THE IMPACT OF RISK MANAGEMENT ON ENTREPRENEURIAL GROWTH AND DEVELOPMENT

Edna Stan-Maduka*

University of East London, UK

Abstract: Against the backdrop of the fledgling entrepreneurship development and the imperatives of risk management to mitigate failure, this chapter discusses the impact of risk management practice on the development of African businesses. It also considers how best to align the practice of risk management in order to achieve business continuity. More than ever before, global competitiveness and the need to trade-out of declining profits are currently driving businesses into risk management efficiencies in order to continue achieving increased returns on assets employed/equities for their shareholders. The attainment of these growth objectives can often be affected by several types of business risk (financial and operational) coupled with unpredicted movements in prices. These movements especially in times of high volatilities impact materially on profit growth potentials regardless of how well a business is managed. This chapter suggests how African business executives can evolve their business management styles to imbed risk management at all stages.

Keywords: *Risk, Management, Business development, Price-Volatility, Financial growth, Proactive Risk, Market Share.*

INTRODUCTION

The changing nature of the African business environment calls for a highly risk-sensitive approach to business development and practice. For many countries of the world, business development is all about increased funding and higher prices for stocks in the international market. As a consequence, there has been a major programme of capitalization and international trade finance, accompanied by cost reduction and restructuring in many countries across the globe in an attempt to free-up working capital and improve performance efficiencies. This perspective to business growth and development has resulted in unprecedented stagnation of business development within developing countries.

For African businesses, many executives believe that there are major opportunities for improved performances based on a step-by–step change transformation to the business environment, market and competitive positions. This is however not a feasible way forward for business as the market environment requires a more proactive rather than reactive approach to business management.

* University of East London, UK, Email: e.stan-maduka@uel.ac.uk

THE EMERGENCE OF A NEW GROWTH PERSPECTIVE

The current practices and global meltdown suggests that a new performance perspective is required in assessing business growth and development, where risk management will be the focal point; as it is no longer the primary objective of businesses to asses their growth potential based on profit figures and market share. In order to compete and succeed in the new business world and especially to trade itself out of poverty and declining investments, African businesses will have to re-evaluate their business models to embed risk management, innovation and constant challenge to existing models against the practicalities of modern day business environment (Doguwa, 1996). This need has been heightened by the complexities of the modern business environment which is saturated by technological advancement and online transactions, alongside their associated risks.

There is the need to optimise the flexibility of business operations. African businesses are usually closed up and dictatorial in their approach to business management. Improvement to the responsiveness and flexibility of business transactions will drive down cost, hence reducing liquidity risk (the risk that a company will not have enough cash/funds to meet its obligations as and when due). If a business concern can manage this type of risk effectively within their operations and business lines, its overall efficiency will improve and it will be easy for the business to be more responsive to changes in the business environment. Again, customer patronage will improve due to positive perception on the management of the business. Adequate management of liquidity risk will ensure that a business can optimise its available capital and deployment of constricted funding for a more flexible and robust balance sheet management.

BUSINESS GROWTH AND THE OPTIMISATION OF MARKET REACH

A major problem for African businesses is the fact that they control only a very small percentage of the global market. They have a highly restricted market reach. This is not a surprise as businesses require in-depth knowledge the practicalities of the global market and subsequent striking of a nitch. For African businesses to develop and optimise global market reach or achieve global excellence in business management and growth, it must achieve an outstanding product/service mix, backed by efficient risk management strategies (Doherty, 2005). This is also required if a business is gearing towards optimum return on asset employed. In order to succeed in the global world, all risks associated with new product design and development must be adequately mitigated. According to Hoffman (2002) country risk and interest rate risk must be reduced to their barest minimum for international businesses to manage their operational risks effectively. This idea is in line with Power (2005) which stated that the emergence of risks within business operations must be recognised and managed by all internationally active companies. African businesses have remained at the low side of growth due to the incessant effects of credit default and lack to funding (Ayadi, 1996). This difficulty to assess loans and the current level of credit default are adequate pointers to poor risk management and risk appraisal.

Risk management practices enable business executives to accelerate decision-making from policy formulation to the execution of such policies in a timely manner. Risk management determines all the steps which businesses will follow in other to identify all the issues which can affect their business and how best to mitigate their impact on business growth and development. If companies are not able to mitigate their risks, they will find it very difficult to take advantages of business opportunities with 'shorter windows of opportunity'. These are opportunities which are presented with very limited time frame within which any investor can take advantage of their benefits. Again, adequate risk management will enable organisations to respond rapidly to business environmental changes. Identification of the full complexities of the business environment will promote a strong alignment of business strategies with the business control framework. It is worth noting here that most businesses believe that the gaining, retaining and deployment of a talented management team is capable of addressing complex market and organisational problems. Regrettably this has not been the case for most businesses operating in the sub Sahara African. If these businesses will regain and maintain shareholder confidence and transparency, then there must be better risk communication and reporting on financial and non financial performance. However, the performance of a business and its ability to remain vibrant within the international business terrain will mean the utilisation of all practices which ensure that performance is measured and managed both qualitatively

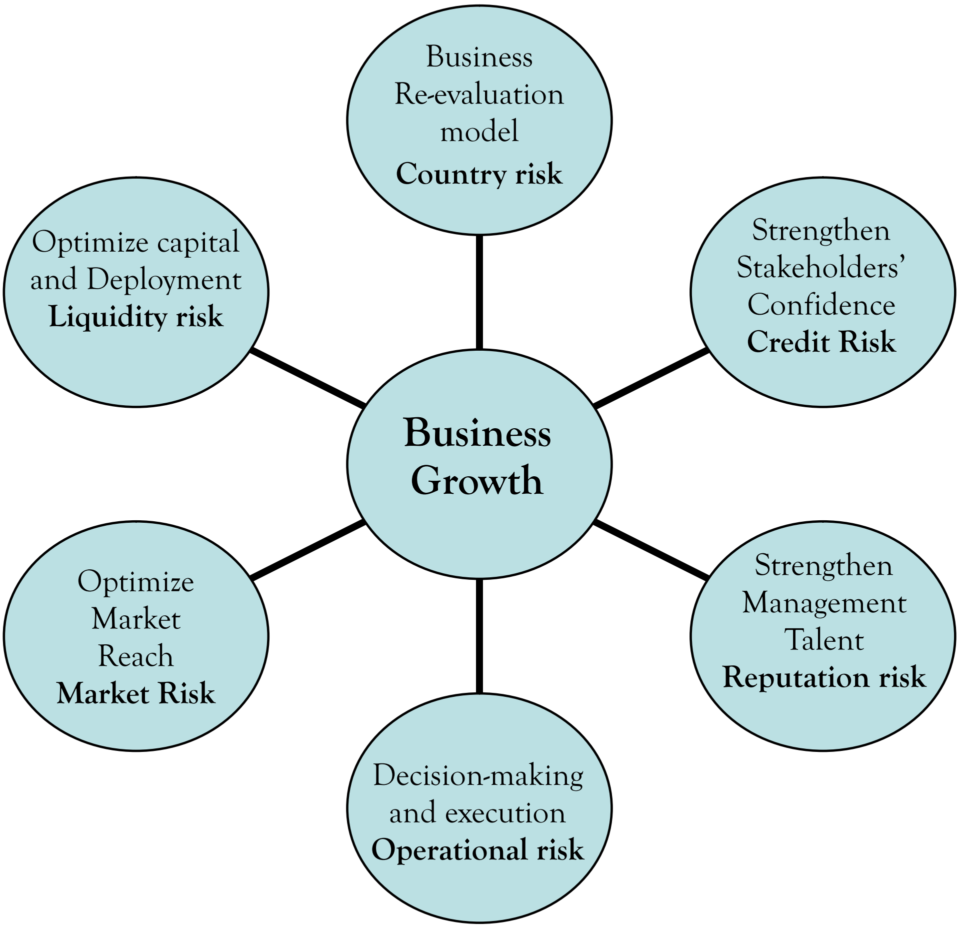

Figure 1 Interlink of risk management and performance measurement.

and quantitatively. As stated earlier, many African businesses has failed to recognise the key role which performance measures such as public perception play as qualitative measures of performance. These measures can determine how well a company is performing based on the risk factors and sub factors associated with the day-to-day running of their businesses.

Risk management and performance measurement can be interlinked to form a wheel of business development objectives. Though their importance in business development may vary from sector to sector or country to country, or even organisation to organisation; they both call for attention if business growth is to be achieved.

The performance wheel can be used by internationally active businesses in focusing management attention as they move towards growth and enhanced performance in the global business environment. It is obvious that there is a place for risk management in all activities performed by business in terms of their growth potentials. Therefore until risk is adequately mitigated in all operations, there will be a long wait for African business development to meet the demands of the modern day business environment.

RISK PROFILE AND MARKET VOLATILITY

The business environment is very volatile with abrupt changes in the prices of goods and services (Mitroff, 1988; Colquitt, et al., 1999). This volatility also affects the way in which business is run in any particular sector and in any country. African businesses have faced a lot of abrupt changes in stock prices within the last five years with prices falling consistently within the last two years. This is an indication of the fact that businesses must understand the risks associated with share price index and their derivatives.

This lack of attention to market price volatilities has kept African businesses at the low side of growth and development. The intense nature of competition and market uncertainties heightens the need to understand and imbibe risk management within the culture of African businesses. The cultural impact of risk management means that every member of the organization understands their involvement and contributes to the development of risk management practices. Business growth must recognise the need to integrate risk management into corporate strategy, be vigilant about counter-party risk–client, banks, derivatives, and the use of alliances to share risks. There is also the need to develop a broader perception within business development strategic decision to create a more risk-aware environment. The fundamental action which African businesses need to take is to ensure that risks associated with their businesses are properly assessed, priced and controlled. In a recent survey of twenty Nigerian companies on risk profile development, 85% of the companies indicated that their business risk profile has increased substantially within the last twelve months: while only 15% indicated that their risk profile has increased reasonably within the last twelve months. None of the companies indicated any increase in their risk profile. Another indication of the souring increase in risk profile of businesses in Africa was also evidenced in a similar study conducted using twenty five Nigerian Companies which concluded that an average Nigerian company spend about 62% of its revenue on risk management activities. This clearly shows that these businesses are reinvesting their profits into risk management as against new product development and business growth activities. With this type of activities, these companies will find it difficult to come out of poverty and declining business. Profits are meant to be reinvested in new product or new market activity for business development. It can be clearly deduced here that if risk is properly profiled , controlled and managed there will be increased confidence in shareholders to invest, which will mean more business undertakings, reduction in unnecessary costs and improved international business presence. The problem for many sub-Saharan African companies, despite their size and business orientation is to get the balance right with risk management. The stagnated growth of these companies mean that their risk models are not robust enough to mitigate all or most of the risks (financial and operational) associated with their business transactions.

These difficulties are usually presented by lack of recognition of these risks and the limited scope of their assessment (Doguwa, 1996). Most identifiable risk assessment models within some companies were either too narrow or excluded interested parties such as customers, suppliers/contractors, employees and counterparties from assessment. Again some o the assessment models were not frequently monitored and reviewed which meant that business executives either operate with historic, stale and inaccurate data which does not aid any efficient evaluation of the business environmental charges.

It can be argued that most business executives are over-concerned with profit goals. There have been well published cases where business growth potentials were purely based on the ability to surpass a certain profit goal set by either shareholders or executive directors. In these cases, risk management were totally neglected both in internal and external operations.

INTEGRATING RISK MANAGEMENT WITH BUSINESS STRATEGY

Many businesses are currently moving towards the incorporation of risk management strategies into corporate decision making process: a process which has evidenced both a change in personnel and traditional business practices. Operational risk, reputation risk, liquidity risks and market risk are some of the areas of risk which have been neglected by businesses (Power, 2005) but now receiving increased attention by companies who aim to trade themselves out of poverty and also position themselves as twenty first century companies. With risk management as a focal point, businesses are expected to pay significant attention to stability of their operations. It continues with the expectation that such companies should have contingency plans to take care of any unexpected circumstances and also ensure that in events of any business disruption, the company can be back to business as usual in the least of time. The continuing fold-up of many companies is also a pointer towards the need for counterparty risk management which can help prevent crisis. The difficulty for counter- parties to meet their obligations as they fall due has a corresponding pull on credit risk management, an area to also watch by internationally active businesses. This therefore indicate that companies wishing to be industry high flyers must monitor all credit ratings – including liquidity risk and capital structure; this does not imply only direct counterparties but also any guarantors to a counterparty. From the foregoing, there is clearly an interlink between business risk exposures and growth potentials.

STRESS TESTING AND SCENARIO PLANNING AS TOOLS FOR BUSINESS GROWTH

In order to prepare for the future, businesses need to be positive towards enhanced risk management practices. Especially in terms of developing better risk forecasting and stress testing. Most regulators currently expect that businesses operating within their economies should overhaul their existing stress testing processes. There is also an expectation that siloed risk – based stress testing framework should be abandoned in order to create a more step by step proactive risk management framework. From prior studies and industry experience, market –wide and organisation – specific stress tests applied in both short and long terms were highly recommended for businesses who wish to adequately control their business practices and trade themselves out of declining profits and stagnation. Many companies operating in sub Sahara Africa have not done any work in terms of stress testing and this leads to over- turned business proposals. Therefore, a detailed revision of risk management practices within the business operations of these companies is urgently required.

CONCLUSION

In order to ensure business growth and development, it is imperative to establish and develop sound practices for identifying the complexities in the business environment and developing processes to manage all risks associated with those complexities.

The purpose of monitoring the risk in any business is not to eliminate risk. As already indicated, it is impossible to eradicate risk from any active business. The aim of monitoring the risk in a business environment is to avoid the high-impact risks that will damage the business and threaten its continued existence. Therefore it should be in the culture of any active business concern to monitor its business activities to ensure that all risks associated with their transactions are adequately managed. Again an organisation cannot afford to be reactive in the management of risk due to the far reaching effects of risk events on profit goals and business growth.

African businesses are therefore expected to develop risk management tools which are capable of predicting areas of increasing exposures so as to proactively manage these exposures and prevent the crystallisation of potential extreme risks. To achieve this, there should be an in-depth understanding of the risks being faced by these businesses due to their operating environment. These factors can then be monitored and action taken when adverse events threatens the development of these businesses. Unfortunately African business executives have always viewed business development as the availability of funding and the increase in investments. They have regarded risk management as either the introduction of additional uneconomic controls to prevent losses or as an activity which does not add value to the business. By developing procedures that proactively identify areas of increasing and significant exposure, and ensuring that these areas are addressed promptly by the business units that own the risk, business executives can in reality reduces losses and avoid potentially adverse unexpected events, which will ensure the growth of African businesses.

REFERENCE:

Ayadi, O., (1996) Marketing of Bank Services, Regulation, and Bank Profitability in an Emerging Banking System, *African Review of Money, Finance and Banking.*,1(2), pp.107- 120.

Colquitt, et al., (1999) Integrated Risk Management and the Role of the Risk Manager. *Risk Management & Insurance Review*, 2. pp. 43-61.

Doguwa, S., (1996) On Early Warning Models for the Identification of Problem Banks in Nigeria. *CBN Economic and Financial Re view,* 34(1).pp 462- 487.

Doherty, N., (2005) Risk Management, Risk Capital, and the Cost of Capital. *Journal of Applied Corporate Finance*, 17(3). pp.119-123.

Hoffman, D., (2002) *Managing Operational Risk: 20 Firms-Wide Best Practice Strategies*. John Wiley & Sons, Inc., New York.

Power, M., (2005) The Invention of Operational Risk. *Review of International Political Economy*, 12(4), pp. 577- 599. Routledge London.

Mitroff, et al., (1988) "The Structure of Man-Made Organizational Crises. Conceptual and Empirical Issues in the Development of a General Theory of Crises Management". *Technological Forecasting and Social Change*, 33(2), pp. 83-107.