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Balancing Conformance and Performance in a Volatile Environment

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The year 2015 got off to a rocky start: plunging oil prices, fluctuations in major economies, and terrorist threats will have an ongoing impact through the year and beyond.

At the same time, regulators around the world are attempting to step up the quality of corporate governance, and investors are subjecting board compliance programmes to greater scrutiny.

Boards may therefore feel that a good strategy for 2015 is to adopt a risk-averse approach, and focus on compliance instead. This is, in many ways, a sound approach. A robust enterprise risk management (ERM) framework, solid risk mitigation policies, and business continuity plans are all strategies that contribute greatly to the strength of a business.

But compliance also represents a potential opportunity cost. Under Singapore's Code of Corporate Governance, the board is responsible for the long-term success of the company. This includes the setting of strategic objectives and oversight of the company's performance. If a board allocates most of its time and resources to compliance, it may inadvertently reduce its ability to guide and assist the company's growth.

RISK OPTIMISATION

Boards use their extensive combined experience to ensure that the company's assets and shareholders' interests are protected. This focus on risk mitigation is primarily internal. To balance this approach, boards should also adopt an external focus, this time on risk optimisation: recognising the opportunities inherent in a volatile business environment, and ensuring that the company can take advantage of them.

Such boards can adjust themselves in several ways to better meet these risks and opportunities. First, they should include individuals who can help to drive their companies' strategy, and who are able to evaluate opportunities equally with risk considerations. Members of these boards should attempt to maximise the value that their roles and responsibilities add to their companies.

A board should also be cognisant of its responses to the risk environment. This may be an opportune time for it to consider how often it should review or change strategic direction. It should also evaluate how its risk appetite will impact the company's strategy and performance. For example, it is useful to recognise when a low risk appetite may have an adverse effect on the company's growth.

At the same time, the board may wish to re-examine existing controls, such as the ERM framework, to ensure that the framework is capable of influencing business decisions where necessary. An assessment of the company's culture may also be useful, to determine whether the company as a whole is able and willing to support risk-optimising decisions.

There are other ways in which the board can contribute to the company's performance. For example, it should consider specific growth opportunities for the company as they present themselves, and determine whether the company is positioned to take advantage of those opportunities. The board can also play a greater role in strategy, or take a hand in ensuring that the company is prepared to handle business interruptions.

OPPORTUNITIES FOR COMPANIES

The risks of 2015 and the coming decade are significant; there is little possibility of these risks decreasing. Besides economic issues such as the fall in oil prices and fluctuating interest and exchange rates, the world is also confronted with geopolitical tensions, environmental degradation, and high unemployment rates which may lead to social instability.

On a smaller scale, businesses face internal risks such as IT security and the increasing weight of regulatory compliance.

While many of these risks may be difficult to mitigate, they also present potential opportunities for businesses. For example, many industries may be able to take advantage of falling oil prices. Manufacturers may be able to reduce their operating costs. Other sectors may wish to reconsider their strategies. Companies in the aviation sector, for example, may take the opportunity to review their hedging strategies.

In such a fast-changing environment, boards should be open to the possibility of taking action as and when the situation warrants, rather than adhering to a fixed schedule. For example, the Swiss National Bank's recent removal of the cap on its currency took international markets by surprise. Businesses need to be nimble and react quickly to such unexpected events, and decide whether to seize opportunities or forestall losses.

It is tempting to think of today's volatile environment as a call for risk mitigation. However, companies may be able to find, and should actively seek, opportunities for risk optimisation as well. To successfully do so, boards will have to take up the challenge of changing their mindset from an internal to an external focus. They will need to reconsider their approach to risk and opportunity. Ideally, they should play a greater role in directing not just the company's compliance, but also its performance. ■