

სამეწარმეო რისკ-მენეჯმენტი საქართველოში

ავალიშვილი-დე ბური მარინა
საქართველოს უნივერსიტეტი

თანამედროვე პირობებში, ბიზნესებს უწევთ სწრაფად ცვლებად გარემოში მუშაობა. ბიზნეს რისკები თანდათან სულ უფრო კომპლექსური, დინამიკური და მრავალფეროვანი ხდება. სამეწარმეო რისკ-მენეჯმენტის დადებითი შედეგების გათვალისწინებით, განვითარებულ ქვეყნებში კომპანიებში აქტიურად იწერება რისკების მართვის სამსახურები და მიმდინარეობს სამეწარმეო რისკების მართვის პროცესის სრულყოფა. საქართველოში ამ მიმართულებით სავალალო მდგომარეობაა და რამდენიმე ფინანსური ორგანიზაციის გარდა სამეწარმეო რისკების კომპლექსურ მართვას კომპანიები პრაქტიკულად არ ახორციელებენ. ამას ბევრი მიზეზი აქვს, რომელთაგან ნაწილი გამომდინარეობს ქართული კომპანიების თავისებურებებიდან, ხოლო ნაწილი ბიზნეს გარემოს სპეციფიკიდან. წინამდებარე სტატიაში განხილულია სამეწარმეო რისკ-მენეჯმენტის ძირითადი თეორიული საწყისები; გაანალიზებულია ფაქტორები, რომლებიც ხელს უშლიან სამეწარმეო რისკ-მენეჯმენტის განვითარებას საქართველოში; წარმოდგენილია რეკომენდაციები ორი მიმართულებით: თუ რა შეიძლება გააკეთონ თავად კომპანიებმა, როგორ უნდა განავითარონ შესაბამისი სამსახური და თუ რა უნდა გაკეთდეს ხელისუფლების მხრიდან, სასწავლო დაწესებულებებისა და არასამთავრობო ორგანიზაციების მიერ.

ERM in Georgia

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Businesses nowadays operate in an entirely different environment than in the past 20 years. Business risks became more complex, diverse and dynamic. Implementing Enterprise Risk Management (ERM) in this environment is no longer a choice. In the current economic climate, companies must be ready to respond to risks at all levels of their development. Enterprise risk management is a relatively new science. There is confusion about the meaning of enterprise risk management in different organizations and countries. There is no commonly used explanation of enterprise risk management, or a classification of enterprise risks and management process steps. It has been very difficult for companies and scientists to agree on a common language for the topic. Nonetheless, it is clear that an integrated enterprise risk management approach has many advantages and benefits and therefore companies recognise ERM as a critical management issue.

There has been a significant increase of interest in Enterprise Risk Management and many companies are in need for comparative benchmark data on ERM. Many international consulting companies study ERM issues and provide consultations about ERM issues to companies as an integral part of their services.

Several global surveys were conducted in the recent years, the most interesting of which are the following: (1) Delloite (2008), Perspectives on ERM and Risk Intelligent Enterprise; (2) AON (2010), Enterprise Risk Management Survey. Our comparison of these surveys leads to the conclusion that important drives of ERM development are often the same. The key reasons for ERM are in particular regulation, regulatory compliance and Rating agency/ financial institution requirements. Other drivers are unanticipated losses, best practice, improved performance and decision-making, CEO impetus, and external stakeholder pressure.

In Georgian companies, enterprise risk management is not developed because of a variety of external and internal factors. Studying Enterprise risk management is of crucial importance for businesses to increase companies' value for shareholders and the society. In the long term, a more active ERM planning in Georgia will have positive economic and social effects for a country in development.

Enterprise Risk Management Theory

The term “risk” has numerous explanations and it is important to separate it from uncertainty. Uncertainty is a lack of certainty that results from a lack of knowledge and the impossibility for measurement. *Risk is related to the potential change of the state (of any object including business) where some possible outcomes have an undesired effect or entail a significant loss.* Risk can be measured by using objective probabilities that are based on statistical and historical data and subjective probabilities that are based on persons’ experience, knowledge and expertise.

Risks are characterized by diversity. New risks emerge as a result of economic and technological development of the modern world. At the same time, very often the same risks are defined by different terms. Sometimes, it is extremely difficult to separate different types of risks from each other, as there is a close cause-effect relationship between them.

There are four major factors for the classification of enterprise risks: Scale, level of acceptance, economic content, and risk sources. We think that in terms of enterprise risk management, it is desirable to classify risks by their sources and we agree with the opinion that the two major sources of risks are the organization’s internal area and the business environment. Risk factors from internal sources include operational, financial, and technological risks. Risk factors from the business environment include economic, social, environmental, legal, political, and market characteristics. However, we deem it expedient to single out strategic risks as a separate risk group from micro risk factors.

Risk management was established as an independent science in the second half of the 20th century and each stage of its development was related to some great industrial disaster. Enterprise risk management is based on the traditional risk management concepts with one major difference, namely that enterprise risk management provides an integrated management tool of all enterprise risks.

Enterprise risk management is part of the organization’s management strategy that aims at reducing the risks. Management and monitoring of various risks is not carried out individually, but in a coordinated way. As a result, the company can gain a long-term competitive advantage. Enterprise risk management increases the company’s value for the owners of the company and generally for the public.

Risk management process consists of six stages: Environment and company analysis, risk identification, risk measurement and prioritization, risk evaluation, planning of the risk reduction, management and monitoring. Each of these stages is an individual process with its own

goals, inputs, outputs, controls, mechanisms and activities. Success on one stage is the basis for the next as the output of the previous stage serves as the input for the next stage. There is a variety of useful mechanisms and activities for each stage that are developed recently. We believe that the most optimal result is achieved by defining the fifth stage (which is also defined to be risk reaction, risk response planning, risk management, etc.) as the risk reduction planning stage, a during this stage a particular strategy is selected about how the company should reduce the risks .

There are six major strategies of risk reduction: Diversification, risk avoidance, loss control, risk transfer, risk reassign, and risk retention. For different types of risks, on certain strategy or a combination of these strategies is used.

ERM in Georgia and activities to support its development

Based on the results of the ERM survey held in Georgia, which was conducted in the frame of the doctoral program last year, we can conclude that enterprise risk management is not developed in Georgia's business companies even at the basic level. The most important factors for the absence of ERM in Georgia are the following: (1) Failure of the company owners to properly assess the goals and benefits of enterprise risk management; (2) lack of support from managers. In addition, we can mention the peculiarities of the management structure of the companies, particularly, the fact that, very often, the owners (shareholders) and directors of the companies are the same people. Other factors include the following: (3) Absence of urgency proceeding from market position and business environment conditions – lack of competition on the market; (4) due attention is not paid to risk management in a business plan while issuing loans by financial organizations; (5) absence of requirements in Georgia (except for certain sectors, such as banking) posed by the regulatory entities for corporate governance. As internal control and risk management are subsets of corporate governance, there is no regulation governing them.

It is of crucial importance for Georgian companies to develop an Enterprise Risk Management Office. This would not be an easy task; however, taking into consideration the available foreign experience on this subject and an understanding of the benefits an ERM Office can generate, the establishment of such an office is worth the expenses and efforts. In the following part of the article, we will try to define the major factors and processes that companies should take in consideration for the formation of the Enterprise Risk Management Office.

Georgian Companies - Formation and Functioning of Enterprise Risk Management Office

Companies have different attitudes towards risks. These attitudes can be summarized on the basis of their risk tolerance as risk-seekers, neutrals and risk-avoiders. Risk tolerance of the companies and their risk management process depends on the following characteristics: Interests of company owners and decision makers, peculiarities of corporate governance, system of compensation for decision makers, size and organizational structure of the company, company's culture (Damodaran, 2008, pp. 340-365).

Enterprise risk management is a difficult, painstaking and, frequently, very expensive process.

While developing the enterprise risk management program, we should answer the following questions:

1. What is the ERM program goal?
2. How should the risk management office look like and what particular place should it take in the company's organizational structure?
3. Which particular instruments are used for identification, risk measurement and prioritization, risk evaluation, risk reduction?

The ERM program goals may be the following: Development of optimal mechanisms for risk management, promotion of implementation of corporate strategies, growth of transparency and accountability, prevention of critical risks, giving due consideration to the risks in decision-making process, observance of the company values by the owners, revealing new opportunities, increase in operational efficiency, etc. Selection of the goal depends on the stage of the company's development and different factors.

The second question entails the determination of the participants in the risk management process, their duties and responsibilities. Generally, all employees of the company are program participants, though it is desirable that responsible persons are those holding particular positions. Corporate governance codes of various countries provide general principles of responsibilities for the participants of the risk management process.

The key participants of the EMR are the following: Board of Directors – BOD (audit committee, risk committee), Chief Executive Officer – CEO/ Executive director, Enterprise Risk Management Executive chief risk officer – CRO, chief financial officer – CFO, risk officers and internal audit officers, managers, heads of departments, project coordinators, and team leaders.

The BOD is responsible for determining the company's strategic and critical risks, supervising risk management process and preparing a report for the owners. The responsibilities for concrete issues can be dele-

gated to the audit and risk committees. The BOD should discuss existing and new risks at least once a year and especially in the process of strategic planning it should provide (1) compliance of ERM program with a strategic plan; (2) optimal compliance of risk management centralization and decentralization; (3) moderate regulation of risk management. A systemic approach towards risk management and close mutual relations with other services stipulates that the relations between all services should be strictly determined; it is also necessary to determine the rights and obligations in various management offices.

The risk management office should be strictly subordinate to the regulation in place and the possibility of its development should be envisaged as well. Therefore, it is essential to find a balance between regulation and the freedom of creative initiatives.

In a modern company the role of ERM, which envisages management and monitoring of various risks (both internal process and external environmental risks) which are coordinated not individually, but under a joint strategy, effectiveness is optimized when the top management carries out the coordination of risk management in the organization (executive director or his/her deputy), while each employee should consider risk management as a part of his/her job. The executive director is the most important representative of the managerial staff, since he/she coordinates the entire process of risk management, makes strategic and tactical decisions and provides duly delivery of reliable and comprehensive information to the Board.

The executive director can create the risk management office or delegate this function to the chief risk officer or the chief financial officer. An executive manager (the name of the position has no decisive importance), who has relevant business skills and can search risk-related information from various sources, should be instructed to develop and implement the enterprise risk management strategy.

The risk management office should be directly subordinated to the executive director. It is desirable that the risk management office is created in the following composition: Information-Analytical Department (risk identification; measurement and prioritization; risk assessment), Risk Reduction Planning Department, Risk Control and Monitoring Department, etc.

Risk officers perform various duties within the frame of the risk management office, while audit officers conduct monitoring of the implementation and efficiency of the ERM program.

As far as top managers, heads of departments, project coordinators and team leaders are concerned, they are responsible for managing the risks (risk identification, accountability, etc.) in accordance with the purposes of their positions.

It is essential to involve the heads of all departments in the process of development of the ERM program. It is important for the heads of all departments (other services existing in the company) to deliver information about risks (presentation of risk management program) and to provide their feedback.

Formation of risk management office requires studying of the company's organizational structure. It is urgent that ERM is included in the formal corporate governance framework. It is especially important that information about risks is integrated into the decision making process by the Board and involve ERM in the business continuity plan (risk management plan is a part of business continuity at a pre-crisis stage).

Obviously, it is impossible to involve all ordinary employees in the process of program development, but it is necessary to develop a mechanism through which an employee will be able to deliver information to the management for the identification of any risk. Frequently, some risks remain unknown to the managers and the employees should notify them about it. Such initiatives on the part of the employees should be encouraged that will give them further motivation to watch business processes and developments closely and to cooperate with the managers in case of identification of a particular risk, or careful consideration of the risk reduction strategy.

Moreover, it is expedient to involve all leading stakeholders, such as key providers, consumers, partners, financial institutions, in the process of EMR program development. Furthermore, at the stage of risk measurement, assessment and development strategy of risk reduction, it is urgent to involve independent experts, who will make impartial conclusions.

To increase the efficiency of risk management office, it is important:

- (1) To provide constant raising of qualification of the head and the employees;
- (2) To bring job characteristics in compliance with staff capabilities;
- (3) To constantly develop the principles of staff motivation;
- (4) Since the staff provides information delivery and processing, their studying and upgrading should take place on a regular basis.

The key basis for the success of the enterprise risk management office is human resources. The staff working for the office should necessarily have a relevant education that requires the existence of special retraining and certification programs, have a good knowledge of the stages of risk management process and their interconnection, be familiar with the methodology used for risk assessment and reduction, have sufficient knowledge about statistical analysis and probability concepts, maintain a balance between theoretical knowledge and practical experience, effectively direct working meetings, which are held at various stages of risk management process while using various methods and with the participation of all stakeholders or experts (for example, upon conducting

SWOT analysis, analyzing the scenarios, etc.), try to improve the used methods and introduce modern methods, create and update business register, use various methods of information delivery (such as strategic risk map, strategic goal tracking board, etc., and also standard documents), be able to determine and implement risk management policy and procedures.

The introduction of information-computer technologies (computer software) has a crucial importance for the development of a risk management office. Development of information technologies promotes the effective and quick solution of managerial decisions as well as processing of database (risk register).

Each stage of the ERM process – business and environmental analysis, risk identification, measurement and prioritization, risk assessment, risk reduction planning, risk management and monitoring – is necessarily accomplished by communication, through which information is exchanged at the internal organizational level and between the organization and the environment. Proper organization of communication is a cornerstone for risk management. During risk management, it is essential:

(1) To constantly provide risk management office with reliable information;

(2) To observe and periodically study external environment and behavior of competitor enterprises;

(3) To establish effective mechanisms of collection, updating and availability of relevant data related to risks;

(4) To observe all types of risks and yielded results and to create a uniform information base (risk register);

(5) To select simple and established parameters for measurement of strategic business goals, risk controls and risk drivers;

(6) To provide confidentiality of information.

Accuracy of any calculation depends on the selected model and proper implications, as well as a moderate use of historical data. It is desirable to use scenario analysis and historical simulation simultaneously. It is logical that while assessing the risks, quantitative methods give a more accurate assessment about the risks, though frequently this is impossible due to a lack of available data. It should also be noted that it is not always necessary to use quantitative methods for assessment; sometimes, identification of a critical risk is enough for the development of a risk reduction strategy. Therefore, it should be defined in which particular cases the risks should be measured either by quantitative or by qualitative methods.

As soon as the company identifies and assesses the risks, risk reduction planning should start. The risk reduction planning stage covers the following activities:

- (1) To determine, whether obtained information is enough and to conduct additional researches in case of necessity;
- (2) To develop several alternatives to each particular risk reduction strategy;
- (3) To assess the value of strategy implementation and to compare it with the amount of losses;
- (4) To elaborate a schedule during strategy implementation;
- (5) To define the risks and difficulties emerging in the process of strategy implementation;
- (6) To develop key risk indicators (KRIs) and early warning indicators (EWIs).

As mentioned before, there are several risk reduction strategies. A company selects its strategy depending on numerous factors of which the most important are: (1) Types of risks, with consideration to their probabilities and impact/losses, (2) expenses to be defrayed for the implementation of the strategy.

In the conditions of a transitional economy, such as in Georgia, companies and investors mostly use two methods of risk reduction: Risk retention (that is cold self-insurance and means creation of the „risk“ fund to cover losses) and insurance. Generally, the use of risk retention method is more effective when the size of the „risk“ fund is small, or when investing in various assets becomes less profitable. We can discuss the advantages of risk retention from economic and managerial points of view. Economic efficiency envisages saving of insurance premium and, respectively, reduction of expenses, as well as opportunities to receive revenues for the reserve fund, saving of money as a result of detailed observation of losses in the past, etc. From the managerial point of view, we can distinguish the growth of flexibility of risk management, maintenance of control on money assets, etc.

Insurance was and still remains the most widespread method of risk management throughout the world. In Georgia insurance is often the only strategy, which most companies use to reduce the risks (although only for a few risks). The insurance market in Georgia is its development stage; the types of basic enterprise risk insurance are provided by insurance companies, though there is actually no demand for some of them.

As far as the second issue is concerned – i.e. determining and considering the expenses necessary for the implementation of the risk management strategy – it can be argued that ERM should be cost effective. However, at the same time, there are frequent cases where companies agree to bear expenses for the creation and implementation of more expensive models and strategies because in this process they generate information to their own companies that eventually assists them in making strategic decisions (quality of decisions increase).

The final stage of risk management process is management and monitoring. Monitoring organized correctly provides granting of necessary independence to the employees, on the one hand, and avoiding of mistakes, on the other.

In order to promote the development of enterprise risk management in Georgian companies, it is essential that various stakeholders, such as the state, the financial sector, educational institutions, non-governmental organizations, and think tanks carry out relevant measures.

The Role of the State

State support is important and essential, especially in the conditions of a transitional/developing economy. In order to provide further development of enterprise risk management it is urgent:

1. *To promote the growth of competition.* Promotion of competition will provide the development of companies' management in the long term; the owners will pay more attention to risk assessment and management.

2. *To focus on the Free Trade Agreement with the European Union and to promote the compliance with the EU standards.*

3. *To improve the Law of Georgia on Entrepreneurs and other laws.* Legislation should promote business in the following directions: (a) improvement of the companies' management structure, (b) introduction of internationally recognized principles of corporate governance, (c) obligation of concluding written agreements between counteragents on particular business operations and elaboration of the rules of submitting necessary information for the agreements, (d) restriction of frequent changes to the Tax Code and business-related laws, (e) introduction and observance of necessary security norms that is especially important in construction and processing industry.

4. *Promotion of the necessity of ERM on the part of the Ministry of Economy and Sustainable Development of Georgia and other state agencies.* It is essential to demonstrate the importance of enterprise risk management to businesspeople. This can be achieved in the following ways: (a) existence of risk management system in the company and adequacy of risk management process can serve as one of the evaluation criteria while holding various business competitions, (b) require the existence of risk assessment and management mechanisms in the companies while holding various tenders on state procurements, especially when the work to be done and the commodities are expensive, (c) in the process of privatization, as well as in the process of submitting investment projects and carrying out talks with the investors, it is essential that the authorities focus on the urgency of risk management, (d) it is important to imple-

ment relevant projects to promote the development of corporate governance.

5. *Promotion of the development of financial markets.* In terms of risk management, it is especially important to develop insurance and securities markets in the country.

The Role of Educational Institutions, Non-Governmental Organizations and think tanks

To introduce enterprise risk management and the related specialties;

To create textbooks in the Georgian language; to create a dictionary (English-Georgian) on risk management terms;

To develop a course of trainings on risk management (similar courses exist in respect of the financial sector, though not for other sectors) for businesspeople and other interested persons;

To conduct researches in the sphere of risk assessment and management by economic sectors as well as to develop relevant recommendations;

To deliver information to the founders of the companies about the best practices of risk management; to discuss particular successful business cases with them; to draw their attention to the importance of risk assessment in business planning.

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