IJBPAS, November, 2015, 4(11), Special Issue: 152-160
ISSN: 2277–4998

International Journal of Biology, Pharmacy and Allied Sciences (IJBPAS)
'A Bridge Between Laboratory and Reader'

www.ijbpas.com

ENTERPRISE RISK MANAGEMENT AND CORPORATE GOVERNANCE

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ABSTRACT

Enterprise Risk Management is one of the important concepts in today's business context. This study attempts to demonstrate role of corporate governance in risk control and also its influence on performance in a form of qualitative paper. In this research, corporate governance emphasizes on board size, amount of non-executive and independent members, amount of financial expertise, risk management committee size, difference between audits and risk management committee. In addition, performance includes financial and non-financial performances.

Keywords: Enterprise Risk Management (ERM), Corporate Governance, Financial Performance, Non-financial Performance

INTRODUCTION

According to Mikes (2005), ERM, Enterprise Risk Management could be described as a systematic method in order to manage risk. Through efficient risk management, organizations and firms can probably reach their corporate goals and as a result generate value for stakeholders. Moreover, Shenkir and Walker (2006) mentioned that an efficient implementation of ERM needs a type of organizational environment which includes optimum commitments from top managers, risk appetite, philosophy of risk management, ethical values and integrity and infrastructure scope of ERM.

ERM, Enterprise Risk Management, is a well-known context globally. So it is considered as a new business concept for different industries which should be paid attention exactly. These days, it is the final concept which can influence risk management. In particular, ERM can extend capabilities of senior managers to study general risk samples which an enterprise can confront with them (Beasley et al., 2006). In addition, ERM can cover specific competitive sources for those individuals who have high potential of strength and ERM (Stoh, 2005; Nickmanesh et al., 2015).

It is assumed that ERM system could not be noted in static regulations that are driven from common nature of risk. Risks can face with some changes inside firms such as industry specific, macroeconomic, firm specific and country specific. Even though such risks could be modified during time but risk management should be evaluated on common issues. This assessment can occur in all of the organizational parts because of ERM explanation.

The internal context could define philosophy of ERM entity and can impact driven risk from employees and their decision makings. Management and board of directors develop a philosophy regarding risk management and assist them to understand how they can monitor risk. Therefore, it is assumed to increase organizational interest related to risk culture and values of ERM (COSO, 2008).

The risk management philosophy is justified by both board of directors and top managers and can be different based on achieved results of the firm. For instance, those firms which are interested in venture capital will be attracted to risk culture. These studies are done with knowledge and also particular risks but they hope if such risks can pay the dividends in future or not? In addition, many mature firms will define risk aversion. Other organizations might be able to generate good level of profit through stable production of similar products along with few changes in them for a long time such as paper producers, soap products companies and restaurants. It is clear that it is not able to describe organizational risk management philosophy in brief but it could be an aim among all of the employees within the organization (COSO, 2004).

We can consider organizational stricter yet as another element of internal context. Besides, some organizations such as bureaucracy and matrix organization are existed around the world but they should do something in order to provide easier communications within companies. Thus, it allows managers to plan, decide, control and assess organizational performance. Organizational structure sometimes, is a function of recent basic beliefs. Since the growth and shrink matters in firms, such functions might be altered to ensure about remained communications. Moreover, organizational structure could empower assignments and cover a vehicle regarding many responsibilities. It will result in developing basic variables of internal control noted in COSO (2004).

According to the mentioned points above, board of directors plays a key role in risk control. On the other hand, board of directors in ERM has a fundamental role that this will result in the fact that current study attempts to present efficient literature review in order to highlight role of ERM in corporate governance.

2. Literature Review

1. Traditional Risk Management and ERM

In general, risk management can add value to organizations and also cover general economic growth through minimizing capital costs and related activities to uncertain commercials. According to Shenkir and Walker (2006) ERM model requires executive management commitment for conducting implementation, based on Committee of Sponsoring Organizations of Tredway Commission (COSO). There is a significant believe that executives in organizations have a tendency to generate commitment toward ERM because they are responsible for support, development and growth of values for shareholders.

As (Banahm, 2004), there are many differences between ERM and traditional risk management presented in below table:

Table 1

Differences between ERM and Traditional Risk Management

Traditional Risk Management	ERM
Risk as individual hazards	Risk viewed in context of business strategy
Risk identification & assessment	Risk portfolio development
Focus on discrete risks	Focus on critical risks
Risk mitigation	Risk optimization
Risk limits	Risk strategy
Risks with no owners	Defined risk responsibilities
Haphazard risk quantification	Monitoring & measurement of risks
"Risk is not my responsibility"	"Risk is everyone's responsibility"

It can be said that ERM study might be conducted in various aspects including Human Resources, Strategy, etc.

Through different studies conducted by many scholars, they realized that ERM is the core paradigm of risk management in organizations (Nickmanesh et al., 2011; Liebenberg and Hoyt, 2003). They asserted that ERM provides firms a good knowledge on risk management in comparison to traditional silo-based aspects of risk management. During the systematic process phase, ERM provides less risk for companies and improves organizational value and performance based on risk management. There is a relationship between usual risk management variables and organizational performance. Casualty Actuarial Society on Enterprise Risk Management (2003, p.8) is explained safely in following ERM explanations which is a type of regulation that firms can evaluate, control, finance and monitor risks for improving long and short term values for shareholders.

One of the famous ERM explanations in literature review is protected issues by COSO (2004) according to ideas of (Moeller, 2007; Beasley et al., 2005).

By referring to COSO (2004), ERM can be used in order to achieve four main objectives below.

1) Strategy: A high degree goal to conduct organizational mission
2) Operations: Beneficial employment of organizational resources.
3) Reporting: Validity of organizational reporting system.
4) Compliance: Followed by many different regulations.

All of these ERM goals developed by COSO (2004) will provide a model for the interal control (IC). The goal of COSO (2004) includes a strategical objective that is not presented in internal control model.

In order to extend ERM model, COSO (2004) noted that appropriate ERM might be completely different among various companies. Then, COSO explained all of the attributes for having an appropriate ERM for an organization. Moreover, ERM includes literature which examines goal of control system management (Nickmanesh et al., 2011).

Financial Characteristics of Companies which Adopted ERM

According to study conducted by Miller (1992), there was not any empirical studies on ERM until ten years later some scholars made an initial attempt to understand financial aspects of firms which employed ERM. In that time, there was high interest on ERM among scholars but there was not enough empirical studies because of difficulty in understanding those companies which applied ERM in their system. In order to overcome such issues, ERM leaders employed the Chief Risk Officer appointment who has been recognized as being responsible for implementing ERM as a proxy for adopting ERM (Liebenberg and Hoyt, 2003).

The research demonstrated that even though there is not any systematic difference among those companies which signal their ERM use through appointing CRO and other companies with same size and affiliation, remarkably leveraged companies are more into appoint CROs and implying more risky firms are more into ERM adoption. Also it was understood that leveraged companies will derive more value from ability of CRO to minimize costs related to risk-shifting issues and to explain risk profile of company to external stakeholders. Also Pagach and Warr (2007) employed similar CRO methodologies announcement to understand ERM firms realized that those companies that are leveraged more, have higher volatile earnings and demonstrated weaker performance in stock market and will more initiate ERM strategies. When CEO value and stock portfolio improves in stock volatility, the company also will adopt ERM more.

In addition Hoyt and Liebenberg (2011) realized that regarding financial features, average of adopter of ERM in insurance firms is larger, less opaque, less leveraged, and has few financial slack and less return volatility compared to average non-adopters.

Also ERM adopters have higher institutional ownership levels in comparison to non-users. Regarding impacts of organizational values, average value of a firm is almost 4% more than those firms with no ERM. These conflicting results might be because of applied methodology in different studies that demonstrated there is no relationship between value and ERM relying on proxies and hard data when the latter one is according to employees' perception.

In other investigation conducted by (Lin, Wen and Yu, 2012) on financial dimensions of ERM adopters, it was revealed that those insurers with higher ratio of reinsurance and bigger geographical diversification will implement ERM more than others. Such insurers might understand more advantages from ERM so they will be more encouraged to utilize this new mechanism. ERM insurers might minimize reinsurance purchase and volatility of asset portfolio but they increase derivatives positions demonstrating that after adopting ERM, insurers decrease reinsurance cost by means of fewer reinsurance purchase and financial risk costs through more usage of derivative and less asset portfolios volatile.

Corporate governance and Proposed Framework

Corporate Governance

Also corporate governance does not have a specific explanation. One of the methods has been used for corporate governance helped to understand relationship between companies and shareholders.

Therefore, corporate governance means financial issues and merely engaged with shareholders and managers it is described as follows:

Stages of controlling and monitoring different functions in order to guarantee managers in an organization are operating in order to fulfill shareholder's interest (Nickmanesh et al., 2011).

Corporate governance mechanism is categorized as two types generally. First category is mechanism of internal governance that is in line with interest of managers to shareholders in organizations such as incentive managerial plans and board of directors, internal system controls and structure owners (Gillian, 2006).

Second category is external governance mechanism. This category forms when firms are in a competitive context with many market forces and constraints. Thus, it should contain some external mechanism to control organizational systems (Gillian, 2006).

Different models in corporate governance can focus on interest of managers equal to interest of shareholders of companies. Besides, providing an approach to motivate managers to operate in shareholders' interest is more important in comparison to their personal interest to get back shareholder's profits (Fama and Jensen, 1983; Nickmanesh et al., 2011).

Conducted study by Nickmanesh et al., (2011) demonstrated that corporate governance can impact financial performance. However, one of the subjects which was not efficiently emphasized in previous studies is the fact that corporate governance can also impact non-financil performance. According to BSC, balanced-scorecard, (Kaplan and Norton, 2001; 1996), performance is not only limited to financial aspect and other perspectives such as internal process, customer satisfaction and learning and growth should be considered too. According to a research conducted by Nickmanesh et al. (2011) corporate governance can include below sub-dimensions:

- Size of Board
- Number of non-executive and independent members
- Number of financial expertise

- Size and existence of Risk Management Committee
- Differentiation between audits and Risk Management

Therefore, proposed framework of current research will be developed as follows:

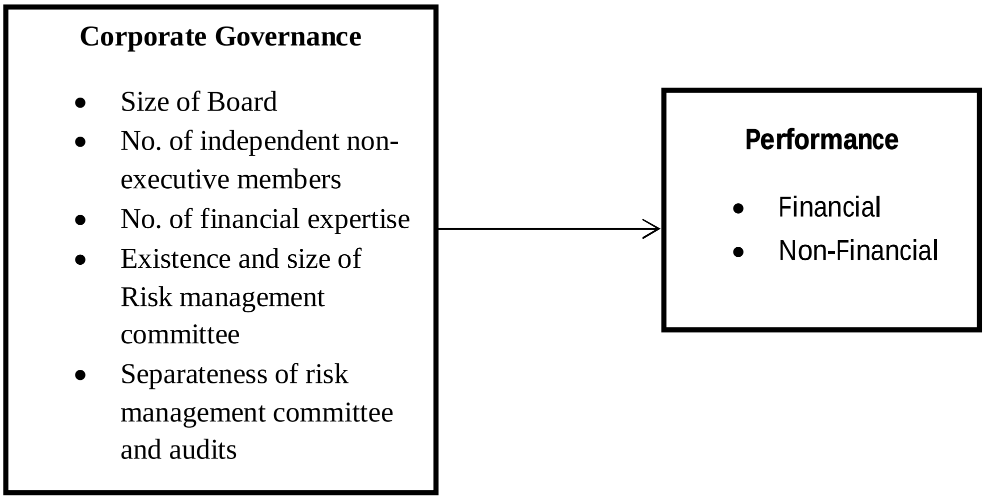

Figure 1: Proposed framework of Study

CONCLUSION AND FUTURE STUDY

First this study attempted to provide enough literature on ERM and important role of board of directors. Finally, through presenting research of Nickmanesh et al. (2011) it attempted to justify impact of corporate governance on non-financial performance.

Future studies can test proposed framework of this investigation in different scopes or other industries. In addition the fact that how we can measure financial performance from annual reports is one of the necessities for future studies.

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