Socio Economic Risk

What is this risk area?

Socio economic risks are those that have a material impact on the welfare, health, well-being and financial position of an organisation, its employees, customers, citizens or residents in a specific geography or country.

Where does this risk area emanate from?

This risk arises from the resulting impact of changes in the socio-economic environment in which the organisation undertakes its business operations. It can also be as a result of regulatory changes.

Example of Socio-Economic risk interconnectedness to other risk areas:

- Over staffed
- Low productivity

HR Risks

- Socio-economic Risks
- Downturn in economy
- Drop in business volumes

Income Statement Risk

- Loss of revenue
- Costs still fixed

Balance Sheet Risk

- Drain on cash resources
- Increase in debt levels

Strategic Risks

- Forced to exit market

Where does this risk area manifest itself?

This risk results in an impact on the operational capability to do business, levels of crime, the strategy of the organisation and ultimately in financial performance and balance sheet.
Why is it important to manage these risks?

Socio economic issues can have a major impact on the operations and financial performance of an organisation and on the people of a country or region. These impacts can be both direct and indirect and happen suddenly or over a period of time.

Where to start in managing this risk area?

Socio economic risk management starts with a review of all the socio-political environments of the countries and markets in which the organisation operates, trades or is reliant on for raw materials, products, supplies or customers.

What is the benefit of actively managing this risk area?

The management of socio-economic risks will ensure that the organisation is better equipped and in a position to take pro-active decisions to deal with ever changing economic and socio political changes in the markets and countries in which they conduct business and operate or rely on.

DottRisk has the following detailed risk guides covering what we believe are the critical areas of Socio-economic risk management.
Introduction to Socio-Economic Risk

Socio Economic Macro Vulnerability Risk Assessment

Global sentiment is largely dictated by day to day socio economic and political events. Global economic growth outlook and liquidity have an overall bearing on sentiment. This in turn has a major bearing on global financial markets, currencies, asset prices and interest rates.

Geo-political risks such as weapons of mass destruction, political confrontation and participation in regional conflict can impact global trade and economies as the leading global powers and blocks position themselves accordingly.

One of the key requirements of risk management is the ability to manage and be prepared to deal with socio-economic risks. These can rapidly manifest themselves in a number of ways e.g. economic downturn, high unemployment, business failures, labour and social unrest, civil disobedience, breakdown of the rule of law, disease outbreaks and pandemics, regulatory and legislative changes, immigration (loss of skills) and financial impacts (interest and exchange rate volatility, commodity price volatility, asset price volatility, foreign currency availability, changing trade regulations around tariffs, limitations on profit remittances, trade embargoes, border closures, lockdowns, sanctions etc.)

In simple terms the demand for products and services in any market or locality is almost totally dependent on the socio-economic conditions that prevail. Conditions can have varying degrees of impact on an organisation depending on its locality and the nature of its operations and the products and services it supplies.

Key vulnerabilities should be identified e.g. social unrest, labour, crime, rule of law, corruption, critical resource reliance (electricity/water/oil/ /fuel/gas/alternative energy/un-sustainable scarce resources/single supplier). Disease outbreaks and pandemics pose a significant risk beyond just their human cost. The economic cost and impact of these is unquantifiable and extends beyond geographic boundaries.

As an organisation you need to continually assess the global socio-economic climate and possible impact on your operations. More specifically this should focus on the political/sovereign risk in all the countries/markets you operate in, rely on for sales or are dependent on for the supply of products or raw materials e.g. reliance on the infrastructure, economic fundamentals, ability to perform, regulatory environment, rule of law, political stability and ability to get paid.

Environmental, Social and Governance (ESG) Considerations

Growing pressures around compliance from regulators, and concerns related to management, performance, unsustainable corporate practices and costs, have also created a need for risk and investment policies that incorporate environmental, social and governance ESG.

ESG involves using environmental, social and governance factors to assess companies and countries on their sustainability. When enough information has been obtained on these three factors, they can be integrated into investment and/or organisational decisions.
Cross Border Risk Management
Doing organisational cross border has specific additional risks which need to be assessed and mitigated before you undertake organisational operations or trade related transactions. Ideally you want to operate in and with credible counterparties from low risk markets/countries that are predictable and stable with low volatility.

Not only do you have to know your end customer or supplier and their organisation as best you can, but you need to understand the country in which they operate and how the organisation operates and is done there. You need to be very conscious of country, counterparty and payment risks in all the markets you operate in and act appropriately. Individual country risk assessment is critical and needs to be on-going once you are exposed to a country.

Cross border risks extend from not just the financial dimension of your transaction but include the safety and security of vehicles and the goods being transported but also the safety and security of staff and employees.

The rule of law and the reliability and integrity of third-party service providers becomes critical as considerable reliance will be placed on them.

Labour Risks
Where your organisation is heavily reliant on organised labour, recognised union representation and collective bargaining, you are highly vulnerable to the effects of prolonged strike action and related labour unrest. This can extend to violence, sabotage and willful acts of misconduct. Loss of critical skills or a scarcity of the required skills is particularly relevant in a world increasingly being dominated by technology. The well-being of employees and a healthy labour force is critical in a world where productivity and quality are essential.

Rule of Law, Social Unrest and Civil Disobedience
The rule of law requires the government of the day to exercise its power in accordance with well-established and clearly written rules, regulations, and legal principles. When a government official acts pursuant to an express provision of a written law, he acts within the rule of law.

Under the rule of law, no person may be prosecuted for an act that is not punishable by law. The rule of law requires that government impose liability only insofar as the law will allow. Government exceeds its authority when a person is held to answer for an act that was legally permissible at the outset but was retroactively made illegal. The rule of law also requires the government to exercise its authority under the law.

It is important to conduct business in jurisdictions where the rule of law is upheld and where contracts are enforceable. Where there is concern that the rule of law may not prevail it is important to protect yourself.

The levels of social unrest, crime and corruption will have a major impact on the ability to undertake “normalised” organisational operations in a country.

Civil disobedience and anarchy can manifest themselves in many ways. Rebellion is an open or armed fight against a government or open resistance to a government or authority.
Revolution is a rebellion that succeeds in overthrowing the government and establishing a new one. Military or rebel rule can see a ruling government rendered powerless overnight.

Countries or regions that are plagued by civil unrest and lawlessness are by their very nature high risk and are extremely hard to do business in and with. The added risk of corruption and falling fowl of international regulations are is also high.

**Tariffs, Embargoes and Sanctions**

Trade agreements and trade related regulations and legislation pose a specific socio-economic risk to organisations from an import/export and market/competitiveness perspective. This is largely because they are subject to on-going review, amendment and even cancellation. These often take place without any discussion or prior notice.

Changes to tariffs, duties and the imposition of embargoes and sanctions can take place over-night and have devastating impacts on markets, export revenues and import costs. This can be particularly severe where export markets have been developed and built up over years at great cost. Imports can also become uncompetitive over-night. It is for this reason that it is important to diversify your country risk and not have a concentration risk on any one country or market for trade or product type category.

Economic sanctions can be used for achieving domestic and international purposes. Once certain countries impose sanctions, there is often pressure on other countries to follow suit for fear of other implications if they don’t align.

An embargo is the partial or complete prohibition of commerce and trade with a particular country/state or a group of countries.