P3 STUDY NOTES

RISK

Chapter 1

Upside risk:

Possible chance of gain. Also called Two-way of speculative risk

Downside risk:

Pure Risk: No chance of gain

Some risks are quoted and have a market rate of return. E.g. Equity

Benefits of taking risks=

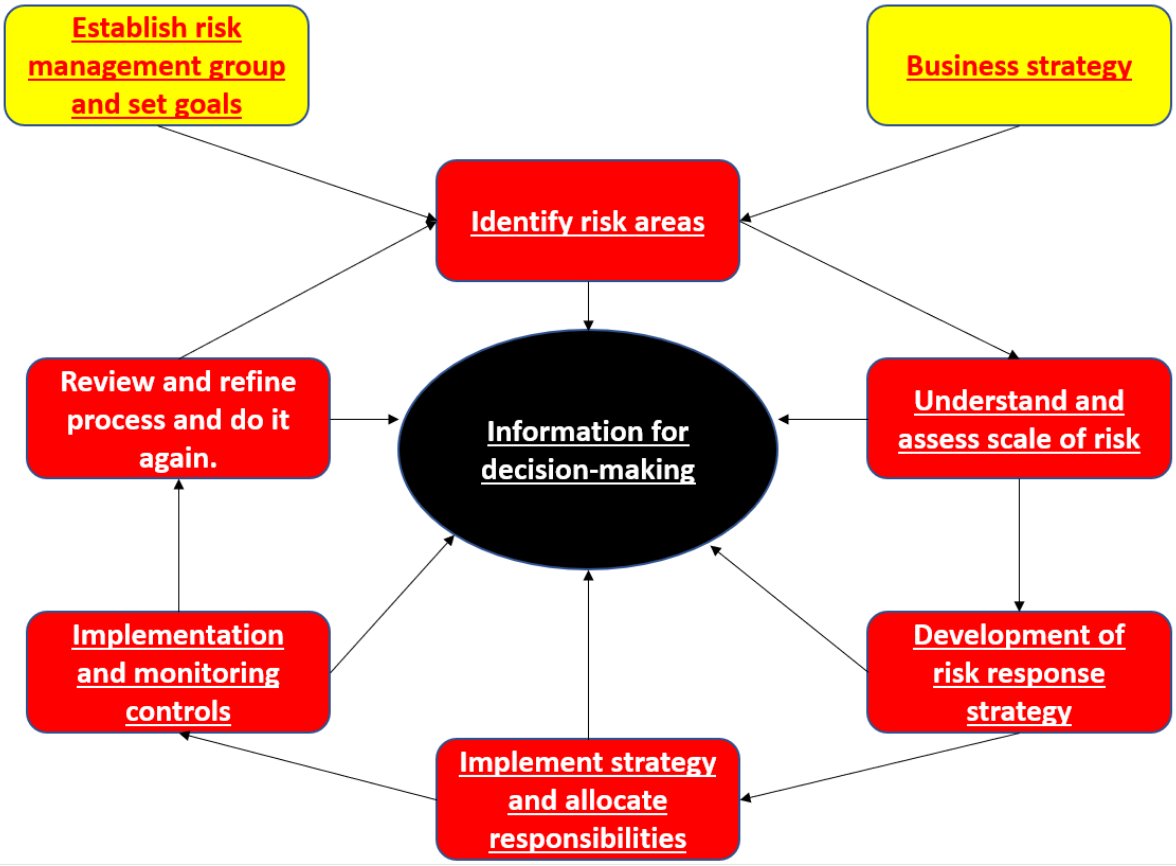
Concerns ability to gain competitive advantage on one side and activity risk on the other.

Advantage received from risk and level of risk being compared below:

		Activity risk	
		Low	High
Ability to gain competitive advantage	Low	2 Routine	4 Avoid
	High	1 Identify and develop	3 Examine carefully

a) **Low, low= Routine**
b) **High, low= Identify and develop**
c) **Low, High= Avoid**
d) **High, high= examine carefully.**

CIMA risk management cycle=



a) Establish risk management group and set goals
b) Business strategy,
c) Identify risks,
d) Understand and assess the scale of risk,
e) Development of risk response strategy,
f) implement strategy and allocate responsibility,
g) Implementation and monitoring control review and refine the process.

Types of risks=

A) Political, legal and regulatory risk= Regulatory regime that they operate in.

a) Political risk= depends on the political stability the country operates in. change of government can have extreme changes in how the business performs.

b) Legal/litigation risk= arises from the possibility of legal action being taken against an organisation. E.g. hospitals, tobacco companies.

c) Regulatory risk= regulations will affect the way business operates e.g. anti-monopoly, competition laws etc.

d) Compliance risk= risk of losses, fines, penalties because of non-compliance.

B) Business risk= kind of business company is in=

a) Strategic risks= risks arising from possible consequences of strategic decisions taken by the organisation. E.g. organic growth or acquisitions.

b) Product risk= risk that customers will not buy new products or that current product share will decline.

c) Commodity price risk= business may be exposed to risks from unexpected increase or falls in key commodities such as oil, petrol etc.

d) Product reputation risk= risk that a company could face because of an adverse event harming the companies brand image and product reputation.

C) Operational risk= risk of losses resulting from inadequate or failed internal processes, people, systems or internal events. Include fraud and malfeasance risk. E.g. Senior member of staff quitting, Raw materials wasted.

D) Contractual inadequacy risk=negotiated contracts and other business transactions without adequate information and consideration of what may happen if things don't go according to plan. E.g. penalty if builder doesn't complete building in time.

E) **Economic risk= changes in the economy affect the business. Those changes could be inflation, unemployment rates, international trade relations, fiscal policy etc. External risk to the business. E.g. The USA Credit crunch example.**

F) **Financial risk= risk of change in the financial condition. E.g. exchange rate, interest rate, credit rating of customer and price of good.**

a) Credit risk= possibility of losses due to non-payment of debtors.
b) Currency risk= Forex risk
c) Interest rate risk= gains or losses from rise or fall in interest rates.
d) Gearing risk= risk arising from exposures to high financial gearing and large amounts of borrowing.

G) **Technology risk= risk that technology changes will occur and will either be an opportunity or be downside for the business. E.g. Dot com bubble in 2005.**

H) **Environment risk= changes in environment for which an organisation might be responsible (oil spills) or over which an organisation has no control (global warming). E.g. Japanese Tsunami.**

I) **Fraud risk= Type of operational business risk.**

Considered controllable by most organisations. Will depend on the probability of the fraud occurring and the size of the loss if the fraud occurs also dependant on the type of business. Can be managed by fraud prevention, fraud detection and deterrence

J) **Corporate reputation risk= can be particularly significant for companies selling goods and services to customer markets.**

Most lie outside the control of the organisation. E.g. employing child labour, causing environmental damage, business scandals etc.

K) **Employee malfeasance risk = means doing wrong or committing an offense.**

Type of operational business risk. E.g. deliberately making false representations about a product or service in order to duping customers, committing a criminal offense by failing to comply to statutory regulations.

Risks in international operations=

a) **Culture**
b) **Litigation**
c) **Credit**
d) **Items in transit**
e) **Financial risks.**

Couple points to know:

a) **Risk identification and management is the responsibility of all**

b) **Dealing with non-democratic governments involves risk of malfeasance and fraud**