

PAPER – 6A: RISK MANAGEMENT

CASE STUDY 3

Sunshine Ltd. is a software company specialized in the software development for their clients. In the last decade it has earned a good name and fame. For example, a super critical boiler in a thermal power plant takes 10-12 days to be fine-tuned or synchronized. It means system is shut for power generation and lead to loss of millions of dollars. Sunshine Ltd. came up with a solution that cuts the time taken to synchronize a boiler from 10-12 days to 3-4 days through the use of software and services of IT Professionals. The main strength of Sunshine is the IT professional they employed with it.

It captured data through sensors on the boilers, use the algorithm built in house to check nearly 240 parameters and over 10,000 combinations to tune the boiler.

It also helped a global heating, ventilation and air conditioning firm to bring down the time taken to design an AC solution in a building or office from 9 days to just 2 hours now.

However, traditional outsourcing business of Sunshine Ltd is dying a slow death as clients cutting their budgets on such services and shifting their focus on newer areas such as digital and cloud.

Three-fourth of the revenue of Sunshine Ltd is from traditional services. However, half of its revenue still comes from fixed price projects which allow it the flexibility to determine the resources it deploys and use software tools to deliver services. Now, the aim is to increase that goal by reducing the dependency on people and more on software led services which coincide with it's goal of IT Modernization.

Sunshine Ltd. derives a major portion of its revenues from customers discretionary spending which is linked to their business outlook. It's major revenues are from UK, USA and other European countries.

Some draft legislations in USA has been made to restrict the availability of work visas. Such protectionist policies threaten the prospect of global mobility of people which may also affect the work of Sunshine Ltd. as distributed software development requires free movement of people.

Appreciation of the rupee against any major currency results in the revenue denominated in that currency to appear lesser in reported terms. Then, there may be different exchange rate when sale took place and when invoice is collected.

The Internal Financial Control System

The internal Financial Control System of Sunshine Ltd. has been laid down as below:

- Recording and providing reliable financial and operation information.
- Safeguarding assets.
- Ensuring compliance with corporate policies.
- Well defined delegation of power.
- Efficient ERP system.
- Internal audit by one of the big audit firm.
- Periodic audit by specialized third party consultants.
- Audit Committee found internal financial control adequate.

A. Questions

- (1) Discuss the SWOT analysis of Sunshine Ltd. (5 Marks)
- (2) Briefly explain the political risk to be encountered by Sunshine Ltd. (3 Marks)
- (3) Elucidate the types of exposures risks to be encountered by the company. (6 Marks)
- (4) How can the company tackle the exposure of difference in exchange rates when sale took place and when invoice is collected. (12 Marks)
- (5) Discuss the efficacy of the Internal Financial Control System of Sunshine Ltd. (4 Marks)

B. Multiple Choice Questions

1. Risk Adjusted Discount Rate Method is based on the concept that.....
 - (a) investors demand higher returns from more risky projects
 - (b) investors demand lower returns from more risky projects
 - (c) investors demand higher returns from less risky projects
 - (d) None of these
2. A project has a cost of capital of 10% and a payback period of 2 years with annual cash inflows commencing from year end 2 to 4 of Rs. 60 crore. The initial investment outlay at the beginning of year 1 shall be
 - (a) Rs. 67.80 crore
 - (b) Rs. 74.58 crore
 - (c) Rs. 60.00 crore
 - (d) Rs. 95.07 crore
3. If interest rates are 3.4% and 1.4% per annum in USA and UK respectively and spot exchange rate is \$ 1.40/£ then 90-days forward rate shall be
 - (a) Rs. 1.346976
 - (b) Rs. 1.347976
 - (c) Rs. 1.406976
 - (d) Rs. 1.407976
4. Which of the following risk will not affect foreign exchange rate?
 - (a) Investment Risk
 - (b) Inflation Risk
 - (c) Interest Rate Risk
 - (d) Sovereign Risk
5. The purpose of Financial Swap is to reduce _____.
 - (a) Interest Rate Risk
 - (b) Exchange Rate Risk
 - (c) Credit Risk
 - (d) Both (a) and (b)
6. In case if principal or interest payment overdue between 61-180 days then as per RBI's framework for Revisiting Distressed Assets in Economy they are classified in category _____.

- (a) SMA – 0
 - (b) SMA – 1
 - (c) SMA – 2
 - (d) SMA – 3
7. _____ as a formal discipline for risk and capital management was born out of financial crises.
- (a) Substantive procedures
 - (b) Test of Controls
 - (c) Corporate Governance
 - (d) Stress Testing
8. Which of the following is not a type of country risk?
- (a) Political Risk
 - (b) Financial and Economic Risk
 - (c) Credit Risk
 - (d) None of the above
9. Which of the following risk action describe:
Reducing the risk likelihood or impact by transferring or, otherwise, sharing a portion of the risk. Common techniques include purchasing insurance cover, outsourcing activities, engaging in hedging transactions.
- (a) Avoid
 - (b) Reduce/Manage
 - (c) Transfer/Share
 - (d) Accept
10. Speech Recognition, Handwriting Recognition and Intelligent Robots uses _____.
- (a) Block Chain Technology
 - (b) Distributed Ledger Technology
 - (c) Artificial Intelligence
 - (d) None of these
- (10 x 2 = 20 Marks)**

Exhibit 1

Domestic ratings agency ICRA said that the appreciation in the rupee is aggravating the troubles of the Indian IT sector, which is already hit by a change in the market landscape and compressing revenue growth.

It said the industry is already reeling under pressures like uncertain macroeconomic environment, lower deal sizes in digital technologies, cloud adoption and high competitive intensity.

The agency said despite a 8.1 per cent growth in USD revenue, IT players have registered a growth of only three per cent in the second quarter of the current fiscal, due to the rupee appreciation of four per cent during the quarter.

Due to the difficulties on the currency front, the agency said the \$160-billion industry will be able to notch a mid-to-high single digit growth till FY20.

On margins, it said the industry should brace for an impact on margins as price led competition is likely to intensify and will negatively impact the spreads.

"IT Services players profitability also remains sensitive to rupee depreciation vis-a-vis major currencies such as USD, GBP and Euro and the same too will have an impact," it said.

Its vice president Gaurav Jain said future growth will be supported by higher spend on digital technologies, continued cost benefit offered through outsourcing model and market share gains for the Indian IT sector.

"While companies have increased spending on digital technologies and awarding new contracts, the overall IT budgets have moderated leading to lower incremental spends," he said.

He, however, warned that an increase in the global IT market, which moved up to 67 per cent in 2016 from 60 per cent in 2012, will be limited as Indian IT Services companies, which are in the midst of re-orienting their business models focusing more on higher-end services such as IT consulting and digital, are lagging behind the competition.

"We expect large Indian IT companies to grab a higher share of the digital services space over the next three years," he said.

From a vertical standpoint, manufacturing is outperforming with a 5.8 per cent growth but the largest revenue contributor of banking and financial services has shown a muted trend over the last few quarters on macroeconomic conditions including factors like Brexit.

Over the next decade, the agency expects consolidation in the sector due to the margin pressures.

The rating agency, however, said that despite the pressures on growth and profitability, credit profile for the sector will remain stable.

(Extract from Economic Times)

Exhibit 2

The U.S. government is toughening up the process for renewing a popular foreign work visa.

This week, U.S. Citizenship and Immigration Services advised its officers to "apply the same level of scrutiny" to extension requests for the H-1B visa, among other sought after visas.

In other words, officers are instructed to review requests for renewal as thoroughly as they would initial visa applications.

The H-1B is a common visa pathway for high-skilled foreigners to work at companies in the U.S. It's valid for three years, and can be renewed for another three years. It's a program that's particularly near and dear to the tech community, with many talented engineers vying for one of the program's 85,000 visas each year.

The directive rescinds the previous guidance, which gave "deference" to previously approved visas "as long as the key elements were unchanged and there was no evidence of a material error or fraud related to the prior determination."

"This updated guidance provides clear direction to help advance policies that protect the interests of U.S. workers," said new USCIS Director L. Francis Cissna, who was sworn in this month. President Donald Trump announced his intent to nominate Cissna last spring.

In April, Trump directed federal agencies to implement a "Buy American, Hire American" strategy, which included proposing new rules and guidance for preventing fraud and abuse of work visas. The H-1B program,

in particular, is one that President Trump has eyed for reform, criticizing abusers of the program who use the visa to replace American workers.

Other visas impacted by the new guidance include L-1, for intracompany transfers, TN for Canadian and Mexican citizens, and O-1, for those with "extraordinary abilities."

Some say the new policy will be unnecessarily burdensome and is aimed at limiting foreign workers.

Betsy Lawrence, the director of government relations for the American Immigration Lawyers Association, told CNN Tech that the previous guidance made it efficient to review cases. Even then, USCIS had the authority to question prior decisions and request additional information in reviewing extensions.

"We are going to much greater scrutiny of these cases, and thus delays, even when the underlying facts have not changed," Lawrence told CNNMoney.

Immigration attorney Chris Wright of The Wright Law Firm told CNNMoney that it fits a broader pattern: "It seems clear that USCIS have been instructed to push back wherever they can..." he said, noting that "the prevailing attitude seems to be, 'How might we be able to deny this petition?'"

<http://money.cnn.com/2017/10/25/technology/business/h1b-visa-renewal-uscis/index.html>

Exhibit 3

Effect on IT sector due to Brexit

The Indian IT sector, faced with multiple challenges, is already bracing itself for a tough ride with US tightening its visa norms. Brexit only adds to the growing uncertainty in the business environment for the IT companies. Of the \$108-billion of the IT industry's estimated exports in 2015-16, 17 per cent was to the UK and about 11.4 per cent to other nations within the EU. For large Indian IT companies, over a fourth of their revenues come from Europe, in particular from the UK.

Currency has always been a wild card for the IT sector. Wild swings in the pound vis-à-vis dollar and the rupee, will also impact revenues and profits for Indian IT companies. The British pound revenues make for 10-15 per cent of the overall revenues in the case of TCS, Tech Mahindra and Wipro. For Infosys, GBP revenue makes for 6.7 per cent of the overall revenue.

With pound depreciating sharply over the past year, dollar revenues of Indian IT companies have been under pressure. The pound has also depreciated over 20 per cent against the rupee. This can reduce cost arbitrage for companies outsourcing to the UK.

(Extract from Hindu Business Line)