



Mitigating risks

The financial crisis gives Chinese enterprises a chance to improve risk management, writes *Wong Chae Sing*

The world is awash in an economic crisis and poor risk assessment is partly to blame.

Historically, risk management has focused on market, credit and operational risks. For banking institutions, this focus is also embedded in Basel II. But these risks are still being managed on a stand-alone basis and management is not paying enough attention to liquidity risk, a big one for banks.

Banks earn their profits from the spread in balancing assets and liabilities. A disconnect between asset-liability management and real-time risk monitoring has once again underscored the importance of adopting a holistic approach to risk management.

Risk management in China

During the past three decades, China has made tremendous progress towards becoming a developed economy. The Chinese government has issued various rules and guidelines in regard to risk management and internal controls to get financial institutions and state-owned enterprises in order. However, a lot remains to be done.

China's exposure to the global financial crisis has been limited, in part because Chinese banks do not rely on capital inflows or international borrowing for liquidity. But the Chinese economy, which is heavily dependent on exports, is facing unprecedented challenges. Coastal provinces such as Guangdong

have come under intense pressure – Guangdong recorded a 5.1 percent slide in exports last year. Comparatively, in November, China exports fell 2.2 percent nationwide, its first year-on-year decline in seven years.

As the economic downturn becomes more severe, corporate profits will level off. Export-oriented industries and small companies are facing tough times. The downturn will become more evident when migrant workers, whose labour forms the base of the global supply chain, return to the south after Chinese New Year. Premier Wen Jiabao has said jobs for displaced migrants and new graduates are a top government priority for 2009.

American and European banks are

selling their stakes in Chinese banks to raise capital to replenish their balance sheets. If this becomes a trend, it will challenge Chinese banks that have been planning to leverage on foreign partners for knowledge and technology transfers. However, since no business can afford to ignore China in the long run, foreign banks will continue to expand into the country and China will still encourage foreign strategic stakes in regional banks.

Turning crisis into opportunity

China can make use of the crisis to strengthen its competitiveness in terms of governance. Shareholders, employees and creditors alike recognize that things must change. Now is the time for leaders to reform their governance structures, create performance-driven cultures and strengthen risk management.

Successful risk management requires the full support of leadership. To ensure that, companies can form a risk management project team composed of managers from across the enterprise. The team should make specific recommendations to a risk management committee, which typically comprises executives who monitor risks.

Critics have recently cast doubt on the benefits of risk management, given the banks that failed had advanced processes and tools. But managing risks is not just about the tools; it is also about the right environment, ethics and culture, with top management setting the right tone and the risk appetite of an enterprise. A failure of leadership will almost always undermine even the

strongest risk management capabilities.

Board members have a fiduciary duty to reasonably assure the effectiveness of internal controls that manage the principal risks of the business. The board needs to know how risk management works, the extent of its authority and accountabilities, lines of reporting and escalation protocols, and the adequacy of process and tools to support risk management. The board must oversee strategies and decision-making, including explicit discussions with management regarding the enterprise's appetite for risk. Good board members challenge management's risk assessments and ask for explanations behind assumptions in strategic plans and likely outcomes if those assumptions prove wrong.

Good governance allows for thorough and regular discussion of risks and aligning risk management with decision-making. The risk manager should be able to challenge management's decisions.

Four steps

To capture China's special opportunities at this time, managers can consider these risk management steps, which can be tested first before being applied to the entire company:

- *Establish single risk assessment:* Outline a single risk assessment approach, a common language and uniform process.
- *Improve risk assurance:* Establish a governance and risk infrastructure, with proper checks and balances to analyze, prioritize and establish

accountability. The relevant managers should be given responsibility for addressing risks that have been identified and their progress should be monitored and reported. Meanwhile, internal auditors should independently assess the adequacy and effectiveness of the internal controls and share the results with risk managers.

- *Implement an integrated system for assessing, tracking and reporting risks:* Integrate risk management into strategic planning and decision-making. Encourage cooperation and communication between different departments to capture key risks and minimize the inefficiencies caused by narrow-focused, disparate processes. The system should allow for the tracking and reporting of risks and the status of remediation.
- *Continuous risk education:* Educate staff about the corporate culture and their individual responsibilities towards risks.

Strategy setting and budgeting for 2009 is a good time for companies to allocate adequate resources for assessing their risk appetite. Now is the time to assume leadership and be the "first mover" in risk management.

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