

Managing Business Risks

SMEs need to take a close look at their business risks and work to mitigate them, using financial planning, risk management and legal tools, opines Jaya Prakash Pradhan, Associate Professor, Sardar Patel Institute of Economic & Social Research

Besides lack of funds and sickness, an important factor that is causing large-scale failures in the SME sector is the inability on the part of SMEs to go for an adequate business protection plan to cover a variety of business risks that can be minimised or managed. Just one or two negative shocks are enough to bring sickness and eventual failure to an otherwise successful small enterprise.

Types of business risks

Concentrated demand and supply SMEs with excessive dependence on a single major buyer or supplier of their key raw materials have a higher risk of significant loss of income and negative effect on survival.

Delayed payment Late payments have a terrible impact on SMEs, as they are perennially suffering from an inadequate size of working capital.

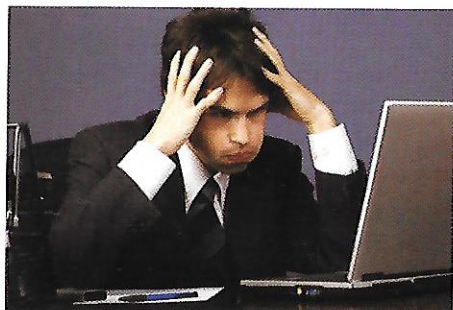
Wide fluctuations in prices Rapid escalation

in input prices tends to force SMEs to absorb a larger part of the rise as they normally fear losing the customer in a competitive market and don't insist on having an adequate escalation clause in their supply contracts. Sudden downward trends in input prices can hit SMEs having an inventory of high-cost raw materials hard.

Single promoter Most Indian SMEs have a limited managerial staff and are run by an individual promoter supported by his family members in all aspects of their functioning. Clearly the risk is that the future of the SME is wholly dependent upon the well-being, health, and survival of this key business owner.

Ignorance about IPR, environment and emerging regulatory issues In a globalised business environment, ignorance of SMEs about intellectual property rights (IPR), environment-friendly practices and changing legal issues at home and abroad can result in considerable risks and costs to their business.

Others The productive assets and abilities of SMEs can also receive impact from risks emanating from natural calamities. Business risks for SMEs can also be from machine breakdown, damage in transportation, fraud by an employee, theft, riots and terrorist attacks.



SMEs operate with a limited resource base. A few small setbacks can bring on sickness and eventual failure

Methods of managing risks

The obvious method to deal with the risks of buyer and supplier concentration is to reduce over dependence on a single party, by diversifying client base and having multiple suppliers. This is purely a firm-specific strategy and SME

entrepreneurs should find ways to implement it.

Recently, there has been a significant attempt at the policy level to protect SMEs from risks of delayed payment. The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, protects SME suppliers (refer policy section).

SMEs can mitigate risks from the sharp rise in prices of inputs by including mutually agreed safeguard clauses in their business contracts with input suppliers and buyers. Export-oriented SMEs are required to adopt selective or complete hedging for foreign exchange risks. Simple ways to address this risk is to accept the export order in more than one currency or to enter into forward agreements to convert a given sum of foreign currency into another at a predetermined exchange rate and date.

The survival risk of SMEs can be minimised by investing in financial protection for the main promoters, essentially for safeguarding business debts, putting in place clear succession plans and employing some managers to look after the daily business activities. SMEs also need to keep themselves aware of IPR issues so as to not violate other firms' IPR and adopt best manufacturing practices as per the evolving regulatory

Risk Management Ideas



- Financial protection for promoters
- Clear succession plans
- Employ manager to handle daily business
- Raise IPR/legal awareness
- Comprehensive business/industrial insurance

regime on health and environmental grounds.

A comprehensive industrial insurance coverage for all such risks is essential. Over the last decade, Indian banks and insurance companies have come up to provide different financial protection plans to industrial firms. However, resource-constrained SMEs, in many cases, are either unaware about the possible business risks, or wherever they are aware have limited financial capability to have a hedged exposure to such risks. Policy intervention is clearly warranted to provide cheap insurance provision to SMEs' risks (i.e., relatively lower rate of premium) and encourage small firms to be part of a protected financial regime. Financially well-protected Indian SMEs are likely to be more competitive and efficient agents of economic and social progress in India.

Corporate Risk Assessment and Planning

Understand what risks you might face and how they could impact your business

Analyse each risk and prioritise to decide which one is more likely to affect you, when and to what extent

List what preventive and contingent actions can be taken for each major risk

Define how each risk will be addressed, by whom and in what time frame

Activity Review

Risk planning workshop

Understand risks that might occur and their impact

Quantitative and qualitative risk and prioritisation

Define risk occurrence rating

Workshop to determine preventative and contingent action

Strategies form input to the business continuity plan

Set the business continuity plan project steps

Specify the project review templates and metrics

Evaluate risks related to business and assets

SMEs must evaluate and think clearly about what risks they are facing with respect to their business/assets. These could be some of the areas of concern:

Asset	Risk to be Covered
Building	All Risks + Fire + Terrorism
Office furniture, computers, refrigerator, phone	All Risks + Fire + Terrorism
Plant and machinery used in any manufacturing activity	All Risks + Fire + Terrorism
Stock	Marine policy covers all material inward/outward import/export within India. Also stored in warehouse branches
Liability insurance	Third-party insurance damage caused to any one visiting your plant/office
Fidelity	Unethical activity done by any employee of yours
Cash in transit	Cash being brought from bank or being sent to bank
Motor vehicle	Own damage and third-party insurance
Mediclaime/health insurance	Up to certain salary level covered by Employees' State Insurance Corporation (ECIS)
	Those not covered can be covered under a group health insurance policy. Even maternity cover/pre existing disease can be covered. Family members can be covered. Even parents can be covered. Full details are available on www.health-insuranceindia.org
Gratuity	If the company comes under the Gratuity Act this can be taken from one of the life insurance companies
Superannuation	If the company comes under the Superannuation Act this can be taken from one of the life insurance companies
Overseas travel	If frequently traveling for short durations then annual multi-trip policy can save you money
Keyman insurance	The owner/entrepreneur/keyman can be covered under a term plan. In the event of the death of the keyman, company gets sum assured that can be used for paying loans/settling liabilities with claim amount