Risk Management (Short Course)

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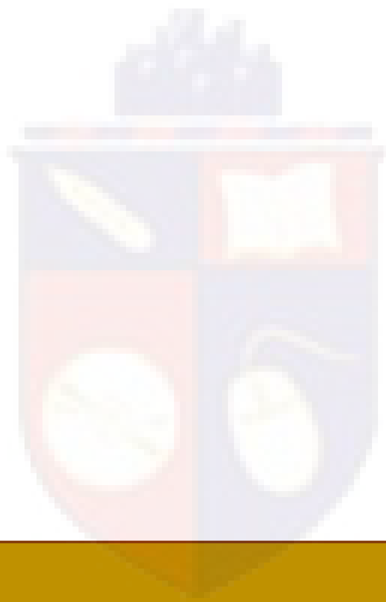

Topic 1

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What is Risk Management

Risk management emerged from the field of Corporate Insurance Buying and it's now acknowledged as a unique and important element for all businesses and organizations.

Risk management can be either a full-time job for one person or for a whole section within a company. People who are responsible for pure risk management are known as risk managers.

Simply put, risk management is a way to protect one's assets. It can be defined as an organized process used by management to deal with the risks faced by the company.

The History of Risk Management and its Concepts

The current form of risk management emerged in 1956 with an article in the Harvard Business Review. The author suggested that a company employee should be placed in charge of "dealing with" their pure risks. At that time, this was seen as a very progressive approach.

The first insurance managers were employed by the first large companies. Insurance became an important item in company budgets due to the growth of capital investments. Over time, the insurance-buying role was given to in-house specialists.

Although risk management has its roots in corporate insurance buying, the changeover from insurance buying into risk management was not an inevitable evolutionary approach.

The move only occurred when attitudes towards insurance changed and people no longer saw insurance as the only way of dealing with an organisation's risk although this had always been the way insurance managers managed risks.

The insurance manager's job was to buy insurance and they couldn't be blamed for thinking this way. What then really caused the change in thinking from buying insurance to the risk management approach?

In the 1950s two scientific studies, the Gordon & Howells Report and Pierson Report, were done on the curricula of American business colleges. Both these studies strongly criticized the curricula at these colleges saying they were outdated and ineffective in training students for their future role as decision makers.

While some business schools objected to the final conclusions of these reports, they began to change their curricula by introducing new programmes and changing the focus of others.

The most important changes made were to add operations research and management science and to move away from detailed courses to normative decision concepts.

Some business insurance buyers began to understand that maybe there was a more cost-efficient way of managing risk.

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They realized that perhaps the most effective option would be to prevent losses in the first place, which would in turn minimize the financial effects of losses they were unable to prevent.

Thus, the idea grew that management could identify and evaluate risks the company faced so they could prepare for and avoid certain losses which would in turn reduce the impact of others. People came to the conclusion that the cost of risk could be managed and kept as low as possible.

This new risk management approach made good sense, and it spread from organization to organization. In its present form, risk management is a combination of three areas, namely; decision theory, risk financing, and risk control.

The Element of Risk

Risk is the possibility that a loss or injury will occur. Avoiding risk in today's world is very difficult. For example, people driving a vehicle, investing in stocks or bonds, or jogging along a country road are in situations that involve some risk.

Risk forms part of every decision made by businesses. The main aspect of making business decisions is the process of evaluating possible risks and gains inherent in different options and choices.

Current Definitions of Risk

Currently there is no universal definition on risk. However, the terms found most commonly in all the definitions are: **indeterminacy and loss**.

- The concept of indeterminacy is present in every definition of risk, i.e.: all risks cannot be anticipated. If we are sure that a loss will occur, then there is no risk involved.

For example, when buying anything, even expensive capital assets, we accept that the item will decrease in value and suffer physical wear and tear. In this situation the loss is both expected and definable, thus there is no risk.

- A risk can occur when one of the possible results is unfavorable. This may be a total loss or it may be a lower profit than what was expected.

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For example, if a person makes an investment but doesn't take full advantage of the opportunity, they "lose" the benefit they could have gained.

Uncertainty and Its Relationship to Risk

The word uncertainty is often used together with the word risk.

Uncertainty refers to a doubtful thought. This is dependent on lack of information about what will or will not occur in the future. Certainty is the opposite, which means surety of a particular situation.

A student says "I am certain I will get an A in this course," which means the same as "I am sure I will get an A in this course." Both statements replicate a conviction about the outcome.

If one claims "I am unsure what grade I am going to get in this course," the declaration displays a lack of knowledge regarding the outcome.

Where there is a risk (a situation where there is a possibility for loss), uncertainty exists. It's possible for an individual to feel uncertain in a situation which he or she imagines that there is a chance of loss. It is possible for an individual to feel certain (sure) with regards to a certain risk when the exposure to loss is not known.

Classification of Risk

The word "risk" includes all situations wherein there is a chance for undesirable out comes to occur. Risks can be categorised in many ways.

Dynamic Risks

Dynamic risks are those that occur due to a change in the economy. For example changes in prices, consumer expectations, profits, productivity, and technology may lead to financial losses.

Dynamic risks benefit society in the end. Dynamic risks affect a large number of people. However, they are less predictable than static risks.

Static Risks

Unlike dynamic risks, static risks are losses that occur even if there are no specific changes in the economy. If consumer tastes, productivity, income levels, and the level of technology could be maintained, some people would still suffer financial losses.

These losses occur for reasons other than from economic changes; e.g. due to the dishonesty of other people.

There is no benefit or gain for society as a whole when it comes to static losses. These types of losses are caused by either the physical wear and tear of the asset itself or its loss due to theft or human error.

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In the real world, static losses are expected. They are predictable. For that reason, insurance can be bought to cover these types of losses, unlike dynamic risks.

Fundamental and Particular Risks

Fundamental risks are impersonal losses in both the type of loss suffered and the result. The losses will affect a huge group of people or even an entire population; e.g. unemployment, war, inflation, earthquakes, floods, etc.

Particular risks, however, are losses that stem from specific individual events. Normally these losses affect individuals rather than many people.

Particular risks can be either static or dynamic. A building burning down or a bank robbery, are both examples of particular risks.

Fundamental risks are beyond the control of the people involved and are, therefore, not caused by the negligence of any individuals.

While some fundamental risks are covered by private insurance companies, social insurance or government programmes will also take responsibility for fundamental risks.

For example, social insurance would cover fundamental risks like unemployment and work-related disabilities. On the other hand, places affected by flood damage or earthquakes can be declared disaster areas and receive government funding and assistance.

Pure and Speculative Risks

Speculative risk refers to situations where there is potential for loss or gain. Most business decisions are seen as speculative risks, for example, when a decision is made to launch a new product. There is a risk involved. If the new product sells well then the company makes a profit. However, if it fails the company suffers losses.

For example, when buying a car a person is immediately faced with the possibility that the car could be damaged or destroyed. Either a loss will be experienced or no loss will take place. A pure risk is a risk that only involves the possibility of suffering a loss, with no possibility of gain.

So, with pure risk there is no gain. For instance, damage caused by a hurricane, fire or car accident is a pure risk because there is no gain if no damage occurs.

The difference between pure and speculative risk is important, as only pure risks are insurable.

Insurance companies will not insure individuals against speculative risks. Speculative risks are seen as voluntarily entered into and are easily identified because of their two-dimensional nature – the possibility of both loss and gain.

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Types of Pure Risk

Pure risks affect individuals and businesses and are categorised as follows:

1. Personal Risks

Personal risk is the possibility of loss of income or assets due to the loss of the capacity to earn an income. Loss of earning power is attributed to four circumstances, namely:

- i. Early death.
- ii. Dependent old age.
- iii. Sickness or disability.
- iv. Lack of employment.

2. Property Risks

- a. Property risks are faced by anyone who owns an asset, because these belongings can be damaged or stolen. Risks to property encompass two different types of loss; **direct loss and indirect or "consequential" loss**.
- b. Direct loss is the easiest to understand. If a property is damaged by fire, the owner loses the value of the property. This is a direct loss. However, the house owner no longer has a place to live, so has lost more than just the value of the building.
- c. The owner will need to rent somewhere else to live, while the house is being rebuilt. These additional expenses are known as indirect or consequential losses.
- d. In the case of a company losing their factory, for example, the company not only loses the value of the building and equipment, but also the income that would have been generated through the use of these assets.
- e. Therefore, property risks include the following two losses:

  The loss of the property

The loss of the use of asset, which in turn causes additional expenses of a loss of income.

3. Liability Risks

- a. Generally liability risk covers the unintentional injury of other people or damage to their property, due to negligence or carelessness. However, liability can also occur due to deliberate injuries or damage caused.
- b. Therefore, liability risk includes the possibility of loss of owned assets, future income due to damages received, legal liability due to either deliberate or unintentional actions, or even the violation of other people's rights.

4. Risks Arising from Failure of Other Individuals

- a. Examples of this type of risk include a builder not completing a construction project as scheduled or debtors that fail to make payments as promised.

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b. The swift development of the Internet, the rapid expansion of e-commerce as well as the increased move toward outsourcing by large businesses, has opened up a whole new range of risks relating to the failure of others.

Risk Management

Risk management is the process of evaluating the potential risks that an individual or company may face. Risk management also incorporates minimizing the expenses involved with those risks. Two types of costs are inherent in any risk.

The first type of cost is that which would be incurred if a possible loss becomes a real loss. An example is the cost of rebuilding and re-equipping a factory which has been burned down.

The second type of cost includes the expenses incurred to reduce or to eliminate the risk of probable loss. Costs included here are all the other costs involved like the net income that the factory might have gained. These two types of costs must be off-set against each other, if risk management is to succeed.

Generally people think that simply buying insurance is managing their risk. However, insurance is not the only method of dealing with risk. Other, often cheaper options are available for different circumstances.

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Some types of risks are uninsurable which means no insurance company will cover those types of risks. In this section we take a look at the three general techniques of risk management.

i. Risk Avoidance

One can avoid the risk of a car accident by not driving the car. A company can avoid the risk of having a product fail by simply not launching any new products. With both methods risk is avoided, however, the cost of doing so is very high.

Not driving the car, could result in the person losing their job. A company that does not bring out new products will probably close down, as they are no longer competitive.

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On the other hand, there are situations where risk avoidance is a logical approach. People who stop smoking or avoid walking through a park after dark are sensible in avoiding these risks and will benefit by their decisions.

To prevent losses through theft in jewellery shops; the jewellers lock their stock in vaults at the end of the working day. Fuel stations may accept only credit card or exact amounts of cash payments at night, to reduce the risk of staff being held up.

At no point will either individuals or businesses be able to stop all risks. On the other hand, no one should assume that all risks are inevitable.

ii. Risk Reduction

Where risk can't be prevented, the loss can at least be reduced. A passenger in a car can wear their seatbelt to reduce the risk of injury if an accident occurs. A company can reduce the risk of product failure through careful marketing planning and in-depth market evaluations.

In both of these examples, the cost of risk reduction is obviously worth the potential saving. Companies may experience risk due to inappropriate operating strategies or bad decisions made by management. An evaluation of operating procedures by either company staff or perhaps outside experts can usually highlight areas where risk can be reduced.

The strategies which can be used are:

- Launch an employee safety programme to promote safety awareness among employees.
- The purchase and application of ideal safety equipment; i.e. safety shoes for individuals.
- Properties can be protected from robberies by installing alarms, employing security guards, and having guard dogs.
- Installing fire alarms, smoke alarms, and sprinkler systems reduce the risk of losses due to fire.
- Introducing accounting and financial regulations will protect a company's stock and funds from theft.

Risks involved in management decisions can be reduced through effective decision making. Every time a decision is made hastily or is based on insufficient information, there are risks involved.

On the other hand, costs to reduce these risks increase when managers take too long to make decisions. Costs will also increase when managers require far too much information before they are willing to make a decision.

iii. Risk Assumption

Risks are a part of life for people and business. People driving to work understand the potential risk of having an accident; however, they wear a seat belt to reduce the risk of injury if one does occur.

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When a business launches a new product, they understand the potential risk of product failure. Therefore, they reduce that risk by means of market testing. Risk assumption, then, is the act of taking accountability for the loss or injury which may result from a risk.

It is sensible to surmise a risk when more than one of the following circumstances exists:

1. The possible loss is too small to be of concern.
2. The risk has been reduced through practical risk management.
3. Even if insurance coverage is available, it's too expensive.
4. There is no alternative option to prevent the loss.

Large companies with many facilities often find a risk control method called self-insurance, to be a practical way to avoid heavy insurance costs. Self-insurance is the process of establishing a monetary fund which can be used to cover the costs of a loss.

For example, assume that approximately 16,000 XYZ grocery stores, each worth £400,000, are spread across the country. A realistic way to self-insure against fire losses would be to collect a specified amount, say £600 annually from each store.

The funds are all placed in an interest-bearing reserve account and used when required to fix any fire damage to any of the individual XYZ stores.

Money which is not used is saved and becomes an asset for the company. As the fund grows, the annual contribution from each store can be reduced. Self-insurance doesn't prevent risks from occurring; it simply offers a less expensive means to cover losses.

However, self-insurance is risky in the beginning. For example, XYZ would suffer a considerable financial loss if perhaps over twenty-four stores were damaged by fire in the first year when the self-insurance programme became operational.

Benefits of Risk Management in a Nutshell

Risk management can be described as a process which offers assurance that:

- Objectives are more likely to be accomplished;
- Destructive situations will be dealt with in a more sensible and practical manner.

The aim of risk management is not to remove risk completely but rather to manage the risks involved in all circumstances, to increase possible gains and significantly reduce negative effects.

Risk Management Tools

There are two approaches towards managing risk; risk financing and risk control.

Risk Financing

Risk financing is focused on creating fund resources to cover losses occurring from the risks that remain, even after risk control methods have been applied.

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Risk Control

Risk control reduces the risk of loss by using risk prevention and risk reduction methods. Risk control includes tactics to reduce, at the very least, possible costs. Risk control makes use of risk avoidance and several tactics to reduce risk through loss avoidance and control efforts.

Risk Prevention

Risk prevention should only be used in situations with catastrophic potential loss and where the risk can't be reduced or transferred. Normally, these conditions exist in the event of risks with high frequency and severity. On the other hand, if prevention is utilized extensively, the company may not be able to accomplish its key objectives.

A manufacturer can't stop the risk of product liability by avoiding the risk and continue to stay in business. Hence, prevention is, in a way, the final resort in working with risk. It is used only if no other option can be found.

Risk Reduction

Risk reduction includes all methods used to minimize the probability of loss or the severity of the potential losses. As the term risk reduction indicates, the emphasis of risk reduction is on stopping the likelihood of loss occurring; i.e. controlling the frequency of loss.

Risk reduction processes concentrate on minimizing the seriousness of the losses that do take place, for example, by installing a fire sprinkler system. This is a loss control measure.

Alternate methods of minimizing the seriousness of outcomes include segregation or distribution of assets and salvage efforts. Dispersing assets won't reduce the number of fires or explosions that could happen, however, it will reduce the impact of the loss as assets are not all in one place.

Risk Management as a Business Factor

Risk management can contribute to the fundamental business's goals and objectives in a number of ways. The first one is in guaranteeing that the organization won't be held back from achieving the other business goals and objectives by pure risk losses.

Risk management can impact company profits directly by managing the cost of risk for the organization. Since profits are measured by costs relative to income, the extent to which risk management can minimise costs will directly increase profits.

Costs can also be reduced through risk control programmes. If the costs of loss prevention and control measures are lower than the amount of losses that are prevented, the cost of uninsured loss is obviously reduced. Not only can risk management limit costs linked to losses, they can also increase income. For example, if the risk manager sees that affordable political risk insurance is available, management may go ahead and in so doing help improve profit margins.

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The risk manager responsible for managing all pure risks can select from many different risk management methods and is, thus, in a position to make a large contribution to the operating outcomes of the organization.

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Topic 2

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Operational Risk Management

A business that does not address Operational Risk Management cannot claim to have an enterprise risk management process. The success of Operational Risk Management will depend on how complete the identification process is.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events.

The FSA (2002) appropriately states that *ultimately firms need to decide for themselves what operational risk means to them* and every company needs to *consider a more specific definition of operational risk that is appropriate to the range and nature of its business activities and its operating environment*. Therefore, businesses need to adapt the operational risk definition in terms of their own end product and the resources and processes they use to produce that product.

Scope of Operational Risk

The sources of risk considered to be included within the term *operational risk* are quite considerable.

The *FSA Integrated Prudential Sourcebook* consultation paper (Financial Services Authority2001) describes operational risk as that covering:

- Business risk that includes adverse changes to a firm's market, customers, or products changes to the economic and political environments in which the firm operates and the strategic risk which a firm faces if business plans, supporting systems, and the implementation of these plans adversely affect the firm;
- Crime risk, including potential theft, fraud, and computer hacking;
- Disaster risk, such as fires, floods and other natural disasters, and terrorist activity;
- Information technology risk, including unauthorised access and disclosure and data corruption;
- Legal risk, including loss arising from legal action against the business and from inadequate, incomplete or otherwise unsound legal documentation and practices;
- Regulatory risk, relating to the lack of observance of rules set by a regulatory body;
- Reputational risk from negative publicity about its business practices or internal controls;
- Systems risk loss, as a result of failure caused by the breakdown of business procedures, processes, or systems and controls; and
- Outsourcing.

The FSA's definition of *business risk* described above includes market, economic, and political risk.

Benefits of Operational Risk Management

Operational Risk Management provides the following benefits:

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- Enables the business to achieve its business objectives;
- Gives management the time and opportunity to generate income, rather than constantly dealing with problems;
- Reduces day-to-day losses;
- Places a strong Enterprise Risk Management System in place;
- Establishes a system by which to correlate, understand, and model different classes of risk.

Implementation of Operational Risk

Developing a solid Operational Risk Management System will depend on a number of issues such as:

- The Risk Management System should not slow down decision making processes or reduce business output;
- Risk managers who implement the operational risk programme should not be the managers of individual business units;
- Risks should be managed at an appropriate level within the organisation; and
- Developing a culture which rewards the exposure of risks when identified, rather than encouraging staff to hide them.

Strategy

Definition of Strategy Risk

A business's strategy is overall approach that a business takes to achieve its objectives. Objectives are the results expected within a particular time period. Results are the measures of performance. What the business will do and the reasons behind it is the strategy they follow.

Creating the wrong business strategy, not implementing a well-planned strategy, or not modifying a successful strategy over time due to changes in the business environment are all forms of operational risk. Strategic risk may thus be defined as the risk associated with initial strategy selection, execution or modification over time, resulting in a lack of achievement of overall objectives.

Objectives

Objectives must be clearly stated and understood to ensure that a strategy will succeed. Objectives are the basis for work and the mission of work. They govern the structure of a business, the main activities that are undertaken, and the allocation of people to tasks. Subsequently, objectives are the basis on which organisational structure and business processes are designed and impact the work of individual business units and individual managers. Drucker states that a business must first be able to create a customer. Hence, there is a need for a marketing objective.

Businesses must have the capacity to innovate or they will be made obsolete by competitors. Thus, the presence of an innovation objective is essential. There are three factors of production on which all businesses depend, human resources, capital resources, and physical resources. There must be

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objectives for their employment, their supply, and their development, respectively. The resources must be used productively and their productivity has to develop if the business is to survive. Therefore, productivity objectives are required. Businesses exist within a society and a community, thus, businesses must take responsibility for their impact on the environment.

Therefore, Drucker argues that there is a need for social dimensions of business objectives.

Finally, he says there is a need to make profit; otherwise, none of the objectives can be achieved. All of these have a cost and the risk of potential losses can be financed only out of the profits of the business.

There are five key areas of risk associated with setting objectives:

1. The objectives are not aligned with the strategy;
2. They do not address the key business areas;
3. They are not SMART;
4. Management lacks the experience to achieve the objectives; and
5. The initial assessment of the risks linked with each objective is superficial.

Business Plan

All businesses, regardless of maturity, need business plans to expand existing business. However, the business plan itself is a source of risk. It is meant to be a communication tool. Whether the strategy is a success or not depends on the plan's ability to communicate the business strategy upon which it is based. The disciplines required to articulate the business' vision, mission, objectives, strategy, or delivery plan in a written document require a logical approach, rigorous analysis, and clarity of thought.

The business plan must tell a *story* and describe how the business will attain its objectives in a comprehensive, clear, consistent, and cohesive manner. The plan should identify the market, its growth prospects, the target customers, the main competitors, organisation, resources, social *fit*, and all forecasts of critical success factors and measures. The plan should be founded on reliable assumptions and must identify the assumptions to which the success of the business is most sensitive. These assumptions will address the future market size, the economy, potential market fluctuations, competitor behaviour, and the capability of the business to deliver. All of these assumptions are possible risks.

Therefore, the plan should highlight the risks the business is facing based on an understanding of the assumptions, how they will be dealt with, and the expected degree of success. The plan should also record the risk management process for the identified risks against their objectives, as discussed above in the *definition of strategy risk*. The plan will need to be updated regularly as it will be referred to constantly when making business decisions, not simply to document the original business idea. Thus, the plan will have a long-term influence on achieving the business idea.

Therefore, there are a number of possible areas of risk associated with creating and implementing a business plan. These include the inability of the plan to clearly describe the strategy, explain how the objectives will be achieved (especially at start-up through short-term detailed operating plans), explain

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the assumptions, identify the risks(and their responses) associated with the assumptions, take account of regulatory priorities(where applicable) and regularly update the risks for each objective.

New Business Development

New business development risk addresses the risks associated with plans to move into new business areas, expand by means of mergers and acquisitions, provide new services and improve infrastructure (e.g. physical factory and equipment, information technology, and networking). Businesses need to protect profitability by developing new products and services but such activities invite additional risks due to:

- Inability to recover costs of additional research and development or marketing;
- The loss of reputation if new information technology fails;
- Substandard work by third-party providers;
- The expenditure and staff costs from high-volume low-margin services outweighing the corresponding increases in profits;
- New customers not being attracted by the new products or services; and
- The new products or services causing higher losses due to fraud or theft.

Businesses within the finance sector are particularly exposed to these types of risk. For example, with the inclusion of electronic bill payment services and the expansion of existing bank card issuing programmes, banks have significantly increased their risk exposure. Businesses in the financial sector that want to compete in high-volume transaction-intensive retail services need to make huge investments in information technology. Strategic plans should reflect these investments and link business-line goals and objectives with planned information technology enhancements. In short, strategic plans should show that the management has investigated the risks and documented the company's plan to mitigate them.

Resources

A business needs to be innovative in order to set itself apart from the competition. Thus, part of the business strategy will be to attain, sustain and improve competitive advantage. Businesses with resources that are inherently different from those of their competitors are more successful than others who are not able to obtain or reproduce similar resources. Businesses, therefore, need to acquire or develop unique resources in-house in order to achieve competitive advantage. Required resources include capital, energy, raw materials, people, buildings, land and machinery. While similar businesses may have the same resources, one business may outperform the other due to productivity. Resources have the following risks: a lack of comprehension of resources needed to meet objectives, an incompatibility between the objectives and existing resources, a disparity between production/sales projections and obtaining required resources, experience, staff qualifications and technical abilities and a mismatch between equity debt and spending profile.

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Stakeholder Interests

The stakeholders are individuals or organisations that are affected by or can affect the business. These include shareholders, lenders, employees, suppliers, business partners, customers, analysts, and sometimes, even the society at large. A clear understanding of the stakeholders' interests should be kept in mind. A stakeholder analysis should be performed to identify the primary, possibly conflicting expectations of the stakeholders, as well as their power of influence.

Stakeholders would probably have different priorities or conflicting interests that need to be recorded, disseminated, openly debated (when applicable) and where possible aligned through negotiation. The agreed course of action should then be recorded and forwarded to the stakeholders, indicating where stakeholders' wishes have not been met. The business plan should reflect the stakeholders 'requirements. If not, this could cause problems in the long run.

Corporate Experience

The risk exposure profile of the company's strategy will highlight company's corporate experience. Aspects reflecting corporate experience will include knowledge of markets, customers, suppliers, contractors, distribution mechanisms, products and services, the legal and regulatory, context, and the risk of their industry. This is not a comprehensive list and will vary based on the services provided, the market segment and the industry.

Reputation

A good reputation is one of the most valuable assets that a business can have. A significant measure of a company's reputation is its brand value. As discussed in the previous unit, branding has value because it is a tool to increase market share. Effective branding can ensure long-term competitive advantage. Successful branding can lead customers to believe that a product is different from its competition, so much so, that they see the rival products as inferior, regardless of whether they are or are not. Brand value can be protected by trademark legislation; however, anything a business does or any statement it makes can add to or detract from the brand value.

Schmitt considers the need to consider five interrelated aspects, to practise effective reputation management (Schmitt 2001):

First, he considers reputation management needs to be broadly conceived, as over the last decade, the concept of branding has expanded from single products to the organisation as a whole, such as the Guggenheim Museum in New York or well-known leading figures such as Virgin Group's Richard Branson (Branson 2002).

Second, brand reputation is an on-going undertaking and should not be confused with short-term crisis management.

Third, the corporate brand has been discovered as an essential new marketing initiative. Businesses that traditionally focused on the branding of their individual products are now focusing on the organisation as a whole.

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Fourth, organisations need to take a unified approach to reputation management across the entire business by instilling the brand into its employees so that they become familiar with it and practise it in their day-to-day activities. On every face of the organisation to the outside world, whether it is through trade fairs, news conferences, or communication with the public, the message needs to be consistent.

Lastly, because of the internet, brand protection needs to be real time to cope with the new form of brand scrutiny. This requires effective management of the corporate website, links to other sites, selective presence on other websites, and fast and suitable responses to electronic queries.

Damage to the reputation from a single or multiple events can cause serious damage to a business. Abad reputation can hinder the sale of goods or services, prevent recruitment of good quality staff, discourage desirable business partners, and debt may become more expensive to obtain. Core value statements, which talk about trust and honesty, need to be spread and practiced throughout an organisation. Consumers are interested in everything related to a brand, from the ingredients of its products to an organisation's environmental programme, and even in the long run to economic, social, and political issues.

People Risk

A business must establish systems and controls to manage people risk resulting from the actions of employees or the business itself. These systems and controls must be in place for the duration of an employee's tenure with the organisation, beginning with recruitment and ending with the employee's resignation, retirement, or termination. On a positive note, people are an important source of competitive advantage and can set one organisation apart from another.

Definition of People Risk

People risk may be described as a combination of employer behaviour which affects employee efficiency, health and safety, loyalty, and the detrimental impact of employee behaviour, which is anything from profit erosion to business failure. In simple terms, there are three levels of severity of the impact that people risk can have.

At the lowest level, people risk covers possible events which would, in the short term, reduce profitability, share value or credit rating. At the second level, risk events may have a negative impact on the organisation's wealth or reputation in the long term. The worst case scenario would be to bring about the eventual collapse of a business due to conscious or unconscious actions of one or more employees.

Types of People Risk

Employees must be managed effectively as they have a high impact on business profitability. The success of human resource management can be measured by absenteeism rates (staff constraint), labour

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turnover (staff constraint), accident rates (health and safety), productivity (management), quality of finished goods (management), and customer satisfaction (management). Having said this, people risks are actually broader than just efficient use of employees, and often result from HR management practices like late payment of wages or salaries, not adhering to statutory or regulatory requirements, staff constraints, dishonesty, corporate culture which does not cultivate risk awareness, risk management, or poor health and safety practices.

Staff limitations occur *either* when companies cannot fill critical positions because of shortages in specific trades or professions (salary and other incentives not drawing new candidates) or when staff retention is poor, causing business disruption. Incompetence becomes a problem when employees lack the level of skills and knowledge to do their jobs properly. The absence of professional training and development would cause human errors. Fraudulent activities, such as theft can be attributed to dishonesty within a company. Legal steps may be taken against companies when employees discriminate against an individual in terms of their age, sex, race, colour, religion, national origin, or disability, either during the recruitment processes or selection of staff for promotion, transfer, or bonuses.

The frequency with which employees miss work will directly impact an organisation, and will incur direct costs and reduced productivity. A corporate culture that does not actively promote risk awareness or encourages making profit, with no regard to the methods used to make them, can result in negative employee behaviour.

Health and Safety

Risk due to health and safety-related issues affect all businesses. These risks can be extensive and the direct and indirect costs to businesses have been calculated at about 3.8% of the market value of the 500 largest EU and US companies that are at risk from these issues. Of this, 2.4% is internal risk (reviewed in this unit) and 1.4% is risk to market value as a result of risk to the public and customers.

The 2.4% risk to value is attributed to:

- Internal health risk at 0.7%;
- Internal workforce safety risk of 0.5%; and
- Historical health liabilities risk is an average of 1.2%.

Maintaining a Health and Safety Management System

The company should develop increased awareness of its legal liabilities for the health and safety of its staff. In doing so:

- It will help keep ahead of legislation and regulators.
- Stakeholder, staff, community and customer relationships will all improve.

Categories of Health and Safety Risk

The health and safety priorities are viewed as management of the risks associated with the following:

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- Chemical substances, carcinogens, and asbestos;
- Stress, overload and pace of work, psychological factors, and poor workplace relations and management;
- Communication of information on hazards;
- Ergonomics, repetitive work, and musculoskeletal problems;
- Organisational and safety and health (quality) management issues;
- Preventive occupational health services, and health promotion; and
- Unforeseen impacts from using new technology.

The following types of health risks pose a threat to organisations and their staff:

- AIDS/HIV;
- Asbestos;
- Asthma;
- Back pain;
- Beryllium;
- Biocides;
- Carcinogenic materials;
- Drugs and alcohol;
- Electromagnetic radiation;
- Environmental health issues;
- Latex allergies;
- Lead exposure;
- Lung diseases;
- Musculoskeletal disorders;
- Neutral toxicity;
- Noise;
- Office-based illnesses, like computer and irritable desk syndrome and passive smoking;
- Radiation;
- Risks to new and expectant mothers;
- Skin damage;
- Work stress;
- Vision impairment; and
- Vocal damage

Examples of high workforce health risk by sector include the following most dangerous jobs from the point of view of carcinogenicity:

- Agricultural workers and chemical exposure;

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- Asphalt roofers;
- Cutting/sewing workers;
- Glass and ceramic decorators;
- Tobacco industry;
- Insulators;
- Metal platers and coaters;
- Hairdressers and barbers;
- Telephone installers;
- Wholesalers; and
- Sculptors and painters

HRM Practices

Previously personnel management was seen as the selection, recruitment, and development of company personnel.

HRM seeks to use the personnel policy to improve or sustain an organisation's competitive advantage with policies in areas like employee resourcing, employee development, employee relations, and rewards within a broad strategic plan for the people part of the business. Analysts are unclear if this paradigm shift was global. What is clear is that organisations adopt different human resource management strategies according to the threats and opportunities they face in their business environments (Tyson and York 1996). No single model of personnel management can fulfil all business requirements.

An organisation's HRM practices need to adapt to the changing environment so that they can contribute towards their organisational goals. HRM can contribute by improving working conditions to enhance job satisfaction, develop and train employees, maintain harmonious relationships and ensure fairness of rewards. It can also help reduce threats to the company, such as low productivity, unfair dismissals, absenteeism, accidents and social abuses, such as bullying, stress induced by unrealistic workloads and sexual and racial discrimination.

Ability to Pay Salaries

Employee remuneration requires an evaluation of the suitability of the risk indicators and their ability to provide accurate and timely information on which management can act. Liquidity impacts the ability to pay salaries. The salary burden must be balanced against the present and projected income and staff numbers.

Regulatory and Statutory Requirements

Contracts

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When one person employs another to perform a particular task as part of their business in a manner that they dictate, a contract of employment comes into existence. The standard principles of the law of contract apply. Therefore, in a contract of employment, there must be an offer and an acceptance, which constitutes the agreement. There must be an intention to create legal relations, consideration, capacity, and consent of the parties. There should be no mistake, misinterpretation, duress, or undue influence. Additionally, the contract must be legal and comply with legislation.

Maternity

Under the ERA, a pregnant employee who has made an appointment for antenatal care, on the advice of her doctor, midwife or health advisor, must be given paid time off. An employer, who is unreasonable and does not afford the employee these rights, can be taken to a tribunal by the employee. However, this must occur within three months following the employer's refusal. Employees with two or more years' service, may take maternity leave from the eleventh week before the birth, with the right to return up to 29 weeks after the birth, with Statutory Maternity Pay (SMP) payable for 18 weeks plus paid time for antenatal care.

Discrimination

Discrimination is prohibited in reference to those protected regarding recruitment, pay and benefits, promotion, training, terms and conditions, transfers, dismissal, action short of dismissal, or any other detriment.

Whistle Blowing

Whistle blowing is the practice of an employee metaphorically blowing a whistle, drawing the attention of people outside of the business to some form of unethical practice inside the business. Employers need to take into account this relatively new form of influence on management.

Previously this was done by individuals taking a personal risk with their employment. After the enactment of the Public Interest Disclosure Act of 1998, workers who *blow the whistle* about any irregularities within their employer's organisation are protected as far as the *umbrella* of the Act extends.

In addition, employees who are *protected* by the provisions may sue for unfair dismissal if they are dismissed for making a protected disclosure. A qualifying disclosure will be a protected disclosure where it is made to the worker's employer or to a person whom the worker reasonably believes to be solely or mainly responsible for the relevant failure.

Certain types of disclosures qualify for protection and are termed to be *qualifying disclosures*. Qualifying disclosures are disclosures of information which the worker reasonably believes show that one or more of the following issues is currently taking place, took place previously or is likely to happen in the future: a criminal offence, the breach of a legal obligation, miscarriage of justice, danger to health or safety of any individual, damage to the environment or the deliberate concealment of information tending to show any of the issues just referred to.

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Dismissal

Dismissing a staff member is never just about managing one person. Approaches to dismissal are part of a corporate culture and can change the behaviour of the remaining staff and in the wider context, if a trend emerges, can increase or decrease the attractiveness of the business for potential employees. The risk faced by any employer in firing a member of staff occurs for not observing the legislation relating to wrongful and unfair dismissal.

Any employee may claim that they were wrongfully dismissed in a common law action for breach of contract in the civil courts or in an industrial tribunal. This is applicable where the employee claims that the employer did not dismiss them in accordance with their contract. One example of this type of claim is where the employer fails to give proper notice as required in the contract. The amount of compensation or damages awarded is normally intended to place the employee financially in the position in which they would have been, had the wrongful dismissal not taken place.

The grounds for categorizing a dismissal as being unfair, as defined by the Act, include: employees taking or seeking maternity, paternity or adoption leave, requesting flexible working arrangements, seeking to assert a statutory employment protection right, taking or proposing certain types of action on health and safety grounds, and performing or proposing to perform duties relevant to their role as an occupational pension scheme trustee, etc.

Recruitment

The recruitment process will directly affect the quality of the staff employed, retain existing valued client relationships (and associated repeat business) and staff retention. A direct correlation exists between recruitment and the success of a business. The key aspects of recruitment are: recruiters, job analysis, job descriptions, interviews, selection, induction, and integration.

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Assessment

Total Marks: 20

1.	What is the relationship between 'Uncertainty' and 'Risk'?	5
2.	Define 'operational risk management'.	5
3.	Explain the factors on which the operational risk management depends	5
4.	Discuss in details the risks associated with people in a business?	5

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