IJFANS INTERNATIONAL JOURNAL OF FOOD AND NUTRITIONAL SCIENCES
ISSN PRINT 2319 1775 Online 2320 7876
Research Paper © 2012 IJFANS. All Rights Reserved Journal Volume 10, Iss 09, 2021

RISK MANAGEMENT IN FINANCIAL HR: ADDRESSING CHALLENGES AND MITIGATING HUMAN CAPITAL RISKS

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ABSTRACT

This study explores the critical role of risk management in financial, and human resources (HR) to address challenges and mitigate human capital risks within the dynamic financial sector. As financial institutions increasingly rely on their human capital as a strategic asset, the paper outlines critical challenges HR professionals face, including talent retention, regulatory compliance, succession planning, cybersecurity threats, crisis management, and diversity and inclusion. The abstract further presents a comprehensive set of strategies to mitigate these risks, emphasizing the importance of risk assessment, ongoing training and development, technology adoption, employee engagement, transparent communication, legal compliance, benchmarking, and collaboration with IT. By implementing these strategies, financial institutions can enhance their human capital management practices, reduce risks, and fortify their resilience in an ever-evolving financial landscape. This research provides a valuable roadmap for HR professionals and organizational leaders seeking to navigate the complexities of managing human capital risks in the financial industry.

Keywords*: Human capital risks, Financial HR, Risk management, Talent retention, Regulatory compliance*

I. INTRODUCTION

The vast bulk of HRM-related writings and studies highlight the many benefits of HRM strategies and procedures. For a long time, proponents of human resource management have argued that it may benefit the organization and society by focusing on outcomes like employee happiness, organizational success, and social contributions (for example, see [1]). Many argue that good HRM can make a difference in the world for the company and society at large [2]. On the other hand, although good HRM may make a difference, it is essential to weigh the benefits against the potential drawbacks of inadequate, incorrect, or nonexistent HRM. Risk management has become a critical strategic objective due to the growing importance of identifying and assessing hazards in organizations [3]. Many standards, including ISO 31000:2009 Risk management principles and guidelines (International Organisation for Standardisation, [4]), have emerged alongside many tools and frameworks to ensure that firms implement and incorporate risk management practices into their operations. Human resource management (HRM) and any issues about people other than health and safety have been largely disregarded in this risk-focused approach and the ensuing frameworks

ISSN PRINT 2319 1775 Online 2320 7876
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and tools. So, looking at it from both the HRM and risk management angles, there is a chance to identify, investigate, and incorporate HRM-related concerns into current risk management procedures.

II. LITERATURE REVIEW

In order to measure the potential risks to a company's long-term viability that could arise from social, economic, and environmental factors, Thomson Reuters (2017) evaluated CSR, breaking it down into its ESG pillars: environmental, social, and governance. According to Thomson Reuters (2017), there are four aspects of diversity and inclusion in the workplace (D&I). These include a diverse board and staff in terms of gender and culture; the inclusion of certain groups in the workplace (e.g., people with disabilities or incurable illnesses); the provision of healthcare services and flexible work schedules; the enhancement of employees' professional development through training and skill development; and the resolution of internal disputes about the three aspects above. The literature lists several indicators that can be used to measure the financial performance of organizations recognized as value creators. These indicators include return on assets (ROA), return on equity (ROE), earnings per share (EPS), cost of goods sold (COGS), labor productivity, profit rate, and profit under its multiple facets (economic or accounting profit, EBIT, or EBITDA).

When experts looked at how diversity and inclusion (D&I) affected companies' bottom lines, it was usually only for the diversity component or, sometimes, both components. According to research conducted by several experts, diversity has a positive effect on the performance of organizations [6]. Companies in the US have significantly benefited from a diverse workforce in terms of "diversity in gender, race/ethnicity, education, and sexual orientation" [7]. This is mainly attributable to the fact that diverse management teams are better able to think strategically and implement plans that will last. A diverse workforce provides advantages in terms of expertise and ideas, leading to a broader range of approaches to resolving issues, indicating the positive correlation between diversity and organizational success [8]. Richard et al. [6] considered two scenarios to evaluate the link between diversity (as measured by ethnicity and gender) and organizational success (as measured by return on equity and productivity): one for the level of creativity within organizations and another for the level of risk-taking. Based on the data, companies with more racial diversity and a culture of innovation tend to be more productive overall and vice versa. Similarly, companies with a risk-taking culture and a diverse workforce tend to have a U-shaped curve representing their productivity dynamics and vice versa.

Conversely, disagreements not just between but also inside newly formed groups may hurt the link between diversity and organizational success [9]. In their study, Rodríguez-Fernández et al. [10] showed that including the controversial component within the ESG dimensions positively affected the financial performance of tourist organizations, as evaluated by ROA and ROE. The data for this study came from the Thomson Reuters database [11]. In their analysis of the effects of ethnic, age, and gender diversity on organizational performance, Choi and Rainey [8] found that these factors had a favorable impact when administered correctly by management. "Diversity can be a source of growth, learning, and intuition, thus enhancing organisational performance"[8] when workers feel valued because they believe the company's leadership cares about their needs. It is only by taking management diversity into account that public firms may see an uptick in performance, supposing that diversity and the promotion of an inclusive workplace are integral parts of the exact total [12]. Organizations must demonstrate their commitment to inclusion,

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ISSN PRINT 2319 1775 Online 2320 7876
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capacity to make proactive choices, and fair treatment of all workers for inclusion to be seen as a competitive advantage. Combining "diversity management with support from leaders and when employees are empowered in making decisions" [12] is critical for ensuring the long-term viability of improved financial results and reduced risk. By reviewing the key findings from the relevant literature (a total of 96 articles were reviewed, with 30 meeting the processing criteria), Mor Barak et al. [13] demonstrated that diversity, when considered in isolation, can have both positive and negative effects on organizations' outcomes, whereas the goal-setting of a diverse and heterogeneous management team to include certain employee groups can result in positive organizational outcomes. According to Tajfel's [14] "social identity theory," which considers the idea that people gravitate towards and identify with others with similar traits, these findings provide credence to that theory's unique approach. Managers from the same category as their subordinates can elicit more effective responses from their subordinates, allowing them to complete tasks more quickly and efficiently than in non-specialist groups. Specialist research has several flaws, such as the fact that it only considers a single D&I dimension [9], poor response rates (Sabharwal, 2014), flawed measurement techniques [7], or the subjectivism of the responses gathered through interviews or questionnaires [8]. Organizational financial performance was evaluated using the following variables/dimensions found in the relevant literature: workers' assessment of the organization's financial success, as assessed using a scale based on questionnaire responses [9], sales productivity, new sales, customer happiness, and Return On Equity (ROE) are all factors that contribute to a performance score. Other metrics include labor productivity, profit rate, turnover, and Return On Assets (ROA).

The number, quality, forms, and factors of risk reporting have mostly been the subjects of prior research. Using metrics including forward-looking relevance, faithful portrayal, understandability, and comparability across location and time, Salem et al. [18] determined that reporting was poor quality. Risk reporting quality is defined and measured differently in different studies, according to a literature analysis by Mbithi et al. [19]. Further research has shown that risk disclosure and its quality are impacted by various variables, including company and board characteristics, institutional leadership, gender diversity, audit committee independence, firm and board characteristics, family on the board, and management ownership ([21]). In addition to the aforementioned, research by Nel et al.[21] adds that some traits (such as board diversity) might enhance corporate governance and transparency to the advantage of stakeholders and apply only to organizations listed on the JSE. Evidence from studies shows that corporate governance features influence risk disclosure. First, the reporting of risks associated with the different capital resources needed for sustainability, and second, risks that do not include financial aspects are areas where research is moving forward. The variables impacting environmental disclosure and its quality have been the subject of several research (e.g., [22]). Leopizzi et al. [23] found that Italian organizations reported more non-financial risks in 2017 than 2016. Health and safety, environmental, and compliance concerns were the most often voiced, with operations and compliance coming in at a distant third. Most of the identified dangers were optimistic or agnostic about the present and the past, which is interesting. Bek-Gaik and Surowiec [24] disclosed concerns about the future, particularly about the company's strategy, potential for expansion, and threats within the industry.

Research is needed to better understand how organizations manage their HC, how HC impacts organizational outcomes, the associated risks and opportunities, and how organizations mitigate these risks, specifically focusing on HC risk disclosure [25]. There has been an increase in HC disclosure since 2006

ISSN PRINT 2319 1775 Online 2320 7876
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[26], but the reported hazards from that year until Adelowotan's research in 2021b are unchanged. These hazards include concerns about health and safety, workforce measures, training and development, equality, compensation, and employee relations. At the outset of this study, most HC disclosures are made to ensure compliance with laws (such as the Skills Development Act and the Employment Equity Act). The ISO supports additional health care disclosures beyond the usual risk disclosures [27] framework. Consequently, this research aims to improve corporate governance and sustainable development by increasing the transparency of HC risk disclosure in integrated reporting.

Despite being descriptive research, the results provide credence to several hypotheses (including agency reliance, resource dependence, and stakeholder theory) that explain why people disclose certain information. According to agency theory, there should be a bidirectional connection between an agent and a principal, with the agent looking out for the principal's best interests [28]. When applied to business disclosure, agency theory seeks to level the playing field for all parties involved, including investors and potential workers. Remember that private and institutional shareholders (both present and future), workers (both present and future), financial analysts, regulatory bodies, stock exchanges, and shareholders are the target audience for corporate disclosure [29]. Since this research recommends thorough HC risk disclosure to promote organizational openness and dedication to sustainable corporate governance, the agency theory is applicable at the most fundamental level.

On the other hand, according to the European Commission, [30] effective corporate governance leads to societal harmony among organizations, their stakeholders, management, and shareholders. The goal of sustainable corporate governance is bolstered by stakeholder theory, which posits that different stakeholders interact to produce value. The long-term viability of a company depends on its ability to prioritize its stakeholders. The study's overarching goal is to establish a connection between HC and the value of organizations through a disclosure framework. Even though stakeholder theory only applies to some stakeholders [31], HC interacts with other capital resources within the organization and can generate value for a wider community of external stakeholders, including investors, future investors, and employees. Another benefit of good HC transparency and governance is that it may help retain and recruit top talent [32]. Staff members are a precious asset since they are hard to replicate and an essential resource for carrying out the company's plan. The resource-dependence hypothesis, therefore, supports organizational transparency. A framework for understanding how organizations may obtain value and lasting competitive advantage via people (internal stakeholders) is provided by the resource-based theory in the area of HC.

III. RISK AND RISK MANAGEMENT

There is no universally agreed-upon definition of "risk" in the scholarly literature, and the term's meaning and definition have been the subject of significant discussion [33]. There is a spectrum of risk definitions, with some emphasizing the negative consequences of an unpredictable corporate environment (e.g., [34]) and others arguing that risk is the unpredictability of outcomes (excellent or adverse). For instance, "we view risk broadly as the uncertainty inherent in potential outcomes for a business entity." Some definitions of risk include uncertainty, while others interchange it with risk (e.g., Sydow & Frenkel, 2013). To be more precise, according to Holton [35], risk cannot exist without exposure and uncertainty. One cannot exist without the other. To be exposed, one must have some stake in the result, and for uncertainty, one must be unable to guarantee that the result will occur. An occurrence, its effects, and the associated probabilities (or

ISSN PRINT 2319 1775 Online 2320 7876
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uncertainty) are the three main components of risk, according to Aven [36], who compiles many formulations.

Because of the presence of repercussions (both good and bad) and uncertainty while working with an organization's human resources, this is the term that we have chosen for this review. Numerous business fields, including behavioral science, economics, and strategic management, have investigated risk and risk management, each with its unique perspective. Risk management has emerged as a critical activity for companies across all sectors and specializations as the economic climate and its uncertainties evolve. Risk management aims to help organizations avoid or lessen the adverse effects of uncertainty and risk by identifying, analyzing, evaluating, controlling, and monitoring these factors [37]. Preventing losses—mostly monetary ones—and ensuring the practical completion of corporate goals have been the driving forces behind the usage and execution of risk management. Dionne [38] thinks contemporary risk management stances emerged between 1955 and 1964 based on research into the field's history. Risk management has developed from its roots in the insurance and financial sectors to become an integral part of modern corporations, aiming to prepare them to deal with unforeseen challenges. Crucially, risk management is not just about following rules or being cautious; according to Elahi [39], in today's complicated and ever-changing world, sound risk management may help you stay ahead of the competition. The importance of human capital as a risk factor for businesses is becoming more acknowledged in risk management and the business literature at large. Risk management professionals understand that "human resources loss" can significantly influence an organization's capacity to implement its strategy.

Given that risk management is primarily concerned with uncertainty and human resources necessarily entail some degree of uncertainty, Nickson[41] contends that it is vital to forge a bond between the two disciplines. There have been many approaches to identifying and classifying hazards throughout the years. At the most general level, risks may be classified as either endogenous (originating inside the company) or exogenous (originating outside the organization), according to Hagigi and [33]. According to some, endogenous risks include things like the firm's people resources and the uncertainties connected to them, as well as things like managerial attitudes and organizational practices [33]. On the other hand, Dionne [38] included risk categorization and proposed that operational risk should consider staff-related concerns (such as employee mistakes). In these classifications, human resources are often recognized, if to a lesser extent, as a component of organizational risk.

IV. RISK, REWARD, AND RISK MITIGATION

As HR professionals and academics, are we essentially bearing the guilt when our organizations fail, when leaders and managers veer off course, or when the consequences of socially unacceptable behavior are ignored or downplayed? An organization's human resources department is often seen as a necessary evil, and the metaphor of "sins" and "sin eating" fits well with this job. As Mishra et al. [43] put it, "a necessary evil," when organizations need to right-size [downsize, offshore, or outsource], the HR department is tasked with developing strategies to implement these strategies [42]. Organizations might experience undesirable employee conduct and unforeseen repercussions when they strive to accomplish very challenging, if not unattainable, strategic goals and objectives, as was the case with Volkswagen and its notorious "Dieselgate" incident in 2016. Employees may act unethically or even illegally when pressured to do so by the severity of the repercussions for failing to meet goals. There is a lack of or insufficient risk management and mitigation

ISSN PRINT 2319 1775 Online 2320 7876
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techniques, which means that HR may feel some benefit in the form of enhanced legitimacy among peers, but this comes against the background of insufficient monitoring of employee conduct.

Conflicts may arise between the organization's objectives and the HR strategy's "human" component, which focuses on things like talent development over short-term "resourcing" concerns [44, 45]. Because of this, one of the numerous sins organizations commit is using performance management systems—like the "Rank and Yank" scheme at Enron—to foster a dysfunctional culture. Alternatively, Jack Welch's politically correct "differentiation"[47], which he saw as a more "nuanced" and "humane" approach to performance evaluation. An excellent illustration of "differentiation" could be seen in the sales-oriented culture prevalent in Irish, British, and American banks. This led to employees being punished for failing to align with strategy and offering financial products to clients who did not require them [48]. Tiaibbi's now-famous criticism of Goldman Sachs, in which he likens the firm to a "vampire squid wrapped around the face of humanity, relentlessly jamming its blood funnel into anything that smells like money," captures the difficulties encountered by HR in its current state. The gradual shift from indiscretion to widespread acceptance of unsustainable and dubious business practices is shown in Tiaibbi's [49] astute examination of Goldman Sachs' organizational drift [50]. Examples like Goldman Sachs and Lehman Brothers [51] and several Irish, UK, and US banks [52] are downplayed or disregarded. Do specific stakeholders (staff) despise human resources (HR)?

In contrast, others (management) adore it (at least temporarily) because HR is "needed" to symbolically "eat the organization's sins" and take a stand for the team (reputation). Does HR disservice the company and profession by metaphorically swallowing the sins? Is HR covering up the truth or devouring sins? Is the potential gain sufficient to justify the potential loss?

V. HUMAN CAPITAL RISK MANAGEMENT AND RISK REPORTING

The significance and applicability of hazards in organizations need to be debated. Organizations' management and board of directors regularly assess potential threats and possibilities as part of their responsibilities as corporate citizens. Contrarily, studies reveal that boards' time spent on risk management is a meager 9%. To be expected, however, HC risk management is not included to the same degree [53]. To put it best, HC is "...the cumulative knowledge, skills and abilities of an organization's people and the impact on an organization's long-term performance, as well as competitive advantage through optimising organisational outcomes," according to the International Organisation for Standardisation (ISO). [27]. A fresh viewpoint emerges when HC is exposed to danger. Uncertainty about the subject, including the potential results, is a risk [33]. As a result, HC risk considers the unpredictability of staff members' expertise, knowledge, and talents, their capacity to provide businesses an edge in the market, and their impact on outputs and performance. As a result, HC risks should influence HRM policies and practices, which should be connected to company strategy [54]. From the argument given earlier, it follows that risk, together with its management, has the potential to be turned into an opportunity.

Finding risks, assessing them, responding to them, keeping tabs on them, and reporting on them are all part of risk management techniques. In order to correctly identify risks, the right risk assessment tool must be able to take both lead and lag signs into account [55]. In contrast to lead indicators, which focus on the future (potential outcomes and hazards), lag indicators look at the past (what has already occurred). Culture, employee turnover, and absence rates are common lag indicators. Imagine for a second that businesses can

ISSN PRINT 2319 1775 Online 2320 7876
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concentrate on lead indicators alongside lag indicators rather than only measuring and reporting on lag indicators. If so, it allows for proactive risk detection, reduction, tracking, and reporting.

If adopted, the HC risk reporting rules ISO [56] issued can be valuable for organizations. Health, safety, and well-being; compliance and ethics; costs; diversity; leadership; organizational culture; workforce availability; skills and capabilities; succession planning; and health, safety, and well-being are among the identified hazards that should be disclosed. Both Becker and Smidt [57] and Meyer et al. [58] have found HR hazards comparable to the ones proposed by the ISO standards. Furthermore, the ISO standard suggests internal or external reporting for every risk provided. Unlike external reporting, which does not consider culture, internal reporting does. One way to improve one's abilities and attract investors is to be transparent about cultural risks and possibilities. Future workers and investors will pay more attention to HC-related governance practices, according to the WEF [59]. To "apply and explain" is the ultimate criterion for governing, according to King IV. The standards need to address inclusion despite the presence of diversity. Culture also emphasizes involvement, contentment, and devotion. This points to the notion that HC-related risk management strategies pay more attention to lag issues than lead ones.

VI. CORPORATE AND HUMAN GOVERNANCE FOR SUSTAINABLE DEVELOPMENT AND VALUE CREATION

Different nations have different corporate governance regimes. Governmental goals are comparable, and common legal frameworks form the basis of several nations' governing systems. Outside of the UK, South Africa was a pioneer in establishing corporate governance standards [60]. South Africa's governance concepts and procedures are governed by the King IV corporate governance code, which aligns with the Companies Act [61]. In order to create long-term value and foster sustainable growth, good corporate governance is essential [62]. This reassures stakeholders and reduces the risks and expenses associated with investing in the company. The two primary goals of implementing corporate governance principles are (1) creating value for stakeholders and shareholders and (2) ensuring compliance ("tick-box"). Corporate scandals [63](e.g., Amnesty International, Foxconn, France Télécom, the South African government, Steinhoff) and unprecedented problems [64] (e.g., COVID-19) have, however, brought excellent corporate governance into the spotlight in recent years. It is reasonable to assume that when confronted with such challenges, organizations and their steering committees would shift their emphasis from satisfying shareholders, who ensure sustainability in the short term, to satisfying stakeholders, who ensure sustainability in the long run. Sustainable corporate governance is hinted at by stakeholder primacy. A focus on long-term sustainable value creation is at the heart of sustainable corporate governance, which necessitates that organizations consider the effects of their operations on different stakeholders (including social, environmental, and human capital) as well as the economy. A wide variety of internal and external parties are considered stakeholders.

Those within an organization who significantly impact its capacity to generate value in the short, medium, and long terms are known as material stakeholders [61]. This includes workers and other internal stakeholders. It is vital to note that workers' performance is influenced by organizations' business operations [61], but it is even more crucial to note that employees' performance impacts organizations' performance. This connection emphasizes the significance of HC and its role in responsible corporate governance. The success of any company plan hinges on HC's ability to see that plan through to fruition. The interdependence

ISSN PRINT 2319 1775 Online 2320 7876
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of a company's business model, strategy, purpose, performance, and sustainability in creating value, risks, opportunities, and other related concepts is the subject of one of King IV's principles of corporate governance. One of the suggested ways to put this principle into practice is for boards of directors to question companies about the opportunities and risks associated with the triple bottom line, how all capital resources are needed to implement strategies, what important stakeholders want and expect, and how capital resources are affected when company strategies are put into action [6].

We must demonstrate accountable leadership beyond just looking at numbers by clearly outlining, tracking, and reporting key metrics related to HC's capacity to achieve strategic and operational goals. Furthermore, investors are demanding more information on company culture and HC. The authors Brown et al.[65] suggested broadening the scope of risk management committees to include non-financial issues. There has never been a better time for the suggestion, thanks to recent events (like COVID) that have heightened the need for HC governance (e.g., workplace experiences and well-being vs corporate culture and diversity and inclusion). One of the biggest obstacles that boards will face as this issue develops is ensuring that HC is a part of all sustainable corporate governance procedures, particularly when overseeing risk management strategies that target HC.

VII. STRATEGIC INTENT VERSUS THE HUMAN CAPITAL CAPABILITY TO ACT

The job demands-resources theoretical framework (JD-R) offers solid empirical evidence to support the idea that lead and lag variables interact. Regarding the JD-R model, three viewpoints are crucial. The first factors considered are employees' health and happiness on the job, organizational success, and the work environment (resources and expectations). In addition, it demonstrates how the work environment influences the happiness of employees, which in turn influences their results and, in the end, the organization's results. Accordingly, the workplace is a leading factor, whereas elements like burnout, engagement, commitment, turnover, productivity, absenteeism, and culture are lag factors. Results from the study by Kotze [66] demonstrate connections between burnout, job engagement, and employees' experiences with workplace resources. Employee and organizational results may be influenced by work-related well-being. Role conflict and burnout were shown to be related, according to Soelton et al. [67], as were employees' intentions to leave their current positions. According to an alternative view, there are two processes: the health impairment process and the motivating process. According to the motivational process, work engagement mediates job resources and organizational commitment. Demands of the job may cause burnout, which in turn can harm one's health.

What workers need to put forth in order to carry out their jobs effectively is a combination of mental, emotional, and physical energy. In order to meet the challenges of their jobs, workers rely on a variety of workplace resources. Factors including mental and emotional stress, as well as workload, are considered demands. Also taken into account by job resources are aspects like leadership and supervisory support and relations, management style and work control, job information, and performance management, role clarity and fairness, communication, and digital enablement [68]. The demands-resources ratio enforces the health impairment and motivational process. An additional protective mechanism against health impairment processes is sufficient employment resources [68]. Therefore, high job demands and resources motivate

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workers and keep them healthy. A positive work environment may help employees and the company run smoothly and reduce risk if it lasts.

On the other hand, opportunities are hindered, and hazards to organizational and personnel performance are increased in an overly demanding and unsupportive work environment. Burnout is recognized by the World Health Organisation (WHO) as a component of health impairment as an "occupational phenomenon" and is included in the ICD-11 category. Exhaustion and skepticism are the main components of burnout. Work engagement is characterized by zeal, commitment, and immersion, and it serves as a motivating counterpoint. One result of employees' efforts is their organizational commitment, which reflects their emotional and motivating investment in the company. Bakker et al. [69] discovered that organizational commitment is linked to various work demands and resources.

VIII. CONCLUSION

A company can only survive and thrive with financially solid human resource risk management. From workforce acquisition and retention to compliance and technical hazards, HR has many difficulties that need a proactive and strategic approach. One way to lessen the impact of potential threats to human capital is to encourage a mindset of constant learning and growth alongside more traditional approaches to problem-solving.

Financial HR can create a motivated and engaged team by embracing diversity and inclusion, investing in staff development, executing robust onboarding and recruiting procedures, and ensuring the company complies with everything. In addition, with a focus on performance management, succession planning, and current HR technologies, organizations may efficiently handle economic uncertainties and market swings as part of their risk management strategy.

If you want to keep ahead of new risks and difficulties, you must often examine, appraise, and change your HR processes. Finally, a well-managed human capital plan does double duty: it prepares the organization to succeed in a dynamic commercial environment while reducing or eliminating risks. Financial institutions may create a strong foundation that can endure pressures and drive the company to long-term success by investing in its employees' growth, happiness, and involvement.

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