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Managing Risk in A Crisis Situation in The Company

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Abstract

Modern business organizations cannot rely on guaranteed development in an uncertain external and internal environment, generating a variety of dangers and threats, each of which requires a specific approach and a specific model of behavior. Adapting to the requirements of the external environment requires effective management of the "input-process-output" cycle. This management goes through different phases of recovery, stagnation, or crisis, requiring risk perception as an objective and permanent asset in the organization. That implies focusing of the management's efforts on the detection of the determinants of individual types of risk, a research on possible adjustments of these determinants as well as establishment of a system allowing elimination of the existing risks. It is very important for the managers to diversify the risks which come out of the crisis. They should identify, measure, and assess the potential risks by priority, to develop program measures guaranteeing the company conditions where it could continue fulfilling its aims and tasks. The article presents the most common problems in a company's management during crisis and focuses on the possible responses to risk, intended to minimize the consequences of events with negative effects or respectively to maximize those with positive effects.

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INTRODUCTION

The survival of an organization depends on its ability to adapt to the requirements of the external environment. The termination of the predominantly continuous process of adaptation is a kind of a crisis in each organization. From the system approach point of view, the factors that could provoke a crisis in the organizations, are all elements of either the external or the internal company environment. In the same context we can classify the reasons that cause the crisis as "external" (ones that do not depend on the company activity) and "internal" (ones that depend on the company activity).

The influence of the external environment factors (both at the input and at the output) could enhance or limit the company activity. Each unfavorable influence is a potential prerequisite for a crisis to occur. For example, sometimes it is **the competitors** who cause the crisis. Their actions should be constantly analyzed by the company management. Thus, it should be possible to outline their strategic and tactical intentions and to forecast the changes it desires. Competitors' targets would specify the alternative for changes in the company and the relevant stage of the crisis development.

The crisis situations become more concrete and are mainly influenced by the conditions of **the macroeconomic stability or destabilization**. In a situation of a public destabilization, the possibilities for crisis situations in a company are many more.

Changes **in demand** of a certain product or service or the changes in the structure of the demand to which the company does not react, could be important reasons for the appearance of a crisis. Changes in **customer's behavior** towards products and services, offered by the company could be treated as an indication for a future unfavorable tendency for the sales revenue.

The movement towards an unfavorable direction of the **raw materials prices** could lead to a change in the distribution policy, search for new distributors and other actions, whose realization is connected to shorter or longer crisis in the company.

The desire to change the production technology. The introduction of a new production technology sometimes requires organizational changes, increasing the performers' qualification, as well as new professional requirements. The process of adaptation towards these requirements quite often causes tension among the employees which could also be a prerequisite for a crisis.

Changes of leaders' targets e.g. company owners. Every company in its development follows the personal and professional development of its managers by showing their weak and strong sides. This could be easily seen in small and medium size enterprises which are managed by their owners. In that connection the change in owners' targets could cause a change in the organization which would lead to a crisis.

Finally, a change in the personnel's targets, being part of a system-formation element, could also lead to a crisis in the organization.

Therefore, we should define the concept of crisis and a crisis in an organization. A review of the economic literature about that problem did not show one single fixed, straightforward, and invariable definition of a crisis. As a concept which accompanies the development of not only the different economic structures, the crisis is also an intellectual, human, technological and natural phenomenon where there is a collapse of the adaptation opportunities of a certain system (an organism, an individual, a group, a community) with two possible outcomes: The first one is fatal, leading to the system destruction and death and the second one is positive, related to a successful, relevant reaction to the challenges where a new type of structure is built, together with a changed model of behavior. Each crisis is characterized with a total influence upon the human social systems and diversity effects, some of which are with positive results (Маринов 2004, p.106).

From a practical point of view, the knowledge of a proper definition about crisis is not useful. On the contrary, it could prevent and not allow a certain situation to be identified as a crisis because in many cases these definitions depend on the specific conditions where a crisis situation undergoes a crisis development or on the crisis targets, defined by a certain public group. The number of situations, depending on the different criteria, which are used to be defined as a crisis are quite limited. Hence, knowing the different types of crisis definitions could be used as a vital identification and an adequate orientation in a company crisis. That is why it is very important to have a general approach and techniques for defining a situation as a crisis. If we accept that crisis is a counterpart of stability in an organization development, we could say that stability of an organization is breached, when there is a diversion from the desired company results and actions and the incapability of the management to rebuild the normal working rhythm depending on its experience and organizational potential. **In other words, when due to any other reason like lack of means, information and bad management, the aachievement of the company targets is blocked, a crisis situation arises.**

The first symptoms of a crisis situation show that it is time when the decisions about the problems that had occurred could lead to turning point in the company development e.g. towards improvement or deterioration (Христов 2002, p.18). The result from the changes, related to these decisions, could be either extremely unfavorable or positive.

The best indicator for the development of a crisis as well as for its separate stages is **the availability of conflicts either in the group or between the groups in a single organization**. Crisis situations influence the activity of different groups of people in a company. In most of the cases these groups are known and undergo a rational management. The bigger the number of conflicts is, the quicker the changes are. The stronger the conflicts are, the most radical the changes are. The longer and the bigger in range the conflicts are, the more influential they are on the market and on the separate market players. After every conflict, a momentum result follows. It can predict the future development of crisis or its separate phases.

We could say, of course as a joke, that the easiest way to overcome the crisis is companies to stop working therefore the economics would disappear, and with it the crisis itself. **The truth is that even in a time of crisis most of the companies would not stop working and therefore their managers would not stop managing.** In such difficult times, it is the role of management that becomes even more important.

The crisis in a company could be invisible and could continue for a long time, diverting big resources. It could pass extremely fast, especially if the managers have assessed the available resources and have defined which ones of them (financial, human, production, distributional, etc.) should be changed or added for the successful overcoming of the crisis.

A company exit from crisis is in fact its management during the crisis. This kind of management requires methods and approaches which significantly differ from managing the company in a normal situation. The so called anti-crisis management aims to avoid or remove the unfavorable phenomena for the business by using the potential of the contemporary management and to develop and realize the specific strategic program of the company e.g. which will allow the elimination of the temporary difficulties by using mainly its own resources. In these conditions the company behavior is new (Христов 2002, p.25).

The outcome of a crisis could not be completely forecasted. The diversity of the output result (no matter whether positive or negative) creates a risky situation itself. In this context, **a significant role for limiting the effects of the crisis plays the successful risk management.** The important role of risk management in the business management in times of crisis has been successfully characterized by Kloman: "… its challenge is to teach us how to live with the insecurity, therefore, to turn the risk into a motive rather than into an unacceptable threat. In the organization itself the risk management should turn into an integral part of the technology and management, where the assessment, control and financing against risks, costs and benefits would be in a constant process of rational sagacity and thought."(Kloman 1992, p.92) It is usually accepted that the risk has a negative side only, hence, the management strategy is a prevention and limit to the potential damages. Recently, however, the risk management is treated more as an activity, trying to study and manage both the positive and the negative side of a certain event. It is very important for the managers to diversify the risks which come out of the crisis. They should identify, measure, and assess the potential risks by priority, to develop program measures guaranteeing the company conditions where it could continue fulfilling its aims and tasks.

Risk identification is the first step in the risk management process. A prerequisite to risk identification is exploration of the risk circumstances which adversely affect the normal operation of the organization. The results of the risk identification are correct if the risk sources (internal and external) are correctly identified. Most common amongst them are:

- The position of the owners of the organization is wrong regarding the development, expansion or change in the business.
- Bad natural and/or climatic conditions preventing or restricting the implementation of the organizational goals.
- Unforeseen changes in the domestic or the international political and economic situation.
- Insufficient qualification of the personnel to deal with embedded new technologies and associated risks in the production process or services, etc.

It is necessary to be identified the effects of these detected risks, which in most of the cases relates to loss of capital, fixed assets, ready production, major suppliers, regular customers, qualified employees, illegally exported and supplied to the competitors confidential information. In most of the cases in the previous step in the risk management process is identified extremely large number of diverse risks. Therefore, the so identified risks need to be analyzed to be determined which of them have a distinct impact on the business or could cause the greatest negative consequences. In this context, the risk analysis is based on the combination of the possible effects of the risk and the likelihood of its occurring (Stavrev, 1991, p.14). For more convenience could be used the formula $P = E \times B$ which determines the level of risk (P) as a product of the presumed consequences/effects of the risk (E) and the likelihood the risk actually to occur (B).

The analysed risks could be measured, i.e. the frequency and the effects of their occurrence to be assessed. The purpose of the assessment is to answer the following two questions: Are these risks acceptable, and if not, what means of protection must be used. From a great importance is a predevelopment of criteria for measuring the risk, its impact, and consequences and, accordingly, adoption of adequate measures for restricting or even overcoming the risk.

Very important are also the results about the level of the risk effects and the risk frequency. According to those results could be defined if the risk is tolerable, acceptable, or not. If the risk is unacceptable, it is subject to special monitoring. Risks with measured low level of effects or rare frequency are acceptable to the organization. The organization accepts them as they are, without interfering. Another important criterion for measuring the risk is whether the cost of the risk treatment is justified or not. If it exceeds the benefits from the treatment such should not be made. The third criterion is for distinguishing between the acceptable risk and other risks.

Any risk is acceptable and, therefore, is not subjected to a risk treatment when:

- the level of influence and the effects of the risk are low enough and does not require special attention;
- the favourable opportunities for profit-making are greater than the chances of loss;
- the risk sources are external factors where the business cannot intervene (e.g. natural disasters, unforeseen economic and political transformations, etc.).

It can be concluded that the risk assessment is a prerequisite for making a decision on how the risk to be controlled and what influence should be exerted on them, i.e. whether the risk is or is not subjected to a treatment and what exactly to be this treatment.

Clearly, the risks cannot be eliminated completely, but they can be significantly minimized by taking the appropriate actions. Once the identified risks are analysed and assessed, the managers of the organization need to consider an appropriate response. Despite the taken specific measures and actions in most of the cases continues to exist the so-called residual risk. This proves that the risk intrinsic for the organization activities cannot be removed completely. It is managers' responsibility to assess whether the level of residual risk is acceptable or further actions for its reducing need to be taken. **The possible alternative responses, intended to minimize the consequences of events with negative effects or respectively to maximize those with positive effects, are the following:**

- ***Reduce (mitigate) the risk.*** This is the most frequently used response to the risk because the risk can rarely be entirely avoided or transferred. It is therefore necessary to be conducted periodical monitoring and analysing of the risk areas within the organization activity. This will allow, depending upon the extent of the risk and the cost which need to be done, promptly acting in order the risk to be limited within acceptable parameters.
- ***Transfer the risk.*** This response is undertaken when the managers consider that the risk is too high, and it is better to be "transferred" to a third party. The classic way to transfer risk is the insurance. In this case extra costs are incurred, but on the other hand the indicator "risk impact" is significantly reduced. Another possibility is an agreement with another organization under which by mutual consensus the carrying out a activity is transferred together with its risks. It is important to emphasize that the risk cannot be completely transferred to another party. Therefore, the risk-sharing is a way of taking some of the potential consequences in accordance with the terms of the obligations under the signed contract for this purpose.
- ***Accept the risk.*** Such reaction is possible only if certain risks have limited (minor) impact on the achievement of organization goals or if their avoidance would costs more than just taking them. Such risks are a normal part of the business activity, but they must be continuously monitored because various external or internal factors could have an impact on their occurrence and future influence, and so to shift them to another higher category.
- ***Avoid the risk.*** Some risks can be reduced or limited to an acceptable level only through the suspension or avoidance of activities accompanied by huge negative and unsolvable problems for the organization. However, in a hasty or reckless termination or avoidance of an activity is very likely to be omitted benefits and subsequently new threats to arise. On the other hand, the inactivity of the management board can be also risky because it could prevent achieving the goals pursued by the organization.

The selected actions for risk response should be analysed in terms of costs and the effects thereof, i.e. it has to be assessed the effectiveness of the chosen response, its duration, the cost of implementation and the level of residual risk after the implementation phase.

Ensuring the efficiency of the process of risk management requires ongoing monitoring at every stage and periodically reporting on the identified risks and the taken actions (responses).

Monitoring activities are undertaken via daily ongoing operational activities or via separate periodic evaluations of the risk management process. It is also possible both forms to apply jointly.

The daily ongoing monitoring should be integrated into normal routine (operational) activities of the organization, to be performed in real time to react to the changing conditions. Therefore, it is more effective than the separate periodic evaluations because they are obtained after the risk event.
Separate periodic evaluations vary in scope and frequency, depending on the degree of influence of the risks and the importance of the responses to them. The high-risk areas and responses are usually measured more frequently. It is not uncommon the evaluations to take the form of self-assessment when the person responsible for a unit or function, establish the effectiveness of the process of risk management in terms of his own activities.

The aim of the monitoring and reporting process is to observe the changes in the risk profile of the organization (the probability and the impact of identified risks) in order to create confidence in the management board that the risk management process remains effective over time and the necessary actions to reduce the risk to an acceptable level are taken.

For the successful implementation of this process it is necessary to be developed internal rules/procedures as part of the overall strategy for risk management in the organization. These internal rules/procedures need to describe:

- The communication and exchange of information (regarding the identified risks) between all levels and employees within the organization;
- The procedure and terms for conducting regular reviews of the risk - register;
- The procedure and terms for reporting all significant risks, the undertaken actions, and their effects, as well as informing about the newly arisen events;
- The responsible departments and employees for the implementation of the necessary actions.

The ways in which the management board will apply these rules and procedures and organize the process of risk management depends on the particular circumstances relateed to the organization (whether its administration has a high degree of self-government, or is centralized; what activities are carried out and from what nature are the risks which the administration faces).

CONCLUSION

The development of each organization goes through several stages - formation, boom, stagnation, decline. The transition from one stage into another is accompanied by a crisis which requires restructuring, change of targets and so on. The decisions in that process of organization development demonstrate the strong and weak sides of its managers. In that respect, the crisis, and the potential risks it creates put the managerial team of the organization to a test. The alternatives for organization actions in the time of crises are rather limited. They should not conflict with the organization capacity (either resourceful or managerial) and also with the new conditions created by the external factors. The choice of these actions must be pursuant with the risk assessment they bring to the company. In this context, risk management as a process that accompanies crisis situations in the development of a company should become a priority for its top management. For the successful implementation of this process it is necessary to be developed internal rules/procedures as part of the overall strategy for risk management in the organization: the communication and exchange of information (regarding the identified risks) between all levels and employees within the organization; the procedure and terms for conducting regular reviews of the risk - register; the procedure and terms for reporting all significant risks, the undertaken actions and their effects, as well as informing about the newly arisen events; the responsible departments and employees for the implementation of the necessary actions.

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