On the risk agenda 2023

Board Leadership Center (India)

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Ever evolving risks for a business

As the world continues to evolve, so does the risk landscape for organisations. In today's business world, risks are no longer limited to traditional areas like finance, legal, and compliance. As the world of unknowns expands; risks are now emanating from various new fronts – risk of pandemic; cyber-attacks; climate crisis; talent shortage; geopolitical and interstate conflicts; rapid technological disruptions; supply chain disruptions, among others. These rising uncertainties are now pushing risk managers to adopt a flexible, nimble, and agile approach to identify, prioritise and manage/mitigate risks across all frontiers of business environment.

Keeping in mind the pace at which risks are evolving, Security Exchange Board of India (SEBI) had recommended formation of risk management committee as an essential step towards improving risk management practices of Indian companies and ensuring their long-term success.

The risk committee is responsible for overseeing the Enterprise Risk Management (ERM) framework of an organisation which covers identification and assessment of risks, developing risk management strategies, and monitoring risk mitigation efforts. The board of directors is responsible for ensuring that the risk committee has appropriate resources and expertise to effectively carry out its responsibilities. As the risks continue to evolve, risk committees and risk leaders need to assess each risk based on its likelihood, severity and impact and formulate multiple solutions (tailored to each specific risk) to meet organisation’s strategic goals. To avert these risks, the directors must understand them; hence, the committee should keep adding new emerging risks to the risk register and prepare a list of threats which could be added in the future.

In the disruptive business environment, continuous monitoring, and assessment of efficacy of ERM processes are vital. With threats evolving, an ERM programme that might have worked wonders for your business in the past may fail to sense emerging risks and their potential impact on the company. Hence to keep pace with changing times, directors need to re-evaluate the relevance of the programme or related components on a continuous basis.

Listed below are some of the key themes which are currently relevant and are emerging as top risks across organisations:

1. Geopolitical uncertainties causing inflation risk

Global uncertainties have been causing inflation risk and affecting supply chains and trade of companies globally, causing a significant concern for their boards of directors. The disruption in supply chains has led to an increase in cost of inputs, resulting in higher production costs and a rise in prices of finished goods. Additionally, recent sanctions and restrictions on international trade and travel have resulted in shortage of critical raw materials, leading to a decrease in the supply of goods and services, further driving inflation, across the globe.

While some geopolitical developments are testing organisation's resilience, others are impacting their business and future strategies globally. As a result, the board of directors are feeling the push to devise effective strategies in areas such as cost management, supply chain and talent retention.

During the last year, boards of many companies played a crucial role in navigating businesses through complex working environment.

While many organisations are still working on ESG issues and tech plans, companies' boards may have to buckle up for persisting inflation and its impact on their businesses. It is time for directors to discuss with management and ensure that their company has a flexible and resilient business model that enables it to withstand today's geopolitical and economic challenges and thrive in the long term.

2. Talent management

Organisations across the board are experiencing talent shortage regardless of their size or industry. Developing an understanding of the impact of talent shortages on critical functions and strategising firm's roadmap to alleviate workforce shortages and related problems is likely to top the priority list for the board of directors in 2023.

An increasingly knowledge-based economy has highlighted the importance of talent and human capital management (HCM) and is marking the beginning of the era of employee empowerment, which in turn is causing many companies and boards to rethink the employee value proposition. With working models changing and the abundance of opportunities in the outside world, organisations are facing difficulty in developing, and retaining a talented workforce.

In the post-Covid world, employees are demanding fair pay and flexibility benefits apart from work-life balance, and opportunities to advance. The workforce wants to engage with organisations whose values – including a commitment to diversity and a range of ESG issues – align with their own. In 2023, we expect continued scrutiny of how businesses will adjust their talent development strategies to meet the challenge of finding, developing, and retaining talent amid a labour-constrained market.

Meanwhile, boards also need to ensure talent development and succession planning as a priority for long-term success of the organisation. Both the areas involve identifying and developing skills and expertise required to fill key leadership positions within the organisation. A procedure to develop talent within the organisation ensures continuity and stability of the business, reduces dependency on external hires and gives competitive advantage to the firm. It also helps mitigate the risk associated with key personnel leaving the organisation.

Having the right leadership and tone at the top is pivotal to driving culture and strategy, navigating risk, and creating long-term value for the enterprise. As younger generations take over, it becomes even more important to have smooth transitioning by providing relevant on-the-job training.

Covid taught us the meaning of uncertainties the hard way and taking lessons from the same, the board must set the seal on succession planning. Building a talent pool for critical roles will ensure that the company is prepared to take on leadership change– whether planned or unplanned, on an emergency interim basis or permanent.

3. Cybersecurity risk

The evolving nature of cyber threats has become a point of concern for businesses. The spike in cyber incidents is giving the board of directors a tough time as it can tarnish the firm's reputation, apart from causing financial losses. In the times when our dependency is more on the digital space, digital trust plays a crucial role, not just for customers, but also for the employees and vendors related to the business.

While cyber risk is leading the priority chart for many boards, the challenge that they often face includes a lack of a focused channel through which it can look at cybersecurity and compliance issues. Many a times, this may lead directors to under or overreact to certain cybersecurity breaches. Therefore, there is still a need to create more awareness for the board on emerging cyber threats.

As cyber threats become inevitable, it is time that boards look at skill diversity and onboard people who have relevant expertise and skillset. To avert the risk effectively, organisations must bring security teams into play to respond, recover and re-establish trust as quickly as possible.

Considering the evolving nature of cyber threats, the role of the board of directors (risk committees) has been underscored by the Securities and Exchange Board of India's (SEBI's) Listing Obligations and Disclosure Requirements (LODR) 2015 regulation as well. According to the provision, the board must keep a track of the frequency of committee meetings to understand if cyber risks are addressed effectively. Also, the risk officers or information security officers should consult and interact with board members on a periodic basis, to seek their inputs and address comments or asks from them.

4. Environmental, social and governance (ESG)

In the year 2023, ESG risks will continue to be on the priority list for boards and management. Integral to an organisation's strategy, the scope for ESG is broadening and pressure is also growing to improve transparency and reporting parameters.

The evolving ESG landscape has been stimulated by recent technological disruptions, unprecedented health crisis, and climate crisis. Assessing ESG-related risk demands ESG competent board. While every individual does not need to hold thorough expertise, but there is an increasing need for the board to be competent enough to understand ESG risks and its impact on long-term value creation. Considering the vastness of the ESG scope, a lot of it can also be driven by the ESG philosophy of each organisation as it might get too overwhelming for organisations and their boards to focus on all aspects of ESG. Depending on their priorities and areas of focus, organisations may also choose to focus on some key aspects such as achieving carbon neutrality; or focus on water conservation; etc. Nonetheless, boards today must understand the ESG-related activities that are of 'strategic significance' to the company, and how deeply they are embedded into the company's core business activities.

Shareholders today expect the boards to assess risks and articulate these through outcome-based measurements. In light of this, organisations will need to adopt rigorous and transparent reporting methods to meet stakeholder expectations and avoid accusations of greenwashing. In the recent past, challenges within the 'S' of ESG have also grown rapidly. Social factors such as how a company manages its relationships with its workforce, the societies in which it operates, and the political environment, are now central to a company's financial performance.

Increasing number of organisations are now embracing ESG agenda to ensure responsible business practices throughout their value chain. Unlike the traditional approach, adoption of quantifiable metrics is going to position sustainability as a critical evaluation parameter for employee remuneration as well.

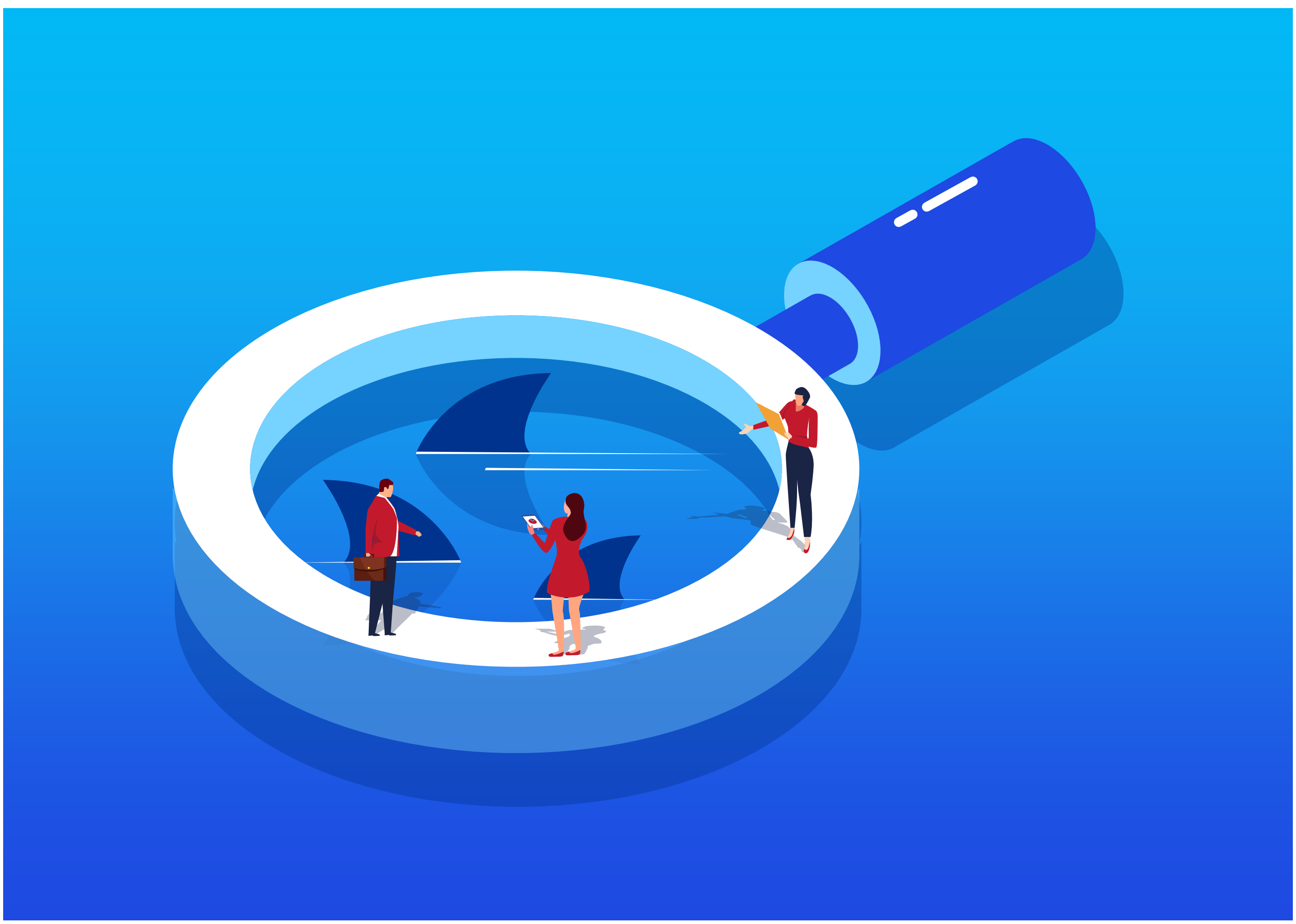
5. Fraud risk

Skyrocketing instances of fraud affecting businesses are giving tough times to the board of directors. Our dependency on technology and the advancing nature of fraudsters have overwhelmed the traditional controlling methods and the surge has led to damaging customers' trust, thereby increasing losses of the firm. As fraud risks continue to advance, leaders must find new ways to tackle the evolving fraud threats, whilst delivering a trusted client experience and enabling new businesses.

To deal with rising fraud risks, the board needs to ensure that the organisation has a robust fraud risk management process in place that follows the principle of 'Prevent-Detect-Respond'. It also includes identifying the types of fraud that are most likely to occur in the organisation and the potential impact of these frauds on the organisation.

Since prevention is the best way to manage fraud risk, organisations should adopt effective fraud prevention measures by developing fraud prevention policies, procedures, and controls, such as employee background checks, segregation of duties, and regular fraud awareness training. However, even with effective fraud prevention measures in place, it is still possible for fraud to occur. Therefore, the directors should consider a robust fraud detection and response process as well. This includes regular monitoring and auditing of financial transactions, employee reporting mechanisms for suspected fraud, and an incident response plan in case of fraud incidents.

Apart from this, induction of whistleblower policies can be an effective tool for boards in managing fraud risk. Such policies encourage employees, vendors, customers, and other stakeholders to report any suspected fraudulent activity without fear of retaliation.



Points to ponder

1. Is the board aware of the top risks and their respective mitigation action plans which impact the organisation?
2. Is the board ESG literate and is it structured to engage meaningfully on ESG issues?
3. How can the board help to ensure that ESG issues are priorities for the company, and it is following through on its commitments?
4. What is the company's plan of action to embed ESG issues into core business activities and drive long-term growth?
5. Does the committee integrate ESG goals and milestones effectively with executive compensation?
6. Is there a cyber risk plan in place to avoid the risk? Does the firm's cyber plan anticipate and adapt to changes quickly?
7. Do we have relevant expertise on the board to avert such risks? Has the management factored in risk with third parties, including outsourced IT and other partners in cyber strategy?
8. Has the management evaluated the legal implications and responsibilities of the board members in case of a cyber breach?
9. Does the business possess a cyber insurance cover? Is the coverage sufficient?
10. Does the board have a good understanding of the company's talent strategy and its alignment with the company's broader strategy? Can it forecast needs for the short and long term?
11. Does the talent strategy reflect a commitment to diversity and inclusion at all levels?
12. How robust are succession planning processes? Are they updated to reflect the CEO skills and experience necessary to execute against the company's long-term strategy? Are succession plans in place for other key executives?
13. Does the firm have a robust fraud combat strategy in place? How often does the board review the action plan to update the strategy as per evolving threats?
14. Is there relevant expertise available to control the damage done by fraudsters?

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