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MITIGATING CORPORATE RISK IN THE BUSINESS WORLD

Maryam Abdu, Ph.D.
Associate Professor, Head
Department of Business Administration
Faculty of Management Sciences
Kaduna State University, Kaduna

INTRODUCTION

The global financial crises which started in the United States and spread all over the world had a devastating effect on economies and business. The crises came unexpected and at a time when some businesses were beginning to grow, and some economies were beginning to record positive results. Businesses that were able to survive the economic meltdown made their strategic plans to cover risks associated with such markets, hence the effect of meltdown did not affect them greatly. The generality of the corporate world was however affected by the meltdown. Companies operate with the view to grow in size or market share and maximize on their profits. Profit maximisation and growth to a larger extent guarantees the survival of the company and the survival has to be well augmented with strategies that mitigate risk. Risk therefore becomes an important factor for companies to take into consideration when running their organisation.

Risk defined in simple terms is the uncertainty about the effects or implications of what will happen given the outplay of an event. Fischhoff, Watson and Hope (1984) expressed their views on risk to be one which is fraught with confusion and controversy, as there is no one definition that is suitable for all problems. As risk looks at actions or choices made to take a decision, organisations are mindful as to the level of choices they make so that any inherent loss can be minimised as much as possible. Risk therefore is a concept of choice.

The theory on risk explains the decisions people make when they are faced with many combinations of many situations. Decisions are predicted based on the success hinged on the outcome. Insurance companies whose success depends on the frequency and magnitude of claims use risk theory to determine their exposure to risks (DeLee, 2014).

KINDS OF RISK

There are different kinds of risks categorised into different sectors according to their peculiarity. In investment activities risk is categorised into Systematic and Unsystematic risk. Verma (2021) categorized the kinds of risk into business risk, non-business risk or financial risk.

a) Systematic risk

Systematic risk is one which is inherent in the market and known as undiversifiable risk, volatility or market risk. This risk affects the overall market as against a particular stock. This kind of risk reflects on the impact of economic, geo-political and financial factors. Systematic risk is one which is unpredictable and impossible to completely avoid (Chen, 2021).

b) Unsystematic risk

Unsystematic risk is unique to a given business or industry. It is known as specific risk, non-systematic risk, residual risk or diversifiable risk. Unsystematic risk is usually caused by internal factors, so it can be avoided, controlled and minimised by diversification (Bhavana, 2021). Unsystematic risk is risk associated with asset or company specific uncertainties.

c) Business risk

Businesses can experience risks arising from operations. This is most common and efforts should be made to mitigate it. Example of a business risk is

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when a company undertakes a high cost in marketing or introducing a product so as to get a market share. The risk element is not knowing whether the product will be a success in the market or not. Ideally when such happens, companies are expected to have conducted a research on the viability or acceptability of the product in the market.

d) Non-business risk

Non-business risk arises out of risks that is not in the control of the business. Such risks include political risk, or risk arising from the imbalances of the economy.

e) Financial risk

Financial risk arises out of financial loses to the firm. Instability and losses in the financial market caused by movements in stock prices, currencies, interest rates and so on explains financial risk (Verma, 2021). Examples of financial risk are market risk, credit risk, liquidity risk and operational risk as illustrated in figure 1.

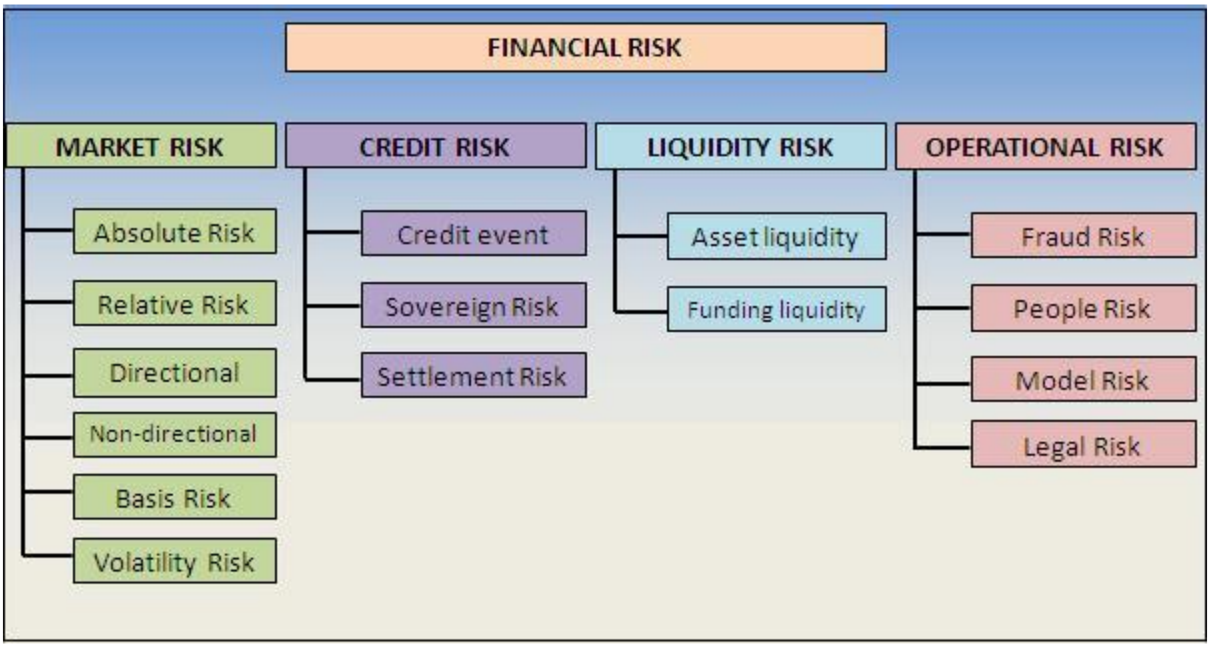

Figure 1: classification of financial risk
Source: Verma (2021)

- Market risk.

Market risk is risk arising as a result of movements of financial instruments in the market. These movements are further explained in the direction the risk is being experienced which could be absolute, relative, directional, non-directional, basis or volatility. When it is directional, it could be as a result of movements in stock prices, fluctuations in exchange rates or movements in interest rates. Market risk can also be systematic and uncertain and whatever risk experienced measures should be taken to mitigate the risk.

- Credit risk occurs when one is unable to fulfil obligations.

This type of risk according to Verma (2021) is further classified into sovereign risk and settlement risk. sovereign risk may happen as a result of difficult foreign exchange policies and settlement risk when one party makes payment and the other party fails to fulfil the obligations.

- Liquidity risk

Liquidity risk according to Verna (2021) is risk associated with inability to execute transactions. Kenton (2021) further explains liquidity risk to be the ability of a firm, company, or even an individual to pay its debts without suffering catastrophic losses. This risk therefore stems from the lack of marketability of an investment that can be bought or sold quickly enough to prevent or minimise a loss.

- Operational risk

Operational risk arises as a result of operational failures, such as mismanagement or technical failures. Examples of such risk are fraud risk arising out of lack of controls and model risk arising as s result of incorrect model application (Verna, 2021).

Legal risk

Legal risk arises due to legal constraints and lawsuits. Whenever a company faces financial losses out of legal proceedings and lawsuits, it is defined as legal risk (Verna, 2021).

Other types of risk are inflation risk, investment risk, interest rates risk, policy risk, mortality risk, global risk and technology risk.

- Inflation risk are risks arising out of inflationary pressures. Such examples include prices of consumable goods which can affect one's savings in the short period.
- Investment risk arises as a result of or the likelihood of occurrence of losses relative to the expected return of an investment. Interest rate risk arises due to fluctuations and changes in interest rates.
- Interest rates directly affect investments especially in fixed deposit schemes.
- Policy risk arises due to changes in government policy such as economic conditions, labour market movements, country debt rates and so on. These changes affect liquidity and stock returns and government bonds.
- Mortality risk is a factor calculation where one's life span is estimated as long term and savings are made accordingly.
- Global risks are risks associated with international investments. As an investor one has to take into condition global risks like laws and policies, foreign exchange rates, natural disasters, terrorism and insurgencies and so on.
- Technology risk is one of the greatest levellers of our times. Companies and investors invest heavily in technology which is bound to change constantly as upgrades and innovations is a continuous process. Obsolescence in machines brings about changes in technology and risks in technology.

WAYS OF MITIGATING RISK

Once risks are identified and assessed, organisations have to devise a method or ways in completely avoiding it, eradicating it or accepting it with minimum losses as much as possible. Risk can be avoided when good policies are put in place. There are several ways in mitigating risk and some typical mitigating strategy actions that companies can adopt are explained as well as the on the risk in respect to action on likelihood, action on impact, and action on proximity are explained as follows:

1. Accept the risk

If the impact of the risk is low and with minimal impact on the business, the risk can then be accepted. Examples of risk acceptance with minimal consequences is when a company decides to take part in a risky activity, which while well managed and supervised is still risky. Going ahead with an event despite the risk of rain.

Effect on risk when the decision is to accept is:

- Action on likelihood – there is effect
- Action on impact – there is effect
- Action on proximity – there is no effect

2. Avoid the risk

Risk is avoided if the outcome has dire and with drastic consequences. Companies should avoid embarking on any activity where the outcome of risk is grievous and would affect the company negatively. Lock (2007) points out that this kind of action requires a complete abandonment and total cancellation of the project. Examples of such activity is a company abandoning a research and development project due to risks of finding a cost-effective alternative.

Effect on risk when hedging:

- Action on likelihood – there is effect
- Action on impact – there is effect
- Action on proximity – there is effect

3. Hedge the risk

Hedging the risk is used to manage financial risk. This risk is offset or limited by taking opposite positions in the market. An example of hedging a risk is where a company is exporting a forward contract with the bank and decides to exchange a certain amount of foreign currency so as not to lose out because of currency fluctuations.

Effect on risk when hedging:

- Action on likelihood – there is no effect
- Action on impact – there is effect
- Action on proximity – there is no effect

4. Provide a risk buffer

In this situation, the impact of a risk is reduced when an alternative is made available. Example of such is where a manufacturer keeps a stock of raw materials in case a supplier is unable to deliver a shipment on time.

Effect on risk when providing a risk buffer:

- Action on likelihood – there is no effect
- Action on impact – there is effect
- Action on proximity – there is no effect

5. Share the risk

Here when sharing a risk, the impact or liability is shared between or among the various departments.

Effect on risk when sharing:

- Action on likelihood – there is effect
- Action on impact – there is effect
- Action on proximity – there is no effect

6. Find options or alternatives

Here, the risk is mitigated when alternatives or options are identified. Example of such a situation is constructing a power station that has the option of either using gas or oil to mitigate the risk of increases in cost of gas or oil.

Effect on risk when finding options or alternatives:

- Action on likelihood – there is effect
- Action on impact – there is effect
- Action on proximity – there is no effect

7. Transfer the risk

When transferring risk, some or all aspects of the risk are transferred to another party. This is mainly done through insurance or other contractual obligations.

Effect on risk when transferring the risk:

- Action on likelihood – there is no effect
- Action on impact – there is effect
- Action on proximity – there is no effect

8. Defer the decision

Deferring the decision here means to delay taking a decision on a particular approach until more data are gathered or until when the company is willing to embark on the project.

Effect on risk when deferring the decision:

- Action on likelihood – there is no effect
- Action on impact – there is no effect
- Action on proximity – there is effect

9. Limit or reduce the risk

Here, safeguards are put in place to limit or reduce potential impact of risk or the likelihood of the risk occurring. Example of such is when authorising expenditure on phases rather than on the whole project.

Effect on risk when limiting or reducing the risk:

- Action on likelihood – there is effect
- Action on impact – there is effect
- Action on proximity – there is no effect

10. Create a plan B or a contingency

Here another plan is put in place in case the risk deployed in one plan is high.

Effect on risk when creating a plan B or a contingency:

- Action on likelihood – there is no effect
- Action on impact – there is effect
- Action on proximity – there is no effect

RISKS WHICH BUSINESSES ARE EXPECTED TO PLAN FOR

Boitnott (2019), identified the kinds of risk which businesses are expected to plan for. These are economic risk, compliance risk, security risk and fraud, financial risk, reputation risk, operational risk and competition or comfort risk.

1. Economic Risk

As the economy is constantly changing, risks are associated with such changes. Market fluctuates some with positive consequences, and others with negative consequences. Some economic events might bring a boom to the business, whilst others a decline in business. To counteract economic risk, it is advisable that companies save as much as possible by maintaining a steady cashflow, and also operate with a lean budget with low overheads throughout the economic cycles of the business plan.

2. Compliance Risk

As businesses are faced with a lot of compliance laws, especially those affected by particular industries, it becomes advisable for companies to stay in line and in compliance with the laws they are operating in. Non compliance will amount to fines and penalties which will affect business. Companies therefore have to be vigilant in tracking compliance and reviewing government agency information and seeking assistance where necessary.

3. Security Risk and Fraud

As the world is witnessing a lot of fraud, internet and on-line fraud and other security challenges, it becomes important for organisations to protect themselves against such fraud. Data that is shared on the internet, identity theft and payment fraud all illustrate how such risks affect businesses. Not only does risk impact on trust and reputation, in some instances companies could be liable for data breeches. To achieve enterprise risk management and security solutions, fraud detection tools and employee and customer education should be adopted and implemented to safeguard organisations against fraud.

4. Financial Risk

Businesses as explained earlier are prone to financial risks. This involves credit extension to customers company debt overload, interest rate fluctuations and so on. Businesses have to make adjustments in their plans that will avoid harming cashflows or creating unexpected losses. It also becomes important not to rely on one source of income but diversify so that other channels of incomes can be enjoyed. To keep debt to a minimum, plans that will lower debt load is also encouraged.

5. Reputation Risk

Sometimes, companies experience negative publicity which affect their reputation as a result of unhappy customer utterances, product failure, negative press or lawsuits. All these affect company reputation and brand name. One tweet or bad review can bring about a drop in sales and customer patronage which could bring losses to the organisation. It becomes important for businesses to be prepared to address such problems that may arise and keep quality at the top. This will help in avoiding lawsuits and product failures which could damage a company's reputation.

6. Operational Risk

Business risks occurs both internally and externally as a combination of factors can cause businesses to encounter losses. Unexpected events, power outages and cuts, technical problems and so on. Operational risk can have an impact on the business and affect the company in several ways including finance, time, reputation. The business needs to provide a means of how to address this problem and also establish proactive measures and a backup plan as measures to ensure that operations are not affected.

7. Compliance or Comfort Risk

As competition is always in the industry, it can be easy for businesses to miss out on what competitors are offering that may appeal to customers in the market. Businesses have to keep abreast of events and ensure that they are always ahead. It therefore becomes important for businesses to continuously reassess performance, refine strategy, maintain strong interactive relationships with their customers.

FINANCIAL RISK OUTLINES TO MINIMISE ON RISK AND REDUCE BUSINESS RISK

It becomes mandatory for companies to device mechanisms on how to minimise risk or reduce the risk as much as possible. In the good interest of ensuring the survival and success of businesses, policies put in place must be one which is healthy and can guarantee continued operations with minimum risk. The following techniques and outline are part of measures to be taken in order to avoid putting businesses in difficult situations.

1. Never under-price your solutions to get a market share as this move may likely result to the inability of the business to break even.
2. Do not hire or employ until the company has the funds to do so, as resisting to hire employees without funds could spell problems for the business.
3. Do not borrow money that is not needed, as this will amount to incurring more debt for the business.

4. Do not depend on just one source of revenue. Diversification is business wise and sense. Revenue base will be widened and more enhanced.
5. Do not fill too many overhead positions as it will decrease the company's return on investment (http://tolmanandwiker.com/5-financial-risks-every-business-avoid/).

CONCLUSION

As risk is inherent in business, it is important that organisations should devise means and way in mitigating risk. Businesses have experienced bankruptcies and losses as a result of risk neglect. All businesses are affected with one risk or the other but the severity of risk associated has to do with the manner in which the organisation prepares and handles the risk. As the business world is now a global village, it becomes important and paramount that organisations plan ahead and take measures to cushion the effect of losses arising out of neglect in risk mitigation.

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