

FACTORS AFFECTING THE LEVEL OF ECONOMIC RISK

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Annotation:

Risk factors are one of the most difficult parts and at the same time one of the key areas of risk management. It is much more difficult to conduct a factor analysis than any other, since the same factors have different effects on the market in different conditions, or may become absolutely insignificant from the decisive ones. It is necessary to know the relationship and mutual influence of various factors that reflect the relations between different states, the history of their development, to determine the cumulative result of certain economic measures and to establish a link between events that are completely unrelated at first glance.

Key words: Risk factors, mutual influence, external factors, internal factors.

Risk factors are determined on the basis of an analysis of the political, economic, and financial and credit policies of individual countries and the global community as a whole. Risk factors serve as the core of the so-called "Firm-Foundation Theory" and play a primary role in making decisions about investing in innovative projects by large companies that own large long-term diversified investment portfolios.

The development of the economy is accompanied by an increase in the influence of various factors on business results. At the same time, as the number of types of factors that affect the future results of the business increases, so does their influence on the conditions of its functioning, growth opportunities, market capture and position in the competitive struggle. In this chapter, we will draw attention to the forms and types of business risk factors that have a significant impact on it; we will conduct a certain classification of risk factors that operate in the modern economy.

After reading the content of this chapter and studying the material presented in it, the student should:

know

- ✚ the main groups and types of risk factors in the modern economy;
- ✚ features of their influence and forms of manifestation;



- ✚ be able to
- ✚ identify risk factors for different types of businesses in the real economy; own
- ✚ Specifics of assessing the impact of external and internal risk factors on business development and its future results.

The main types of risk factors

Business risk factors in the real sector of the economy can be divided into three main groups: external, internal and unknown risk factors.

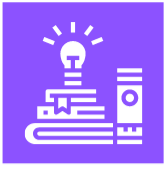
External risk factors can be classified as follows:

- ✚ Market risk factors that are determined by changes in market conditions in the markets in which the firm operates. It can be a set of markets in which the products of this company are sold and purchases of raw materials, materials, components are made; the labor market, financial markets, etc.;
- ✚ prospective policies and developments of competitors related to the production of competing or replacement products;
- ✚ non-economic risk factors, which include political stability, social legislation, climatic conditions, social and demographic factors, etc.;
- ✚ macroeconomic risk factors in the home country's capital, which include the sustainability of economic development, the growth rate of the economy, the General level of inflation, tax and Finance law, investment climate, etc.;
- ✚ global risk factors due to the country's place and role in the global communications system, as well as the impact of the problems and crises of individual countries on the development of business in this country.

The main feature of external risk factors is that in the management process, managers or entrepreneurs must take into account the impact of these factors and can take measures to protect themselves from the impact of these factors, but they cannot directly influence them.

Internal risk factors exert their influence within the enterprise or firm in question. Internal risk factors include:

- ✚ production factors determined by the specifics of the company's industry affiliation, the equipment and technology used, and the organization and management policy;
- ✚ the level of qualification and relationships of staff in the process of doing business;



- ✦ miscalculations and mistakes of managers and entrepreneurs when making risk decisions and managing their execution;
- ✦ financial condition of the company, which determines both the possibility of financing the development of the business, and the repayment of long - and short-term obligations.

The specificity of internal risk factors is that managers can manage these factors, reducing their undesirable impact or, conversely, increasing the beneficial impact on business results.

Among the risk factors, we can note those that are both external and internal. For example, environmental factors can have both an internal and external origin for a given company.

Each company should have a list of specific or possible risk factors to date. It should include both genetic risk factors, i.e. inherent in general economic or industrial and commercial activities, and specific for this type of enterprise. It is desirable that risk factors are ranked by importance or by the degree of contribution to the overall risk profile of a particular manufacturing enterprise. There are different ways to classify risk factors. In this case, the natural requirement for classification is its orientation to methods of compensation or counteraction to risks. In other words, the classification of risk factors (more precisely, types of factors) should be correlated with the classification of risk management methods. This limits the possibility of formally combining essentially different factors in one classification grouping.

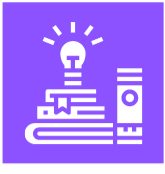
All possible risk factors in practice are divided into two groups. The first category includes the "foreseeable" ones, i.e. those known from economic theory or economic practice. At the same time, it is obvious that there may be factors that are not realistic to name at the a priori stage of the enterprise risk analysis. These factors belong to the second group. One of the most important tasks is to create a regular procedure for identifying risk factors, narrow the range of factors of the second group and thereby reduce the impact of the so-called "incomplete generation" of risk factors.

Among the risk factors of the production type of enterprise, external and internal can be distinguished, depending on the place of occurrence. External factors include factors caused by reasons not directly related to the activities of this enterprise. Internal factors will be considered the appearance of which is generated by the activity of the enterprise itself.



1. External factors.

- ✚ Political factors: the domestic and foreign policy situation, the stability of the government, the possibility of local conflicts and civil conflicts, nationalization without adequate compensation, the introduction of restrictions on currency exchange, etc.
- ✚ Socio-economic factors: the possibility of changing the rules of conducting foreign economic activity, errors of the tax service personnel, violations of the terms of the contract (changes in prices for raw materials, materials, etc. after the conclusion of the contract), a drop in effective demand in the geographical sector of the market for traditional products, fluctuations in the exchange rate of the national currency beyond the predicted interval, the emergence of new competitors.
- ✚ Environmental factors: changes in the regional environmental situation, stricter environmental requirements for enterprises, the introduction of restrictions on the use of local natural resources.
- ✚ Scientific and technical factors: the emergence of a new production technology with lower costs among competitors, the development by competitors of the production of substitute goods, the accelerated copying by competitors of the enterprise's innovations through the use of industrial espionage.
- ✚ The risk factor caused by the innovation activity of other entities may, under certain conditions, pose a threat to the economic security of the enterprise. For example, the development of new technology by competitors, which significantly reduces production costs, will allow them to gain an advantage in price competition. A similar danger is the use of scientific and technological advances to produce a new substitute product, as was the case, for example, in the case of paper and plastic containers instead of glass for packaging liquid food products (milk, juices and other beverages).
- ✚ A special place among the risk factors that owe their appearance to scientific and technological progress is occupied by industrial espionage. The specific vulnerability of any structural element of an enterprise is determined by the information that it possesses, representing a certain value for the enterprise, which needs to be protected. Systematic leakage of information from any link negatively affects the activities of the entire enterprise, which is a single whole. Scientific and technological progress also opens up opportunities for



destructive actions against competitors (invading other people's databases in order to destroy them, entering false information, damaging computer programs, etc.).

Internal factors.

- ✚ Risk factors of the main production activity of the enterprise: interruption of the technological cycle due to the fault of non-main divisions, accidents of the main equipment, violations of technological discipline by the personnel.

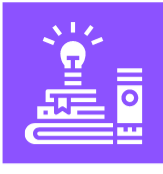
One of the most common and "traditional" risk factors in the main production activity is industrial accidents, unscheduled equipment shutdowns or interruptions in the technological cycle of the enterprise due to forced equipment changeover (for example, due to unexpected changes in the quality parameters of raw materials), violations of technological discipline by personnel, etc.

The harmful consequences of accidents and related accidents are manifested in the deterioration of the social climate at the enterprise, an increase in the level of absenteeism, an increase in distrust of the enterprise from the outside environment (especially if the incident is surrounded by secrecy), and are reflected in its image and prestige, which are intangible competitive advantages of the company, thus increasing the "invisible" losses of the enterprise. Other dangers that threaten physical property and personnel may include various types of theft of property, destruction of equipment, often in the form of gratuitous and hidden vandalism, and terrorism.

Risk factors of auxiliary and supporting activities of the enterprise: accidents of auxiliary production equipment (ventilation, sewerage, water supply, etc.) that do not cause the shutdown of the main equipment, lengthening of the terms of repair of equipment in comparison with the standard ones, power outages and fuel supplies.

Risk factors for supporting activities: accidents or overcrowding of warehouses, problems in the information processing system, insufficient patent protection of products and their manufacturing technologies.

In auxiliary production activities, risk factors may arise such as power outages, indefinite extension of the duration of equipment repairs, accidents of auxiliary systems (ventilation devices, water and heat supply systems, etc.), unpreparedness of the company's tool facilities for the development of a new product, etc.



In the field of servicing production processes of the enterprise, the risk factors may be failures in the work of services that ensure the functioning of the main and auxiliary equipment, an accident or fire in warehouses, failure-complete or partial-of computing power in the information processing system, etc. The risk of being stolen is not only the physical property of the enterprise and human resources, but also the intellectual property of the enterprise, for example, the insufficient patent protection of the enterprise's products and manufacturing technologies, which allowed competitors to master the production of the same products without spending money on the purchase of a license, as well as the industrial espionage mentioned above.

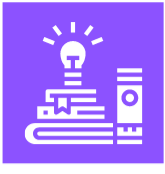
Risk factors in the reproduction activity of the enterprise: the outflow of skilled labor, an incorrect assessment of the required period of training and retraining of personnel, risk factors in the field of investment activity of the company.

Factors in the sphere of circulation: violation of the terms of the contract (discipline of deliveries in terms of terms, quality, etc.), the risk of non-demand for products, bankruptcy or self-liquidation of counterparty enterprises, erroneous choice of the target segment of product sales markets, loss or deterioration of the quality of goods during transportation or storage, increased circulation costs due to unforeseen non-production costs in the sales network.

The reproduction side of the company's activities is mainly related to investment activity and the processes of recruitment, training and advanced training of personnel. In terms of personnel problems, risk factors such as an incorrect assessment of the required period of training and retraining of personnel, the outflow of qualified labor due to local ethno-political conflicts, natural and man-made disasters in the region, etc. can manifest themselves.

Risk factors in the field of enterprise management: inadequate assessment of the strategic potential of the enterprise, incorrect formulation of the company's own strategic goals, erroneous forecast of the external environment, open opportunities for economic abuse, insufficient quality of management.

Internal risk factors arise directly in the course of the company's activities, which are usually divided into industrial and non-industrial. The non-industrial (mainly social) side of the company's activities, aimed at meeting the everyday and cultural needs of the team, is not considered in this work. The industrial activity of the enterprise, as is known, consists of the processes of production, reproduction, circulation and management. In turn, the production process is a



set of interrelated main, auxiliary and service processes of labor. Each of these areas has its own specific risk factors.

In the sphere of circulation, the company's activities are subject to such risk factors as the violation by related companies of the agreed delivery schedules of raw materials, components, etc., the unmotivated refusal of wholesale consumers to export or pay for the received finished products, the bankruptcy or self-liquidation of counterparty enterprises or business partners and, as a result, the disappearance of suppliers of raw materials or consumers of finished products.

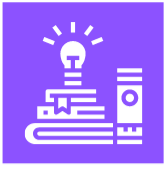
The decisions of the company's management are usually attributed to one of three levels: strategic, tactical and operational. It is natural to allocate risk factors based on this stratification of decisions. At the level of strategic decisions, the following internal planning and marketing risk factors can be identified:

- ✚ erroneous choice or inadequate formulation of the company's own goals,
- ✚ incorrect assessment of the strategic potential of the enterprise,
- ✚ the risk of developing a strategic plan based on an erroneous forecast of the development of the external economic environment for the enterprise in the long term.

Let us focus in more detail on the characteristics of these risk factors.

Strategic planning begins with the explication of the company's targets, which are then used as the basis for the development of the strategy. If you misinterpret your own goals, all subsequent strategy development can go in the wrong direction.

The risk factor of erroneous assessment of the strategic potential of the enterprise may be due to the error of the initial data on the technical and technological potential of the enterprise due to the rudeness or inadequacy of the chosen method of diagnostic examination of the enterprise, the absence or ignoring of information about the technological leap brewing in the industry (for example, during the diagnostic examination of the enterprise, a statement may be made about the initial phase of the life cycle of technologies implemented at the enterprise, while the conditions for updating the technology are already ripe). A similar error in determining the production potential of an enterprise can lead to an incorrect assessment of the degree of autonomy of the enterprise, i.e. its independence from other production or commercial structures. There



may be situations of incorrect assessment of the actual division of property rights, ownership and management of land, fixed assets, income, etc.

The accuracy of forecasting the dynamics of changes in the external socio-economic environment is very low. Options for a strategic plan based on an erroneous forecast scenario may not be feasible or lead to negative results.

The risk for tactical-level decisions is primarily associated with the possibility of distortion or partial loss of meaningful information during the transition from strategic to tactical planning. If the developed specific tactical economic decisions were not checked for compliance with the chosen strategy of the enterprise, the results achieved may be out of the main strategic direction of the enterprise and weaken its economic stability.

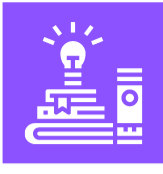
The group of risk factors at the tactical level includes insufficient quality of enterprise management, which may be due to the lack of "management team" cohesion, teamwork experience, people management skills, etc.

Obviously, at any level of decision-making, there will be both external and internal risk factors for this enterprise. It can be assumed that for the successful implementation of strategic decisions, the role of external risk factors is much higher than for tactical or operational ones.

Identification and identification of risk factors is one of the most important tasks of the economic analysis of the production enterprise activity at the present time. The above classification is intended not so much to list all the risk factors, but to create a certain system that would allow not to miss anything significant when building a differentiated risk profile and studying the total risk of a manufacturing enterprise.

Unknown risk factors may arise in future periods and have a significant impact on the results of the implementation of the material investment project under consideration or other business development decisions.

These include: the emergence of new equipment and technology in the market and in production; shifts in consumer demand; the appearance in the future in the financial markets of new types of securities, for example, shares of new issuers or new types of debt obligations; changes in tax legislation; the development of crisis phenomena and processes in the Economy, increasing in the process of global interconnections; man-made disasters and accidents. Such factors, which are not known at the time of making a risk decision, affect the future results achieved as they appear in the environment surrounding the



entrepreneur. The peculiarity of their impact on the simulated distributions of future results is that it can be taken into account only based on the subjective opinions or judgments of the manager or the owner of the capital. The success or failure of the business depends significantly on the extent to which these opinions and judgments will be consistent with the future conditions of the project.

The most important group of fundamental factors is political. Political risk factors include:

- ✚ wars, conflicts, explosive situations and any statements made by political figures about the aggravation of the situation;
- ✚ resignation or change of government, elections (a change of government leads to the possibility of changing the political and economic course of the country affects the attractiveness of investment in its economy; the resignation of the head of the Central Bank or the change of someone holding important political or financial positions causes an immediate market reaction);
- ✚ the threat of nationalization;
- ✚ change of the political system, etc.

Full economic analysis is carried out on three levels. Initially, it examines the state of the economy as a whole. This allows you to find out how the overall situation is favorable for investment and makes it possible to determine the main factors that determine this situation. After studying the market situation as a whole, an analysis of individual market areas is carried out in order to identify those that, in the current general economic conditions, are most favorable for placing funds in terms of the selected investment goals and priorities. At the same time, the state of industries and sub-sectors of the economy is considered. The identification of the most preferred areas for the allocation of funds will create a basis for the selection of specific types of investments within their framework, investments in which would ensure the most complete implementation of the tasks set. Therefore, at the third level of analysis, specific innovative programs, projects, the state of individual firms and companies whose equity or debt stock instruments are traded on the market are covered in detail. This makes it possible to decide which tools are attractive and which ones should be discarded.

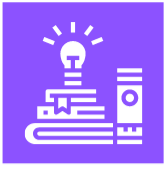
The study of the general economic situation at the first stage of the analysis is based on the consideration of indicators that characterize the dynamics of production, the level of economic activity, consumption and accumulation, the impact of inflationary processes, the financial condition of the state. At the same time, attempts are made to establish specific mechanisms for influencing the state of affairs in the economy of the most important political and social events. Identifying the factors that determine the economic situation as a whole and directly affect the market allows you to determine the general conditions against which you will have to conduct an investment policy and make forecasts about the prospects for their change. Since the macroeconomic situation is the subject of close attention from a wide range of economists, when conducting a fundamental analysis of the CE, it is possible to rely on fairly deep studies and conclusions made by leading experts in this field.

The general economic situation reflects the state in most areas of the economy, but each of these areas is subject not only to general, but also to its own private (internal) laws. Accordingly, the conclusions drawn at the macro level need to be concretized and adjusted in relation to them. Even if the analysis of the situation as a whole shows that it is unfavorable for investment, this does not mean that it is impossible to find industries in which it would be possible to invest money with great profit.

In the course of the industry analysis, the indicators reflecting the dynamics of production, sales volumes, the value of commodity and raw material reserves, the level of prices and wages, profits, savings are compared both in the context of industries and in comparison with similar indicators in the national economy as a whole. At the same time, in advanced economies, analysts rely on standard indexes that characterize the state of affairs in various industries.

Once the most suitable industries for placing funds have been identified, from the entire variety of companies and existing innovative projects that are included in them, it is necessary to choose the vehicles that allow you to realize your investment goals.

Thus, the risk factor involves taking into account the past in dynamics, economic knowledge in general and in particular, allowing you to think on a large scale and in time to consider and evaluate the ongoing qualitative changes.

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