The Essence of Enterprise Risk Management in Today's Business Enterprises in Developed and Developing Nations

Subhani, Muhammad Imtiaz and Osman, Ms. Amber

Iqra University Research Centre (IURC), Iqra university Main Campus Karachi, Pakistan, Iqra University

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Muhammad Imtiaz Subhani
Iqra University Research Centre-IURC, Iqra University, Defence View, Shaheed-e-Millat Road (Ext.) Karachi-75500, Pakistan
E-mail: drsubhani@yahoo.co.uk
Tel: +92(21) 111 264 264 (Ext. 2010) ; Fax: +92(21) 5894806

Amber Osman
Iqra University Research Centre-IURC, Iqra University, Defence View, Shaheed-e-Millat Road (Ext.) Karachi-75500, Pakistan
E-mail: amber.osman@yahoo.com
Tel: +92(21) 111 264 264 (Ext. 2010) ; Fax: +92(21) 5894806

Abstract

Risk as expected is not that fearsome matter, although it may keep management awake at night; revenue would not be possible without it. Enterprise Risk Management at basics is broadly portrayed as structure of handling and managing risk across an organization. The key concern of this research is to investigate the ERM. The findings highlight that there are very few enterprises from developing nations which are into ERM while the developed nations' enterprises are huskily and vigorously involved in it and this gap is due to the lack of awareness and serious concerns for value maximization of enterprise share holders in developing nations.

Keywords: Risk, Enterprise Risk Management, Financial Institutions, Developed Nations, Developing Nations.

1. Introduction to Enterprise Risk Management

The long-established risk management approach is an approach of handling organization's risks having various types of risks in separate units within an organization. For instance, financial organizations mostly handle credit, liquidity, operational and market risks separately in individual risk silos. Conventionally, the other types of organizations also follow a similar pattern of handling financial, hazard, operational and strategic risks (Risk Management and Insurance Review, 2003).

For starters, to understand the Enterprise Risk Management, it's basically is a packet for businesses to seek and handle the unforeseen and evident risks at hand. There has been a shift of handling ERM from conventional way of handling risk to an enterprise wide approach, which takes into account all the risks types into an organization's overall risk portfolio and deal it has holistically.

Enterprise risk management is a method and practice as result by the organization's officials and other personnel, to apply certain strategies and settings across the enterprise, to seek and identify potential events that may affect a certain article/body of the enterprise in a uneven way, as an obstruction to the enterprise. To manage the risks adequately, to provide rational reassurance of the achievement of article/body objectives restored or contained as it is (COSO, 2004).

Figure 1.

* Source : Strategic Finance: Outsourcing at your own risk. Beasley, Bradford, & Agach, 2004)

From the extant studies, it is evident that Enterprise Risk Management (ERM) has gained concentration of risk aversion professionals and academia globally. Viewing the contrasting effect from the traditional 'silo based' approach to the present corporate risk management, the present approach of ERM gives benefits to organizations in an integrated way to manage risk that alters the center of the risk management function since mostly defensive to all the time more offensive and strategic.

The world is a global village, today's economy demands service-orientation as well. The businesses now cannot afford uneven happenings at their own faulty risks and allow also unforeseen areas of risks remain anonymous. The current economy shows drastic currency fluctuations, evaporating distribution channels, human resources in foreign countries, corporate governance and unparalleled reliance on the technology are just to name a few risks numbered, which requires calculative management and resolutions from time to time. There are few organizations binding by the Enterprise Risk Management developments and also demand similar collateral approach to risk identification, measurement and treatment. By adopting this proactive approach to managing risk, organizations can budge from a "silo" management approach to a deeper integration of its various businesses (AON, 2010).

2. ERM-Integrated Framework

Entities created for the organization has to provide value to its stake holders, which is the ultimatum objective and it is also a fact that uncertainties are a part of all entities and it is up to the management to work in the best interest for its stake holders for determining the degree of uncertainty acceptance to one organization for the growth purposes. Uncertainty not just proffers risk but also brings in diverse opportunities, to deteriorate or boost value. The Enterprise Risk Management is capacitated for the purpose to manage and sought counter effective solutions for uncertainty/risk and/or opportunity in line with building the organizational value.

ERM represents a very exciting opportunity for the financial services industry to create new markets for their products. However, handling these new exposures presents some real challenges for them. Whether they can successfully rise to the challenge will be a dominant question for the industry in this decade.

The 'Value' is maximized when management positions the strategy and objectives to excise an optimal steadiness between growth, return goals and associated risks that efficiently and effectively install resources in quest of the entity's objectives.

ERM is an approach for the quantification of value essential to all aspects of the ERM process. This value-centric focus has two key advantages:

- Measures the effect of ERM on shareholders' value
- Creates a common "language" that combines otherwise contrasting ERM processes.

Enterprise risk management covers:

- Management takes into account the '*entity's risk appetite'* in assessing strategic alternatives, aligning related objectives and mounting mechanisms to administer related risks.

- Enterprise risk management provides the dynamism to locate and select amongst options of '*risk responses and decisions'* i.e. risk avoidance, reduction, sharing and acceptance.

- Entities attain enhanced potential to identify potential events and establish responses, reducing surprises and associated costs or losses.

- An enterprise encounters numerous risks affecting divisions of the organization and enterprise risk management makes possible responses to the '*interconnected impacts and integrated responses to multiple risks'*.

- Complete range of potential events is considered as the management is located to '*categorize and actively apprehend opportunities'*.

– Acquiring robust risk information allows management to successfully review all capital needs and augment capital allocations (COSO, 2004).

These capabilities innate in enterprise risk management are of assistance to management for achieving the entity's performance and productivity targets and prevent loss of resources.
In ERM, various external and internal factors are considered and its vital task for one to contain an idea of increasing firm's value by reducing inefficiencies which are being further conferred.

2.1 Limitations

Human judgment is counted in the limitations that can be faulty, responding to risk and instituting controls also requires consideration to the relative costs and benefits. Certain failure can be caused due to human errors. These limitations rule out the board and management from having absolute assurance to the entity's objectives achievement.

2.2 Roles and Responsibilities

All individuals are responsible for risk management in each business unit. The supreme control is headed by the chief executive officer, having the ownership. The support managers are also present for the unit's risk management philosophy, in compliance with its risk appetite and maneuver risks within their bubble of responsibility consistent with risk tolerances.

The key responsibilities are assigned to risk officer, financial officer and internal auditor. The remaining unit's personnel are accountable for the accomplishments of enterprise risk management keeping in mind the established directions and set of rules. The directorate grants significant supervision to enterprise risk management and corresponds with the entity's risk appetite. Business partners, external auditors, customers, vendors, regulators and financial analysts are said to be external parties, which are also helpful for handful of ERM information but they are not liable for the efficacy of, nor are a part of, the unit's enterprise risk management (COSO,2004).

2.4 Driving forces behind ERM

The trend towards the adoption of ERM is attributed of external and internal factors. The foremost external controls that have determined organization to move towards risk management in a holistic manner are a broader scope of risks arising from factors such as globalization, industry consolidation, and deregulation; increased regulatory attention to corporate governance; and technological progress that enables better risk quantification and analysis (Miccolis & Shah, 2000). Internal factors are crucial to maximize shareholder's wealth. ERM believers argue that an integrated approach adds to firm value by reducing inefficiencies natural in traditional approach, stabilizing earnings, improving capital efficiency and reducing the expected costs of external capital and regulatory scrutiny (Miccolis & Shah, 2000; Cumming & Hirtle, 2001).

The nature of risks facing financial firms has changed due to the recent wave of industry consolidation that has resulted in more complex financial institutions. Financial conglomerates offer a wide array of products that imply potential liabilities and risks that are increasingly interdependent (Cumming & Hirtle, 2001), and deregulation of the energy industry has forced utilities to become more efficient and more profitable.

In general, increased competition has shifted the emphasis of risk management from a defensive focus to one that is more offensive and strategic (Meulbroek, 2002). While traditional risk management is largely associated with safeguarding an organization against unfavorable monetary effects of risk, ERM enables companies to make better risk-adjusted decisions that maximize and optimize shareholder value (Meulbroek, 2002).

Firms that pursue in ERM are able to comprehend the collective risk intrinsic in different business actions. This gives objective stance for resource allocation, as a consequence improving capital efficiency and return on equity. Organizations with a wide range of investment opportunities are likely to benefit from being able to select investments which rely on a more accurate risk-adjusted rate (Meulbroek, 2002).

While individual risk management activities may reduce earnings volatility by reducing the probability of catastrophic losses, potential interdependencies between risks exist across activities that might go unnoticed in the traditional risk management model. ERM is structured for risk management activities hooked on an incorporated framework that facilitates the detection of such mutuality's. Thus, while individual risk management activities can reduce earnings volatility from a specific source (hazard risk, interest rate risk, etc.), an ERM strategy reduces volatility by preventing the aggregation of risk across different sources (Meulbroek, 2002; Risk Management and Insurance Review, 2003).

2.5 ERM in Financial Services Industry

Financial services companies have a distinctive, competitive reason to get ERM precise. The financial business relates to other people's risks and their core competencies are to mount sophisticated tools. A financial institution that demonstrates the fact of mastering ERM internally makes itself more trustworthy in the marketplace, more probable to draw and retain the old clients and customers.

Secondly, financial establishments are experiencing industry-specific strategic and operational issues that lend themselves to an ERM solution. At present, for instance, Insurers face growing competition and falling margins from unusual sources, more challenging stakeholders and moreover capital pursues too little business. The industry is progressing with dynamic transformation in technology, distribution systems and customer expectations that produce new risks and challenge high performance.

In this riskier environment, to gain maximum value, the financial managers have to make good and appropriate decisions in the following stream:

- Products/markets
- Investments/assets
- Operations
- Capital
- Hedging

(Goenka, 2004).

2.6 Fully Implemented ERM in Financial Services Industry– A Strategic Framework

First need, to account for the complete risk setting within which the financial institutions operate should be assessed. The external environment involves: the political and regulatory conditions, economic drifts, social and legal tendency, natural calamities, consumer behavior and competitors. The enterprise's internal environment involves: growth and diversification plans and programs, the organizational culture, delivery systems, the appetite for risk, people competencies and intellectual capital, work processes and technology. The above-mentioned are all the part of the financial risk and can be also included in other organizations than financial ones. The strategies are also aligned and set by these external and internal risk factors.

In short, financial institution managers require applying comprehension holistically to administer their financial and operational risks by making the most of the natural hedges and effects from the portfolio among the alignment of risks when they are treated together and not in individual "silos"(Goenka, 2004**).**

2.7 Risk in Business

Assessing risk varies across different businesses. For instance, doctor deals with medical risk, a civil engineer deals risk of structural failure and so on.

The customary measure of risk for a class of events is said to be as:

Risk = Probability (of the Event) times Consequence.
(The total risk is then the sum of the individual class-risks) (Holton, 2004).

2.8 External and Internal Risk Factors

Financial Risks: Risk is a major concern, when in financial services organizations implement new product lines, penetrate into new markets and lose the protection of traditional industry barriers. It has been a norm that many firms proffer products and services that cross what had once been traditional restrictions. In effect, it is important to control *default, interest-rate* and *market risks* as well as risks associated with *liquidity* and *operations* (Santomero, 2004).

2.8.1 Strategic Risks

Strategic risks are those risks which are associated and arise from:

* Merger and acquisition activity;
* Research and development;
* Changes among customers or in a demand;
* Industry changes;

2.8.2 Operational Risks

Due to inadequate internal processes, people and systems or from the external events, risk of loss is originated. For example, the September 11 and the Northeast blackout events directly impacted the back offices of financial institutions and in that sense they had to fit the narrow view of an externally-driven operational incident (Rutledge, 2004).

Operational Risk will primarily be driven by:

- New Product
- New Technology
- Business Volume
- Mergers and Acquisition
- Expense
- Culture
- Recruitment
- Regulation
- Reputation
- Supply Chain etc.,

2.8.3 Hazard Risks

Hazard risks generally contain only the possibility of a failure and cannot reverse commonly. In this type of risk, risk professionals favor to presume as much risk as deemed within your means, channeling only such exposures that are catastrophic in nature, e.g. the types of occurrences where there would be a material impact on financial results. Hazard risks are of the following types:

- Fire and other insurable perils, Terrorism; liability & crime risks etc.
- Public Access
- Employees
- Properties
- Products & Services
- Contracts
- Natural Events
- Suppliers
- Environment (Agius, 2009).

2.9. Risk Management

Risk Management is one of the key concerns of any organization's strategic management. Pertaining to all the activities on-going in the organizations risks are fetched for accomplishing the activities and their goals beneficially in all portfolios.

Proper gain of risk management is the detection of the risks and its solution. The ultimate result from it should be the maximization of the organization's value. It enhances the chances of success than failure with prompt risk assessing.

It is the part of the strategy of any organization for keeping the track of the past, present and future activities for risk interventions and its prevention. For organization not into risk management should delve it into their organizational culture via senior officials. This management will help the strategy that translates into operational and tactical objectives, handing over responsibility organization wide and employees liable for the management of risk as part of their job description.

2.10 Risk Management Process

***2.10.1* Risk Assessment**

It includes the risk analysis and risk evaluation process.

2.10.2 Risk Analysis

It includes the following points:

2.10.2.1 Risk Identification
Risk is identified at this stage. Intimate knowledge about the organization such as market operations, social, legal, cultural aspects exists in line with its operational and strategic objectives. Key success factors with threats and opportunities are also critical.

2.10.2.2 Risk Description.
The objective risk description is to show the identified risks in a controlled format i.e. nature of risk, scope of risk, stakeholders, quantification of risk, risk tolerance, risk treatment and control, potential action and strategy/policy developments.

2.10.2.3 Risk Estimation.
Risk can be estimated in three ways i.e. quantitative, semi-quantitative or qualitative provision to the chances of risk occurrence.

2.10.2.4 Risk Evaluation.
After the risk analysis process completion, the estimated risks should be matched and compared to the risk criteria designed by the organization. As discussed earlier about the external and internal risks, the established risk criteria includes those factors only, which are concerns of stakeholders ,legal requirements, costs and benefits, socioeconomic and environmental factors etc. The Risk evaluation part is therefore to come up with a conclusion about the significance of risk appearing and whether to accept them as it is and/or giving treatment.

2.10.2.5 Risk Reporting and Communication
Of course communication is the source of channelizing the information and in this regard also it is mandatory to provide feedbacks and relevant information about the risk evaluated as a part of internal reporting. For e.g. the board of directors should be given the foremost feedback of serious risk witnessed and being faced by an organization i.e. should be knowing the possible effects on share holder value of deviations to expected performance ranges etc.

Different business units and individuals should be aware of the risks entering into their own domains the probable effect it may cause on the other areas depending on a certain business unit and the counter-effects on the other areas. From top to bottom, all the relevant members should know to tackle the response to the risks arising.

In terms of external reporting, the organization is accountable to its stakeholders on a routine basis for setting the risk management policies for achieving the objectives.

2.10.2.6 Risk Treatment.
This process and phase basically implements measures to control and modify risk present in an organization. It also extends its support to risk transfer, avoidance and financing etc.

2.10.2.7 Monitoring and Review of Risk Management Process
This phase counter-checks the risk measurement assigned to improve the efficiency. A proper review and reporting ensures the risks are effectively being quarantined. Regular appraisal policy and compliances should be conceded to identify prospects for improvement (Institute of Risk Management, 2004).

2.11 Enterprise Risk Management in Developed and Developing Nations
Most firms have a lengthened approach using Enterprise Risk Management as Strategic business tool. Most executives comment about building up ERM processes but only few percent have completed their implementation (Subhani & Osman, 2011).

Executives from a diversity of industries throughout North America and Europe enlighten that majority of the panel of boards of directors and senior management staff believes the ever increasingly importance of ERM responsibility. Even this study clarifies that there is higher degree of awareness of ERM in financial/operational sectors and levels in organizations.

Survey respondents whose companies have already implemented ERM say that it has added significantly higher levels of value than those who are still in the implementation process and the organizations that have the ERM implementation are superior in improving management practices such as strategic planning and also delineate towards weighing risk-reward equations in their decisions (Subhani & Osman, 2011).

Corporations seek to put up this better comprehension of grave risks to hold the operational and tactical decisions that an organization has to make which enable them to appraise business returns on a steady base.

2.12 September 11, 2011, the Recent Japanese Earthquake & Tsunami, March 2011 and ERM

The world endured and suffered an awful loss on September 11; gigantic emblems of the public and private sectors were severely damaged; entire enterprises in numerous sectors destroyed. Insured losses approximately exceeded $35 billion to $55 billion while all industry interruption and third-party liability claims are matured. Similar to some extent, the Japan witnessed a major natural fall out in March 2011 and still in a major recovery mode which may go to perhaps a decade.

For such catastrophic events as September 11, and Japan's earthquake and Tsunami, ERM could be particularly effectual in these certain five parts:

- Extreme event risk planning
- Capital management
- Exposure management
- Disaster response
- Stakeholder relations

The methodical and integrated contemplation concerning risk that is heart of ERM would relatively enabled insurance companies to be primed to control the improbable as it occurs. Clearly, September 11 and Japan's catastrophe has made to a great extent the need for serious major risk management. Certain disputes and dangers are certainly beyond human's reach, ERM does assist in helping one all suppose and make contingency plans for the unimaginable (Goenka, 2004).

Also, a major reflection of uncertainty handlers like Emergency relief agencies and industrial manufacturers, but when calamity strikes they face parallel risk management difficulty.

'Organizations formulate money by taking risk and lose money by not successfully administrating risk' said Leslie Lamb from Cisco systems. Cisco wants to move from being a resilient enterprise with advanced business continuity plans and scalable and agile business processes, to what it refers to as an adaptable corporation, where real time data monitoring is coupled with a self-deciding, self-optimizing and self-correcting association.

Adele Martz, Director of corporate risk management at General Motors, shared out a alike vision. 'In 2004, for example, a hurricane in Oklahoma demolished US assembly plant'. 'There were 1,200 people and not one person was hurt because evacuation plans were in practice'. These maneuvers are just one component of GM's Business Continuity Planning, inclusive of weather-monitoring systems, preemptive evacuation procedures and backup supplier networks. The planning process also includes investment in future technologies to be less defenseless to a wide variety of uncertainties. For both Cisco Systems and General Motors, the key to a successful risk management strategy is to establish a structured approach coupled with top leadership support as well as an integrated effort at all levels of the organization.

Relief organizations have not yet developed such risk management practices, but expressed great curiosity in the prospective of these approaches. As disasters such as the earthquake in Pakistan in 2005 and Hurricane Katrina in the United States underline, if emergency handlers can develop more effective risk management strategies thousands of lives could be saved.

There is a wave of awareness about Enterprise Risk Management in developing nations like Pakistan as well. Many are organizing for the betterment of growth and vigilance are now shifting towards ERM, also as a competitive advantage e.g. a commercial bank, United bank limited in Pakistan to adopt risk-management systems. Bank Alfalah Limited, also incorporates risk management system to evaluate risks in the banking operations and system and opt solutions to minimize risk.

3. Findings and Conclusion

Enterprise Risk Management is a global term. This research confirms that corporations are changed when and how they view risk, from a silo approach to an enterprise wide approach specifically in advanced nations. Furthermore, the scores of ERM for developed and the developing nations were investigated and measured and it was found that the ERM as the whole is in more practice by the enterprises of the nations which are developed. Among developed nations Swedish enterprises are huskily into it whereas, on the other hand for the developing nations these scores, which reflects the involvement of enterprises in ERM were found very low and such low scores accentuates that in the developing nations the enterprises are meagerly involved in ERM practice and for the Pakistan the score was found lowest among the all nations except of few like Nigeria etc.

Table 1. Scores of Enterprise Risk Management for selected developed and developing Nations

Scores of ERM in Developed Nations			Scores of ERM in Developing Nations		
S.No.	Developed nations	Score	S.No.	Developing nations	Score
1.	Sweden	0.97	1.	Brazil	0.30
2.	Belgium	0.95	2.	India	0.25
3.	United Kingdom	0.91	3.	Srilanka	0.21
4.	United States	0.90	4.	Bangladesh	0.18
5.	Japan	0.85	5.	Pakistan	0.15
					(Definition of scores: 1 = 100%)

Enterprise risk management is the future of risk strategy and analysis for the 21st century. These strategies and analyses are in many cases completely different from traditional approaches, ERM though difficult initially, but the payoff is worth the sheer efforts.

It has been explored via this study that foreign countries have adopted the strategies of ERM and very much into operations; developing nations like Pakistan, India and Nepal on the other hand has also incorporated ERM to a certain extent in financial service industry and outsourcing. Pakistan is doing what it can to showcase its impressive off shoring assets, including 17 million English speakers, a highly educated workforce with IT skills, and wages on par with India's. The country is working diligently to fix its biggest hurdles, namely its negative security image and a skilled IT workers shortage. As risk, being a critical issue for any organization needs to resolute at diverse periods regularly for the welfare and advantage of the organization itself. Pakistan has tried to manage to develop risk awareness in organizations and various educational institutions, with implementation which will be elongated in future, which can be seen in their most recent flood relief campaign in 2010 and terror attacks within the country causing shut-downs and strikes in businesses.

It is true that change creates apprehension but one believes that the honors of the rewards are worth it and in today’s moment in time the risk-caretakers can be the leaders of positive revolution in the enterprise risk area.

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