RISK MANAGEMENT: ITS IMPORTANCE AND REIMAGINING IT IN THE POST-COVID WORLD

Written by ***Gnyanada Pallepati***

5th Year BBA LLB Student, O.P. Jindal Global University, Haryana, India

ABSTRACT

Risk in general is considered to be an important element in the complete structure of corporate governance and its functioning. In order to handle this risk, there has be a properly established process of identifying and analyzing the risks efficiently so that the company can go ahead and achieve its objectives without any problems. Studies reveal that failure of bank's corporate governance and risk management have been the main causes of the 2008 financial crisis. Not only the financial crisis, but also many scandals that happened in the past which have outraged the financial community have revealed the serious flaws in the corporate governance. Therefore, from then risk management has become a key concern of the board of directors in order to strengthen the corporate governance of a particular organization.

Risk management is defined as following by Coleman, 2011: "Risk management is the art of using lessons from the past to mitigate misfortune and exploit future opportunities – in other words, the art of avoiding the stupid mistakes of yesterday while recognizing that nature can always create new ways for things to go wrong. Thus, risk management is much more than numbers; it is the art of using numbers and quantitative tools to actually manage risk. Risk is the central, maybe the central component of managing a financial organization."

In order to have an effective risk management in an organization, it is always best to have a risk management committee with a chairman as the head. However, the board has the responsibility to identify the risks to the organization and then look at the acceptable levels of the risks and monitor and control these detected risks. Good risk management must calculate and predict the influence of risks on a particular business, later after assessing the risks they have to choose between accepting or rejecting such risks and such acceptance or rejection

depends on the tolerance levels of the organization towards such risks. If the particular organization sets up a committee for risk management which assesses the risks as a continuous process then such risk management structures can be useful for the other risk mitigation systems. A good risk management structure includes planning, cost controlling, organization and budgeting.

Once a risk is detected the following steps can be taken to handle the risks:

1. Risk Avoidance
2. Risk Mitigation
3. Risk Acceptance

However, effective risk management is not just about eliminating risk but a driving force for the business. The main aim of risk management is to understand and manage the risk once it's communicated. The risk management has to be done on the basis of an enterprise-wide approach rather than just treating every business individually. The risk management at the end can be efficient in nature when the board is efficient in overseeing and handling the complete structure.

After the 2008 financial crisis, the Enron scandal and few other scandals, the organizations all around the world have taken measures to have effective risk management system as per the changed rules in the countries. By following the prescribed processes, risk management has kind of been a settled issue for now.

However, at present the complete world is dealing with the COVID-19 pandemic which has created a very serious crisis all over the world. This pandemic has brought in new and unique challenges in all the fields but especially for the corporations. Now, the board of directors are given the responsibility to look at the short-term and the long-term condition of the corporation and its business prospects in this crisis. One of the important issues which has to be looked after is the risks which this pandemic will bring in and how those risks should be handled. There have been studies conducted and insights being given from many organizations and universities. Few of these insights included the following suggestions:

- Enhancing the company's existing reporting and information systems that are used by the board to provide oversight.
- Forming a committee.

- Enhancing communications with company management.
- Confirming the feasibility of the company's disaster plan.
- Evaluating potential disruptions to operations and business relationships.

This paper will be mainly focusing on the risk management and its importance in the corporate governance structure in the past and in the present so that a good future can be established. The paper will start with an introduction of risk management and its importance. It will later on go and talk about the damages which can be done if a proper risk management is not done which will be explained using both the theory and the practical examples which happened in the world in the past decade (Enron scandal, 2008 financial crisis, etc.).

The paper will then move on to talk about how the risk management has become a settled issue after following the proper mechanism. The paper will then move on to talk about the importance of risk management during this pandemic. Since everything has become completely unpredictable it's important for the board and the risk management committees to bring in new mechanisms and ideas to handle the present situation so that the corporation do not face any further losses. There are organizations which have started studies and have given their insights which can help the businesses in handling the upcoming risks in the present situation and how they could be helpful. The paper would then be concluded with my personal views and suggestions towards the situation and how it could be handled in an effective way.

***Keywords*:** Risk Management, corporate governance, organization, risk, financial risk, systematic risk, unsystematic risk, market risks, board of directors, efficiency, credit risk, pandemic, financial institutions, COVID-19, operational risk, scams, scandals,

INTRODUCTION

Risk is considered to be a very inherent aspect of maintaining a business be it however small or big the business is, however, not just taking a risk is important but managing it is also very important for the retain the business. It short it can be said that without taking risk and managing it efficiently, no gain can be made. There are various types of risks which subsist in a business and these keep varying on the basis of the business which one deals with. In olden days risk management and mitigation was only pertinent towards having relevant equipment which can safeguard from any form of natural calamity, however, with the rapidly evolving world and its global economy the types of risks faced by the businesses have also increased the ones dealing with the legal issues, restructuring issues, business sustainability issues, etc.[i] In the year 1992, the Cadbury Committee Report which dealt with financial aspects of Corporate Governance also mentioned that efficient risk management is the only way in which financial frauds can be avoided and efficient risk management is the board's responsibility.

Risk management is a very important element which has to be handled efficiently in order to attain good corporate governance structure and functioning. In a way, risk management should be an considered as an important component by the board of directors of a company. Looking at the previous scandals and the 2008 financial crisis has showed us what kind of destructions can take place when the risk management committees are inefficient in doing their work. In the case of Lehman Brothers' scandal, their risk committee had only two meetings in the years 2006 and 2007 respectively and in the year 2008 the company went bankrupt. The company's risk management lacked the competence to assess a risk and handle it, alongside, the chair of the committee did not have enough knowledge of the banking practices which are related to debt obligations, financial instruments, etc. Therefore, it is also important to have a well experienced people in the risk management committee who have the capability to assess the upcoming risks and handle them efficiently. The lesson learnt from Lehman Brothers' scandal, Enron scandal and other scandals have been examples to show us the importance of risk management in corporate governance.[ii]

RISK

The Oxford dictionary defines risk as "Exposure to the possibility of loss, injury, or other adverse or unwelcome circumstance; a chance or situation involving such a possibility". However, when it comes to risks dealt with in the companies and the businesses, risk is considered to be a hinderance or an obstruction to the company or an organization from achieving its objectives.[iii] Risk can lead an organization into financial disadvantage and result into loss of the company's opportunity to increase their operations or their activities.[iv] However, taking some amount of risk is important for any business especially for the start-up's. The companies have to be in a situation where they are willing to take some amount of risk because without risk there is no gain. In the companies with good corporate governance structures, it can be observed that the companies make sure that the risk is efficiently understood, managed, communicated and shared with the concerned people.[v]

CLASSIFICATION OF RISKS

Risks in general are classified on the basis of how they can be controlled, which are controllable risk and uncontrollable risk. The uncontrollable risk is known as unsystematic risk, whereas the controllable risk is known as systematic risk.[vi]

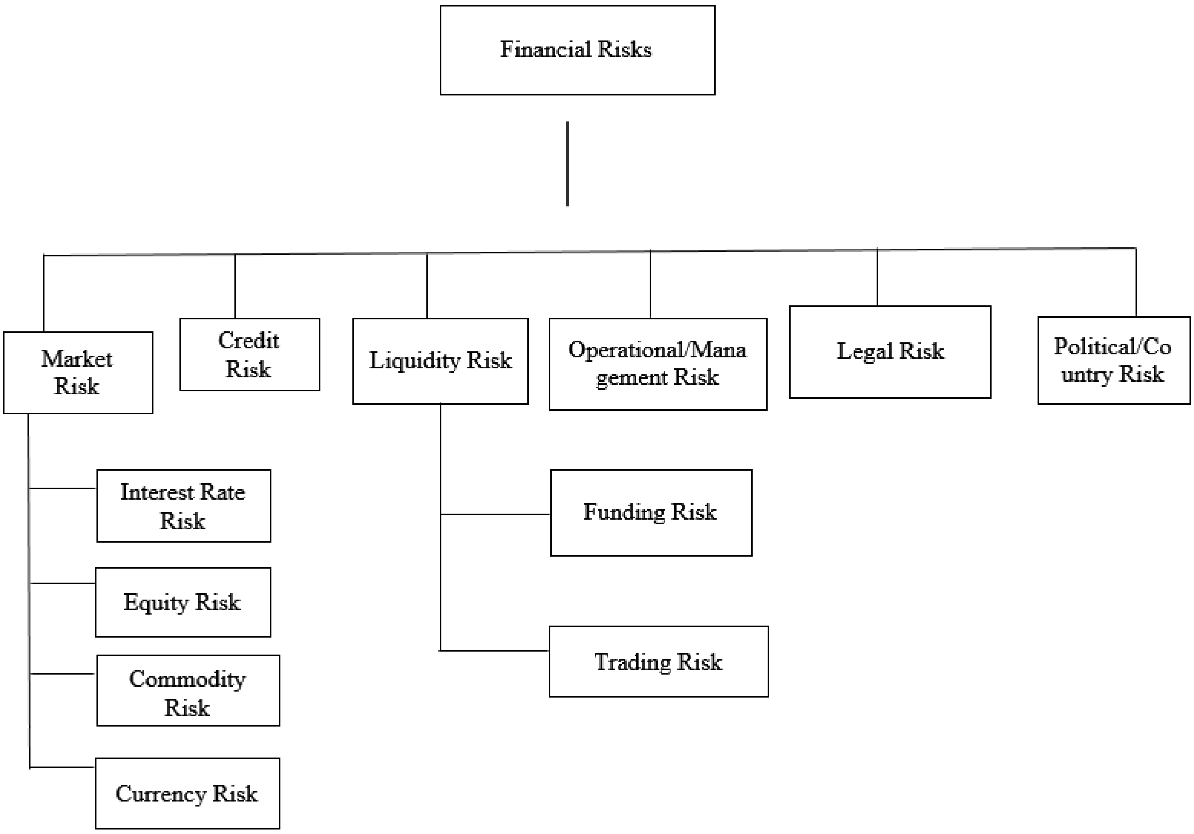
Systematic Risk	**Unsystematic Risk**
• This risk is uncontrollable by the organisation	• This risk is controllable by the organisation.
• It's usually unpredictable in nature.	• It is predictable in nature to a reasonable extent.
• It macro in nature as it effects a wide number of organisations dealing with the business under the same stream.	• It is micro in nature as it effects on the organization or the company which is facing that risk.

E.g. The 2008 financial crisis effecting most of the financial institutions across the world.	
• It is related to the external factors which in general are not under the control of the company.	• With proper governance the risk can be assessed in advance and with proper mitigation it can be avoided.
• Examples: Power Purchasing Risk, Market Risk, Interest Risk.	• Examples: Financial Risk, Business Risk, Liquidity Risk, Operational Risk and Credit Risk.[vii]

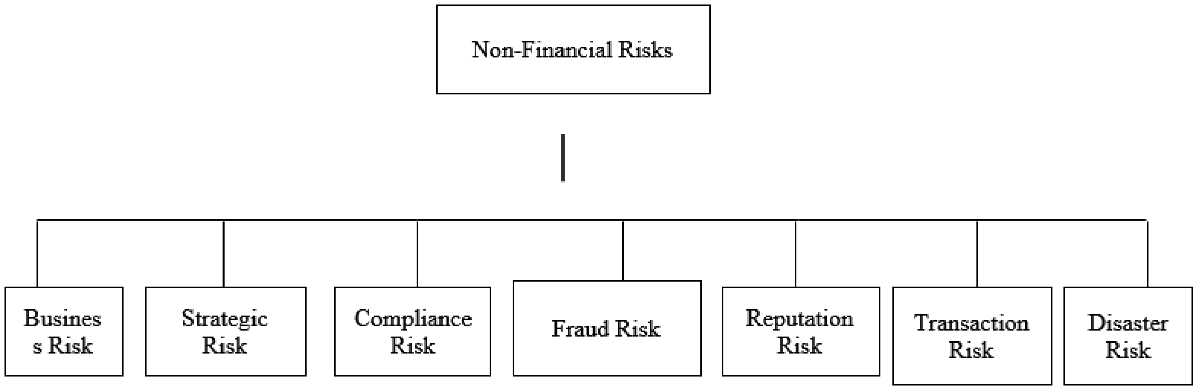
TYPES OF RISKS

Risks can be divided into financial risks and non-financial risks.

Financial Risks can be further classified as per the following structure[viii]:



Non-financial Risks can be further classified in the following as per the following structure:



The non-financial risks may not show immediate effect on the financial situations of the company, however, if its seriousness increases with time then it shows the financial impact on the company which may lead to serious consequences.

RISK MANAGEMENT AND ITS IMPORTANCE

Risk Management plays a vital role in the corporate governance strategy as it protects the assets of an enterprise and helps to use those assets in much productive manner for the growth and upliftment of the enterprise. Risk management follows a systematic procedure which includes risk identification, analyzation, evaluation, communication, mitigation and treating of a risk in order to maximize the availability of the opportunities for the organization. Effective risk management can also improve the quality of the strategy planning and helps in cost refusal by limiting the amount of legal actions. Proper risk management mechanism not only helps the enterprise with its reputation, but also assures the important stake holders in regard to the decisions and the actions taken by the government. [ix]

In 2011, Coleman has defined Risk management in these words: *"Risk management is the art of using lessons from the past to mitigate misfortune and exploit future opportunities – in other words, the art of avoiding the stupid mistakes of yesterday while recognizing that nature can always create new ways for things to go wrong. Thus, risk management is much more than numbers; it is the art of using numbers and quantitative tools to actually manage risk. Risk is the central, maybe the central component of managing a financial organization."*

Board of Directors and the managers play a very important role when it comes to risk management. The Turnbull Report has spoken about this particular issue. It talks about how the responsibility in this regard has to be divided between the directors and the managers. The guidance provided by the report divides the responsibilities between the two sets of people in the aspects of risk management policy, the strategy, practice and reporting of the policy of the organization. The following are the points listed by the Turnbull report in this regard[x]:

"Required elements in acceptable approaches to corporate risk management: the Turnbull Guidance

1. *Development of accepted corporate policies for risk management.*
2. *Implementation of accepted risk management policies through risk-based internal control systems capable of continuously monitoring the corporate internal and external risk environment.*
3. *Periodic reviews of the risk-based IC systems (at least annually) to quality-assure on-going effective control of organisation-wide risk in a dynamic environment.*
4. *Annual reports of compliance on risk management policies and effective risk management, with reasons for any non-compliance."*[xi]

Not only the Turnbull Report, the Companies Act, 2013 ('Act') also talk about the responsibility of the board when it comes to the aspect of risk management:

- Section 134 (n) of the Act says that, the board of directors must include a statement indicating development and implementation of a risk management policy for the Company including identification of elements of risk, if any, which in the opinion of the board may threaten the existence of the Company.
- Section 177 (4)(vii) of the Act talks about the responsibility of the audit committee where it says that, the Audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include evaluation of internal financial controls and risk management systems.
- Schedule IV Part II-(4) of the Act talks about the responsibility of the. Independent directors where it mentions that Independent directors should satisfy themselves that financial controls and the systems of risk management are robust and defensible.[xii]

ISO 3100 which is published in November 2009 provides with 11 key points that talk about the importance of the risk management and its implementation. These pointers are published in order to help the organizations. The following are the 11 points:

"• Increase the likelihood of achieving objectives

• Encourage proactive management

• Be aware of the need to identify and treat risk throughout the organization

• Improve the identification of opportunities and threats

• Comply with relevant legal and regulatory requirements and international norms

• Improve financial reporting

• Improve governance

• Improve stakeholder confidence and trust

• Establish a reliable basis for decision making and planning

• Improve controls

• Effectively allocate and use resources for risk treatment

• Improve operational effectiveness and efficiency

• Enhance health and safety performance, as well as environmental protection

• Improve loss prevention and incident management

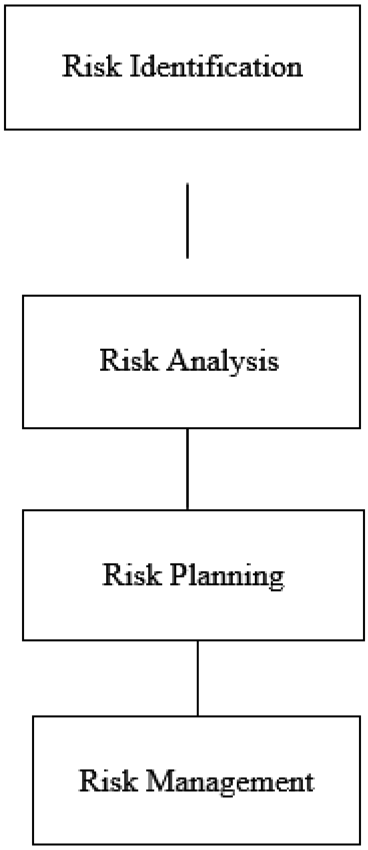
• Minimize losses

• Improve organizational learning

• Improve organizational resilience."[xiii]

RISK MANAGEMENT PROCESS

Risk management process is a continuous cycle which takes place throughout the lifetime of the company. The following are the four phases of the risk management strategy which have to be followed by the board of directors and the managers of the company.



The Turnbull Report also defines the above-mentioned four phases in the following manner:

"The four phases of risk management:

Phase 1. Risk identification: identifying those risks which, associated with corporate activities, may prevent or hinder achievement of corporate objectives.

Phase 2. Risk analysis: determining the probability of occurrence, likely impact and timing of significant risks.

Phase 3. Risk planning: preparing plans for containing the level of risk and assessing its potential impact within reasonable and acceptable limits.

Phase 4. Risk management: carrying out the management activities required for effective and efficient implementation of plans."[xiv]

RISK MANAGEMENT IN THE COVID-19 TIMES

Assessing a risk is one of the important points of risk management but assessing a pandemic like COVID-19 something that is completely unexpected. There has been a pandemic like plague in 1920's but the global market then was not this fast growing, but now since the market is rapidly growing the pandemic has shook the roots of many businesses and there have been many studies which are saying that the world is in to face another financial crisis which would worse than the 2008 financial crisis. COVID-19 has created various challenges for the corporations and their boards. The companies and their boards which are responsible for looking at the short-term and the long-term issues of a company have come into a fix due to these unexpected events. However, there are few studies done which advice on how the boards can rebuild their corporate governance models and do what is the best for their companies in the present situation.[xv]

Financial Institutions:

The corporate governance mechanisms taken for the financial companies are different from the ones takes for the non-financial companies. Firstly, it is required to make sure that the financial institutions are acrobatic to the changes in the market and operational domain. There has been an increase in the non-performing loans in the post COVID-19 world as a result of which the financial companies have to revise their risks by taking the low-risk assets into consideration. There has been a increase in digitalization in the pre COVID-19 times and the pandemic is going to increase the usage of the digital platforms and this increase in the usage of these advanced methods is very much expected in the banking chain. The changes in relation to the reduction of cost and increase in efficiency has led to major changes on the structures of the financial institutions. Due to the above-mentioned circumstances, the role of risk management has also increased and following are the few of the main areas which have to be dealt seriously[xvi]:

1. *Credit Risk*:

The credit rating models made by the financial institution has to be changed in order to include the amended risk accounts of the industries and products which were affected due to the pandemic. The industry which is highly effected should be given more focus and reviewed more to identify the issues in order to take suitable actions.[xvii]

2. *Operational Risks:*

Due to the pandemic the work mode has mostly become online i.e., work from home, with this change in the structure and system of working it has become necessary to reconstruct the mechanisms to handle the technology risks, cyber risks, organization reputation risk, etc. Moreover, whatever problems come in the business domain, continuation of busines and managing it properly is important.[xviii]

3. *Capital Management and recovery planning:*

A testing framework has to be created in order to assess the impact of the pandemic on the important earnings, company capital and the profitability measures on a continuous basis. The business plan and the risk assessment need to be reviewed and updated regularly. The funding that is being provided and the capital plans should be in line with the business plan of the institution. It is very important for the companies to be ready with crisis management and continuously develop the recovery options which would ensure solvency of the institution.

PUBLIC LISTED COMPANIES

In the case of, *In re Caremark Int'l Inc. Derivative Litig.*, the Delaware Courts have said the following:

"have found that a failure of director oversight would occur:

(1) if directors failed to implement any corporate reporting or information systems or controls or

(2) if such a system or controls were implemented, the directors consciously failed to monitor or oversee the company's operations, thus removing themselves from being informed of material risks or problems requiring their attention."[xix]

The following are the few pointers for good corporate governance in public listed companies:

1. *Forming a committee:*

To monitor and take the responsibilities a committee has to be formed which could be the in charge to evaluate the company's operations and when there is a necessity, the committee could adopt the preventive measures necessary to protect the company's operations from the impact of this pandemic. It should be made sure that the meetings and the resolutions of this committee have to be documented as an evidence.[xx]

2. *Enhancing communications with company's management:*

The board should increase their conversations and interactions with the management of the company with regard to the issues that deal with business risks, workplace health and the safety issues which are caused due to the pandemic. The management and boards should collectively evaluate and look into the regulatory and the legal developments made at the central and state level with regard to the COVID-19 pandemic and accordingly should amend their risk-mitigation policies and adjust other such protocols on the basis of the regulatory measures which are announced if they are related to the company's operations.[xxi]

3. *Feasibility of the company's disaster plan:*

The disaster management plan which is adapted by the company should be able to handle the issues related to cyber security, employee availability, IT systems functionality, etc. Due to this pandemic, the board along with monitoring the present issues should also be in a position to discuss the implementation issues with the management and check if any modifications have to be made for the disaster plan.[xxii]

4. *Evaluating the potential obstructions:*

This evaluation shall include the management aptly looking at the impact caused by the pandemic on the main customers, suppliers, the financing sources of the company. They have to consider the issues relating to reviewing the contracts and the legal implications which may occur through such reviewing and changing. The governments have also sanctioned funds due to the disaster the pandemic has caused, therefore, it is important for the company to find the scope to gain access to such emergency government fund. The company's insurance coverage should also be efficiently re-checked in order to check if the potential claims are being properly preserved or not.[xxiii]

CONCLUSION

The post COVID-19 times had brought in a lot of chaos in almost all the business sectors. Therefore, proper risk management strategy has to be followed and implement in order to procure. At this point, more than profits it's very important for a company to make sure that it remains liquidated, however, if the company is running well profits can be their main goal but this has to go in hand with proper risk assessment and analysis. There are many companies which have taken efficient steps to withhold their companies through this pandemic. Risk management committees worked hard, there were situations where if one issue was handled, another issue came up and moreover, taking, transferring or terminating the risk was not possible due to the pandemic. The boards and the managements together found out that the solution to handle this situation was continuous communication between the management and the power; better relationship between shareholders and the stakeholders and providing regular updates by increasing the frequency of the meetings and exchange of information. The pandemic has taught us the lessons by increasing our ability to act quickly and that there has to be a trust built in between the company and the public and also amongst the management and the employees of the company, along with this diversity has also become a great strength during these times.

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