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Strategic planning and risk management — Closer integration, better business

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COMPANIES face threats in the form of new competition, new technology, changes in consumer tastes, and so on. But only a few of them manage these risks effectively. Those who do are alert to changes in the environment and are willing to change internally to respond to them. These companies know how to integrate their risk management processes tightly with strategic planning. For they understand that risk management is all about pursuing the `right' opportunity and dropping the `wrong' one.

A few examples will illustrate the point. Swedish company, Stora, has shown remarkable ability to formulate strategies according to the need of the hour. It has not hesitated to go outside its core business when the situation has demanded. Once it even took on the King of Sweden to retain its independence. To cope with the changing environment, the company has from time to time moved into new businesses — from copper and iron smelting, to hydropower, paper, wood pulp and chemicals. In the process, the company mastered steam, internal combustion, power and even microchip technologies. Had Stora continued in one business, it probably would not have survived.

Another example is that of Nokia, one of the most admired companies in the world today. Though Nokia has come to the limelight only lately, it has been around for more than 100 years. At one point, Nokia dealt in wood, pulp and paper. Today, it makes sleek cellular phones loaded with powerful software. As the environment has changed, Nokia has constantly fine-tuned its strategies to keep ahead of the competition and to take advantage of the new opportunities emerging in the business environment.

Royal Dutch Shell (Shell) is another good example. The company has mastered the art of scenario planning. Shell constructs scenarios which paint the possible future. As a result, Shell managers are well equipped to deal with discontinuities in the environment.

The lesson from Nokia, Stora and Shell is that strategic planning lays the basic foundation for a company's risk management processes. Effective strategic planning implies the ability to digest what is

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happening in the environment and to reshape the organisation accordingly. This becomes easier when an organisation is prepared for various eventualities. Then, as events unfold in the environment, it is better equipped to decide which strategy would work best. Straitjacketed thinking, on the other hand, makes employees impervious to external developments. When changes do occur, the employees are taken by surprise.

A simple, day-to-day activity would drive home this point. A person who travels by bus to office would not be unduly worried about a prolonged railway strike, as it does not affect him. But a person who realises there could be an occasional bus strike which would necessitate travel by train, would follow the strike with greater interest. In short, by being open to various possibilities and examining the possible course of action for each of them, strategic planning can, to a large extent, keep risks within manageable limits.

The essence of risk management is to help a firm survive and grow in a profitable manner. When the environment is unfavourable, the firm will concentrate on survival and when it is favourable, it will attempt to exploit new growth opportunities. The speed with which a company adjusts to the environment depends crucially on the ability of its senior managers to observe and understand what is happening outside and respond accordingly. This is where strategic planning comes in.

It may be emphasised that the aim of strategic planning is not so much about coming up with magic solutions as to facilitate the process of institutional learning by encouraging people to question basic assumptions. This will train them to challenge conventional wisdom and encourage them to think of possibilities they had not considered earlier. This makes them better equipped to absorb and digest information and, most important, act quickly in a fast changing environment.

The way a company approaches strategic planning has a significant impact on the way it manages risk. Just like risk management, strategic planning calls for a right balance between intuition and use of hard data. Many companies take strategic decisions relying totally on their gut instincts during times of uncertainty. This is obviously a wrong approach. Intuition has to be backed with numbers for strategic planning to be effective.

Mr N. R. Narayana Murthy, Chief Mentor, Infosys, has constantly emphasised that sound decision-making is possible only when the relevant data is carefully collected and examined. The most common reason for wrong strategic decisions is the influence of emotion. Mr Murthy feels the key to effective decision-making is taking emotions out of the picture. And the way to avoid the influence of emotions is to take a dispassionate look at the hard data. Microsoft's Bill Gates has made the same point in his book *Business @ the speed of thought*.

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To manage risk effectively, strategic planning must combine a judicious blend of top down and bottom up approaches. While the top management can give the overall direction, no one understands the environment better than the frontline employees.

If the inputs of lower level employees, based on their day-to-day experiences, can be fed into the strategic planning process, risk management will be that much more effective.

Clearly, the need of the hour is to integrate risk management tightly into strategic planning. Keeping risk management as an isolated function is both undesirable and avoidable.

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