

INSTITUTIONAL RISK MANAGEMENT

THE TOTAL POINT VALUE FOR THIS QUESTION SET IS 13 POINTS

Explore Sport (XS) is a successful international sportswear brand. The brand provides sponsorship to many well-known global sporting teams and individuals. The XS business model relies heavily on international third-party outsourcing to manufacture products at a low cost while maintaining a high level of quality. XS chose the developing country of Bovania to base its manufacturing operations. Because of its huge international presence, XS is reliant on a global distribution network.

Bovania has few employment or health and safety regulations, and the per-unit manufacturing costs are significantly below those of developed countries. The current government treats foreign firms favorably with little regulation and low corporate taxation. Local elections will occur later in the year, where it is expected that the opposition party will take power and may introduce significant policy changes.

Bovania has a hot and dry climate with few businesses having modern air conditioning. This results in reduced productivity over the hottest summer months.

Tara Jensen is a portfolio manager with the Islander Foundation (IF), an internationally respected charitable institution providing grants to disadvantaged young people to encourage investment in education and training within developing countries. IF has recently increased its investment allocation to XS stock after a positive earnings surprise.

Question 6 of 19

Question ID: 1609292

Identify two critical nonfinancial risks facing IF. For each risk, **justify** your response with *one* reason.

Grading Guide

1. **Reputational risk** is faced by IF for its investments in XS:
 - Potential human rights violations and accusations of health and safety violations could be very financially damaging for IF.
 - IF's mission is to help young people in developing countries rather than profit from their mistreatment. As a result, investing in XS may be viewed as being contrary to the IF mission statement.
2. **Political risk** is faced by IF for its investments in XS:
 - With upcoming elections, it is expected that the opposition party will take over, making significant policy changes—likely lowering corporate profits and negatively impacting XS and IF.

Candidate note: IF is an internationally respected charitable institution, and XS is also a successful global brand name; thus, the same reputational risk that applies to IF also applies to XS. Both reputations are at risk from decisions made to set up manufacturing in a developing country to cut costs. Bovania has few employment laws or health and safety protocols, so it has the potential to allow the mistreatment of local people. Potential human rights violations and accusations of health and safety violations could be very financially damaging for both XS and IF. With the upcoming elections, it is expected that the opposition party will take over and make significant policy changes that may include more onerous regulations and increased corporate taxes—which would likely lower profits, with a negative impact on XS (and IF).

Scoring key:

6 points possible: 1 point for each nonfinancial risk and 2 points for each justification. Only one justification is required for each risk.

(Module 28.4, LOS 28.c)

Question 7 of 19

Question ID: 1609293

Identify *one* climate-related risk and **discuss** how it would potentially affect XS.

Grading Guide

Global warming and climate change are contributing to increased temperatures over time (*chronic physical climate risk*) and an increased frequency of heatwaves and other one-off climate events (*acute physical climate risk*).

Because Bovania has a hot and dry climate with few businesses having modern air conditioning, global warming and/or climate change have the potential to further reduce the number and/or duration of working days during the summer—and therefore, further disrupt XS operations.

Scoring key:

2 points possible: 1 point for identification of either *chronic physical climate risk* or *acute physical climate risk*, and 1 point for discussion using case facts.

(Module 28.4, LOS 28.c)

(Module 28.3, LOS 28.b)

Question 8 of 19

Question ID: 1609294

Identify *one* social-related risk and **discuss** how it would potentially affect XS.

Grading Guide

Social-related risks include (1) occupational health and safety and (2) basic human rights.

In choosing to base their operations in Bovania with few employment and health and safety regulations, XS could be associated with the exploitation of local workers and human rights abuses for profit.

(Only one risk is required.)

Scoring key:

2 points possible: 1 point for identification of one risk, and 1 point for discussion using case facts.

(Module 28.3, LOS 28.b)

Question 9 of 19

Question ID: 1609295

Jensen tasks her assistant with analyzing the impacts on XS of a global pandemic or local epidemic in the Bovania region.

Identify and **discuss** one additional risk impacting XS (other than those identified in the previous questions) as a result of a potential future global pandemic or local epidemic.

Grading Guide

1. **The health and well-being of employees** and those within the XS supply chain are likely to suffer, and it may be necessary to operate at reduced staff levels, with a consequent negative impact on operations.
2. **As countries close their borders**, there are likely to be disruptions to XS's global distribution network, with significant negative impact on their business model.

(Only one risk is required.)

Scoring key:

3 points possible: 1 point for identification of either risk factor, and 2 points for discussion.

(Module 28.4, LOS 28.c)