9

# STRATEGIC MANAGEMENT ACCOUNTING


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# Contents

# 8

# A Glance at Risk Management in India

M. SELVAM AND M. JEYAKODI

## INTRODUCTION

One of the problems in decision-making process is that it faces the dilemma of a trade-off at every stage. The 'Return' comes only after Risk'. If an organisation tries to increase its profitability, it runs the risk. It is a common phenomenon that every business is having a certain degree of risk due to internal and external factors. The plan of an organisation may be upset by the occurrence of unforeseen events. The factors which convert the certainty into uncertainty is called 'Risk'. This may be described as probability of an unexpected event which would result into financial loss.

## MEANING OF RISK

Risk could be defined as a danger, volatility of outcome or simple uncertainty. Risk is not simple incidence of adverse outcome. Unpredictable favourable outcomes are also a form of risk. Risk is an intermediate situation wherein a number of outcomes are possible.



## RISK MANAGEMENT TECHNIQUES

The techniques by which the risks are managed are called as Risk Management Techniques. Risk Management is nothing but commonsense, to organise, to plan, to manage the risk which, if not managed in the best way, could lead to adversity. It comes to be practised as a tool and discipline of management.

It is a known fact that risk management in India is in its infant stage; since last 6 years, with Government's liberalised economic policies, the importance of risk management has enhanced.

## OBJECTIVES OF RISK MANAGEMENT

The real objective of risk management is to reduce fear of the unknown and unexpected events and to create confidence in the future. The objectives of risk management of any organisation may be centered around the following aspects:

(a) Survival of an organisation,
(b) Efficiency in operation,
(c) Identifying and achieving acceptable level of worry,
(d) Earning stability,
(e) Uninterrupted operation,
(f) Continued growth, and
(g) Preservation of reputation.

## ELEMENTS OF RISK MANAGEMENT

Now it is easy to point out the various elements of risk management:

I. Identifying the Risk,
II. Evaluating the Risk,
III. Risk Control,
IV. Risk Retention, and
V. Risk Transfer.

These elements of risk management may be analysed further to establish its importance to modern business enterprises.

### I. Identifying the Risk

Risk identification can be stated as an art of combining formal information such as check lists, reports, personal inspections and interviews to locate the risks associated with a product. It also requires knowledge about an organisation, its market, the legal, economical and political and climatic environment. It consists of naming and defining each of the risk associated with a transaction. In short, risk identification helps in what could go wrong that could impact the business significantly.

### II. Evaluating the Risk

The next element in risk management is the risk evaluation which is the most difficult one. It is the estimation of the size, probability and timing of a potential loss. It consists of an assessment of:

(a) the probability of a loss occurring, and
(b) its severity.

It helps in knowing the causes and effects of risk; the causes may be product fault, fraud, over-ambition, fire, etc., while effects may be the changes in the share price, market share, public relations, management bonus, etc.

### III. Risk Control

The next important element in risk management is risk control and this includes avoiding, eliminating or reducing the chances of loss. In order to exercise effective risk control, considerable technical knowledge is required. The major alternatives available in risk control are:

- ❑ avoid the exposure,
- ❑ reduce the impact by reducing frequency or severity,
- ❑ avoid concentration in risky area,
- ❑ transfer the risk to another party, and
- ❑ employ risk management instruments to cover the risk.



### IV. Risk Retention

The risk of low severity and high frequency may be retained by the business enterprise after cost-benefit analysis. In the risk retention, internal financing through the following ways is of more significant:

- ❑ Charging of losses of operating costs as they occur,
- ❑ the formation and operation of internal contingency funds, and
- ❑ the formation and operation of captive insurance companies.

### V. Risk Transfer

It is the last element in risk management. Insurance is an important risk financing methods and is a form of risk transfer where the organisation transfers the risk to the insurer. It is a lost option of risk management.

Insurance may not be beneficial where:

- ❑ the risk has a very low loss potential, and
- ❑ even with high frequencies of occurrences, the loss severities are low.

## RISK MANAGEMENT IN INDIA

The attitude of Indian businessmen was unfortunate. They felt that Risk can't Happen to My Business", 'Whatever has to Happen will Happen to All", etc. This feeling has been slowly changing. It is no doubt that risk management in India is gaining increased importance and significance.

The Institute of Risk Management, U.K., has been conducting examinations in India through the Indian Institute of Insurance and Risk Management (IIIRM) for the past 7 years; the aim of IIIRM is to built up qualified risk manager in India. Further, once in two years, IIIRM conducts conference on International Insurance and Management.

In India, very few companies have full-fledged risk management divisions. With liberalisation and reforms in the insurance sector and with new entry of overseas companies in India, it is no doubt that competition will come to play in risk management and insurance buying will become more professional.

## CONCLUSION

The Indian risk management has a challenge to face during the 21st century. Good risk management is essential for good institution; the good institution is essential for profitable survival. A professional approach in the identification, measurement, control, etc., will safeguard the interest of any organisation in the long-run. It is no doubt that Indian risk manager will manage the challenges successfully in future.

9

# The Value-at-Risk (VAR): Methodologies and its Relevance to Indian Banks*

Satchidananda S. Sogala

Bank management today is essentially risk management. We need to measure banking risks. The Value-at-Risk (VAR) is emerging as an important tool for this purpose because this technique is able to summarize the risks of a bank across different positions and business segments in a single number; and also because it enables adjustment of the bank's overall risk level through continuous measurement. This versatile statistical approach is useful to the bank management for setting the overall risk target; for evaluating the performance of business units; for assessing risks of new investment opportunities; for making policy rules to guide investments, hedging and trading and for fixing risk limits for internal capital allocation. The VAR

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