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Risk and Project Management in the Banking Sector – an interview with Adesh Jain

Q & A

What are the main challenges & concerns of ERM in banks?

ERM is a risk-based approach to managing an enterprise. It integrates concepts of

- Strategic planning,
- Operations management,
- Performance management
- and Internal governance and control.

So Banks will have to take a more holistic view considering Risks at different level of the organization which will go beyond the traditional financial risk considerations.

As you know, bank deals with the future and future is nothing but risky as well as uncertain. ERM is the backbone of the financial banking and insurance companies. Unfortunately, quite often, banks confine themselves to financial risks. The risks associated in lending money as a part of project of a customer is not done so scientifically that it often could have a good probability of becoming a non performing asset.

How does Enterprise Risk Management differ from traditional risk management in the financial sector?

Traditional risk management in Financial sectors are more concerned with risks at operational levels. Such as,

• Credit risk or the risk of default, that is that a borrower will fail to repay the principal borrowed and/or the interest on the amount borrowed
• Liquidity risk
• Interest rate risk. The risk of changing interest rates and the effect this has on the bank's margin between the borrowing and lending rate
• Market risk. The loss in the value of a portfolio of trading assets

ERM on the other hand looks at many other aspects. Such as, what is the risk involved if a bank's customer database is lost due to system malfunction? It looks at the 'whole' and builds part by part. It compels professionals to be on the ground floor and at the Balcony at the same time.

Do you think the process of implementing ERM is the same for every financial company or does it vary from firm to firm?

There are three levels of Strategic and Business Risks:

a) Macro Level (Strategic): threats originating from geopolitical and macroeconomic environment in which all businesses operate e.g. Global economic recession
b) Sector Level (Strategic and Business): Changes in the sector specific business environment e.g. Govt policy on Financial Sectors
c) Operational level (Business): Risks which affect day-to-day operational and project performance of the organization

The category of business risk are unique to the environment of a particular organization. Business risks will vary between organizations within an industry and between various industries ERM implementation will vary from Firm to Firm at Business or operational levels.

There are some models like COSO or ISO which could be taken as a standard and within it, we could evolve specific to a sector. This is quite innovative to do so.

Can you give an example of effective ERM applied in practice at various banks?

Almost all Banks have some form of risk management in place. Annual Report of various Banks mention their risk management activities. For example, in October 1999, the risk management function in ICICI Bank was reorganized and integrated into a distinct and independent Risk Management Department. The Risk Management Department works in close association with the business units to implement various risk management strategies and identifies, assesses, monitors and manages all major risks in accordance with well-defined policies, procedures and practices. Bank risk managers should have full appreciation of the essentials of project and programme management including portfolio management. Bank Risk Officers should be certified project managers as well based on demonstrating the competency based assessments. International project Management Association (IPMA) is the only federal structure based organization comprising of 57 countries from all the continents that have 4 levels of project management certification with heavy emphasis on risk management. China has 43% of the total certified project managers of the globe as it has placed heavy emphasis on competency based qualifications.

What is the role of the treasury and insurance in an ERM environment?

The treasury department or the corporate treasurer has responsibility for managing financial risk. Treasury is concerned with the relationship between the business and its financial stakeholders, which include shareholders, lenders and taxation authorities.

Insurance involves protection against hazards by taking out an insurance policy against an uncertain event. The premium cost will be influenced by the extent of risk management carried out by the insured in order to prevent or mitigate risks from eventuating such as fire prevention precautions

What role could professionals like Cost and Management Accountants play to develop sound ERM environment in your organization?

Cost overruns in project implementation is a major risk in successful project implementation. Cost management professionals can provide valuable inputs in terms cost estimation and cost control of a project. CMAs are very important in contributing to ERM. Cost related risks are very high in financial sector. CMA should also able to promote certification in cost engineering etc.

How effective has the Internal Auditors been in implementing ERM in banks?

It depends on the internal control and governance policies set forth by the Board of Directors and the top management. Internal auditors, most likely will have the task of investigating the fraud and should review the adequacy of internal controls.

The core internal auditing roles that relate to ERM are:

• Giving assurance on risk management processes.
• Giving assurance that risks are correctly evaluated.
• Evaluating risk management processes.
• Evaluating the reporting of key risks.

> IN MY VIEW, THE ROLE OF GOVERNMENT IS TO CREATE FRIENDLY POLICIES IMPROVING THE CONFIDENCE LEVEL OF THE INVESTORS. INVESTORS MUST BE REASONABLY ENSURED TO GET HIS REASONABLE ROI AND THAT CAN HAPPEN IF THE PROJECT IS COMPLETED WITHIN THE STIPULATED TIME AND COST BUDGETS

• Reviewing the management of key risks.

Unfortunately, Auditors often do not have as much as necessary the exposure the finer aspects of project risk management as well as ERM concepts at a broad level. They should also be certified in project management.

In the advanced countries, banks have been rolling out project management around cost efficiencies and risk management, how far do you think the practice has been advanced in India ?

Indian Banks also do proper feasibility studies and due diligence before project financing. But project implementation in India is very complicated and risky due to various external factors such as Political, Social, Legal environment in which we work. Projects often are over budget and behind schedule.So the initial cost estimation often does not work. India needs to develop as a country the project mindset. For Nation's prosperity, project mindset is MUST. Project mindset in simple terms implies the 'holistic' thinking and planning First and then speedy implementation of its 'parts' to make the whole. Upfront planning is most necessary to be done based on realism in giving time and cost estimates keeping in view the necessary buffers for the risks associated. In today's context, there is no room for time and cost overruns. Mere one day delay of 600 MW Power Plant can be 10 crores. If you want to see the impact on the total economy including indirect benefit to industry to have well deserved energy, it could be 3 to 4 times i.e. the total loss could be of the magnitude of 30 to 40 crores just by delaying a power plant of 600 MW. If you go even a step further in computing the impact on the 'happiness factor' i.e. having one day of extra light in the midst of darkness in the rural areas, it could be significant. We the professionals have no reason what so ever to accept delays. The delays can only be acceptable if the force majeure conditions apply. We got to have 'fire in the belly' to complete projects. Our lack of due diligence at the project appraisal and planning stage and over optimism of overcoming all the hurdles etc. give rise to demoralization and tardy progress of projects in India. We have some successful stories and should able to replicate with simplified processes of approvals and good planning and risk management templates and mindset.

How different is project financing from traditional corporate lending?

Corporate Lending could be for day-to day operations for working capital and cash requirement. Operations are fundamentally less risky as future is not too uncertain.

Project Financing is much more risky due to the points mentioned above. In undertaking projects and in particular, the infrastructure and capital intensive, project financing is the backbone.

Post the global financial crisis, how do you see the project financing market in India, especially during an economic downturn?

I think current economic downturn is more linked with political uncertainty prevailing in the country at the moment. Ups and downs are always there in an economy. India fundamentally needs lot of investment in developing infrastructure and hence project financing is a must. However, one has to make sure successful implementation of these projects within specified Time and Cost by applying modern project and risk management techniques.

I once again lay emphasis on certification of risk managers and project managers with the world renowned IPMA 4 Level Certification. Unfortunately, today professionals have not understood the main difference in exam based certification which some organizations in USA promote heavily to competency assessment based qualifications in which you do need to demonstrate the competencies in three distinct domains i.e. Technical, Behavioral and Contextual covering 46 elements. Exam based certification is like obtaining the drivers license where competencies assessment based qualifications is demonstrating the skills in driving in multi lane and multimode highway systems. There is lot of difference between the two. Exam based certification is just a base to build on.

The government has recognized the importance of infrastructure development as prerequisite catalyst of growth, what sort of support does it give banks to enhance project financing?
Government support should come by way of removing bureaucratic hurdles in regulatory clearance, resolving land acquisition issues etc.

If these external factors can be controlled more projects will be successful and therefore the risks will be mitigated.

In my view, the role of government is to create friendly policies improving the confidence level of the investors. Investors must be reasonably ensured to get his reasonable RoI and that can happen if the project is completed within the stipulated time and cost budgets. Delays make the projects go for six and all the financial calculations go haywire. PPP can only work if we have trust all around amongst all the players. Each player must have its share of profit making which is appropriate and reasonable for their efforts

Project financing involves complex & challenging transaction, especially in these days of economic downturn, there is more chance of the assets going bad, how do you thing professionals like the Cost & Management Accountants contribute and help you in his regard?
Cost Management and Project Management professionals can complement each other in terms proper financial feasibility analysis, Cost estimation and budgeting of a project.

In a way, cost management is one of the three legs of project management stool. Cost estimation itself is a big science. In India, as a whole, we lack certified cost engineers.

Growth remains contingent on upgrades & development to facilities across power, roads, rail, ports & social infrastructure, do you see project financing a huge area of the business in future?
Absolutely. No doubt about it.

In most of the developed countries, project financing has been carried out under the governments private finance initiative, how has the concept of Private Public Partnerships (PPP) featured in India in this regard?
The union government has estimated an investment of more than $300 billion in the infrastructure in the 10th plan. The major infrastructure development projects in Maharashtra (more than 50%) are based on the PPP model. In the 2000s, other states such Karnataka, Madhya Pradesh, Gujarat, Tamil Nadu also adopted this model.

Sector-wise, the road projects account for about 53.4% of the total projects in numbers, and 46% in terms of value. Ports come in the second place and account for 8% of the total projects (21% of the total value). Other sectors including power, irrigation, telecommunication, water supply, and airports have gained momentum through the PPP model.

Recently at the opening of the 21st Global Symposium with the theme of 'Linking project mindset to nation's prosperity', Dr. Verrappa Moily addressed you as the 'Bhisma Pitamah' of project management. You are also the Honorary Chairman of China Project Management Committee besides Government of Turkey released postal stamp in 2010 for your contribution to project management, what suggestions you have for us in India!
I am a good student and always ready to acquire more knowledge to be applied in real life situations. Thank you for your recognizing some of my achievements. I am clear that India's progress in general in management of projects is far below the potential we have in terms of achieving excellence. We have some successful stories but those are exceptions and cannot be the rule of the profession. We must look at the big picture first and we can do so if the functional silos are demolished. The big picture is not by owned by a party or a group but owned by the majority of the stakeholders. It is the big picture which needs to paint gradually with quality built into it at every stroke of the brush. We must understand clearly that delaying decisions could be due to lack of boldness or belief or could be partly impacted by politics. In any case, decision deficit would not able to create the future which we all want to have. Risk management is the key. Future is unknown and we must be prepared to go wrong in our decisions inspite of taking all the factors in account. We need to build self confidence in stating where we went wrong and for what reasons. Learning from our mistakes could be the most beneficial asset entry in our balance sheet of 'Corporate Competiveness'. We must be transparent to our actions and in our thoughts. We must replace the last element of hidden agenda with transparency. Intellectual Integrity is the Ultimate in building effective teams and that is what we need more of that in India to be a role model for other countries and to serve our own huge number of stakeholders with smiles on their faces. MA