ELSEVIER
Long Range Planning 37 (2004) 259–276
LRP long range planning
www.lrpjournal.com

Risk management and the business environment in South Africa

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Risk management involves tracking market and non-market long-range risks, understanding their adverse impact on the business environment, and managerial responses to reduce risk exposure. As an emerging market, South Africa poses a challenging array of long-term political, economic, financial and operational risks to investors. Risks such as concerns about increased costs, lack of transparency, limited capacity to enforce the rule of law, government intervention, a volatile currency, regional contagion and the HIV/Aids pandemic heighten uncertainty about the business environment. Managerial responses to anticipate and mitigate risks include matching mode of entry with risk tolerance, superior intelligence and lobbying, maintaining low tolerance for corruption, selecting appropriate financial instruments and balancing shareholder and stakeholder interests.
The risk management framework presented, consisting of three elements: type of risk, impact of risks and managerial response to counter adverse risk impacts, may be refined and expanded for potential application to other emerging markets.
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Introduction

South Africa (SA) is known as the 'engine of growth' for the African continent, generating 45 percent of the continent's GDP from only 10 percent of its population. The country's economic output ranks 29th in the world, making it one of the 10 leading emerging markets. SA offers a sophisticated business environment in terms of infrastructure, legal system, natural and human resources, telecommunication network and financial services.

Since 1994, SA has undergone sweeping political and economic transformation, but, as with all emerging markets, transformation is a work-in-progress. Since the end of Apartheid, the democratically elected ANC government has embarked on an extensive program of economic liberalization. The positive results have included an increase in competitiveness, international trade and inward bound investments. However, a variety of risks are still present in the business

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doi:10.1016/j.lrp.2004.03.001

environment. After a decade of dramatic changes, it is prudent to assess the risk profile of SA and to raise awareness of the long-term risk management policies for present and potential investors. It is our intent to outline a risk management framework consisting of three interrelated elements: first, to identify the manifestations of various market and non-market risk types in SA; second, to illustrate how these risks may impact on business operations; third—the primary thrust of our framework—to analyze the various policy options that managers and firms may adopt to preempt or mitigate the adverse impact of risk.

We have organized our paper into three parts: (1) a theoretical analysis of risk management; (2) a study of risk management in South Africa that addresses the three elements of risk identification, risk impact and managerial policy options; and (3) conclusion and suggestions for further inquiry.

Framework for risk management analysis

Strategic management theory has accumulated into a large body of knowledge, and understanding about managerial decision-making has been well advanced in terms of firms' sustainable competitive advantage over their competitors. However, risk management, as an integral part of strategic management, remains underdeveloped. Too often, strategic risk management is narrowly perceived as the impact of market, industry and financial factors upon the performance or return of firms. Managers, fixated on the risk-return paradigm and financial metrics based on accounting data, often under-emphasize non-market forces as a source of risk.[1]

Managers often under-emphasize non-market forces as a source of risk

Even respected models, like Porter's Five Forces and the Resource-Based View, pay little attention to non-market risk factors.[2] The PESTEL approach to strategy is also problematic since its broad analysis of external influences on decision-making is not cost effective and creates information over-load for risk management. It is good to identify long-term external trends outside industry but, as Narayanan and Fahey have noted, it is less effective in distinguishing between vital and merely important developments.[3] Noy considers risk as a major component of strategy, particularly the risk attitude of managers. Eisenhardt and Sull regard risk as one of the seven strategic logics of a simple rules-approach to strategy.[4]

Three general assumptions underpin risk as a concept. Risk is viewed as a (1) unit of analysis or level of analysis which must be determined; (2) broad rather than a narrow concept that is not necessarily mutually excluded from related concepts; and (3) multi-dimensional concept.[5] Specifically, risk may be analyzed on three subordinate levels: (1) general environmental uncertainty, i.e. systematic countrywide risks cutting across all industries or individual firms; (2) industry risks, i.e. differences in industrial or product specific variables; and (3) firm specific risks, i.e. operating uncertainties.

The subject unit of analysis has influenced the definitions of risk. Studies linking risk and performance or variance of return are more concerned with firm specific risks. Risk in this regard refers to financial risk, an ex post accounting measure of stock returns, financial ratios and income stream uncertainties.[6] While crucial, the tendency to term this concept strategic risk is unsatisfactory because it does not reflect the full range of market and non-market risks facing the firm.

The ordinal ranking approach to risk that is applicable to all three subordinate levels of analysis defines the concept as the probability for any reference set (firm, industry, market for a product, country) losing rank position vis-à-vis other competitors. Risk is viewed as the chance of loss, the degree of probability of loss and the amount of probable loss.[7] In our view ordinal rankings, like country risk, are too broad and diffused. As managerial guides they fall short

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