Legal Risk Management

Running a business means taking risks. The biggest risk an entrepreneur can take is not to think about risks at all. It is therefore wise to identify the risks that a company is exposed to in order to control them where possible, also known as risk management. In this way, costs can be saved and more profit generated. After all, prevention is always better than cure. Risk management is an ongoing process that requires in-depth knowledge not only of a business, but also of the environment in which the business operates. This includes legal risks, as well as legal solutions to other kinds of risks. Therefore, apart from a CEO (Chief Executive Officer) and a CFO (Chief Financial Officer), an increasing number of organizations also have a CRO (Chief Risk Officer), often a former lawyer.

What Is the Best Way to Deal With Risks?
There are four different ways to deal with risks:
1. A business owner can decide to bear the risk himself.
2. He can transfer the risk to others, for instance by taking out insurance. It’s very important, however, that an insurance policy include the risk that needs to be covered.
3. He can decide to avoid the risk. However, that means certain activities will not be performed because the risk is too big.
4. The fourth way of dealing with risks is more attractive. It’s trying to control the risk. Any available opportunities can be taken while any potential negative effects will be limited as far as possible. Legal means play an important role in this, as the following overview of different types of risks will show.

Risks
What are the risks for your business? And what opportunities are there to limit these risks by legal means? Some obvious risks include changes in the global market, unprofitable investments, fire, liability, defective product liability claims or wrong advice damage claims, defaulting suppliers and customers. The different types of risks are generally divided into five categories: (1) strategic risks, (2) operational risks, (3) financial risks, (4) risks in the area of knowledge management and (5) compliance.

Strategic Risks
Strategic risks include risks to reputation, badly executed mergers and acquisitions, not having the right or most recent software, and major changes in regulations. An entrepreneur who is aware of imminent safety and environmental requirements can anticipate risks and thus stay one step ahead of competition.

An important tool to limit strategic risks is the corporate structure. How do you prevent a poorly performing business unit from dragging along the entire business? Establishing subsidiaries is one way to prevent this. A business owner who intends to determine a corporate strategy is well-advised to consult his outside corporate counsel.
Operational Risks
Operational risks result from the production process, for instance: changes in prices of semi-manufactured products or materials, availability of personnel, bad suppliers, weather, theft or fire, and availability and reliability of information technology. Many of these risks can be covered by concluding good contracts with personnel and suppliers. These contracts must contain provisions on retention of title, warranties, pledge and mortgage, joint and several liability, compensation for default, etc. An important tool in risk management is the use of General Terms & Conditions, so that your liability will be limited in each contract.

Financial Risks
This refers to the effective control of finances, including debtors, while taking account of exchange rates, interest rate, liquidity and solvency. This type of risk will generally be discussed with and covered by an accountant, but it’s also closely connected to General Terms & Conditions and the contracts a business concludes. Clear contracts with debtors can simplify collection and thus increase the liquidity of a company.

Knowledge Management
Especially knowledge-intensive organizations, such as consultancy and information and communications technology, face this risk. It is very important to control sources of information effectively, to protect knowledge, and to limit the risk of key staff leaving. Patents, trademark protection, and confidentiality and non-compete clauses in employment contracts are important tools for retaining and protecting knowledge in your organization.

Compliance
Compliance means that a business acts according to the effective legislation. This applies to all business departments. Thus, compliance is not just a field reserved to the legal department, but it is also important for the purchasing and sales department, human resources, accounts department and the manufacturing department. Does your accounting department comply with the regulations on administration and annual reports? Are the terms of employment correct? Are you dealing with consumer complaints the right way? Do you have all the permits required? Are your products and the manufacturing process in line with the safety requirements? It is therefore important to check (or have checked) the management in all departments for the aforementioned risks. Ultimately, non-compliance can lead to criminal prosecution of the management.

Internationally operating businesses will be confronted with the fact that regulations on compliance may differ from country to country. In Europe there are, for instance, far-reaching regulations on the protection of data of employees, customers and citizens in general. In other parts of the world, privacy regulations are less important. If your business sells goods to European customers directly through an online store, the complaint handlings system containing customer data has to comply with these regulations on data protection.

The Outside Corporate Counsel, Your Risk Manager
Legal risks can be alleviated or avoided by consulting an outside corporate counsel. Just as you readily take out insurance and pay a small monthly fee to prevent financial disasters, so should you consult your outside corporate counsel on a regular basis at a low cost. This approach is cheaper and less stressful than unwanted expensive litigation. After all, your outside corporate counsel knows your business and your market well and can quickly provide you with sound legal advice, so that you will be aware of potential risks in time and deal with them, if desired.