minimize losses and surprises.

The report highlights five “families” (or stages) of risk management process maturity and summarizes the results about companies in each family:

- Rules-driven companies represent 39% of respondents and are those companies that operate in a highly regulated sector. These companies often include financial institutions and public bodies.
- Balanced and sophisticated companies represent 26% of the survey respondents. These companies focus on balancing their shareholders’ interest in conjunction with compliance objectives. These companies are rather large firms and financial institutions.
Fire fighters made up 18% of the survey respondents whose companies tend to focus on compliance and merely react to adverse events. These companies are limited to how much they can invest in risk management and are small to medium sized companies.

Self-motivated companies represent 9% of survey respondents and focus on shareholders’ needs instead of regulatory forces and are private owned, mid-sized companies in commerce.

Happy-go-lucky companies represent 8% of respondents and are companies new to risk management and have an unsophisticated risk management approach. These companies are small public bodies that have not seen a need for risk management in the beginning stages of development.

Similar research, conducted by Standard & Poor’s in 2008 demonstrates the following data on the European enterprises risk management score distribution (see Fig. 3).

Companies in Europe are realizing that for risk management to be truly effective it needs to be linked with real time decision-making strategies. Therefore, companies are seeing the increasing need to link risk management with their strategy planning activities. Self-motivated and balanced and sophisticated companies are the best at being able to link risk management and strategy decisions together.

It is important for companies to be able to quantify their risk. Companies quantify global corporate level risk, certain categories of risk, and certain activities or geographical locations of risk. The tools that companies decide to use depend on the type of risk they need to quantify. Most companies use internal databases and internal brainstorming, along with value at risk and scenario simulation models. The balanced and sophisticated and self-motivated companies use the most sophisticated techniques while the happy-go-lucky and fire fighter companies use the most basic techniques.
3. Globalization risks and avoidance techniques

While globalization has brought many benefits to businesses, companies need to spend more time studying the new and emerging risks involved and planning for low-probability event.

All the factors affecting entrepreneurial activities can be divided into internal and external ones (see Fig. 4). At first site it seems that globalization risks are related only to external factors. Nevertheless, there is no doubt that globalization of business stimulates unification of organizational structures, corporate strategies’ templates, and not to forget corporate culture. Informational systems, as well as R&D activities nowadays are driven by quite similar mechanisms. Thus, to our opinion, globalising processes influence on the emergence of both internal and external factors as well as the criteria, which are used in defining and assessing entrepreneurship risks.

![Diagram of key external and internal risk factors](image)

**Fig. 4:** Examples of key external and internal risk factors

Let us describe the group of globalization risks according to the Risk Management System Standards. The objective of risk description is to display the identified risks in a structured format, for example, by using a table (see Table 1).
Table 1: Globalization Risk Description

<table>
<thead>
<tr>
<th>Scope of risk</th>
<th>Global markets at local places as well as regional areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of risk</td>
<td>Globalization processes</td>
</tr>
<tr>
<td>Stakeholders</td>
<td>Of any companies conducting international business activities</td>
</tr>
<tr>
<td>Quantification of risk</td>
<td>Political and Economic structures, functions and processes, time and the political and economic space are decisive determinants for local and regional development effecting the business environment</td>
</tr>
<tr>
<td>Risk tolerance / Appetite</td>
<td>According to the determinants of risk, corporations and investors are confronted with a broad spectrum of risks, especially political risk, as it is associated with foreign ventures and investments, and their exposure to different cultures, customs, operational procedures, micro and macroeconomic environments</td>
</tr>
<tr>
<td>Risk treatment and control mechanisms</td>
<td>To become and to remain competitive, it requires to integrate the political risk strategy into the decision making process and to use the risk methodology as a guide for policy formulation</td>
</tr>
<tr>
<td>Potential action for improvement</td>
<td>Structural changes within the political and economic systems</td>
</tr>
</tbody>
</table>

The risk description table above can be used to facilitate the description and assessment of risks. The use of a well-designed structure is necessary to ensure comprehensive risk identification, description and assessment process. By considering the consequence and probability of each of the risks set out in the table, it should be possible to prioritise the key risks that need to be analysed in more detail. Identification of the risks associated with business activities and decision-making may be categorised as strategic, project/tactical, operational. It is important to incorporate risk management at the conceptual stage of projects as well as throughout the life of a specific project.

4. Conclusion

As business leaders seek new ways to build shareholder value, they have begun to think in new ways about how risk management is tied to value creation. Across industries and organisations, many are recognising that risks are no longer merely hazards to be avoided but, in many cases, opportunities to be embraced.

Risk management should be a continuous and developing process which runs throughout the organisation’s strategy and the implementation of that strategy. It should address methodically all the risks surrounding the organisation’s activities past, present and in particular, future.

With operations scattered around the globe, companies face a host of new perils: political and currency risks, cyber attacks, failed communications with suppliers, just-in-time delivery strategies. And, of course, they face dramatic, unpredictable risks associated with terrorism, not to mention non-compliance with attendant anti-terrorism trade and shipping guidelines. But, nevertheless, companies still also face traditional property-related risks to their supply chains and businesses as a whole, to control which they also need an advanced risk management systems and strategies.

5. References


