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Risk Management: Can it be a Panacea for State-Owned Enterprises Ills?

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Abstract: There is a requirement in terms of King IV code of good practice that the directors should disclose their role on the risk oversight function of an entity, this disclosure should be covered in the annual financial statements. The board's oversight role on risk functions includes amongst others, how the risk function is administered as well as the impact that such oversight role has on the entity's processes. What could be the impact of failure in the oversight role and what are the contributors of such failure in the performance of such oversight role. The failure of boards and individual directors that is experienced in the state-owned enterprises, what could be the contributing factor or factors to such failures, can it be attributed to their laxity in the implementation of risk management programs or is there any other cause? The paper will review the background on risk management function and its attendant programs. Also, the wider duties of directors of state owned enterprises and their duties will be briefly analysed before a coming to any conclusion that can be made that could enable and capacitate directors in the implementation of risk management programs. The relationship will be drawn between the successes and failures in the implementation of risk management programs and the failure of boards in the state-owned enterprises. The article will show that risk management programs can play an important role in performance of fiduciary duty of directors in the state-owned enterprises as is the case in the private sector. It will further indicate the consequences on the director who fails in carrying out this fiduciary duty of proper performance of the oversight role on risk management.

Keywords: Directors, Disclosure, Entity, Risk, State owned enterprise

1. Introduction

The establishment of every organisation is premised on a mission that it should accomplish which is based on the goals that they set for themselves (Braig, Gebre & Sellgery, 2011:1-2). As a result of the envisaged mission that needs to be accomplished, it can therefore be inferred in absolute general terms that such organisation has the responsibility to protect itself against any event that have the possibility of placing the pursuit of such mission in jeopardy or at risk (Venturini & Verbano, 2013:187; Kaplan & Mikes, 2016:2; Braig, Gebre & Sellgery, 2011:1-2). The concept of risk can be understood as the possible damage that is connecting to the situations of uncertainty, which could culminate in the negative outcome (Venturini & Verbano, 2013:187; Eloini, Dulmin & Mininno, 2007:548). According to King IV code of good practice, risk consists of three parts which are; uncertain events happening, the likelihood of the event occurring and its effect then the resultant outcome which could either be positive or negative (King IV:30). King IV outlines that the understanding of risk as having to make a balance between the negative embedded in a risk and the opportunities that are inherent in a risk. In terms of principle 11 of King IV code of good practice, it deals with the governing of risk in the organisation with the aim of setting and achieving strategic objectives of an organisation.

According to the report by PriceWaterhouseCoopers (2015:8, 2012:3), State Owned Enterprises ('SOE') are branded by different names which include, Government Corporation, government linked companies, parastatals, public enterprises, government business enterprise, public sector enterprise or units etc. SOE's possess influence and they are growing force that is used most frequently by governments to better their global economic positions (Vergotine & Thomas, 2016:675; PWC, 2015:6, 2012:3; Hood & Rothstein, 2000:1-2).

2. Risk Management Principles

Risk management addresses all kinds of substantial and material risks that can have an impact to the objectives of the institution (Venturini & Verbano, 2013:187; Kirkpatrick, 2009:6-7). Board of companies must be clear when it comes to strategy and risk appetite (Kirkpatrick, 2009:5). Such risks do not have to be bias toward any risk control function as such

(Reid & Rietchie, 2011:330). Risk management must can address all fragments of the institution and no part of the institution can absolve itself from participating in the processes (Chornous & Ursulenko, 2013:122; Acharyya, 2013:4). It is expected of the risk management ultimately work its way through the entire organisation in order to ensure that all levels of management participate in such processes (Naude & Chiweshe, 2017:3; Eloini *et al*, 2007:548). Prevailing risks and associated functions such as security risk management, insurance, health and safety risk management, etc. must also align their activities with the organisation's risk management plan being pursued in the organisation (Venturini & Verbano, 2013:187; Acharyya, 2013:6). It can therefore be inferred that this configuration of activities will then allow for risk management to reconfigure as Enterprise Risk Management. In the public-sector environment, risk management is recognised as an appropriate technique to deal with the prevailing organisational risks (Hood & Rothstein, 2000:1-3; Kirkpatrick, 2009:6-7).

The concept of risk management is not new in organisations; nevertheless, what is new and recent is the need for organisations to assess and plan how to integrate and deal with the identified risks that can have impact on the strategic and decision-making processes that affect the organisation (Hardy, 2010:7; Venturini & Verbano, 2013:187-188). The legislations that include the Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA), together with corporate governance codes such as King IV expect institutions or organisations to implement their risk management plan (King IV, 2016:4; Department of Environmental Affairs, 2013:7). As results of organisational failures and crisis that have been experienced in the past, the stakeholders do not want to be caught unaware and unprepared by risk events (Venturini & Verbano, 2013:187; OECD, 2014:13). They have expectation that assurance division in the organisation, which are inclusive of management, internal control and other risk mitigation mechanisms will be based on a thorough assessment of institution wide risks assessment (Chornous & Ursulenko, 2013:122). It can therefore be inferred that the stakeholders are awake and alert to the realities of risks that if not attended to could destroy the value of companies.

In terms of the past practices, the Members of the Accounting Authorities were not involved in risk management because they viewed risk management as an operational function (Naude & Chiweshe, 2017:3). It can therefore be argued that this could be one of the main causes of corporate failures because there was no attention given to risk management and the stakeholders requires assurance providers and management to take the necessary steps that will protect their interest (OECD, 2014:13). It can be further inferred that it is the view of the stakeholders that the management will always protect and operate at their best interest. In terms of corporate governance, accountability for risk management has been placed in the hands of the Accounting Authority/Officer to ensure that they adhere to that. Due to the responsibility of risk management that have been placed on them, the executive authorities, accounting authorities, accounting officers and stakeholders now want to know more about the risks facing the institutions that they are responsible for (Naude & Chiweshe, 2017:3; Eloini *et al.*, 2007:548).

Risk management as a field, is a management discipline that has its own techniques and principles that must be understood by the business organisations (Reid & Rietchie, 2011:330; Naude & Chiweshe, 2017:3). Risk management is a recognised management science as such it is used in businesses and has been formalised by international and national codes of practice, standards, regulations and legislations which can be used when making assessments (Reid & Rietchie, 2011:330). Due to the nature of risk management, it is part of management's core responsibilities and it therefore forms an integral part of the processes of an institution (Eloini *et al.*, 2007:548). Due to the usage of enterprise risk management and its prevalence, enterprise risk management has become a popular way of describing the application of risk management throughout the institutions (Eloini *et al.*, 2007:548; Acharyya, 2013:4). The use of risk management refers to the deliberate way in which they focus on all risks of an institution and how they can be either mitigated or eliminated (Naude & Chiweshe, 2017:3).

To provide understanding of risk management, there is need to describe it. Risk management can be described as a systematic process of identification, evaluation and addressing on a continuous basis the risks that exists in an organisation, before such risks can impact negatively on the institution's service delivery capacity (Eloini *et al.*, 2007:548). This is not the only way in which enterprise management can be described, as there are many other alternative ways in which risk management can be described that are also used by the enterprise risk management community (Naude & Chiweshe, 2017:3). Proper execution of risk management provides a reasonable assurance that an organisation will successfully execute its strategic objectives thereby achieving its set goals (Chornous & Ursulenko, 2013:122).

As already indicated in terms of King IV, risk management falls within the ambit of corporate governance as contained in principle 4 and 11 of the king code. In order to supplement and complement risk management and monitoring, organisation make use of risk-based internal audit that incorporate strategic direction with written assessment to board of directors that details the adequacy and effectiveness of internal controls.

3. Risk Management Processes

The risk management process is based on risk management requirements and they are comprised of the platform from which the enterprise risk management process is developed (Naude & Chiweshe, 2017:3; Reid & Rietchie, 2011:331). Risk management policy is connected to the strategic objectives, goals and the nature of an organisation's activities and must be developed to deal with the relevant risks (Chornous & Ursulenko, 2013:122; Reid & Rietchie, 2011:331; Venturini & Verbano, 2013:187). Enterprise risk management demands that strategic risk should be identified and be dealt with as they have the propensity to detail the achievement of organisation's strategic goals (Reid & Rietchie, 2011:335; Venturini & Verbano, 2013:188).

The management of risk has become a strategic business domineering matter, thereby forcing the heads of organisations to place an increasing emphasis on the management of all types of risks that are rampant in their organisations (Vergotine & Thomas, 2016:677; Venturini & Verbano, 2013:187; Reid & Rietchie, 2011:330). The prevalent of corporate scandals have highlighted the need for boards of directors of companies to evaluate a wide range of risks within environment of growing regulations, and one in which institutional investors regards robust risk management process as constituting a worthy cost of business (Hardy, 2010:7). In addition, the boards of directors are progressively anticipated to take ownership of managing company risk as outlined in particular in King Report on Corporate Governance. There is lack of consensus on models of risk management and on the application of existing models in business.

The success of risk management depends on the existence and usefulness of management framework that lays the foundation for embedding the process across the organisation (Naude & Chiweshe, 2017:3; Eloini *et al.*, 2007:548). Traditionally risk management involves the process of identifying, measuring, monitoring and reporting on risk with little formality, structure or centralisation (McPhee, 2005:2-6). The management of risk has evolved from a traditional silo-based approach to non-silo-based approach, which is known as enterprise risk management and is a process that is endorsed across an organisation and applied in the development of organisational strategy (Naude & Chiweshe, 2017:1; Vergotine & Thomas, 2016:678; McPhee, 2005:2-3). It equates to integration and likes strategic objectives and organisational growth opportunities to potential risk exposure as well as identifies risk factors in a business, assess the severity of such risk, quantities its magnitude and mitigates the exposure (Venturini & Verbano, 2013:188; Department of Environmental Affairs, 2013:7).

Enterprise risk management can also be described as a systematic approach that purposes to evaluate and manage all sources of risks that have the capacity to can negatively influence the achievement of organisational objectives (Acharyya, 2013:4; Hardy, 2010:7). Enterprise risk management can also unite organisational internal procedures with the external risk environment with the aim of heightening the organisation's return on investment (Acharyya, 2013:4). By using enterprise risk management, an organisation can be able to direct and control the risk management system which is imbedded with the responsibility, accountability and authority (Acharyya, 2013:4). The use of risk management also assists in strengthening the rules and procedures that can be used in decision making (Acharyya, 2013:4). ERM can also provide a structure that will ensure that the organisation's strategic, operational and financial risk are identified, rated and managed within the organisation's risk appetite (Naude & Chiweshe, 2017:3); National Audit Office, 2010:8-9; McPhee, 2005:2). Risk management process also demands that an organisation addresses its risk in a comprehensive and coherent manner and it is expected that the risk management process outcomes will be aligned with the corporate governance and organisational strategy (Naude & Chiweshe, 2017:3).

4. Risk Management at State Owned Enterprise Level

As indicated above, risk management is established with the aim of providing structure that will ensure that the organisation's strategic, operational and financial risk are identified, rated, a mitigated and managed within the organisation's risk appetite (Naude & Chiweshe, 2017:3). In 1999 the PFMA was promulgated and the act became effective on the 1st April 2000. The promulgation and the use of PFMA has given effect to the Constitutional provisions as contained in the Constitutions of the Republic of South Africa, no. 108 of 1996, which relate to national, provincial spheres of government as well as government entities. The PFMA adopts an approach to financial management which focuses on outputs and responsibilities. According to Public Finance Management Act, national government business enterprise is defined in section 1 as an entity which is:

- "*A juristic person under the ownership control of national executive;*
- *Has been assigned financial and operational authority to carry on a business activity;*
- *As its principal business, provides goods or services in accordance with ordinary business principles; and*
- *Is financed fully or substantially from sources other than The national revenue fund; or*
- *By way of tax, levy or other statutory money.*"

According to this definition as stated above, all national government business enterprises are national public entities, these are entities as per the definition, can either be companies or others. According to the Companies Act, 2008 state owned company is defined in Section 1 as:

- "*An enterprise that is registered in terms of this Act as a company, and either*
- *Is listed at a public entity in Schedule 2 or 3 of the Public Finance Management Act, 1999 (Act No. 1 of 1999; or*
- *Is owned by a municipality, as contemplated in the Local Governance, Municipal Systems, 2000 (Act. 32 of 2000), and is otherwise similar to an enterprise referred to in paragraph (a).*"

The state-owned companies fall within the realm of the PFMA which have more extensive provisions in contrast to those in the Companies Act, which means that state owned enterprises need to conform to additional provisions over and above those that are contained in the Companies Act.

King codes IV of good practice introduced supplements to the codes that directly deals with entities (King IV, 2016:111). There is a King IV supplement that deals directly with state owned entities (King IV, 2016:111). The supplements are not necessary independent of the King IV codes of good practice, they should be read together with them (King IV, 2016:111). The decision to have Presidential committee that was to deal with the review of state owned enterprises have created a foundation that is expected to underpin economic growth and transformation as South Africa is regarded as a developmental state (King IV, 2016:111). The King IV supplement applies to all public that is listed in Schedule 2 and 3 of the PFMA. King IV is underpinned by governance outcomes and principles and they apply to State Owned Entities (King IV, 2016:111). King III had 75 principles and the King IV has 17 principles and King IV has summarised the principles and they are now 17, and one of the principles deal with risk management. King IV, have also adopted the position of apply and explain contrary to previous one in King III which was apply or explain and the aim in King IV was to move away from compliance of tick box. In the apply and explain mode of application of King IV report it entails how company achieve the application or how it is striving to achieve the application.

In the compliance with King IV there is expectation of four outcomes which are; ethical and effective leadership, performance and value creation which should be pursued in a sustainable manner. Additional, these outcomes should be premised on the adequacy and effective controls, trust, good reputation and legitimacy. These are the outcomes that are expected from King IV. The seventeen principles of King IV are addressed under each outcome and they are applicable to institutional investors, while other organisations must comply with the sixteen principles. Under the outcome of performance and value creation, the first principle that is discussed herein, which is principle 4, deals with the governing body that should appreciate that the organisation's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process. In this outcome, one of the areas that the issue of risk have been raised, however under the outcome of adequacy effective control, principle number eleven is outlined that deals with the governing body's role of governing risk in a way that will support the organisation in setting and achieving its strategic objectives (Department of Environmental Affairs, 2013:7). In dealing with risk, the areas that will need to be attended to include the positive and negative effect of risk, the appetite termination and mitigation risk as well as monitor the effectiveness of risk management (Department of Environmental Affairs, 2013:7). In the sector supplements for state owned enterprises, similar principles are dealt with, which is principle 4 and 11 that deal with risk and how risk should be governed.

The legislations that are applicable to state owned enterprises include, the Companies Act, the PFMA and King IV report and they share principles of good governance and alignment of that these are not only possible, but desirable in the spirit of the overarching governance principles of accountability, fairness, transparency and responsibility. In instances where there are areas of conflicts between the Companies Act and the PFMA, the later supersedes particularly where there are irreconcilable differences. PFMA demands more burdensome requirements in one instance than compliance with the Companies Act is needed. PFMA provisions that relate to the role and functions of the board can be matched to an appropriate King IV principle and requires the board of state owned enterprises to interpret the legislation within the wider framework of King IV.

Compliance with risk management of any other business activity, should take place within the context of leadership and rigorous governance principles. The board of an organisation has duty and responsibility to ensure that the organisation complies with all applicable laws and rules. In addition, the board also has a responsibility to consider adherence to codes and standard as none adherence could result in regulatory risk (PWC, 2012:3; National Audit Office, 2010:6).

In terms of section 66(1) of the Company's Act 71 of 2008, State Owned Enterprises must have a board, and such board should have the authority to exercise all the powers and must perform the functions that are conferred on such enterprise. The exercise of these powers as bestowed by section 66(1) must however be carried out within the limitation as contained in the section or such should be carried out in terms of Memorandum of Incorporation. The accountability that the board of state owned enterprises have the same powers in terms of section 49 of the PFMA and is aligned to King IV (King IV, 2016:12). The principle that necessitates the board to act as the principal point and guardian of the corporate governance (King IV, 2016:12). It can therefore be inferred that the ultimate accountability of a State-Owned Enterprise rests with the board.

In terms of section 66(1) the affairs and business of the State-Owned Enterprise should be managed under the direction of the board because the board has the authority to perform and exercise all the functions that is in a company. The PFMA in section 51 stipulates that the board should maintain effective, efficient and transparent systems of financial and risk management and internal control and make use of combined assurance.

Risk is common in all organisations, irrespective of the origins, being whether private or public. It should be noted that despite the practical difference that exists between private organisations and state-owned enterprises, risks exist in respect of them and they experience different risk exposures and their categories (Department of Environmental Affairs, 2013:7). The commonalities that exist between private and state-owned enterprises suggest that the process of managing risk at state owned enterprises is no different to that which applies in the private sector. The management of risk as practiced in the public sector is a general management function and which is applicable to all managers and its aim is to support government imperatives (Naude & Chiweshe, 2017:3; OECD, 2004:53-57; Hood & Rothstein, 2000:1-3). Corporate governance standards pertaining to state owned enterprises and legislative requirements regulate and control the use of public funds as such they place pressure on state owned enterprises that must develop effective, efficient and transparent system of risk management (OECD, 2004:53-57).

Risk in state owned enterprises environment is never static; as such there should always be constant monitoring of risk. According to Vergotine and Thomas (2016:688), there are several common enterprise wide risk management assessment processes that have been identified across the state-owned enterprises. For the organisation to maintain consistent and structured risk management the method that need to be adopted in these companies includes the world accepted standards such as, Australia and Standard New Zealand, the COSO and the ISO 31000 risk management standard. In the South African context, such should be applied with the inclusion of the practices of the South African Institute of Risk Management code of practice (Hardy, 2010:7-8).

5. Impact of Lack of Risk Management in an Organisation

Corporate scandals have highlighted the need for boards of directors to assess a wide range of risk within environment of growing regulatory interventions, and one in which institutional investors regard robust risk management processes as constituting a worthy cost of business. The board of directors are expected to take ownership of managing risk as outlined in King IV Report on Corporate Governance in principle 4 and 11 (IOD, 2016). There is still absence of agreement on models of risk management and on the application of existing models in business.

In 2011, The Auditor General found that 69% State Owned Enterprises were not complying with the regulatory requirement that are related to risk management which is one of the key areas that should have been monitored (Vergotine & Thomas, 2016:675). The office of the Auditor General also found that 61% of the State-Owned Enterprises did not maintain risk management strategies while 61% of them lacked business continuity and disaster recovery plan, which means that in the event of a disaster they will not have backup plan or fall-back position (Vergotine & Thomas, 2016:675).

The decision to include components of risk management as part of the business strategies is key for the success of state owned enterprise. The non-inclusion of risk management strategies can have far reaching consequences (Yimaz & Flouris, 2010:162-163). The absence of risk management will therefore deny an organisation the opportunity to understand the risk position, while the enterprise wide risk management processes will allow the state-owned enterprises an opportunity to explore the potential opportunities that are presented by risk exposure. The identification of risk can serve as a checklist that will ensure that the major areas of risk management are adequately identified, assessed, mitigated and strategies devised to proactively deal with the risk exposure (Reid & Rietchie, 2011:330).

The concept of governance, includes risk management, and is an act or process of providing oversight, authoritative direction and control (McPhee, 2005:2-6). The lack of risk management could result in the poor governance, leadership and discipline which could culminate in value creation activities of an organisation overriding the risk concern. Therefore, lack of risk management could also distort risk early warning raised by the independent risk management function and lead to an organisation failing to deal decisively with the risk (McPhee, 2005:2-6). It can also create lack of board focus on risk oversight, which could result in directors failing to take tough decision and asking the tough questions at the appropriate times (McPhee, 2005:2-6). Lack of risk management could result in myopic focus on the short-term goals, which could result in the organisation mortgaging the future for the present when taking risk and therefore end up with short life span which could have been avoided (McPhee, 2005:2-6). It can also result the failure to deliver on the strategic intent of the organisation, which could be regarded as having elements of reckless risk taking by the organisation (Naude & Chiweshe, 2017:1; Vergotine & Thomas, 2016:678; McPhee, 2005:2-6). Such action could be labelled value killer instead of having appropriate risk appetite with its capacity to deal with and the resultant accountability which will ensure prudent risk taking by the organisation (Kirkpatrick, 2009:5; Venturini & Verbano, 2013:187-188; McPhee, 2005:2-6). The organisation could also end failing to implement effective enterprise risk management, which will be lead to non-existence, infective or inefficient risk assessment (Hood & Rothstein, 2000:1-3; Kirkpatrick, 2009:6-7; McPhee, 2005:2-6). This could culminate in not integrating risk management with strategy setting and performance management which could result in the failure of the organisation which could have been avoided, had the organisation taken the necessary steps (Naude & Chiweshe, 2017:1; Vergotine & Thomas, 2016:678; McPhee, 2005:2-3).

6. Conclusion

It can therefore be concluded that risk management has become a critical issue in all businesses and organisations. There is a need for organisations to have proper risk management strategy in place to address critical issues in a timely manner. The responsibility of risk assessment and strategy formulation, is the responsibility of an organisation irrespective of whether it being in the private or public sector. It is evident as was established in the study by Vergotine and Thomas (2016:690), that the acceptance of internationally recognised frameworks and methodologies to guide enterprise wide strategies are crucial in any organisation. The institution of governance structures involving the boards of directors and operational committees are key contributors in the management and mitigation of risks. The practice of identification of specific enterprise wide risk management focus areas, or processes that covered the management of business continuity, the prevention of fraud, compliance with the laws and regulations, financial coverage risk and the undertaking of internal audit are based on risk management (Pankaj & Hare, 2016:27). It can therefore be inferred that risk management is not a solution of every problem in an organisation, but it assists in ensuring that a company is not caught unaware of what is happening in and around it. It is evident from the materials referred to in this article particularly King IV, that the issue of risk management is key critical for the success of business. The risk measures have been adapted to varying degrees by state owned enterprises to address risk with board of directors tasked with providing an oversight role (McPhee, 2005:2-6). The themes that can be extracted from the literature referred to above indicate the importance of governance in general and state-owned enterprises. It is evident that it is important to embed the culture of risk management in the organisation and the leadership thereof have the responsibility to show commitment to risk management process (Pankaj & Hare, 2016:27-29; McPhee, 2005:2-6). It is important that entities will have to adhere to sound enterprise wide risk management methodologies and framework. There is no doubt that with the pronouncement made by political heads of government that there is a need for a sound governance of state-owned enterprises which ardently will have an impact on the organisational culture and leadership in these entities. It can therefore be inferred that the failure of risk management could result in poor governance, reckless risk taking, inability to effectively implement Enterprise Risk Management, non-existence of risk assessments and the organisation strategies could end up not being integrated in the organisational strategy setting with the resultant performance management (Pankaj & Hare, 2016:27-29; McPhee, 2005:2-6). It can therefore be concluded that the establishment of Enterprise Risk Management can provide a structure that will ensure that strategic, operational and financial risks are identified, rated, and managed within the origination's group risk appetite (Venturini & Verbano, 2013:187-188; Kirkpatrick, 2009:5). This process will ensure that state owned enterprises are not caught unaware and they will know of the risks before they happen.

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