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Risk management — Nothing risked, nothing gained

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WITH competition hotting up and the business environment becoming more volatile, companies have to be on their toes to prevent themselves from being overtaken by rivals. Risk management assumes a vital role in this regard.

But though the environment has become riskier in recent times, the approach to risk management still remains simplistic in most companies.

Corporate treasurers and CFOs have long tended to equate risk with fluctuations in interest and exchange rates, or stock and commodity prices. Their focus has been on covering these risks with appropriate hedging techniques such as forwards, futures, options, asset liability management and so on.

Yet, risk management is far more encompassing than this traditional approach. Businesses have to take risk. Otherwise, they cannot grow. And if they do not grow, they will become marginalised. For instance, the retailing industry. Many of the retailers in the US are in trouble not because they did anything exceptionally wrong but because one of them, Wal-Mart, has grown so fast (today, it is the largest company in the world) that they have now been relegated to the status of bit players. At the same time, the growth should be sustainable and profitable. In its quest to grow, a business cannot afford to take more risk than it can handle.

For instance, the Essar group. To exploit the business opportunities opening up in a liberalised environment, the group diversified into many areas in the early 1990s.

But very soon, Essar, which started off in commodities and then moved into shipping, found that it had underestimated the competencies required to handle many of the new businesses it entered. Today, it is in deep trouble and its market capitalisation has been eroded.

The essence of risk management is identifying the right opportunity and exploiting it effectively. Companies which do this well are today's star performers. For instance, Hero Honda. The company correctly understood in the 1980s that the future lay in motorcycles, not scooters. So it channelled all its resources into motorcycles. That is how it was able to dislodge Bajaj Auto, the unchallenged market leader for long in the country's two-wheeler market. Of course, Bajaj Auto too caught on and gained ground.

Similarly, Infosys. In the early 1980s, the company understood the importance of tapping the US software market. So it built a strong international marketing team.

Also, it pioneered its global delivery model, essentially consisting of a strong marketing set up in the US and cost-effective operations at its Offshore Development Centres in India. Today, the global model has become more sophisticated with a network of development centres across the world.

Identifying the correct opportunity is not easy, as the environment keeps changing and markets never cease to surprise.

Yet, companies must learn to take a position. Trying to play safe or trying to do everything is the surest way of losing out in the marketplace. The pharma industry is a good example. Some firms such as Ranbaxy are betting heavily on the generics opportunity.

This is because many drugs in the US are going off-patent and there is a tremendous opportunity to reverse-engineer them.

So, Ranbaxy is investing heavily in its global marketing, legal and manufacturing infrastructure. At the same time, there are a few companies which have decided to take a different approach.

One of them is Nicholas Piramal which feels that partnering with global pharma firms in areas such as contract research, and clinical testing is the way forward rather than challenging the patents of the global pharma MNCs. Unlike other drug majors, which have been more focussed on the export market, Nicholas Piramal believes there are big opportunities in the domestic market.

Only time will tell which will be the right strategy. But the fact remains that to manage risk effectively, the environment has to be understood to take a decision on the direction the industry will take. Risk management is also about understanding the company's competencies well. This ensures that the company does not try to exploit opportunities it is not equipped to handle.

It also ensures that potential opportunities are not ignored even when things are currently going well for the company. When a company is aware of its strengths and weaknesses, it is better able to take strategic decisions relating to capacity expansion, diversification, and so on. And the ability to take better decisions is what risk management ultimately boils down to.

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