



Emerging trends in risk management

Risk Consulting



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Foreword

Businesses today are jostling for space and operating in a dynamic and constantly evolving, highly competitive environment. Heightened dependence on rapidly evolving technology, integration and access to global markets have exposed organisations to a plethora of risks, even as they pursue growth at a blistering pace.

In the backdrop of regulatory, compliance risks, market disruption, environment, health, safety and even obsolescence of business models, there is an urgent need for companies to alter their mindsets. The shift in mindset should be in the approach to risk management from a largely compliance and operations perspective, to a risk-based strategy and decision making perspective.

Globally, risk management is evolving and taking centre stage in how companies run their businesses. While Indian companies are also moving in that direction, they need to quicken their pace, especially when it comes to incorporating risk management into business strategy and growth.

Although the Companies Act 2013 created a strong framework for risk management, it is now incumbent on India Inc. to work on the 'tone at the top' and embed the culture of risk management across their organisations to be able to sustain the shocks of uncertainty.

This white paper is an attempt to offer insights into the leading trends and best practices in risk management. We believe that there are also learnings for India Inc. that will help them weather the risks on their growth trajectory and pave the way for them to take off to newer heights.



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Risk management in a VUCA world

The American military coined the term 'VUCA' to describe the extreme and harsh conditions of operations in Afghanistan and Iraq. VUCA is an acronym for Volatile, Uncertain, Complex and Ambiguous. No wonder then, that the term 'VUCA world' has come to denote the eerily similar conditions that prevail in today's volatile business environment, akin to a battlefield, where businesses have to defend, fight hard and strategise in order to survive and thrive. Those businesses that are not nimble or agile enough to catch on, end up paying a heavy price. The market is replete with such examples.

Creative disruptions, as they are called now, are shaking up markets all around us and have dealt severe blows to the businesses of monoliths that did not gear up to newer technologies and competitive strategies on time.

A 2012 article by Richard Foster provides great insights into the accelerating turnover of companies in the S&P 500 index. U.S. companies in the S&P500 in 1958 stayed in the index for an average of 61 years, which was reduced to an average of 25 years by 1980. By 2011 that average was further reduced to only 18 years. At the current churn rate, 75 per cent of the S&P 500 companies in 2011 are likely to be replaced by new ones entering the index, by 2027.

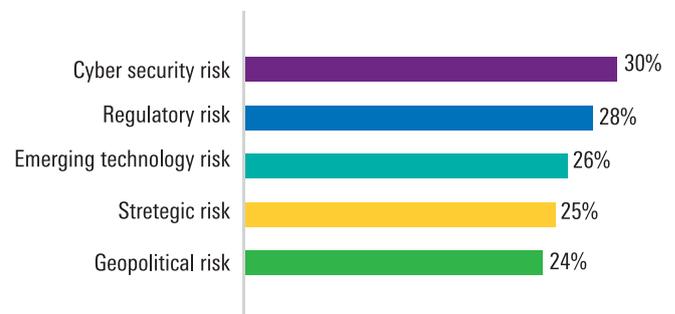
A prime example of business model disruption, is the age old taxi cab system, which has started crumbling in the last few years. Old models of yellow and black taxis plying independently on city roads were replaced by organised taxi companies. Before these companies could boast of having steady revenues on board, app based taxi services came knocking at their doors for market space and disrupted their still nascent business models.

In India, the recent case of demonetisation, had a considerable impact across sectors and industries, especially the ones dependent on the cash liquidity in the hands of consumers such as telecom, retail, e-commerce, FMCG, etc. However, at the same time, the move gave a significant push to digital payment service providers who have been growing at a good pace post demonetisation.

The overall business operating environment, both domestically and globally, has become highly volatile for companies today. Several factors influence this volatility, including macro-economic factors, such as the Brexit and the U.S. presidential election, which could potentially alter the broader strategy framework of an enterprise. Other more specific factors impact every day operational functioning, such as changes in the domestic, regulatory or competitive landscape and technological advancements. These variables are increasing further complexities to the already uncertain business environment.

KPMG International conducted a Global CEO outlook survey in 2016 to determine the top five risks CEOs felt that their companies faced. A majority 30 per cent of CEOs mentioned cyber security risk as their top-most priority. Regulatory risk came in second place, with 28 per cent votes, closely followed by emerging technology, strategic and geopolitical risk respectively at third, fourth and fifth spots.

What risks are you most concerned about? (Top five)



Source: 2016 Global CEO Outlook, KPMG International

In an increasingly interdependent world, India too, is significantly dependent on international markets for driving domestic growth. This makes Indian businesses vulnerable to global mega trends and geopolitical developments, a fact clearly reflected in KPMG's Global CEO Outlook survey. Over the past couple of years, there has been a strong positive sentiment in India Inc. on account of several factors influencing the domestic market. However, interconnectedness of Indian businesses to global markets make them vulnerable to global shocks, and this factor cannot be ignored.

Operating in such an interconnected world and rapidly changing environment means that any company will always be exposed to a multitude of risk variables, which may emanate from different geographies, different stakeholders (customers, suppliers, regulators, etc.), each with different and constantly changing impact and velocity.

Therefore the importance of an all-encompassing and dynamic risk evaluation and mitigation framework is of critical importance for firms in India today, as they are exposed to greater uncertainty and evolving challenges on a regular basis, while attempting to tread a steep growth trajectory.

Companies need to take a critical look at their risk portfolio and ensure that they have identified those risks and vulnerabilities that could threaten the organisation's overall business strategy. They need to deploy future-focussed risk assessment to reassess that strategy in the light of internal and external emerging risks. For example, if an organisation is planning to buy another company, approaching the transaction with not just a 'growth lens' but also an 'enterprise risk lens' is vital. Viewing the risk from the prism

of such analysis, shifts the focus of the question from being merely, 'Does this acquisition fulfil our immediate strategic growth ambition?' to more importantly, 'Does the impact on our business model make sense in the context of our changing competitive/industry risk environments and the social and geopolitical context?'

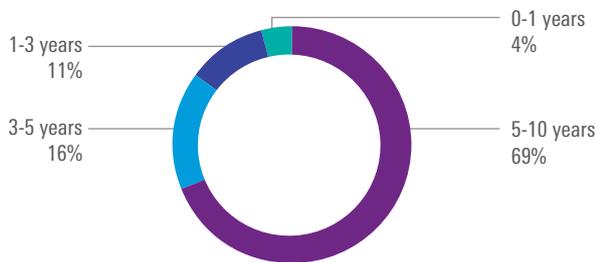
Further, with the pace of change, risk management can't be a one-time effort. It has to be a way of life in this VUCA world.



Risk management practices as highlighted by India Inc

KPMG in India conducted primary research on around 90 companies across sectors and industries. Based on our research, we analysed the risk management practices being followed by India Inc. In this process, various parameters were used to evaluate the maturity of risk management programme, preparedness to deal with emerging risks and future priorities for risk management to transform it into a value adding function. Key findings from the research are as follows:

How old is your Risk Management programme?



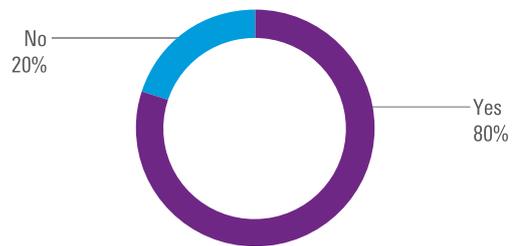
Source: KPMG in India, primary research data analysis

What are the main drivers behind your risk management programme?



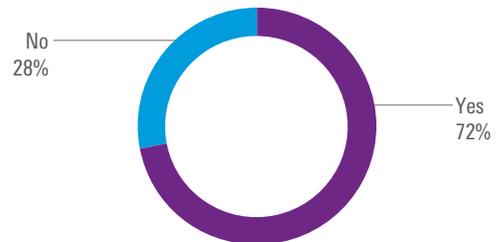
Source: KPMG in India, primary research data analysis

Do you have a separate Board level risk committee?



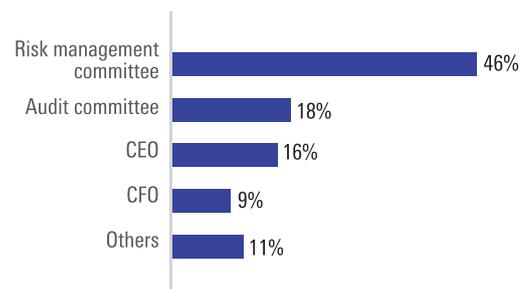
Source: KPMG in India, primary research data analysis

Do you have a Chief Risk Officer (CRO) in place?



Source: KPMG in India, primary research data analysis

Who does the CRO report to?



Source: KPMG in India, primary research data analysis

Risk governance trends

Risk management programme for a majority of respondents (69 per cent) is more than five years old, which is an encouraging trend and shows that India Inc. had risk management on top of their agenda before the release of Companies Act 2013 amendments on risk matters.

Furthermore, it's interesting to note that the key driver behind risk management programme for India Inc. was 'strategic priority' (77 per cent) rather than a distant regulatory compliance (52 per cent) and risk averse nature of the management (19 per cent).

It is encouraging to note that a majority of respondents, 80 per cent, have established a separate board level risk committee within their organisation. However, only 72 per cent stated having Chief Risk Officer in place to supervise the risk management function, which further went down to only 44 per cent having independent reporting to the risk management committee. There are instances where CROs directly report to executive management and in some cases executive management itself taking up the additional responsibility of risk management.



Sectoral trends and key risks

Agriculture

A large majority of India’s rural population still depends on agriculture for sustenance. Agriculture is a major contributor to the country’s Gross Domestic Product (GDP). The GDP of agriculture and allied sectors was USD244.74 billion in FY16. Agriculture is one of the key throttles of the engine of Indian economy. Its exports constitute 10 per cent of the country’s exports and it is the fourth-largest exported principal commodity.¹

The prospects for agriculture look promising in the near future as per RBI’s outlook for the sector. In the second quarter of FY2017, RBI in its monetary policy assessment mentioned that the outlook was bright, owing to a strong south west monsoon, which ended the season with a cumulative deficit of only 3 per cent below the long period average, with 85 per cent of the country’s geographical area having received normal to excess precipitation².

Top risks

Vagaries of weather	Drastic change in weather patterns, erratic climate, unseasonal rains, drought, etc. have a major impact on cropping patterns in the country. Normal sowing cycles are disturbed due to delayed rains or a deficiency thereof.
Regulatory risks	Changes in regulatory environment in the agriculture industry have been highlighted as an area of concern by major players.
Price or market risks	Volatility in farm harvest prices. Significant price fluctuations in commodities and areas where price support mechanism is not functional. The unpredictability and fluctuating nature of prices impact farm income.

Automotive

The Indian auto industry is one of the largest in the world. It is estimated that the sector accounts for 7.1 per cent of the country’s Gross Domestic Product (GDP). A growing middle class and a young demographic is also reflective in the popularity of the two wheeler segment which has captured 81 per cent of the market share, leading the automobile market. The overall Passenger Vehicle (PV) segment has 13

per cent market share. India is also a prominent auto exporter and has strong export growth expectations for the near future.³

The auto industry is hopeful that the implementation of Goods and Services Tax (GST) will give boost to the sector by buoying the consumer sentiment. The Union Budget 2017-2018 had some positives for the sector. In particular, benefits are expected to accrue to manufacturers of farm equipment. The measures were aimed at offsetting the impact of demonetisation which had dented rural sales.⁴

Top risks

Technology risk	Inability to develop critical technology in-house was one of the critical risks highlighted by major players.
Geopolitical and economic uncertainty	Geopolitical and economic uncertainty in key markets where the players operate.
Competition	Significant undercutting in the market by leading competitors is another area of risk for automotive firms.
Diesel fuel	The recent developments impacting diesel automobiles poses a significant risk owing to the amount of investment in the space.



01. "Indian Agriculture Industry: an overview", IBEF, <http://www.ibef.org/industry/agriculture-india.aspx>, 28 February 2017
 02. "Fourth Bi-monthly Monetary Policy Statement, 2016-17 Resolution of the Monetary Policy Committee (MPC), Reserve Bank of India", RBI, https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=38224, 28 February 2017

03. Society of Indian Automobile Manufacturers (SIAM), 28 February 2017
 04. "Budget 2017-18: Impact On The Indian Automotive Industry", NDTV, <http://auto.ndtv.com/news/budget-2017-18-impact-on-the-indian-automotive-industry-1655086>, 28 February 2017

Capital projects and infrastructure

Infrastructure sector is a major growth driver for the Indian economy. While the sector gets some support from the government's focus on development, most big players in the industry are burdened with leveraged balance sheets and slow moving or stalled projects. Uncertainty in land acquisition, delays in approvals and problems with long term funding are a few challenges that constrain recovery in the sector⁵. The infrastructure sector is expected to remain largely sluggish in the coming year as it remains weighed down by poorly performing assets.

Top risks

Regulatory and political risk	There are several aspects to Political and regulatory risks in this sector. These range from community opposition on investments, changes to asset-specific regulations and breach of contract.
Access to financing	Access to funding, touches upon the core feature of infrastructure: its long-term payback period. It affects financiers and investors who are looking for long-term and steady returns. Long term loans have become a challenge after the global financial crisis, not only internationally, but also in India.
Competition	Price war and pressures for price cuts and cost management due to (a) downward revision of prices by competitors; (b) cascading effect of pressure on customers' margins due to economic environment changes.

IT/ ITeS

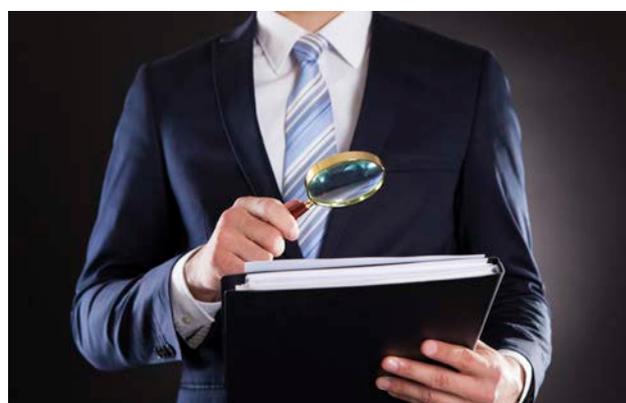
India is the world's largest sourcing destination for the information technology (IT) industry, accounting for approximately 67 per cent of the USD124-130 billion market. Over 10 million people are employed by the industry which is also credited to some extent with the altered perception of India in the global economy.

Cost competitiveness in providing IT services, at roughly 3-4 times cheaper than the US, continues to be the driving force of its unique selling proposition (USP) in the global sourcing market. However, India is also gaining prominence in terms of

intellectual capital with several global IT firms setting up their innovation centres in India.⁶

Top risks

Automation	Automation is expected to be a game changer for companies all over the world in the next few years. The Indian IT services industry is poised to lose 6.4 lakh 'low-skilled' jobs ⁷ as a result of this massive transformation.
Political and regulatory risk	The U.S. presidential polls are a prime example of how political risk can weigh heavy on IT firms. President Trump's anti-immigrant, outsourcing and crackdown on H1B Visa's stance has forced Indian IT majors to rethink their strategies to brace themselves for what lies ahead.
Skill shortage risk	A shortage of skilled talent is one of the biggest risks faced by the sector. There is a palpable dearth of qualified engineers to tap high-end business opportunities such as artificial intelligence and cloud computing. ⁸ Retaining top performers is another challenge highlighted by the industry.
Cyber security risk	The rapid evolution and spread of cybercrime incidents in India have seen it emerge as one of the biggest challenges for CXOs of many technology companies. Concerns over data exposure due to wide access to multi structured data poses a serious threat to personal information of employees and the organisation.



05. "Indian Construction and Infrastructure Sector", ICRA, <http://www.icra.in/Files/ticker/SH-2015-Q2-1-ICRA-Construction.pdf>, 28 February 2017

06. "IT & ITeS Industry in India", IBEF, <http://www.ibef.org/industry/information-technology-india.aspx>, 28 February, 2017

07. IT sector to lose 6.4 lakh "low-skilled" jobs to automation by 2021: HfS Research", Economic Times, <http://economictimes.indiatimes.com/industry/jobs/it-sector-to-lose-6-4-lakh-low-skilled-jobs-to-automation-by-2021-hfs-research/articleshow/53052040.cms>, 28 February, 2017

08. "IT sector to lose 6.4 lakh "low-skilled" jobs to automation by 2021: HfS Research", Economic Times, <http://economictimes.indiatimes.com/industry/jobs/it-sector-to-lose-6-4-lakh-low-skilled-jobs-to-automation-by-2021-hfs-research/articleshow/53052040.cms>, 28 February, 2017

Metals and mining

As per KPMG’s Global Metals and Mining Outlook 2016, prospects for a recovery in the sector seem bleak for a couple of years, unless there is a major turn in fortunes.⁹

In India, it is believed that the industry, is constrained by high government regulation and therefore is not performing optimally. Low reserve to production ratio indicates significantly untapped areas, limited funds for exploration, land acquisition issues, procedural delay, inadequate infrastructure, corruption and many social and religious reasons that can be attributed to the industry not achieving its peak yet¹⁰.

Top risks

Regulatory and compliance risks	One of the most impactful risks highlighted by multiple companies is changes in the regulatory and compliance environment.
Natural calamities, and health, safety and environment	Owing to the nature of business, natural calamities pose a major risk. Also, this adds additional risk to employees’ health and safety.
Strikes, closures, social unrest	Strikes, disruptions and protests are a few common risks that plague the metals and mining sector. These disruptions have the potential to impact supplies and lead to huge losses.

Pharmaceuticals

The pharmaceutical industry in India is considered a sunrise sector. Not only is it growing at a rapid pace domestically, it is also considered the third largest in the world. The estimated value of the industry is at approximately USD12.26 billion and is growing at a rate of 10-11 per cent per annum on a compounded growth rate basis.

Although the total turnover of the pharmaceutical industry is estimated at USD21.04 billion, about 65 per cent of this revenue is from exports. Around 18 per cent of this revenue is spent on research and development (R&D) activities. Additionally, India’s clinical research industry is estimated to be USD2.2 billion with a high growth rate of 23 per cent. Moreover, the Indian pharmaceutical offshoring industry is slated to become a USD2.5 billion opportunity by 2012, due to low R&D costs and a high-talent pool¹¹.

Top risks

Regulatory and compliance	As the pharmaceutical industry grows beyond geographies, it also has to contend with meeting stringent regulation and compliance parameters. In the recent past, the USFDA imposed bans on some drug factories in India on concerns over production quality. The FDA has banned more than 40 pharmaceutical plants in India in the past few years. There have also been instances where drug makers have had to pay fines for the manufacture of substandard drugs. In fact, in India itself, the government last year moved to ban the manufacture and sale of over 340 fixed dose combination drugs, many by pharma majors ¹² .
Currency risk	Since the Indian pharma industry is export oriented with exports contributing to over 50 per cent of pharma revenues, strong rupee and currency fluctuations impact export realisations. Rupee depreciation is a positive for pharma companies, which are net exporters, but any weakness in other emerging markets currencies also impacts bottom line.
Low R&D investment	Globally the pharma industry is driven by the amount of R&D made by the firms, and companies spend over 15 per cent of their annual revenue on R&D. However, Indian pharma companies invest just 4 per cent of the revenue for R&D. Keeping the long term growth perspective and sustainability, Indian companies has to necessarily increase their spend on R&D to seize upcoming opportunities in complex generics, CRAMS and blockbuster drugs as well ¹³ .

09. "Global Metals and Mining Outlook", KPMG, <https://home.kpmg.com/content/dam/kpmg/xx/pdf/2016/08/kpmg-metals-mining-outlook-2016.pdf>, 28 February, 2017

10. "Metals and Mining Sector", The Money Roller, <http://themoneyroller.com/2016/05/10/metals-mining-sector/>, 28 February, 2017

11. "Pharmaceuticals, sector overview", Investindia, <http://www.investindia.gov.in/pharmaceuticals-sector/>, 28 February, 2017

12. "India's ailing pharmaceutical industry needs a cure", TheNational, <http://www.thenational.ae/business/economy/indias-ailing-pharmaceutical-industry-needs-a-cure>, 28 February, 2017

13. "Indian Pharma Industry: SWOT Analysis", LinkedIn, <https://www.linkedin.com/pulse/indian-pharma-industry-swot-analysis-sean-palanna>, 28 February, 2017

Public Sector Undertakings (PSU)

In 2016, the government announced the start of the third phase of reforms in public sector banks, and decided to consider all aspects including consolidation. In 2017-18, plans are underway to achieve a 60 per cent jump in disinvestment revenue by listing central PSUs. The Department of Investment and Public Asset Management (DIPAM) has outlined that a profitable PSU would have to list on the stock exchanges within 165 days, after the administrative ministry is on-board for the plan¹⁴.

Top risks

Geopolitical and security risks	Terrorism and disruptions arising from political strife in key geographies is a major cause of concern for PSUs.
Lack of skilled talent, and strikes, closures and unrest	Delays in completion of projects owing to inadequate logistical infrastructure, non-availability of talent with specialised skills and sub-optimal utilisation of manpower are also risks for PSUs.
Price fluctuations	The change in prices of raw material as well as final products is seen as a major area impacting the revenue of PSUs, exacerbated by price downs of oil, steel, electricity.

Retail

India's retail market is burgeoning fuelled by consumption from the growing middle class. The market is expected to nearly double to USD1 trillion by 2020 from USD600 billion in 2015, driven by income growth, urbanisation and attitudinal shifts. As per estimates, while the overall retail market is expected to grow at 12 per cent per annum, modern trade is expected to expand twice as fast at 20 per cent per annum and traditional trade at 10 per cent. India's Business to Business (B2B) e-commerce market is expected to reach USD700 billion by 2020. Online retail is expected to be at par with the physical stores in the next five years. India's direct selling industry is expected to reach a size of INR23,654 crore (USD3.51 billion) by FY2019-20.¹⁵

Top risks

Health and safety standards	Inability to meet prescribed food health and safety standards is a major concern in the retail industry.
Consumer behaviour	The shift in consumer behaviour is forcing many traditional retailers to set up an online presence in order to compete with e-tailers who have completely different margin structures. Social media has become a forum for brand positioning and promotion, and this is forcing retailers to create communication strategies that are interactive and immediate. Consumers are also willing to wait for special deep discount promotions to make their purchases. ¹⁶
Supply chain disruption	Supply chain disruptions are a major risk for retailers, both domestically and globally. The recent demonetisation initiative saw the supply chain operations of several start-ups take a hit. The cash crunch caused procurement problems. In order to better handle disruptions, companies may have to reconfigure their supply chains and make them resilient to risks through improved planning and execution.



14. "Centre lays out time-bound plan for listing of Central PSUs", Indian Express, <http://indianexpress.com/article/business/business-others/centre-lays-out-time-bound-plan-for-listing-of-central-psus-4530749/>, 28 February, 2017

15. "Retail Industry in India", IBEF, <http://www.ibef.org/industry/retail-india.aspx>, 28 February, 2017

16. "Analysing customer behaviour in retail", Business Standard, http://www.business-standard.com/article/management/analysing-customer-behaviour-in-retail-113092200710_1.html, 28 February, 2017

Logistics

Indian companies are exposed to numerous supply chain risks. Many risks such as infrastructure and operational risks are beyond the control of a firm and need to be managed at a government policy level.¹⁷

Supply side of the challenges in India mainly relate to poor infrastructure, complex tax infrastructure, weak distribution system, fragmented market, and lack of technology adoption. Though India has the second-largest road network in the world, most of it is of poor quality. National highways account for less than 2 per cent of the total road network, but carry 40 per cent of the traffic.¹⁸

Top risks

Infrastructure	This is one of the major challenges that the industry faces and it has been a major threat to its growth. Issues like poor connectivity, inefficient sea port capacities and bad road conditions have been a continuous nuisance.
Skilled labour	Lack of skilled labour and manpower is one of the major challenges that the industry needs to overcome. The logistics industry is not the first choice of young graduates, thereby making the hiring of qualified professionals challenging. This also results in poor adoption of technology in the industry.
Enroute damage / pilferage / theft in shipments	Damage of products, delayed timelines as well as theft of shipments are other risks highlighted by the logistics industry.

Telecom

The telecom revolution in India has paved the way for the country to flock the information super highway. India is currently the second-largest telecommunication market and has the third highest number of Internet users in the world. The Telephone subscriber base grew at a CAGR of 19.96 per cent, reaching 1058.86 million during FY07–16. In March 2016, tele density was at 83.36 per cent.¹⁹

Interestingly, the disruptive entry of a new operator in the telecom sector in 2016, led to competitive pricing and innovative tariff structures. In the long term, low tariffs are not sustainable, with high spectrum fees and ongoing capex requirements.

The financial distress of operators and continuous pressures on profitability have triggered prospects for a sector consolidation. It is expected that the Indian telecom sector is likely to stabilise to five to six players in the long term. Further decline in data tariffs and erosion of domestic voice revenue would impact operators’ profitability and sustainability. As compared to developed and emerging telecom market, India boasts of one of the lowest data tariffs²⁰.

Top risks

Disruption of business models	The disruptive foray of an operator into the market last year has led to a 20 per cent revenue loss to the telecom industry. Consolidation in the industry is expected to help a quicker return of pricing power. The proposed merger of two leading telecom operators is expected to be a positive for the telecom industry by eliminating duplication of spectrum and infrastructure capex ²¹ .
Regulatory risk	Telcos globally are exposed to regulatory risks. But in a market where the framework is still evolving, like that of India, this risk is high. In the wake of consolidation in the telecom sector, additional regulatory requirements are likely.
Capex / operating expenditure risks	Increase in cost structure (capex / operating expenditure) is a major area of concern for providers, especially keeping in mind the increased pressure of revenue due to increased competition in the telecom industry.

17. "Supply chain risk management in India – practical insights" Research Gate, https://www.researchgate.net/publication/282394507_Supply_chain_risk_management_in_India_-_practical_insights, 28 February, 2017
 18. "India's Supply Chain Is Improving, But Still Has a Long Way to Go", Supplychainbrain, <http://www.supplychainbrain.com/content/world-regions/asia-pacific/single-article-page/article/indias-supply-chain-is-improving-but-still-has-a-long-way-to-go/>, 28 February, 2017
 19. "Telecom Sector in India" IBEF, <http://www.ibef.org/industry/telecommunications.aspx>, 28 February, 2017

20. "An overview of Indian telecom industry in 2016 and outlook for 2017" Economic Times, <http://telecom.economictimes.indiatimes.com/tele-talk/an-overview-of-indian-telecom-industry-in-2016-and-outlook-for-2017/2035>, 28 February, 2017
 21. "Reliance Jio free services resulted in 20 per cent revenue loss to telecom industry: Report" Economic Times, <http://economictimes.indiatimes.com/news/company/corporate-trends/reliance-jio-free-services-resulted-in-20-revenue-loss-to-telecom-industry-report/articleshow/57195140.cms>, 28 February, 2017

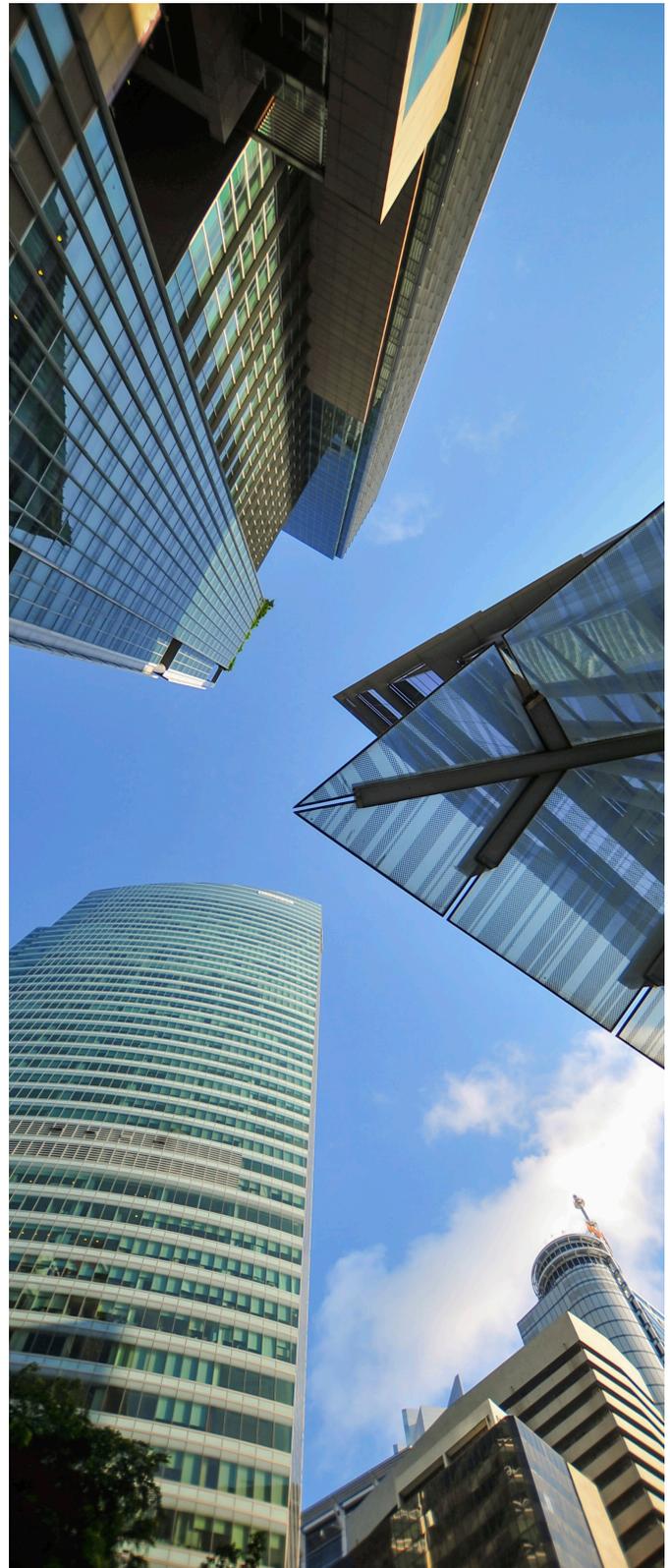
FMCG

India is expected to become the world's fifth largest consumer market by 2030. The growth in India's FMCG and retail sector has been primarily driven by the increase in consumption brought about by economic prosperity, as a result of strong GDP growth post liberalisation in 1991.²²

Consumer markets are going through a major transformation offering new opportunities and challenges. This can be attributed to dramatic shifts in the buying behaviour, growing urbanisation, emergence of the service sector, changing trends/lifestyle, and most importantly, the increasing power of the retailer as a key link between a buyer and seller. Policy measures such as the implementation of GST are expected to also boost business sentiment and aid growth in the sector.²³

Top risks

Competitive intensity	Competitive intensity and the presence of product substitutes is a big risk for companies. Substitutes are a threat to profitability as they are relatively cheaper than the original. Several brands are positioned with narrow product differentiation. Competition in gaining market share is invariably reflected on prices of substitutes.
Supply chain disruptions	Supply chain disruptions in both the developed world and in emerging markets majorly affected sales.
Consumer behaviour	The global economic meltdown, and the recession that followed, altered consumer spending patterns. A major shift in consumer behaviour was witnessed involving cutting back on lavish and impulsive shopping, price comparisons, etc. This sudden change in behaviour was not in line with the pre-recession consumption trends, and thus it became difficult for companies to cope up with such changes. ²⁴



22. "Top 6 Risks and Opportunities of Consumer Goods Companies" KPMG, <https://assets.kpmg.com/content/dam/kpmg/pdf/2015/09/FICCI-Massmerize.pdf>, 28 February, 2017

23. "Consumer Markets", KPMG, <https://home.kpmg.com/in/en/home/industries/consumer-markets.html>, 28 February, 2017

24. "Top 6 Risks and Opportunities of Consumer Goods Companies", Green World Investor, <http://www.greenworldinvestor.com/2012/12/18/top-6-risks-and-opportunities-of-consumer-goods-companies/>, 28 February, 2017

The tool of risk management against uncertainty

It is now invariably acknowledged that given the complexity of business and other factors, risk can emerge instantly and unpredictably from anywhere, causing increased uncertainty and volatility. This uncertainty increases the need for companies to thoroughly understand the complexities associated with the company's growth objectives and in its operations. To combat this ever-evolving uncertainty, companies look towards implementing enterprise-wide Risk Management programmes.

Potential benefits of Enterprise Risk Management (ERM)

- Risk based allocation of resources and performance measurement
- Improves strategic decision making within the organisation
- Increases accountability and encourages proactive management
- Provides clarity on key organisational opportunities and threats
- Greater confidence from compliance activities leading to stakeholder confidence
- Reduced cash flow volatility using derivatives, insurance or improved controls

Moreover, apart from being taken up as a strategic tool to drive value, Enterprise Risk Management (ERM) is also implemented by a large number of companies to be in compliance with requirements of the law, specifically the Companies Act 2013 and SEBI's Clause 49 of the listing agreement. As per the Act, the board and audit committees have been given specific responsibilities in assessing the robustness of risk management framework implemented in the company.

Compliance requirements

Section 134: The Board of Directors' report should include a statement on development and implementation of risk management framework for the company, including identification of the risks which, as per the Board's opinion, could threaten the very existence of the company.

Section 177: The audit committee shall act in accordance with the terms of reference specified by the board, including

the risk management procedures implemented by the management.

Schedule IV: Independent directors are required to get assurance that systems of risk management are robust and defensible.

Clause 49: As per Clause 49 of the Listing Agreement, disclosures are to be made to Board of Directors on risk management, on whether the company has laid down any procedures to inform the Board members about the risk assessment and mitigation procedures.



Bringing efficiency into risk management

Our primary research data indicates that many organisations have already invested in a variety of risk processes and functions, but these mechanisms sometimes lack a unifying vision and clear objectives. Processes have been built without a clear view of what the 'desired state' is for Enterprise Risk Management (ERM) in the company. Consequently, the potential benefits of ERM as a strategic value tool remain under-utilised.

Companies take varying approaches to ERM, depending on the size and needs of the organisation and its risk profile. Although customised ERM approaches help in early adoption of risk management practices, but maturing them over a period of time will help in unlocking the full potential of ERM.

The potential of ERM also gets limited by the mindset that risk management is only about preserving or protecting the value rather than creating value. Perhaps, owing to our risk averse nature, companies have perfected the art of defence by deploying various tools and methodologies, from hedging and insurance to oversight and audits, but are not so proficient in using risk management as a tool to support rapid growth in uncertain times. An often used example is that to drive fast one needs good and reliable brakes. So risk management processes are the brakes that give confidence to an organisation to grow rapidly.

Key building blocks of a risk management framework



Effective risk management requires a consistent approach to mature itself over a period of time. ERM practices adopted by companies need to be continuously evaluated using various maturity models, as well as benchmarking against global standards and industry best practices. As per the maturity

model outlined in **Figure 02**, ERM approaches can be plotted along a 'maturity continuum' to understand the current maturity of the ERM function as well as the journey towards attaining the next level of maturity.

Figure 02 ERM maturity continuum

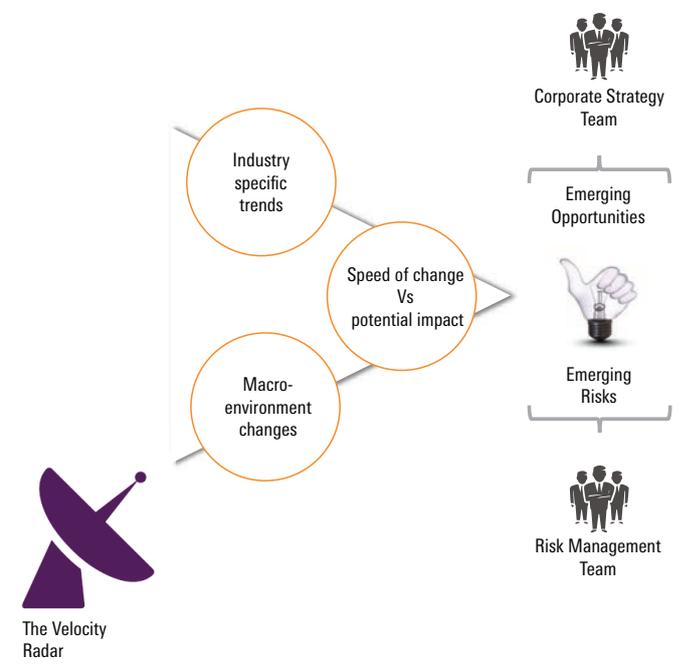
	BASIC ▼	MATURE ▼	ADVANCE ▼
 Risk Strategy and Appetite	Some formal consideration of risk in strategic planning and basic definition of the overall corporate risk appetite	Risk is a key aspect of strategic planning and used to support business decisions. Risk appetite is clearly defined and understood across the organisation	Risk integrated with strategic planning and risk strategy includes use of sophisticated tools such as scenarios, KRIs, KPIs and advanced measurement of risk appetite elements
 Risk Governance	A central risk management policy to support external requirements	Formally documented organisational model for risk governance supported by defined responsibilities, including all three lines of defense (Business, Risk/Compliance, and Internal Audit)	Enterprise risk governance is endorsed by senior management and by the board. Risk management is integrated into risk owners' business activities and performance management
 Risk Culture	The business culture and operating philosophy and their relationship with risk management is loosely understood	Employees can describe the organisation's risk culture, influenced by Leadership tone and communications	Senior management leads by example by making risk management a clear priority and encouraging appropriate risk management behavior.
 Risk Assessment and Measurement	Annual risk assessment with limited analysis, interpretation and reporting	Established risk assessment cadence, methodologies and tools and systematic approach to analysis and reporting	Risks are identified on a continuous basis, with real time escalation, leveraging use of data, risk metrics, and employee inputs
 Risk Management and Monitoring	Basic definition of major risks and limited or ad hoc processes to monitor risks	Business-as-usual management and monitoring of major identified risks	Monitoring responsibilities are seamlessly applied across the three lines of defense, with integrated reporting of risk and assurance activities to the Board
 Risk Reporting and Insights	Business risk reporting is ad hoc and designed primarily to support external requirements	Regular and robust risk reporting to the Board, Audit Committee and senior management, including on emerging risks	Single comprehensive view of risk on a real-time basis across all risk classes to all internal and external stakeholders
 Data and Technology	Data is nonstandard with varying levels of quality, and key risk tools exist in silos across the organization	Automated technology solutions are used to store and analyze risk data. Risk data standards and data quality policy established	Automated and integrated technology is used to store, manage, and report real-time risk data. Risk flags are programmed, and data integrity checks are embedded in business processes

Synergising risk management in the organisation

The success of an enterprise's risk management framework depends on the degree to which it enables the organisation to manage its risk profile, along with bringing a risk-reward perspective to its strategic decision making process. The following are some leading practices in risk management being observed globally and by some Indian companies.

- Strategic alignment:** Risk management has become an increasingly inalienable consideration for an enterprise, hence the need to back strategic decisions with a thorough risk evaluation, is being felt more strongly today in corporate board rooms, than at any time in the past. KPMG's Global Pulse Survey reveals that 53 per cent of directors think that better decision making hinges largely on closer linkages of strategy and risk. Forty one per cent wish to clearly define risk appetite, promoting the risk culture, and taking a harder look at the 'upside' of risk-taking.
- Chief Risk Officers (CROs) traditionally have been entrusted with managing the 'downside' of risk but nowadays are being included in strategic business decisions to help management evaluate the 'upside' of risks
- Companies are moving towards merger of their risk and strategy committees forming a joint Strategy and Risk Committee to evaluate business decisions in entirety
- Companies are adopting risk-based strategy formulation wherein opportunities are harnessed from market disruptions, including the inherent risks involved with their impact, probability of occurrence as well as adding a third dimension – velocity of change
- Risk appetites are defined at corporate level in line with the company's strategic growth priorities, current risk profile and the total risks absorbed so far
- Key Risk Indicators (KRIs) are defined for top business Key Performance Indicators (KPIs) to act as an alert mechanism for approaching risks and any breach in risk thresholds
- Risk appetites along with KRIs are further cascaded down to business units using the Balanced Score Card approach to keep their relevant business risks under defined tolerance levels
- KRI performance is integrated in management reporting prompting executive management in case of any tolerance alarms or threshold breaches.

Risk-based strategy – A collaborative approach



- Enhancing risk governance:** To keep pace with the changing risk environment, boards are focussing, first and foremost, on the quality of risk information they are receiving. Directors continue to express concern that the quality, including the quantity, of information they receive may hinder their oversight. As per the KPMG Global Pulse Survey, 61 per cent of respondents expressed the desire for improvement in risk related information flowing to the board.
- Boards are seeking a wider variety of sources to help minimise 'asymmetric information risk' – the over-reliance on a single source of information (i.e. from management) – including analysts, investors and outside experts
- Changing the Board's committee structure and reallocating risk oversight responsibilities to balance

committee workloads are also being considered. For example, an IT sub-committee to look into the cyber security related risks, which an audit and risk committee would have looked into in the past, or a dedicated regulatory compliance sub-committee, for companies operating in a heavily regulated environment such as the financial sector

- Forming a standalone Risk Management Committee (RMC) independent of audit committee to avoid any conflict of interest as risk management processes are subject to internal audit procedures
- Designating CRO with direct reporting lines to RMC to avoid any conflict of interest with executive management. The CRO may have a dotted line reporting to CEO
- Internal audit and other lines of defence are integrated well to provide a holistic view of risks faced and managed by the company.
- **Creating a risk resilient culture:** Embedding risk culture in the DNA of the organisation is a prerequisite for a successful and effective risk management programme. Most organisations utilise their entity level instruments to direct the desired behaviour and risk culture in the organisation. However, that is not

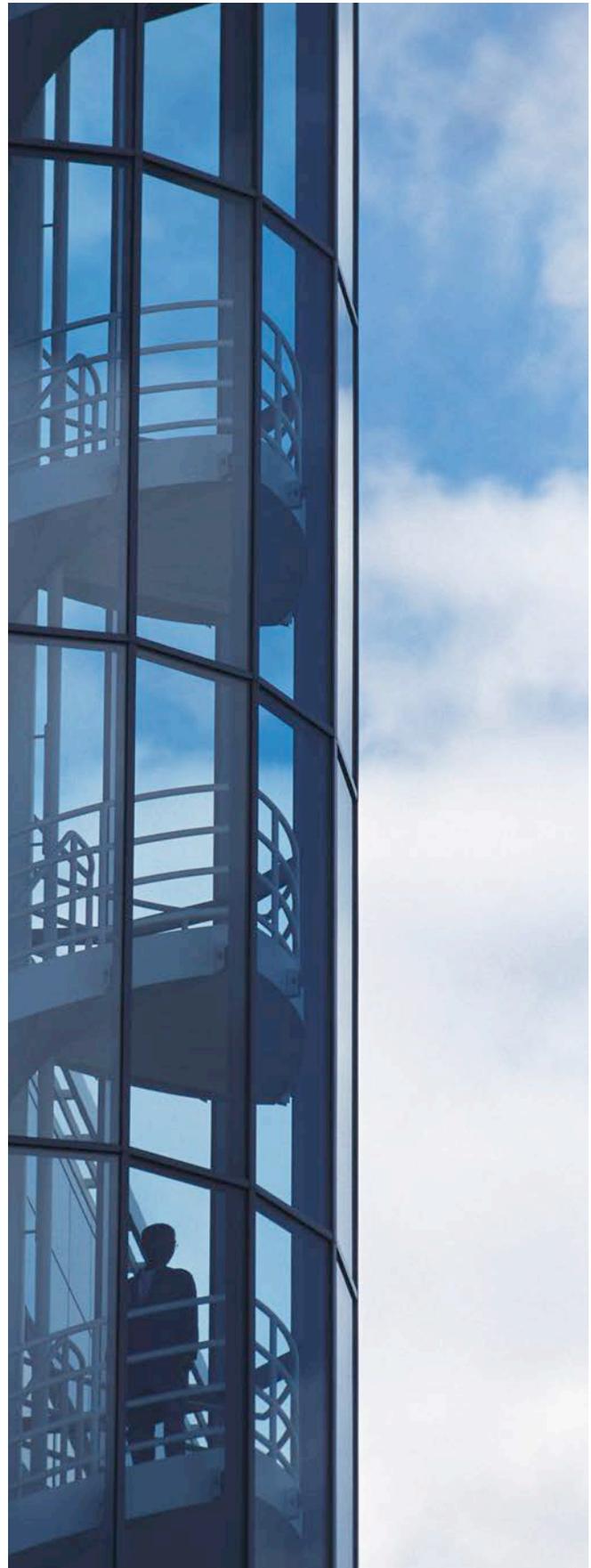
sufficient. Risk awareness and risk appetite are two such instruments, which are deployed to drive risk culture within the organisation. Risk awareness ensures that risk issues and perspectives are actively and effectively incorporated in decision making, and this is achieved by setting the right 'tone at the top' by the board itself.

- Risk appetite provides an overarching framework for companies to further the cause of risk management in a more objective manner
- The board is ultimately responsible for overseeing the definition of risk appetite and the corresponding organisational culture. Board members need to have a clear understanding of the desired culture and measurement approach
- The risk management function is responsible for ensuring that risk culture is embedded well in the overall organisational culture and also appropriate systems are implemented to drive the desired risk culture.
- Internal audit should define an audit methodology to measure the appropriateness, adequacy and effectiveness of the risk and control environment.

Key enablers of risk management



- **Tech-enablement in risk management:** Risk managers nowadays face the primary challenge of risk data being scattered across business unit silos and the lack of transparency on the part of process owners to disclose them. Equally challenging is the mindset of many organisations that risk management does not need any help on the technology front and is better-off functioning with the most basic tools available such as spreadsheets and PowerPoint presentations. Risk inventories are still being developed manually without analysing internal and external data for predictive and directive risk modelling. Predictive risk analysis could offer a leg-up to the Board and executive management to make better informed decisions.
 - Risk management tools available off-the-shelf are being successfully implemented by market leaders, and in some cases they are customised to business needs, including integration with their ERP systems
 - The advent of cloud-based technologies offering on-demand Governance Risk and Compliance (GRC) software as a service (SaaS) which is proving to be a cost-effective alternative rather than implementing an off-the-shelf GRC tool
 - Implementation of a dedicated risk event database to record risk incidents as and when they happen, thereby enhancing the precision in risk forecasting and probability analysis
 - Big data analytics is offering deeper insights by analysing risk events through scenario building and evaluating the probability and impact of risk events
 - Enhanced real-time communication between various risk stakeholders, timely recovery of risk incidents, automated alerts in risk threshold breaches, etc.
 - Integration of ERM systems with the management information system to provide seamless reporting on performance of Key Risk Indicators (KRIs) to executive management on a continuous basis.



Key takeaways

Our primary research has revealed perceptions of the risk being faced by Indian companies across sectors, and has provided deeper insights into how effective the risk management practices are on the ground and how leaders are marking the way.

- Expectations from risk management are outpacing ERM capabilities. Improvement in the maturity of risk management programmes is expected to equip the organisations in addressing the entire risk spectrum in a cohesive manner
- Risk governance for many is still in the hands of executive committee members, which leads to divided attention as well as conflict of interest, especially when their own function is in the line of fire owing to any serious risk incident
- Adopters of risk management are positively responding to the call of 'integrated assurance', aligning all three lines of defence in the company such as business units, risk management and the audit committee
- Some companies still consider operational and profitability risks among the top five risks. However, market leaders are proactively evaluating emerging risks such as business model disruptions, cyber security, social media threats to brand and reputation, advent of robotics, artificial intelligence and cognitive computing, etc.
- As far as strategic alignment of risk management is concerned, most companies claim to have aligned their risk management with business priorities and growth objectives. However, the true potential of strategic alignment with risk is still to be realised. Market leaders are seen taking adequate steps in that direction by forming joint strategy and risk committees, and by putting risk management discussions on the Board agenda
- Risk 'early warning systems' are implemented by market leaders to track 'signals of change' which are disruptive in nature. Contributing back strategy and planning team to drive the risk-based strategy agenda
- Risk appetite is another area of improvement for companies climbing the risk maturity curve. Some organisations still view it solely as a line not to cross, whereas leading organisations have successfully implemented it, pushing the risk limits further in search of greater rewards
- Companies Act 2013 has greatly contributed to enhanced awareness about risk management by clearly delineating the responsibilities for Board members including independent directors. It is up to the Boards now to be proactive and lead from the front on risk matters, not just for value protection but also value creation by considering the risk-based strategy approach.

Conclusion

The world has changed in the last decade. From an explosion of information, technological revolutions, digital transformations to the rise and fall of large business institutions, the global economic meltdown, regulatory tightening, all only outpaced by the evolution of newer and more ominous forms of risk.

As the dust begins to settle, there is a new awareness with which businesses globally are treading the path of growth. One where risks are taken mindfully after careful calibration, where they can be either converted into opportunity, or mitigated before they can cause any permanent damage.

While businesses and entrepreneurship cannot be fostered in an environment of fear and trepidation, organisations can also no longer afford to be flippant or dismissive about the new realities that they are operating in.

Companies that make informed choices and exercise discretion, with appropriate risk mitigation mechanisms, are the ones that will be ready to take on new challenges head-on and are the ones likely to eventually succeed.



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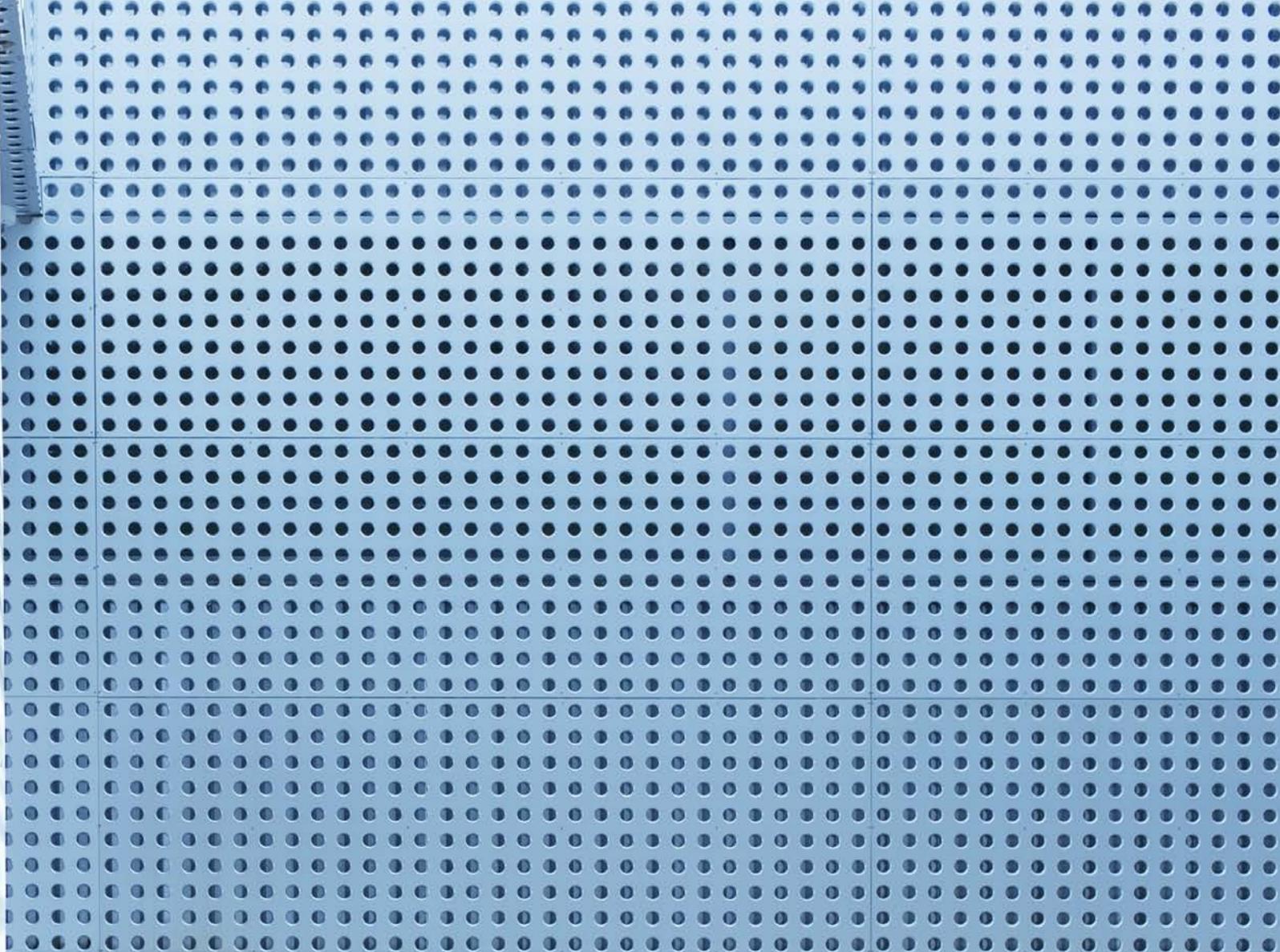
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