

Association for Information Systems AIS Electronic Library (AISeL)

WHICEB 2013 Proceedings

Wuhan International Conference on e-Business

Summer 5-25-2013

Research on control strategies of economic risks in China's Inter-regional transfer of industries

Chen jingling

Business college Yangzhou university, jing_ling_chen@163.com

Follow this and additional works at: <http://aisel.aisnet.org/whiceb2013>

Recommended Citation

jingling, Chen, "Research on control strategies of economic risks in China's Inter-regional transfer of industries" (2013). *WHICEB 2013 Proceedings*. 41.

<http://aisel.aisnet.org/whiceb2013/41>

This material is brought to you by the Wuhan International Conference on e-Business at AIS Electronic Library (AISeL). It has been accepted for inclusion in WHICEB 2013 Proceedings by an authorized administrator of AIS Electronic Library (AISeL). For more information, please contact elibrary@aisnet.org.

Research on control strategies of economic risks in China's Inter-regional transfer of industries

Chen jingling¹

Business college Yangzhou university, yangzhou, jiangsu, china

Abstract: In the process of China's inter-regional transfer of industries, there is a large number of economic risks. This article tries to develop a set of scientific and practical control strategies of the economic risks, to achieve the desired goal of stable and sustainable economic growth and continued improvement in local social welfare.

Keywords: Inter-regional transfer of industries, Economic risks, Control strategy

1. INTRODUCTION

Against the background of spreading Europe-debt crisis and weak economic recovery in other developed countries, it will be the main theme of China's economic development during the twelfth five-year to vigorously develop the domestic market, to accelerate upgrading of industries and to promote coordinated regional development and living standard improvement. And a large number of practice and studies of international industrial transfer have shown that the transfer of industries, industrial upgrading and regional economic development are closely linked to an organic whole. In contrast, although China's inter-regional transfer of industry has experienced for many years, "The unbalanced, uncoordinated and unsustainable issues in China's development are still outstanding", which illustrates a large number of economic risks existing in the process of this type of economic activity, impeding the desired objectives achieving which is "stable and sustainable economic growth, continued improvement in the quality of life". Therefore, making a comprehensive analysis of the generating reasons of economic risks and further putting forward strategies to prevent and control them are imperative to further promote inter-regional transfer of industries, and are the full argument that China's inter-regional transfer of industry do promote economic and social development.

The government is the dominant force to control the economic risks in China's inter-regional transfer of industries. The strength of the capacity of a local government to control the economic risks is the mainly depends on three key factors: the first one is how much resources the local government can control. The stronger a local government finances is, the stronger ability of a local government to control economic risks; The second one is how the governing ability of a local government is. The more efficient a local government in decision-making and implementation, the more powerful a local government is to control economic risks; The third one is the state of local economic. The more developed the local economy is, the stronger self-repair capacity for a region resists and controls economic risks. So even if the same risk different regions are facing, it is not the same strategy and methods for different local governments to implement. Therefore, basing on the specific circumstances, every local government should take appropriate risk management and diversification strategy to minimization the loss of economic risks to the local economic and social development.

2. METHODS OF CONTROLMENT OVER ECONOMIC RISKS: COST-BENEFIT ANALYSIS

When a region makes a decision whether to undertake or to release a particular industry, it always balance the expected benefits and costs produced by the transfer. Revenue represents the increase of the total welfare through the transfer; Costs refers to the losses of the total welfare the transfer may result in, that is, economic

¹Corresponding author. E-mail:jing_ling_chen@163.com

risks in the transfer of industries. We believe that the total benefits to a region include two aspects: economic benefits and social welfare, and we should place more emphasis on the long-term interests of the region and the sustained benefits of growth. Here we assume that the local government is the defenders of the interests of the local welfare. When the net income was positive after benefit minus costs, local governments will actively support the transfer; If the net income is zero, the local government may take an ambiguous attitude to this industrial transfer; When net income was negative, the local government will clearly opposed to the implementation of the industrial transfer, so we can see in reality some projects can't get the approval of the relevant department and lead to abortion. Of course the local government has more than two options "support" or "resistance" in practice, and will take a variety of strategies and methods to response to various economic risks in industrial transfer to maximize local welfare.

The economic risks in China's inter-regional transfer of industries is various in kind. From the point of view that a local government can control the risks or not, all the risks can be divided into controllable ones and uncontrollable ones; From the point of view that the risk is serious or not, risks can be divided into serious ones and the slight ones. To facilitate our analysis, we fit them together, that is, according to the different controllability and risk degree, the economic risks in inter-regional transfer of industries can be divided into four typical categories, as shown in Figure 1:

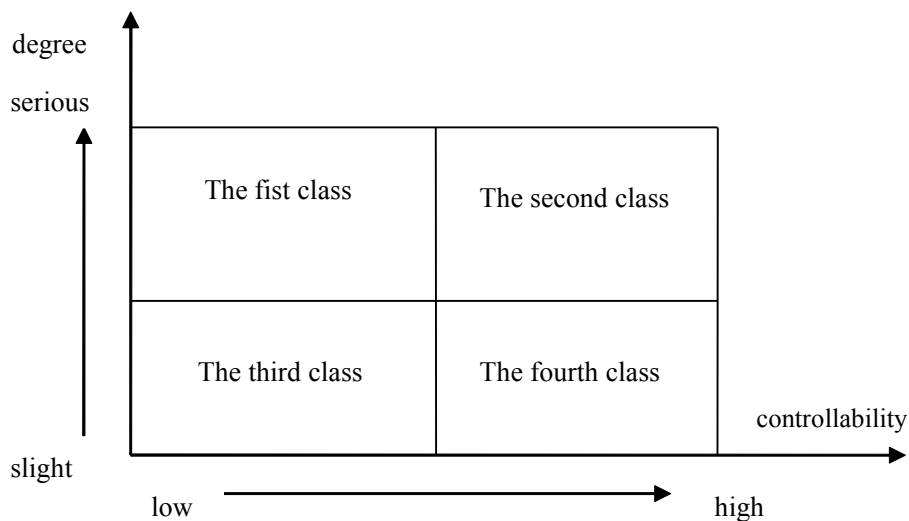


Figure 1 four classes of economic risks with degree and controllability combination

The first class risks: The degree of economic risks is very high and the controllability is very low. Such transfer of industries will lead to negative result after the subtraction of the increased revenue and increased costs, that is, the transfer of industries probably will not promote local economy and social welfare. Local governments should refuse such industrial transfer by using prevention mechanism.

The second class risks: The degree of economic risks is very high but the controllability also very high. The result of such transferring is probably positive after the subtraction of the increased revenue and increased costs. To such inter-district transfer of industries, local governments need to make the necessary prevention and control of the economic risks before promoting transfer of industries.

The third class risks: The degree of economic risks is low but the controllability is relatively slight. after the subtraction of the increased revenue and increased costs, the expected benefit is greater than zero. However, in view that the economic risks are difficult to predict and is difficult to advance effective prevention, local government should make adequate preparedness for the emergency to cope with such risks.

The fourth class risks: The equivalent of economic risks is low and at the same time the controllability is pretty high. The result of such transfer is undoubtedly positive after the subtraction of the increased revenue and increased costs. Such inter-regional transfer of industries will favor for sure local economy and social welfare to increase, and the local government should give active support, even if some cost could be paid because the transfer will not only contribute to local economic and social development, but also will be probably conducive to win-win cooperation between regions.

Except the first class of economic risks, local government will go on certain control over the other three classes of economic risks before promoting the realization of industrial transfer. According to risk-management theory, generally we can divide the strategies and methods commonly used into four types, that is, risk aversion or risk avoidance, the transfer of risk, risk control and risk retention or risk self-retention. In the practice of risk control activities, the four classes of strategies can complement each other to reduce the probability of risk occurrence and the loss to the maximum level. Combining the characteristics of economic risks in China's inter-regional transfer of industries, we put emphasis on discussing the scope and application of the four typical strategies.

3. Strategies and methods of economic-risk control in China's inter-regional transfer of industries

3.1 Economic risk aversion

Risk aversion is an action of giving up initiatives after balancing the benefit and cost in advance accompanied by the industrial transfer. In fact, this is an ex ante control. Through prior identification of risk factors and the analysis of the likelihood of the estimated risk, local government decides to give up or change plans and actions. This is a negative strategy which will eliminate thoroughly loss of risk impacting on local interest, but at the same time it may not bring any possible benefits.

Mostly risk-avoidance strategy is used in the period of the start or planning stage of the inter-regional transfer of industries. It means taking the likelihood of the risk event into account, and then taking the initiative to give up or refused to implement the program that may lead to great risk of loss. In the industrial-transfer decision, the local government will give a comprehensive survey of the various risks to economic and social welfare. Risk aversion strategies can be used when such plans and programs are facing higher frequency of occurrence and greater unavoidable risk of losses. By risk aversion, the region will completely eliminate the risk may be caused by the inter-regional transfer of industries, not just reduce the impact of loss.

The strategy of risk aversion is to avoid as much as possible of all expected risks, thus it can eliminate the whole future loss in a simple, easy way. But it should be noted that, before local government uses this strategy, they should have sufficient knowledge about the corresponding risk with the transfer, thereby they should ensure that the "avoidance" is meaningful; Meanwhile, avoided strategy can not be used in dealing with all of the risks, for some risk difficult to estimate, or force majeure risks (such as: earthquakes, floods, typhoons, snowstorms and other natural disasters) the government should consider other risk strategies. In addition, risk aversion is effective in use on a particular point of view within a specific range. Another risk will emerge after avoiding some kind of risk, i.e., a local government decides to give up undertaking an industry because of the pollution problem, it may cost the delay in local economic development. To governance? Or to avoid? Selection of risk aversion strategies must be weighed carefully in advance.

There are a lot of cases in using risk aversion in China's inter-regional transfer of industries. For example, when a region is in seeking for technological progress, it tends to switch to a mature technology to reduce the risk rather than the application of a new technology if the new technology is not stable enough. Avoid activities of these risks can be applied in the following forms: (1) abandon or terminate an investment activities; (2) to change the features of an activity; (3) abandon an immature technology, and so on.

3.2 Economic risk transfer

Transfer of economic risk is a risk-control method to transfer the rights and responsibilities of relative risks to third parties to assume. Risks transferring is different from risk aversion. It is not subject to give up or change the program or activity, but local government tries to transfer risk to the others to bear through the purchase of insurance or signing contracts or outsourcing.

In implementation of risk transfer of, the government will be trying to transfer the risks out by paying a certain amount of money in order to avoid larger future losses or pay enormous cost of risk controlment, at the same time, the undertaker can get his wanted income by bearing a certain risks which can be relatively easy for him to control. However it should be noted that it will introduce the third party risk or to cause legal dispute if the undertaker is not qualified enough to perform according to the terms and conditions of the contract or a local government can't manage the contract properly.

Economic risk transfer is a strategy that is often used to manage economic risk in the process of China's inter-regional industrial transfer. By signing contracts or agreements, a local government can transfer corresponding financial consequence to the third party of the projects in order to avoid the responsibility of risk losses arising therefrom. For example, as a main investor, a local government goes into a project, of which the technology is relatively complex which means a great deal of hidden risk. The department in charge of the project can subcontract to the scientific research institutions or the experienced technical teams that are equipped with professional personnel and equipment.

Insurance is a specific way of risk transferring which the future loss can be compensated by the insurer according to the law when the covered risks really occurred so that the economic risks in industrial transfer can be transferred to the insurance company. At present, the percentage of investment projects in China's inter-regional transfer of industry is very small, and the variety is only limited to accident insurance, liability insurance, and so on. There are two reasons of the low coverage of investment projects. On the one hand, it owes to the complexity and diversity of industrial transfer projects and lack of relevant supporting policies which leads to low coverage and the lack of diversity. On the other hand, it is also a fundamental reason that the lack of risk awareness of related persons and department in the project management so that there is lack of enough power to motivate insurance. Therefore, we believe that it should make clear the running mechanism of insurance for policy investment, and then local government should provide the projects of transfer of industries with subsidies of insurance premium as the national policy of insurance, enrich the variety of insurance, establish risks fund of inter-regional industrial transfer, make clear the source of funds, the place of claims and the scope of application etc. In a word, we should establish and perfect a set of policy system to match with the ongrowing China's inter-regional industrial transfer as soon as possible.

The above are main ways to implement the strategy of economic risks transfer. Although the result is to transfer the risk to others to take and it does not eliminate the risk or reduce the risks in amount, it is the most directive and effective way to reduce the losses of local economic and social development by delaminating risk from investor temporarily. Therefore from a certain perspective, the strategy of risk transferring can display the advantage of the inter-regional transfer of industries to the full, at the same time, it is an active strategies to maximize local welfare, and an important method to improve the level of local development. So this method of risk controlment is worthy of in-depth study and practice.

3.3 loss controlment

Loss controlment contains two meanings: One refers to reduce the probability of loss occurrence by eliminating the incentives of risks, two is to minimize the loss once risks actually occur. That is to say, the key to control the loss relays on eliminating the risk factors and reducing the loss of risks. Combination of China's

inter-regional transfer of industries, the following focuses on various measures to reduce loss when or after risks happen, that is, how to carry out effective loss controlment.

Usually there are three types of methods to control economic loss: segmentation, reserve and formulating relevant documents.

Segmentation is to divide a series of risks into many separate, smaller units for allocation of risks. In the practice of China's inter-regional industrial transfer, on the one hand, a local government can let many units involved in the transfer to cope with risks, that is, to break up the whole project risk into parts to achieve the purpose of sharing risk. For example, project outsourcing is one of effective ways commonly used. On the other hand, strengthening regional cooperation in the inter-regional transfer of industries realize complementary resources to reduce risks. For example, some areas sharing similar geographical location and/or economic conditions can undertake one certain industry, or develop new products and new technology etc. Research shows that rational use of segmentation can achieve the regional overall welfare to the maximum level.

Reserve method means to reserve human resources, property, data, etc. related to the projects in advance which can be immediately put into use to reduce the risk loss once the economic risks in industrial transfer actually occurs or the original resources are failure in use. Local government should pay more attention on resource reserves in the process of inter-regional industrial transfer, for example land reserves, capital reserves, basic technology research, because they will play an important role in dealing with economic risks and become an important guarantee for the effective control over the risk loss in China's inter-regional industrial transfer.

Formulating relevant documents is to introduce a set of rules and regulations and technical guidance program in advance in order to provide policy and technical guidance as soon as possible, which will become one of important measures to reduce the risk loss.

3.4 Economic risk retention

Risk retention is more frequent used by far in dealing with the economic risks in China's inter-regional transfer of industries when local economy has the ability to bear the adverse consequences or has to bear the risk loss for certain purpose.

There are three reasons at least in use of this strategy. Firstly, it is because the profitability of the project is strong enough to insist the economic risks in the inter-regional transfer of industries after careful consideration and balancing; Secondly, because of regional social characteristics of industry transfer and the existing mode of operation, there are limited choices so that local government has to keep the transfer of industries, while the local government should rely on other methods to deal with the risks therefrom; Thirdly, some local governments' consciousness of risk prevention and controlment is quite weak which results in the blind implement of industrial transfer. Once the risks occur, the local economy will be forced to choose the risk retention strategies without any other choice.

The strategy of economic risk retention can be positive, such as making a variety of emergency plan. When risk event occurs, relative department can launch the emergency plan to minimize risks loss. Of course, the economic risk retention can also be negative, i.e. less or no action to control the degree and scope of risks when the risks occur, because risk retention is a more economical way when the cost of prevention risks is more than the possible loss, after all, the risk may not occur at all.

The strategy of economic risks retention in China's inter-regional transfer of industry can be accomplished in two forms: self-insured retention and non self-insured retention. Self-insured retention means, the relative department should make reasonable prediction and evaluation of the existing factors of economic risks in the planning phase of inter-regional industrial transfer, and then extract a certain proportion in advance according to the investment scale. When the economic risks occur, it can be used to reduce the risk of harm or compensate for the loss, so self-insured retention is an active method to deal with the economic risks. Non self-insured

retention is to establish a risk reserve in advance to give a certain compensation for the risk loss in a pay-as-you-go way, so it is a relatively passive method in dealing with the economic risks in the inter-regional transfer of industries.

The above is four kinds of strategies of economic risks control commonly used in the process of China's inter-regional industrial transfer. The choice of risk strategies depends on the comprehensive factors, including the type of economic risks, the strength of economic risk, the specific people who bear the loss caused by economic risks, and according to different projects every strategy has different specific forms in use. This problem needs to be further explored in future studies, and will continue to be discussed in subsequent papers.

ACKNOWLEDGEMENT

This research was supported by Jiangsu Education Project of China under Grant 2012SJB630068.

References

- [1] Liujun. (2005). Introduction to risk management, China financial publishing house: 127-129,
- [2] Xiaolin. (2005). Value management and risk financing, Shanghai People's Publishing: 87-89,
- [3] C.Arthur Williams, Jr., Michael L.Smith, Peter C.Young. (1998). Risk Management and Insurance, 8th ed, New York: McGraw-Hill Inc.: 32-37,
- [4] Renn O. (1992). Concepts of risk: a classification, In: Krinsky, S. and Golding D. ed., Social Theories of Risk, Westport: Praeger.: 174-191
- [5] M. Lupton D. (1999), Risk, London: Routledge: 79-96
- [6] Holzmann, R. and Steen Jorgensen. (2000) Social Protection as Social Risk Management: A New Conceptual Framework for Social Protection and Beyond. Social Protection Discussion Working Paper, No.6, World Bank.