

Risk Management Meeting the e-Commerce challenge

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Meeting the e-Commerce Challenge

What is the challenge...

The business...



Risk management....



Agenda

Meeting the e-Commerce Challenge

- Defining e-Commerce and e-Risk
- Decomposing the risk
- Adapting the risk management process
- Enabling the business

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Definition



e-Commerce is :-

....the buying or selling of assets, products or services across an electronic medium (such as the internet). The purpose of e-Commerce is to generate revenue, directly or indirectly, and it may be transacted 'business-to-business' (B2B) or 'business-to-consumer' (B2C)....



Definition



e-Trading is :-

“any use of electronic means of sending orders (bids and offers) to the market, electronic order routing. automated centralised execution and subsequent disseminated price and volume information”



Definition



e-Risk Management is:-

.... *the identification, evaluation and management of the particular risk characteristics of e-Commerce activity...*



Decomposing the Risk Evolution not Revolution

“The *fundamental* principles of risk management do not change based upon the medium”

(In the style of Michael Foot, Managing Director of the FSA, November 1999)

.....*but*

Decomposing the Risk Evolution not Revolution

*“There are identifiable factors in e-Commerce activity which **intensify** the risks - in particular, **strategic risk, reputational risk and operational risk** become more significant with e-banking”*

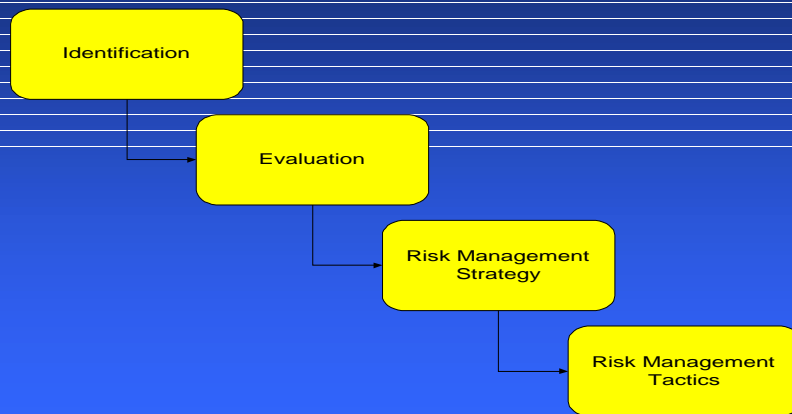
(Basel Committee on Banking Supervision, Electronic Banking Group, January 2001)

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Decomposing the Risk Evolution not Revolution



Decomposing the Risk e-Commerce Characteristics

- Speed of development and delivery
- Territorial reach
- Legal & regulatory environment
- Primacy of security & integrity
- Volume control & capacity

Decomposing the Risk e-Commerce Characteristics

- Organisational ownership of customer
- Customer loyalty
- Visibility & vulnerability
- Partnership requirements
- Barriers to entry

Speed of development and delivery

- First to market or fast follower?
- Internal design and build processes
- On-line transactional throughput (STP)
 - ❖ Authorisation
 - ❖ Monitoring
 - ❖ Portfolio change
 - ❖ Liquidity
 - ❖ Data Capture



Territorial Reach



- Customer acquisition, identification, verification
- Understanding the customer base
- Points of vulnerability
- Legal & regulatory compliance
- Portfolio management

Legal & Regulatory Environment

- Law and regulation are territorial
- e-Commerce is borderless
- Establishment of domicile & jurisdiction
- e-legislation and e-case law are lagging
- Potential informality of e-Contracts



Primacy of Security & Integrity

- 🔒 Securing the **value** :
 - data*
 - intellectual property*
 - brand*
- 🔒 Securing the **identity** :
 - supplier/provider*
 - customer*



Volume control & capacity

- Nothing is completely 'on-line' - funnel effect
- How strong is the weakest link?
- Volume and liquidity volatility
- Contingency becomes a USP (and a risk)
- Help-desk & operations support in front line

Customer Ownership

- Knowledge of customer base – more or less?
- Individual v. aggregate behavioural monitoring
- Acceptance and management of risks
- Integration with existing customer offering:
 - ❖ Single customer view (aggregation)
 - ❖ Leveraging relationships
 - ❖ Managing transition

Customer Loyalty

- Internet lowers costs of search and arbitrage
- Funds migration
- Customer migration – cybercustomers
- Bots and smart agents



Visibility...

- Media attention is 'failure-focused'
- One mistake, multiple victims (or opportunists)
- Share price is e-Commerce sensitive
 - + *Halifax shares up 22% on online insurance*
 - *System crash wipes \$5bn from eBay*
 - *"Pearson profits hit by web – shares close down 64p at £14.97"*



...and Vulnerability

- *"15,700 Western Union accounts compromised"*
- *"Microsoft sites down for 24 hours"*
- *"Egg failure is beyond a yolk"*
- *"Lloyds TSB users hit by on-line glitch"*
- *"System crash derails HSBC & First Direct"*
- *"Genie struggles to convince over system security"*



...and Vulnerability

- *“On-line fraud grows more slowly than feared”*
- *“Disney abandons on-line arm – writes off \$150m”*
- *“Lloyds TSB drops launch of Evolvebank...”*
- *“ANZ/OCBC abandon on-line bank ..\$19m loss”*
- *“Citibank shelves internet think tank costing \$300m p.a.”*
- *“Swiss Bankers prove they are only human – at a cost of £150m”*



Partnership



- e-Commerce is a collective enterprise
- Supplier management skills in greater focus
- Partnership of unequals – quasi-equity
- Convergence of objectives and values



Lower barriers to entry?



- Disintermediation
- 'Bank in a box' for £10M in 5 months ?
- 'Clicks' vs 'Clicks & Mortar'

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- **Adapting the risk management process**
- Enabling the business

Adapting the Risk Management Process

- Fundamental principles remain the same...but does the shoe still fit?
- Map e-Risk characteristics to existing framework:
 - Gap analysis
 - Gap resolution
- Recognise new dependencies
- Understand limitations – few precedents/metrics
- Define 'appetite' for e-Risk

Adapting the Risk Management Process

- Map e-Risk characteristics to existing framework:
 - Gap analysis:
 - ❖ Basel Electronic Banking Guidelines (Regulatory Framework)
 - ❖ High-Level Controls and Policy Framework
 - Gap resolution:
 - ❖ Group New Product Approval Process
 - ❖ Group Corporate Security Policy
 - ❖ Technology Architecture Standards
 - ❖ Purchasing Policies and Principles

Adapting the Risk Management Process

- How much e-Risk does a business want to take?
 - ❖ “Risk Appetite is the pre-determined amount of risk, or unexpected loss, the Group is willing to run in its businesses while achieving its targeted long-run risk adjusted return...”
 - ❖ ‘Soft’ boundaries of appetite:
 - ✓ Prescriptive frameworks, policies and standards
 - ✓ ‘Acceptable’ on-line fraud as % turnover or system downtime
 - ✓ Financial limits per customer/account/transaction/day etc
 - ✓ Tolerance for liability, warranty, liquidity and volatility
 - ✓ Acceptable levels of insurance

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Enabling the business



- Close engagement in project lifecycle
- Governance Boards
- Application of solutions
- Centres of expertise in 'governance' areas
- Revisit Business Recovery & Contingency

Questions?



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