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# Risk Management Support and Organizational Performance: The Role of Enterprise Risk Management as Mediator

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**Abstract** - Risk is inherent in all parts of the organization and if it is not efficiently managed by the senior management it will affect the confidence and expectations of the stakeholders. Enterprise Risk Management (ERM) is said as a best practice technique to evaluate and manage all these risks in this new economic reality. Therefore, organizations practicing ERM are more prepared in managing the feasible threats. In fact, there is a general consensus by scholars and researchers that organizations practicing ERM will improve the organizational performance. However, empirical evidence regarding this matter is still considered scarce. As such, the purpose of this paper is to investigate the mediating effect of ERM on risk management support and organizational performance among public listed companies.

*Keywords* - Enterprise Risk Management, Board of Directors, Organizational Performance

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## I. Introduction

Measurement of performance and productivity has garnered significant interest amongst both academics and practitioners in the last two decades (Tangen, 2005). Organizations strive to improve performance in order to attract investors to invest in the organization (Parker, 2000). Neely (2004) supported the argument and suggested that in order to increase market share and attract investors, it is crucial for an organization to perform well and have a good track record in order to gain shareholders' and customers' confidence as well as maintaining a good relationship with their stakeholders. However, the current economic environment has made major corporations around the world face a dreadful array of risks in their business operations. Furthermore, with rapid globalization, technology and internet advancements as well as mergers and acquisitions, have increased the competitive intensity, thus creating a riskier operating environment for all businesses in the world.

Therefore, these unexpected issues, business failures as well as the recent financial crisis have increased the awareness towards risk management. Risk management is the formal process that enables an organization to identify, measure, analyse, treat and monitor the potential threats of risk. However, today's businesses are more focus on the enterprise risk management. The appearance of enterprise risk management is due to the further development of risk management. Lam (2003) stated that companies that adopt an enterprise risk management framework have experienced an improvement in organizational performance. This has so because enterprise risk management supports key management decisions including product development and pricing, capital allocation and mergers and acquisitions. On top of that, enterprise risk management also helps the organization identify

and alleviate the root-cause risks throughout the organization which leads to better organizational performance (Minsky, 2017).

Enterprise risk management will lead to improvements in terms of reduced losses, lower earnings volatility, increase earnings and improved shareholder value. This is due to the fact that, enterprise risk management is an important component of decision-making which involves every part of the organization (Anderson, 2017). Furthermore, the International Organization for Standardization (ISO) also recognizes the importance of risk management towards businesses and has endorsed an international standard for enterprise risk management (ISO 31000:2009). Malaysia has followed by introducing its own risk management standard known as MS ISO 31000:2010. Moreover, enterprise risk management has been highlighted in the National Integrity Plan (PIN) in order to foster good corporate governance (Roslan & Mohd Dahan, 2013).

The next section presents the literature of this academic research on the possible relationship between risk management support, enterprise risk management and organizational performance.

## II. Review of Literature

### A. Agency Theory

Agency theory has been adopted by scholars in many disciplines. Agency theory also broadened the risk sharing literature to include the so called agency problem when cooperating parties have different goals. Specifically, agency theory relates the unique relationship between agent and principal and the metaphor of a contract. Agency theory also proposes a series of mechanism to manage the agency problem by adopting governance mechanisms. Yatim (2010) stated that the concept of risk management is related to the organization internal control as it has become fundamental to corporate governance. Agency theory supports this study based on the fact that the implementation of enterprise risk management will help an organization to improve the performance as well as achieve its business objectives and eventually maximize shareholder value (Lam, 2003); Nocco & Stulz, 2006).

### B. Enterprise Risk Management

Olsson (2002) defines risk as an uncertainty of future outcomes where risk is an essential component of living and that is where the importance of risk management came across (Rochette, 2009). Moreover, risk management also is believed to provide a systematic approach to cope with risk and uncertainty towards the decision makers (Williams, Bertsch, Dale, Wiele, Iwaarden, Smith, & Visser, 2006). However, the scope and functions of risk management have increased over time due to the rapid economic changes. The emergence of enterprise risk management has received several attentions from businesses, practitioners and academicians as a response to these changes. Enterprise risk management requires the understanding of the risks where it will look at the organization from a bigger aspect of risk concerns and will narrow down by providing views and information on the specific risks to each department or unit.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2004) defines enterprise risk management as follows:

*“....a process affected by an entity’s board of directors, management and other personnel, applied in a strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.”*

The definition of enterprise risk management reflects certain fundamental concepts where it encompasses:

- A process, ongoing and flowing through an entity
- People at every level of an organization will be affected
- Applied in strategy setting
- Applied across the enterprise, at every level and unit, and includes taking an entity level portfolio view of risk
- Designed to identify potential events that, if they occur, will affect the entity and to manage risk within its risk appetite
- Able to provide reasonable assurance to an entity’s management and board of directors
- Geared to achievement of objectives in one or more separate but overlapping categories.

Furthermore, COSO (2004) said that the enterprise risk management is fast becoming the best practice standard because the traditional approach to managing risk has not produced effective result. Furthermore, what is more important is that the organizations that have adopted a more integrated approach which is the enterprise risk management for managing enterprise wide risks have experienced significant benefit. COSO (2004) also highlighted that enterprise risk management helps organization to achieve the organization's objectives and helps in avoiding pitfall and surprises along the way.

### *C. Risk Management Support and Organizational Performance*

Previous studies indicate that the board of directors (BODs) has an impact on the organizational performance. Ferrero, Izquierdo & Torres (2012), concur and found that the larger size of the boards will lower the levels of organizational performance. Furthermore, they highlighted that in order to improve the organizational performance, the BODs are responsible in monitoring, guiding corporate strategy as well as overseeing the actions of managers. In terms of implementing enterprise risk management, the organization needs someone to monitor and initiate the enterprise risk management program in the organization (Wan Daud, 2011). Therefore, a mandate from the top is needed in assuring the success of the risk management team in establishing the ERM program to help in the achievement of organizational goals (Burnaby & Hass, 2009). This statement has been supported by Beasley, Clune, & Hermanson (2006) where they stressed that in order for ERM to be effective, the ERM must be fully embraced by the board of directors (BODs) and senior management. The responsibilities of the BODs are in terms of setting strategy, formulating high level objectives and also broad based resource allocation. The chief risk officer is also considered as a significant function in the enterprise risk management implementation besides the BODs (Aebi, Sabato & Schmid, 2012). According to Rochette (2009), risk governance such as the board involvement, enterprise risk management committee as well as dedicated chief risk officer becomes the main components of enterprise risk management value-based framework. This is because evaluating the organization internal procedures is the main indicator to monitor compliance with good governance (Demidenko & McNutt, 2010). Thus, the appointment of a chief risk officer in the organization sends a clear signal internally and externally on the organization's commitment towards enterprise risk management practices (Kasim and Hanafi, 2012). In a research done by Beasley, Clune and Hermanson (2005), the study found a positive relationship between chief risk officer and enterprise risk management implementation stage. Wan Daud, Yazid and Hussin (2011) also found a significant influence of quality chief risk officer towards the organization's enterprise risk management practices. Hence, this research proposition is posited as:

Proposition 1: There is a positive relationship between risk management support and organizational performance.

### *D. Risk Management Support and Enterprise Risk Management*

The success of the risk management team in establishing the enterprise risk management program is assured when there is a mandate from the Burnaby & Hass (2009). This statement has been supported by Beasley, Clune, & Hermanson (2006) where they stressed that an effective enterprise risk management can be accomplished when it is fully embraced by the BODs and senior management. The tasks of the BODs include setting strategy, constructing high level objectives and also broad-based resource allocation. In addition, BODs also will review the organization's portfolio analysis of risk and consider it against the organization's risk appetite (Williams, Bertsch, Dale, Wiele, Iwaarden, Smith, & Visser, 2006). Moreover, Kleffner, Lee and McGannon (2003) found that the encouragement from the BODs is one of the key factors in the execution of enterprise risk management in their study of the impact of corporate governance on the use of enterprise risk management amongst Canadian firms.

Furthermore, prior studies generally theorize that among other things, board independence provides the most effective observation and control of the organization activities (Yatim, 2010). This is because the non-executive directors have the aim of recognizing and correcting reporting errors intentionally. Therefore in fulfilling this aim as well as complementing the board's own monitoring responsibilities, these non-executive directors should support an extensive risk management as well as internal or external auditing (Desender, 2007). However, Desender (2007), found that enterprise risk management and board independence alone has no significant relationship. On the hand, a study done by Beasley, Clune, & Hermanson, (2005) revealed that a more independent BODs is positively associated with an extensive extent of enterprise risk management deployment.

Moreover, the market for directors is likely to remove those directors who are involved with corporate financial scandals and the organization they had led a poor performance, so these independent directors may seek to protect their reputation as experts in monitoring (Yatim, 2010), thus they tend to actively ask more question and ask for higher quality governance than executive directors (Subramaniam, McManus, & Zhang, 2009). The top management is ultimately responsible for the performance of the organization. They are responsible for the smooth operation and upkeep of the organization, in order to achieve the organization's main objective which is enhancing the overall shareholders' value (Yazid, Razali & Hussin, 2012). Therefore, decision to implement enterprise risk management by the top management team will provide a strategic competitive advantage to the organization. Thus, the implementation of enterprise risk management increases the organizational performance and value (McShane, Nair & Rustambekov, 2011). Therefore, it can be concluded that the implementation of enterprise risk management requires an active involvement and high commitment of senior management and BODs. It also requires coordination of risk management efforts by all functional areas.

Proposition 2: There is a mediating effect of enterprise risk management practices on risk management support and organizational performance.

### III. Proposed Framework

This paper aims to develop a conceptual framework that contributes to a better understanding of enterprise risk management practices by investigating the practices of enterprise risk management among Malaysian public listed companies. This paper aims to examine the extent of enterprise risk management practices among public listed companies in Malaysia.

Furthermore, based on the literature, there are many factors that affect the extent of enterprise risk management practices in an organization for instance board of director's encouragement to implement enterprise risk management and also the influence of the risk manager (Kleffner, Lee, & Mc Gannon, 2003). Therefore, this paper aims to examine the relationship between risk management support and organizational performance as well as the mediating effect of enterprise risk management on this relationship.

### IV. Methodology

#### 1.1 Sample and Data Collection Method

Primary data will be used in this study and will be collected using survey questionnaire. The suggested population of this study comprises of eight industries listed on the main board of *Bursa Malaysia*. The sample size is 793 organizations from consumer products, construction, industrial products, infrastructure, plantations, properties, trading/services and technology. The financial industry will be excluded due to differences in regulatory requirement and enterprise risk management framework that has been established in that industry. The unit of analysis is the organizations listed on the main board of the *Bursa Malaysia*. Questionnaires using a seven-point likert measurement scale ranging from "strongly disagree (1)" to "strongly agree (7)" will be addressed to the senior management who has direct dealing with enterprise risk management practices in the organization.

#### 1.2 Instrumentation

– The study variables comprising risk management support, ERM practices and organizational performance will be measured using questionnaire instrument adopted from previous studies. **Conclusion**

In conclusion, this paper attempt to develop a conceptual framework by explaining the mediating effect of enterprise risk management practices on risk management support and the performance of the businesses. There are two propositions that have been developed under the proposed framework and will be tested empirically. Enterprise risk management is a relatively new management concept in the emerging economies compared to developed countries. Therefore, this paper is intended to contribute to the existing body of knowledge. Furthermore, the ambiguity and lack of research in this field in Malaysia suggest that this study will be able to contribute to the literature on the enterprise risk management practices in Malaysia. This paper will also provide

an insight for Malaysian regulators to formulate new policies or strategies on matters pertaining to enterprise risk management in Malaysia thus fostering good corporate governance. Since this is a conceptual paper and it is without limitations surrounding similar conceptual academic work.

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