ACHIEVING ORGANISATIONAL EFFECIENCY THROUGH RISK MANAGEMENT

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ABSTRACT

Definitions of risk are very wide and it is usually defined or determined according to the environment or situation. The main definition of risk is the possibility of loss due to different hazards. There are physical hazard and moral hazards. Every department is exposed to numerous risks, as risk is well known of its existence in all conditions. Those risks that can be insured could be transferred to the insurance company or managed by the risk management department. But there are still those risks, which are uninsurable and normally related to moral hazard. The functions of risk management department are wide but due to certain factors its operation is quite limited. They are more towards handling of major risks. The main problem now is to identify what are those risks faced and how does each department response to these uninsurable risks. The main focus is to measure the understanding and awareness of the organisation and on the issue of risk management and how they perceived risk. However, the main purpose is to emphasize on the degree of impact of effective risk management process which is practised by or within the departments in relation to their behavior, mindset, level of acceptance, decision making and motivation. These are subjective elements that support the risk management process. Control of risk can help minimize the probability of loss and interruption. It also helps in enhancing the business development towards a success.

INTRODUCTION

Organisations are in the business of placing capital at risk in pursuit of ventures, which are uncertain. This includes financial institutions, governmental bodies, corporations and non-profit organisations. They all have goals, and they allocate resources to pursue them. Because all organisations face uncertainty in achieving their goals, they all face risk.

The risk does not only come from derivative instruments. It arises from the many sources of leverage, which are available today. These include derivatives, reports, securities lending and structured notes. Such tools have increased liquidity in the markets and enable institutions to efficiently manage many of their risk exposures. In the wrong hands, however, they can devastate an organisation. The problem is not the financial tools, but the people who sue them. While many financial tools are new, the problem of people acting fraudulently, or just irresponsibly, has always existed. In the past, risks were unrevealed, so trading losses were limited. They might cost few individuals their careers, but they would rarely make the newspapers. Today, people take the same types or risks, but they leverage them, and the losses burgeon.

Finally, organisations are embracing enterprise risk management because it makes good business sense. Today, they actively make the decision to change the way they take risks. They implement innovative procedures. They install new technology. They actively reshape their corporate culture to facilitate better risk taking Implementing an effective strategy of enterprise risk management is not easy, and for each organisation, it is different. There are, however, three fundamental elements which should comprise any risk management strategy: corporate culture, procedures and technology.

It is a fact that an organisation will only manage risk if its members want to manage risk. Regulators struggle with this everyday. They can force a bank to implement a multi-million dollar value at risk system. They can require and insurance company to implement hundreds of pages of procedures. But they cannot force an institution to effectively manage risk. It is individuals who decide whether or not they are going to manage organisational risk. Unfortunately, there is a big incentive for them to choose not to. The very sorts of behavior, which reduce organisational risk, entail significant personal risk. Risk management is about rocking the boat, asking questions and challenging the establishment. No one can manage risk if they are not prepared to take risk. While individuals' initiative is critical, it is corporate culture which facilitates the process. Corporate culture defines what behavior the members of an organisation will condone, and what behavior they will shun. Corporate culture plays a critical role in risk management because it defines the risks which and individual must personally take if they are going to help managing organisational risks. A positive risk culture is new which promotes individual responsibility and is supportive of risk taking.

Group decision making is bad risk management because no one is accountable. When a single person makes a decision possible with the help or approval of others that individual is personally accountable. His reputation is on the line, so he will carefully analyze the issues before proposing a course of action. In a positive risk culture, people question everything. Not only this identifies better ways to do things, it also ensures that people understand and appreciate procedures. No risk culture is perfect. Fortunately, few are beyond repair. The challenge of enterprise risk management is to honestly assess an organisation's culture, and then work to improve it.

LITERATURE REVIEW

The extent to how individual perceived risk is much depends on the understanding of subject matter and it occupies much literature, which is full of competing views. Bannister et. al. (1981) describe that risk has been part of man's whole history on this planet. For our Stone Age predecessors, risk could be seen in terms of wild animals, failure of food supply, lack of food for other reason, loss of dwelling through catastrophe, or attack by other men or group of men. Those hazards are still with us today, although in different forms.

Dickson (1991) wrote that risk exists whenever the future is unknown. Because the adverse effects of risk have plagued mankind since the beginning of time, individuals, groups, societies have developed various method for managing risk. Since no one knows the future exactly, everyone is risk manager not by choice, but by sheer necessity. Dickson also added that most human activities involve some risk and uncertainty. This pervasiveness of risk can be illustrated such as placing of new product on the market or purchasing a new plant may prove to have been an unwise business decisions; a gambler may lose on a particular bet; increasing use of technology may affect the social structure of our population in some unpredictable and unfortunate ways; because of a new stature or court decision, certain persons may unexpectedly become guilty of violating the law; a hopeful suite may receive a negative response to a proposal; certain forms of exercise may damage as middle-aged hears; and the action of one nation may cause another response with overwhelming force.

The understanding of the behavioral aspect or pattern in the business organisation is very important. Crockford (1991) clearly discusses that knowledge of what the workforce feel about risk could also be useful in terms of how the company should promote safety training and education. If we have some idea of how the workforce perceived risks within the workplace, then, this could give positive guidance to the risk manager for his overall approach to safety education

Drucker (1973) stressed that to try to eliminate risk in an enterprise is futile. Risk is inherent to the commitment to present resources to future expectations. Indeed, economic progress can be defined as the ability to take greater risks. The attempt to eliminate the risks, even the attempt to minimize them, can only make them irrational and invariable. It can only result in that greater risk of all: rigidity.

Further discussion was made by Crockford (1976). In his compilation of papers in risk management, Crockford explained that risk management, as an integrated procedure, is still much more often talked than practiced. However, there are encouraging signs that cooperation is replacing competition between some at least all those responsible for the practical implementation of various aspects of risk treatment. Risk management stand at the place where all the many specialisations which are mentioned meet. It must, however, seek to elevate itself into a new specialisation; for this would be merely to repeat the errors of the past. Risk management must always be a linking function ready to learn form the expertise to other fields where it may have fresh application. Above all, it must preserve its view of risk as a whole and resist any attempts that may be made to treat any particular aspect of risk as a special case calling for entirely different treatment.

ADAPTING RISK MANAGEMENT AGAINST ORGANISATIONAL CHANGES

Every organisation should have procedures for changing procedures. Because procedures become outdated over time, it is easy for organisations to change how they operate without formally recognising that the change is taking place. Informal practices evolve out of habit, instead of a deliberate process. Because they may be adopted out of necessity or convenience, without considering how they impact organisational risk, they too are a source of risk. Whenever procedures do not exist, there is increased potential for

disagreement, misunderstanding and conflict. A lack of procedures increases the personal risk that individuals must take if they rare going to manage organisational risk. Accordingly, a lack of procedures tends to promote inaction. Effective procedures, on the other hand, empower people. They lay out specifically what people should do and what they should not do in a given situation. By reducing uncertainty of individual risk, they can promote action.

Institutions should manage their information flows with the assumption that individuals will attempt to corrupt or undermine the process. Automation can play a valuable role by eliminating opportunities for manual intervention in such processes as deal capture, confirmations, reporting and funds transfers. This, however, is just one benefit of automated data management. Even without fraud or human error, data management has always been a bottleneck for enterprise risk management. Managing such risks as an organisation's total yield curve exposure, or its total credit exposure to counterparty is impossible without comprehensive information about those exposures. Before an organisation can attempt to manage risk on an enterprise wide basis, it first must collect and communicate all necessary information relating to those risks.

In the past, organisations have had limited ability to do this. They have faced too many different and complex risks, and professionals have had no convenient means of communicating exposures across and organisation. In the past, this problem prevented organisations from managing risk on an enterprise-wide basis. Instead, each desk or each department would be given broad authority to manage those risks, which arose from its own operations. Instead of having each professional managing the specific risks for which he or where was best qualified, individuals were called upon to be generalists. Each would manage multiple risks. In this environment, each desk would be five its own credit risk limit for each counterparty and its own market risk trading limits. In order to mange risks, organisations need to be able to measure those risks prospectively. They need to know based on their positions today, how mush risk they are actually taking. This is a difficult question to answer. Clear distinction should be made between risk management and risk taking. Risk management oversees and ensures the integrity of the process with which risks are taken. To maintain objectivity, risk management cannot be a part of the risk taking process. Individuals who manage risk need to be completely independent from individuals who are responsible for taking risk. Risk management is a complex and multifaceted process which varies from one organisation to the next. It should be viewed as an ongoing process which needs continual oversight, planning and modification as needs evolve.

IMPORTANCE OF RISK MANAGEMENT

Risk management helps the company to reduce cost and disruption. An effective risk management provides a benchmark for decision-making process of which risks are worth pursuing and which should be avoided. Risk applies to all businesses, but some are more likely than others to benefit from formal risk assessment. Risk issues should be discussed as a main heading for the company future prospectus as to avoid any future catastrophic losses. Risk management is particularly necessary for the company business because it involves construction activities in number of different sites. Some of the businesses are mega projects, which involve a large amount of money. Any threats to the projects will absolutely generate high losses.

There are other reasons for the management of the company to seriously practised risk management. All risks swung between catastrophe and the daily small but request incidents. The former cannot be predicted, wither in time or extend, whereas the latter can be predicted and, therefore, budgeted for. They both fall within the framework of risk economy. Sometimes small incidents are high in frequency, but the consequences of each one are small, often ineligible. It is sometimes treated as part of the daily operations. Experience has shown that some of the small risks might end up delivering huge losses. This can, in turn, lead to unplanned maintenance resources being put into repair work rather than into systematic preventive maintenance.

INPUT REQUIRES FOR ACCURATE RISK MANAGEMENT

Accurate risk measurement requires an aggregation of a firm's holdings, a description or model of how each position is affected by key factors such as interest rates or shocks to a particular industry, and a catalogue of possible values for key variable in the associated scenarios. Knowing the risks of a firm means understanding how liabilities and asses values are related to interest rates, industry return's and return to

size and growth factor, and also understanding the volatilities and correlation of these rates and return in the economy. It is simpler to sue the realised historical return of portfolios that to base aggregate risk analysis on the current holdings of individual portfolios. However, this can be very misleading. In general, risk management cannot rely simply on historical portfolio returns. Accurate risk measurement must consider the current holdings of portfolios and employee a dynamic model of the risks of those holdings.

The risk management process involves four steps: identifying potential losses, evaluating potential losses, selecting the appropriate techniques for treating loss exposures, and implementing and administering the programme. The first step in the risk management process is to identify all major and minor loss exposures. This step involves a painstaking analysis of all potential losses. The second step in the risk management process is to evaluate and measure the impact of losses on the firm. This step involves an estimation of the potential to the probable number of losses that may occur during some five-time periods. Loss severity refers to the probable size of the losses that may occur. The third step in the risk management process is to select the most appropriate techniques for treating loss exposures. These techniques can be classified broadly as either risk control or risk financing. Risk control refers to techniques that reduce the frequency and severity of accidental losses. Risk financing refers to techniques that provide for the funding of losses. Many risk mangers use a combination of techniques for treating each loss exposure. At this point, we have discussed three of the four steps in the risk management process. The fourth step is implementation and administration of the risk management program. This step begins with a policy statement. The principles of corporate risk management are also applicable to a personal risk management program. Personal risk management refers to the identification of pure risk faced by an individual or family, and to the selection of the most appropriate technique for treating such risk.

RISK AND HUMAN ATTITUDES

The whole area of risk and human behavior could well occupy an entire text but in this context we can confine ourselves to particular aspects: the attitudes to risk and how such attitudes can measure the role that risk plays in the decision making process and the behavior of individuals when working as members of a group. When we look around, we see wide variations in response to risk. There are those who voluntarily assume risk by, for example, participating in some dangerous sport, those who select a hazardous occupation and others who gamble regularly. On the other hand, some people rarely venture out of their armchair. They prefer sedentary jogs and insure everything in sight. In insurance jargon we think of people as being risk referrers or risk averse. In short we are all different. There is no one correct behavioral response to risky situations.

It is the case for private individuals then it is actually accurate for business. Some banks lend money on far riskier ventures than others. Some soul companies seem to exhibit more risky behavior in their drilling decisions than others; certain exporters transact business with countries where the risk element is high while other avoids such countries. This phenomenon exists and is easy to observe. When we turn our attention to risk management men the whole question of behavior in risky situations is brought into sharp focus. In risk management we see individual behavior combining with corporate behavior. From the individual's point of view, for example we see him or her faced with the risk of personal injury and having to decide whether or not to use the machine guard, the hard hat, the safety screen or the barrier cream. From the standpoint of the company, we see it responding to exactly the same risk but for different reasons. It is not only concerned with the personal injury of the employees but it must also consider the overall cost to the company of any risk materializing.

Behavior is the result of your attitude reacting with the environment as you see it. When the environment matches what we want to do, then, our attitude is a good predictor of behavior but in other cases, the person's perception of the environment may lead to some different form of behavior that that predicted solely by attitude. Knowledge of what a workforce feels about risk could also be useful in terms of how the company should promote safety training and education. If we have some idea of how the workforce perceives risks within the workplace then this could give positive guidance to the risk manger for his overall approach to safety education.

From the vast literature on measuring attitudes towards risk we can detect at least two broad methods emerging. It is extremely difficult, verging on impossible; to state that one person is a risk seeker and another risk avoider. The rest that can be achieved by most tests is a differentiation among people so that we can then say that one person is more of a risk seeker than another. The first method is based around a

concept known as the Standard Gamble and is concerned with measuring attitude to risk in a financial setting. The second category of measurement techniques, known as Perceptions of Risk, concerns more with measuring how individuals' perceive risk. The latter category of method is probably more important to risk management.

CONCLUSION

Risk management, therefore, sought from the art to bring together again essentially simple concept which had become complicated out of all recognition by its fermentation into separate disciplines, the practitioners of which each had a few interlocking parts of the jigsaw and believer they had the whole picture. Risk management is, thus, a special case of management, but all forms of management contain some degree of risk management. This explains why risk is important to be effectively managed. There might be some situation where we can predict but the prediction made is usually far from the real outcome. A company, for example, might forecast their sales but due to uncertain circumstances the sales might be different from the one forecast. It might become a loss. This is when risk management comes into action. Every part of the organisation is responsible in managing risk because each of them forms the organisation as whole.

Risk management has sometimes been described as applied common sense. The occasional major disaster that we see and hear everyday, including both violent and white-collar crime and the problems of avoiding political and social disruption nationally and at the level of individual enterprise, illustrates the problems. Risk management is a practical subject. It can be sophisticated and complicated but the starting point should always be a simple assessment of the problem and possible solution. It is a fact that risk does exist in almost all circumstances or situations only that it varies according to the situation and environment.

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