

## COMPONENTS OF RISK MANAGEMENT IN TRANSPORT COMPANY

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*Summary: Continuing problems of transport companies in consequence of financial and economic crisis are clear-cut evidence that risk management in transport companies plays a very important role to achieve long term competitiveness and profitability. The paper is dealing with business risks and risk management in transport companies.*

*Key words: risk, risk factors, risk analysis, risk management, transport company*

### INTRODUCTION

Today's constantly changing business world becomes volatile, unpredictable and more complex every day. Integrated Europe brings together with transport development also greater business, creates longer carried distances and enables greater performances. Transport companies have possibility to realize their business ideas, support their own competitiveness and obtain profitable position on the market. At the same time these companies, that have a key role in economic activities, have to face new risk horizons and grapple with the changes brought about by a post-down economy. Although historically, business has viewed risks as a necessary evil that should be minimized or mitigated, modern risk management conceptions provide mechanisms that except identification of risks representing potential pitfalls identify also risks that bring opportunities.

### 1. BUSINESS ENVIRONMENT AND BUSINESS RISKS

Globalization brings huge opportunities for today business environment. Borders are coming down, new markets are opening up and technology development drives the growth. New competitive environment and market internationalization offer to transport companies great opportunities. Business now operates in an entirely different environment compared with just 15 years ago. Many companies perceive a rise in the number and severity of the risks they face. Nearly all operational tasks and processes are now viewed through the prism of risk. The term "risk" has become shorthand for any company activity. But it is not possible to create business that does not take risks. Therefore companies are looking for more effective and efficient ways to deal with the risks that are everywhere. Risk, as one of the main aspects of the managerial work, is rarely managed correctly. The prejudice that risk analysis and

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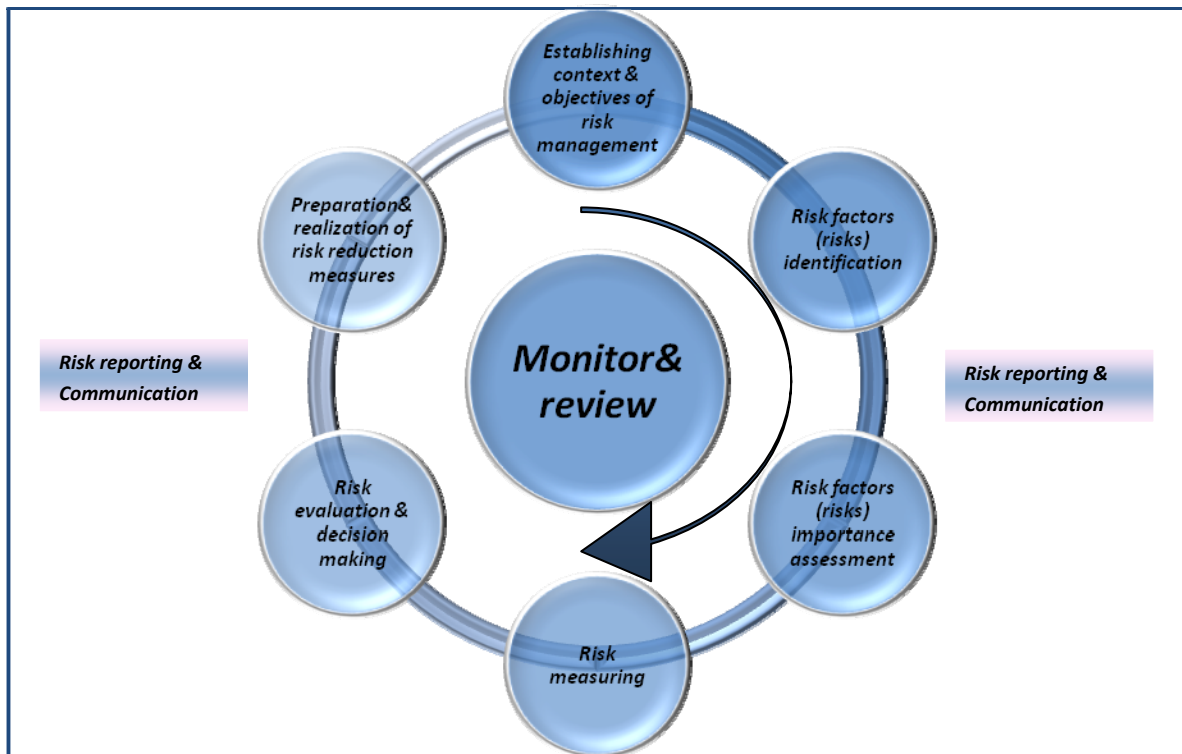
management is domain of especially great companies that can afford to pay the specialists is still persisting. Risk is inescapable in business activities and especially small and middle transport companies, in respect of their weaker capital ratio, can neglected risk factors feel more severe than companies in other fields of business.

As the example we can indicate e.g. air company Sky Europe that suffered a loss in consequence of strategically mismanagement and missing risk management. Transport is an essential component of the European economy. The transport industry at large accounts for about 7% of GDP and for over 5% of total employment in the EU of which 4.4% corresponding to transport services and the rest to transport equipment manufacturing, while 8.9 million jobs correspond to transport services and 3 million to transport equipment (1). This data does not include transport carried out on own account.

Business in transport is not only a survey of transfer market but especially complex package of knowledge and techniques necessary for maximum satisfying all transfer requirements. The state economic and social policy affects transfer market in greater extent than other fields. In this meaning transport business is understood not only as economy segment but also as a part of infrastructure. Proportions of market principles and government's interventions are one of specialties characterized by transfer market. Over the last period, customer orientation as the awareness of the customer's needs, get to the forefront in transport companies business. Companies producing tangible goods have possibility to innovate their production programme continuously and so stimulate their demand and profit. Transport companies offering services have a different situation because stimulating demand for services has different character in comparison with tangible goods. It depends much more on living standard and inhabitant's style of life. Immaterial service as the result product of the transport together with customer orientation should be considered in the strategic risk management, especially within selection of suitable methods and systems for management supporting. The objectives of the strategic risk management have to be in accordance with the business objectives of transport companies. The task of the strategic management in transport companies is to sustain or obtain strategic competitive advantage, to define and in certain time achieve real long-term objectives. The objective is to reduce the risk of possible failure and get the organization to the situation when it is able to foresee the changes, reply upon them, activate the changes and use them in own benefit [4,5,6].

## **2. RISK MANAGEMENT IN TRANSPORT COMPANY**

Business risk management in modern understanding means systematic and coordinated way of work with risk and uncertainty affected within the whole company and involving all types of risks. Single components of risk management are shown in Figure 1. The whole process has cyclic character and should be a continuous and developing process. (2).



Source: authors

Fig. 1 – Components of risk management in transport company

**Risk reporting & communication and monitor & review** are also the components of the risk management.

**Risk reporting & communication** is responsible for preparation of reports for internal (e.g. Board of Directors, Advisory Committee,) and external users (e.g. banks), too is a communication process that uses consultation to make effective decisions. Importantly, consultation is not an outcome or an end in itself; it is a means by which outcomes are achieved. Consultation gives stakeholders the opportunity to influence decisions, however, it is not joint decision making, but rather an effective way to receive useful input and ensure that all relevant viewpoints are taken into account in identifying and evaluating risks.

**Monitor & review** is concentrated on keeping or enhancing risk management system in dependence on changing conditions or possible changes of company strategic objectives including risk management objectives. Monitoring and review should be designed to detect both gradual and sudden change. Continuous monitoring is most likely to detect a dramatic change in a timely fashion, whereas periodic review of a particular aspect of the risk process is more oriented towards detecting trends and incremental change. Methods can include data evaluation, audit and compliance measurement.

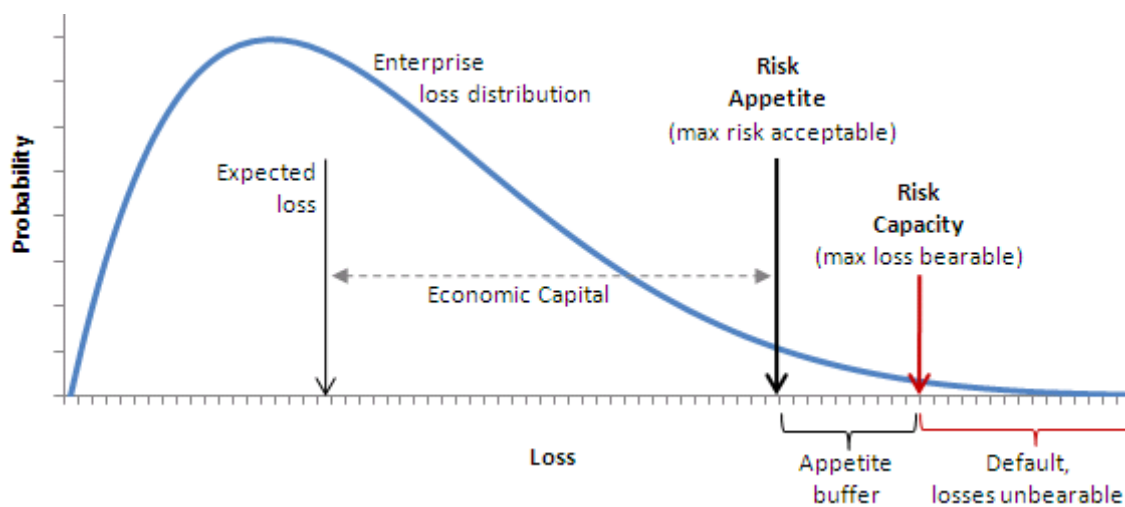
The task of the initial phase of the risk management - **Establishing the context & objectives of risk management** includes especially:

- specification of the internal and external environment in which the company is acting, setting the risk management objectives in line with the company strategic objectives,

- setting the risk capacity – a level of the greatest amount of the loss the company is able to survive in dependence on size and structure of its capital and ability to obtain other sources of financing,
- setting the risk appetite – a risk level respectable for company within its risk capacity in dependence of management attitude to risk and stakeholders requirements and expectations. Generally risk appetite can be defined as the volatility in results that an organization and its senior management accept in support of the declared company strategy, it must articulate clearly key sources of risk in a form that is readily comprehensible to non-specialists. The end product is typically expressed through a risk appetite statement, which deals with all these requirements.

Transport company should consider these key questions:

- What risks will the company not accept?  
(e.g. environmental or quality compromises)
- What risks will the company take on new initiatives?  
(e.g. new product lines)
- What risks will the company accept for competing objectives?  
(e.g. gross profit vs. market share?)



Source: Virenfeldt, 2011

Fig. 2 – Illustrating Risk Appetite in a Loss Distribution Framework

Some components of the risk appetite can be quantified accurately with proven risk models, others are based on more subjective and qualitative evaluations. It is important never to rely solely on quantitative approaches, common sense and good judgments must at all time be an integral element of assessing the risk appetite.

**Risk factors (risks) identification** should be approached in a methodical way to ensure that all significant activities within the organization have been identified and all the risks flowing from these activities defined. All associated volatility related to these activities

should be identified and categorized. Business activities and decisions can be classified in a range of ways, examples of which include:

- **Strategic** - These concern the long-term strategic objectives of the organization. They can be affected by such areas as capital availability, sovereign and political risks, legal and regulatory changes, reputation and changes in the physical environment.
- **Operational** - These concern the day-to-day issues that the organization is confronted with as it strives to deliver its strategic objectives.

A large number of techniques exist for risk identification, such as checklists and prompt lists, brainstorming, structured interviews, causal analysis, cognitive mapping, Delphi groups and various diagramming approaches. There is no single “best method” for risk identification, and an appropriate combination of techniques should be used.

It is evident that great numbers of identified risk factors (usually titles) could cause problems in further stages of risk management. Therefore it is necessary to consider the importance of these factors and work in next steps only with the most important factors. **Risk factors importance** can be assessed e.g. by expert evaluation or by sensitivity analysis.

At present **risk measuring** is based to a great extent on using mathematic-statistical methods with use of calculus of probabilities that in comparison with simple deterministic models provide better information support for decision making processes.

**Risk evaluation** should lead to the conclusion about acceptability or unacceptability of certain risk and influence forthcoming preparation, selection and realization of the risk counter measures or avoid new activities connected with respective risk. In decision making process, the managers can use various approaches considering risks and evaluation criterion. Manager attitude toward risk plays an important role in his decision making process. Expressive aversion towards risk is often connected with opportunities rejection, avoidance to innovations and so it is not presupposition for successful management work.

When the risk analysis process has been completed, it is necessary to compare the estimated risks against risk criteria which the organization has established. The risk criteria may include associated costs and benefits, legal requirements, socioeconomic and environmental factors, concerns of stakeholders, etc. Risk evaluation therefore, is used to make decisions about the significance of risks to the organization and whether each specific risk should be accepted or treated.

**Risk reduction** - each unacceptable risk will have a number of treatments. Other than the option of avoiding the risk entirely, treatment options will do one or all of the following:

- Reduce the likelihood of the risk eventuating.
- Reduce the consequences of the risk if it eventuates.
- Improve the controls rating to “Adequate” or “Excellent”.

Activities oriented to risk reduction are usually divided into two basic groups:

- strategies aimed at effect on risk generation reasons to prevent unfavorable situation occurrence in the future or to reduce the probability of such situations formation. These approaches present preventive measures and usually are indicated as offensive strategies,

- strategies aimed to reduce adverse impacts of risk situations on certain economically acceptable level of risk consequences. These approaches present corrective measures and usually are indicated as defensive strategies.

Both groups of measures should be realized in time, so before a risk situation occurrence. Generally they are connected with certain expenditure, so the risk reduction and higher security cannot be achieved free of charge. In some cases these measures can start so called secondary risks that require adequate and prompt response.

## CONCLUSION

At present transport companies' managers are facing with a bewildering array of uncertainties, as the environment within which they operate changes at an increasing rate. Uncertainty is still evoking especially negative feelings in human mind. People perceive it mostly as danger, stress. But uncertainty can also lead to unexpected opportunities that could be exploited if they were recognized early enough. Risk management is dealing with uncertainty in order to reduce threats and maximize opportunities. It can be seen as a way that enables to create sustainable competitive advantage but no risk management process can create a risk-free environment. Managers who lead transport companies should be able to demonstrate their ability to deal with frequent and often changes caused by market development, political events, technological inventions and environmental hazards. Poor risk management may lead to bankruptcy whereas good risk management practices can excel company performance outcome.

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