

## **Making risk management a priority**

*by Lynette Khoo*

### **Companies need to allocate more resources to cope with risk and "black swan" events**

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RISK management has been brought to the fore since the financial crisis. Once considered a brake on growth and seen to compete with revenue-generating resources, there are now greater concerns that poor management of risks could lead to corporate collapse.

But companies are not living up to this awareness and have not allocated sufficient resources to manage risks, industry observers say.

"In most organisations, there is a fundamental mismatch between risk exposures and risk management resource allocation," says Ng Siew Quan, Risk & Control Solutions partner at PwC Singapore. He notes that risk management resources are also not proportionally allocated to where they should be.

"According to some estimates, the risks leading to 60 per cent of 'rapid losses' (drop in shareholder value by one-half within one year) experienced by Fortune 500 and FTSE 100 companies are strategic in nature. Yet, the majority of risk management resources tend to be focused on operational, financial, and compliance risks."

#### **Current state**

A KPMG Enterprise Risk Management (ERM) survey of 203 companies in Singapore last year found that about half of the respondents have implemented an ERM programme, while 27 per cent of the respondents intend to do so within the next one to three years.

Unsurprisingly, the survey shows that ERM implementation is a function of ownership and size. About 73 per cent of companies with more than \$2 billion annual revenue have implemented ERM, while only 26 per cent of smaller companies with less than \$50 million annual revenue have done so.

Among public listed companies surveyed, 59 per cent have implemented ERM, compared to 45 per cent of private companies.

But the KPMG report noted as "alarming" that 20 per cent of the public listed companies without an ERM programme were not planning to implement one at all.

These findings seem to mirror a global trend apparent in a global risk management survey by Deloitte & Touche conducted in Q3 last year. It similarly found some 52 per cent of respondents having a ERM programme and another 27 per cent in the process of implementing one.

"There is too much conservatism with short-term bias", particularly in the East and emerging markets, says Aubrey Joachim, immediate past president of Chartered Institute of Management Accountants (CIMA) and the institute's spokesman for Asia-Pacific.

Mr Joachim notes that companies are generally not equipped to manage new business risks that have emerged in this post-financial crisis era. He believes the biggest risks facing companies now are "strategic risks", which refer to adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes. In this context, management accountants need to understand the strategic factors driving the company to build sustainable growth, he adds.

#### **Risks and black swans**

Other business risks that have also grown to be more pertinent post-financial crisis include increased volatility in asset prices and commodity markets, legal and regulatory changes, rapidly shifting demographic patterns that result in talent shortages, rising labour costs, as well as fraud.

There are also emerging risks or the so-called "black swan" events – which are high-impact, hard-to-predict and rare events beyond the realm of normal expectations. They tend to be global large-scale events or circumstances that

go beyond one's capacity to control, but are likely to have an impact on multiple parties across geographic borders, industries and sectors.

These could take the form of natural or man-made disasters, political crises, and terrorist threats. Companies that ignore the possibility that calamity might strike, often without warning, run the peril of major losses when it does.

A case in point is how civil unrest in Libya affected Singapore-listed **Boustead**, which incurred heavy provisions for two projects in the war-torn country. This sank the group into the red, with a net loss of \$1.05 million for the fourth quarter ended March 31, 2011.

**Boustead** vice-president of corporate marketing and investor relations Keith Chu says the incident has made the group put in place more measures to assess country risk versus commercial risk and to have contingency plans to tackle similar emergencies should there be further upheavals in countries in the Middle East and North Africa region.

"Thankfully, we used our best efforts to evacuate all 31 **Boustead** staff from Libya right at the beginning of the civil war and were one of the first foreign companies operating in Libya to get all our staff out of the country," Mr Chu recalls.

Another company faced with an event of a catastrophic nature recently was OCBC Bank, whose office in Tokyo was affected by Japan's March 11 earthquake. But the bank managed to move seven local employees and their families from Tokyo to Fukuoda as part of its business continuity plan.

As emerging risks show up more prominently on the radar of companies, they need an efficient system to actively identify and assess such risks, devise strategies to minimise the impact and regularly monitor changes in exposures.

"The uncertainty over a sustained recovery in the US, lingering Eurozone debt concerns, rising commodity prices and interest rates in Asia, have continued to reinforce the importance of risk management," says Keppel Corp general manager for group risk management, Tina Chin.

With climate change resulting in more severe storms, floods and harsh winter conditions in many parts of the world, Keppel "continues to scan for possible threats and establish plans

through Business Continuity Management (BCM) to enhance operational preparedness", Ms Chin adds.

The goal of the BCM, she explains, is to put in place robust business continuity plans to ensure that Keppel can respond seamlessly to external events while minimising operational disruptions. Last year's focus, for instance, was on building resilience against events such as pandemic flu, IT downtime and power outage.

As a conglomerate with an international network, another major risk facing Keppel Corp is currency risk as it has receivables and payables denominated in foreign currencies like the US dollar, European and other Asian currencies.

To hedge its currency risk exposure, the group uses forward foreign currency contracts but does not engage in currency trading. The group also maintains funding flexibility by ensuring that ample working capital lines are available at any one time, and adopts stringent procedures on extending credit terms to customers and monitoring of credit risk.

A Singapore Telecommunications spokesman notes that since the global financial crisis, financial markets have become more volatile and this has resulted in a reduction in available financing and a higher credit spread for many organisations and financial institutions.

But this risk is mitigated at SingTel through having a strong investment grade rating (Aa2 by Standard & Poor's and A+ by Moody's), diversified funding sources, sufficient committed bank facilities and a prudent debt maturity profile.

"Beyond funding risks, we are also conscious of risks as a consequence of our relationships with business partners, customers and suppliers - in matters such as their financial solvency and governance," says the SingTel spokesman. "We mitigate these risks by ensuring we have diversity and limit single partner dependency."

### **Oversight role**

Since the fallout of the financial crisis, audit committees and board members are under increased pressures to identify and manage risks. The benefit of having strong reporting lines to the management and to the board ensures that issues on risks get adequate attention at the highest levels of the organisation.

The 2010 KPMG survey noted that more companies in Singapore are appointing people to dedicated risk management roles. Almost 40 per cent of the respondents delegate the oversight role to a risk management committee at the board level, 31 per cent to the board of directors while 24 per cent assign the role to the audit committee.

Only 6 per cent of the respondents indicated that they have not clearly defined or attributed the ownership of risk management oversight. This is a significant improvement from the 2006 survey, where only 30 per cent of the respondents that implemented ERM programme have an oversight committee.

At SingTel, there is a board-level risk management committee, which reports to the board via a sub-committee - Finance Investment and Risk Committee.

Similarly, Keppel's Board has overall responsibility for risk oversight and is assisted by the Board Risk Committee (BRC), comprising three independent directors, including the chairman.

Ms Chin notes that risk management is an integral part of the strategic, operational and financial decision-making process at all levels in the Keppel group. To inculcate risk awareness, the group conducts workshops to train management staff to better manage risk and undertake regular communication through forums and in-house publications.

"In addition, embedding risk management in the performance evaluation process helps to raise risk accountability and reinforce a risk-centric culture in the group," Ms Chin says.

Deloitte also observed in its 2010 report on global risk management survey that risk management goes beyond models and methodologies.

Organisations need to create "a culture that places a value on appropriate risk-taking", it says. This is why companies may start paying more attention to how they can incorporate risk management into performance goals and incentive compensation decisions.