Enterprise risk management: Challenges and the strategies for success

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ABSTRACT

The objective of this paper is to identify the challenges of implementing and adopting an effective ERM system and to suggest alternative strategies that could be pursued as countermeasures to those challenges. This study is based on survey data gathered from 379 respondents representing 129 companies listed on the Colombo Stock Exchange of Sri Lanka. This study found that the lack of availability of information to make risk-based decisions; the need to ensure that all decisions are made within the organization’s risk tolerance level, and the lack of top management support for ERM implementation; are the most influencing challenges for business organizations that obstruct ERM effectiveness. This study suggests that organizations should promote a good corporate culture that fosters ERM supportive internal environment. It is also suggested that the support of the top management and their commitment to being corporate with the firms’ ERM function without making ERM the sole responsibility of the finance people. Further, it is suggested that organizations have a designated position dedicated to overseeing the ERM function and providing executive leadership for its effective implementation.

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Introduction

In the context of the global political uncertainties and war-tone, emerging global environmental issues, industry convergence and disruptive technological advancements, increased consumer empowerment through social media, corporate scandals, ethical and governance issues, today’s global business environment has been highly dynamic and uncertain than ever before. This highly uncertain business environment presently exerts a great deal of challenges to the corporate managers when assuring the organizational growth and sustainability. Enterprise risk management (ERM) has gained an increased attention amongst the practitioners and academia as a holistic and strategic approach to manage wider range of risks towards creating and preserving long-term shareholder value.

The Enterprise Risk Management (ERM) has gained an increased attention by the corporate managers as a holistic and strategic approach to manage wide range of risk factors affecting organizations and creating and preserving the long-term shareholder value.

ERM is highly praised by the practitioners as an integrated and strategic approach to manage risk as opposed to the traditional approach where risk management is said to be a silo-based approach of managing risk in isolation. ERM, as a holistic approach to risk management, is considered as a highly proactive approach. It aims at responding to downside of the risk while taking actions to capitalize the upside of the risks that are emerging from the changing business environment. This proactive approach enables and empowers organizations to minimize business surprises and reduce the volatility in their earnings.

According to Beasley et al (2008), reduce volatility and business surprises through effective implementation of ERM increases firm performance. Many prior researchers have made some significant contribution towards empirically verifying the value implication of ERM on firm performance. Nevertheless, there is little evidence with respect to what factors and forces could adversely affect the success of ERM implementation in a corporate setup.
The objective of this study is to identify the most crucial challenging factors that adversely affect on the success of ERM implementation and suggesting alternative strategies to overcome those challenges.

**Literature Review**

**Conceptual Background**

The concept of ERM gained an increased attention during 1990’s in the context of high-profile corporate scandals and business failures. Global economic crises (1998, 2008), the collapse of Barings Bank (1995); Enron case (2001); WorldCom case (2002); Volkswagen emissions scandal (2015); in particular, made a significant influence on regulators and law enforcement bodies to take some urgent counter measures to address the governance issues in the corporate setups and making board of directors are more accountable for the corporate performance.

The best practices of corporate governance recognize that the directors of a company are responsible for designing and implementing a sound system of internal control and risk management for corporate success (Fernando et al, 2014). As per the enterprise risk management-integrated framework published by the committee on sponsoring organization (COSO) of Treadway Commission (2004), ERM is defined as:

“a process affected by an entity’s board of directors, management and other personnel, applied in 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.”

Many prior researchers (Karunarathne et al. 2017; Mahmood et al.2013; Ansari, 2013; Mustafa et al., 2016; Pae et al., 2002), are of the view that the dynamic nature of the modern business environment with the disruptive technology and their advancements, there is a great deal of uncertainty with respect to; the customers perception of the firms products; shorten product life cycle, and the long term stability of the businesses. In this context, the enterprise risk management (ERM) has gained an increased attention amongst the corporate managers, professionals and academia, as an effective and integrated approach to address a wider range of risks faced by the modern business organizations and to facilitate risk aligned strategic decision making for creating and preserving long term shareholder value.

Literature shows that ERM provides mixed results on the premise as to whether ERM increases firm performance and the value of the business. According to Beasley, Pagach and Warr, 2007; Liebenberg and Hoyt, 2003; Hoyt and Liebenberg, 2011; Pagach and Warr, 2011 etc. in particular, assert that the adoption of ERM has a positive impact on firm performance. Nevertheless, according to Pagach & Warr, 2010; Tahir and Razali, 2011; and Gates, Nicolas & Walker, 2012; their empirical results fail to support the theoretical expectation that ERM increases firm performance.

These mixed results induce the researcher to explore as to what factors are affecting on the successful implementation of ERM towards realizing its intended benefits.

**Research and Methodology**

**Data**

This study is based on the survey data gathered from 379 respondents representing 129 companies listed on the Colombo Stock Exchange in Sri Lanka. As stated above, the objective of this analysis is to identify and rank the most influencing challenges for ERM implementation and to identify alternative strategies for the effective implementation of ERM for corporate success.

Based on the prior researchers’ works and the literature on risk management, researcher identifies nine challenges of implementing an entity-wide ERM system and six alternative strategies that could be adopted to overcome them.

Survey questionnaire let the respondents, based on their perception, to rank these challenges and strategies in order to recognize and rank the most influencing challenges and strategies that affect the effectiveness of the ERM implementation.

According to the respondents’ perception, researcher expects to rank these challenges and the strategies from the highest to the lowest based on their perceived impact on ERM success. In order to achieve this objective, researcher expects to check whether the mean values of all challenges and strategies of implementing ERM practices are same or not.

If it is same, it implies that all challenges and strategies are equally influencing for the operational success of ERM system. If not, researcher can rank the most influencing challenges and effective strategies for the success of ERM. This is tested by using ANOVA test and the statistical output with respect to challenges and strategies is presented in table 1 and 2 respectively.
Table 1: ANOVA test for the challenges of ERM implementation

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>20.756</td>
<td>8</td>
<td>2.594</td>
<td>8.318</td>
<td>.0001</td>
</tr>
<tr>
<td>Within Groups</td>
<td>359.297</td>
<td>1152</td>
<td>.312</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>380.053</td>
<td>1160</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 2: ANOVA test for the Strategies ERM Success

<table>
<thead>
<tr>
<th>Statistics</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>40.160</td>
<td>5</td>
<td>8.032</td>
<td>44.959</td>
<td>.0001</td>
</tr>
<tr>
<td>Within Groups</td>
<td>137.206</td>
<td>768</td>
<td>.179</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>177.366</td>
<td>773</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Analysis and Findings

Challenges for ERM effectiveness

ANOVA test significant value is 0.001; P value is less than 0.05. Then at 95% confidence researcher can say that at least one mean value of the challenges of implementing an entity-wide ERM system is differ from others. So, the researcher needs to check what is differing from other by using Homogenize subset. The statistics with respect to the homogenize subset relating to challenges is given in table 3.

Table 3: Mean values for groups in homogeneous subsets

<table>
<thead>
<tr>
<th>Challenges for ERM</th>
<th>N</th>
<th>Subset for alpha = 0.05</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>There are no costs and budgetary constraints</td>
<td>129</td>
<td>3.4322</td>
</tr>
<tr>
<td>Lack of embodiment of ERM in organizational culture</td>
<td>129</td>
<td>3.4802</td>
</tr>
<tr>
<td>Ambiguity in roles and responsibilities in risk management</td>
<td>129</td>
<td>3.5037</td>
</tr>
<tr>
<td>Inadequate application of the risk management framework</td>
<td>129</td>
<td>3.5337</td>
</tr>
<tr>
<td>Risks information is properly linked to strategic decision making</td>
<td>129</td>
<td>3.5478</td>
</tr>
<tr>
<td>Complexities in risk measurement</td>
<td>129</td>
<td>3.5862</td>
</tr>
<tr>
<td>Risk management is seen as a priority by top management</td>
<td>129</td>
<td>3.6505</td>
</tr>
<tr>
<td>All decisions remain within the organization’s risk tolerance level</td>
<td>129</td>
<td>3.7823</td>
</tr>
<tr>
<td>Adequate information is used to make risk-based decision</td>
<td>129</td>
<td></td>
</tr>
<tr>
<td>Sig.</td>
<td></td>
<td>.060</td>
</tr>
</tbody>
</table>

According to the statistical output with respect to the Homogenize sub set relating to the ERM challenges, the researcher can rank the challenges of ERM implementation from highest to the lowest degree as follows;

Rank 1: The most influencing challenges of implementing ERM:

i. To ensure adequate information is used to make risk-based decision

ii. To ensure all decisions remain within the organization’s risk tolerance level

iii. To ensure risk management is seen as a priority by top management
Rank 2: Lowest degree challenges of implementing ERM:

i. Complexities in risk measurement

ii. To ensure that the risks information is properly linked to strategic decision making

iii. Inadequate application of the risk management framework

iv. Ambiguity in roles and responsibilities in risk management

v. Lack of embodiment of ERM in organizational culture

vi. To ensure that there are no costs and budgetary constraints to implement risk management

According to the ANOVA test, respondents perceive that the use of adequate information to make risk-based decision as a great challenge for them. This could be due to lack of availability of updated and timely information with respect to changing environment and difficulties in predicting and forecasting the future. So, it is needed to establish formal system of risk information that could facilitate the management in making risk-aligned decision making.

Need for restricting all the operational and strategic decision within the organization’s risk tolerance level is recognized as the next big challenge for ERM implementors. The term risk tolerance usually means the degree of volatility that a firm is ready to accept. This restricts the managers to expose for high-risk decisions that could bring greater loss as well as avoiding the opportunity for higher earning potentials. This is perceived by the respondents as a challenge to striking a balance between both risk and return. Lack of top management support for ERM implementation is perceived as another challenge face by business organization. Prior researchers (Mensah et al. 2015) find that the top management support is vital for a successful ERM implementation in any organization.

According to the perception of the respondents, complexities in risk measurement, linking the risks information properly to strategic decision making, inadequate application of the risk management framework, ambiguity in roles and responsibilities in risk management, lack of embodiment of ERM in organizational culture, and having costs and budgetary constraints to implement risk management, are recognized and ranked from the highest-level challenges to the lowest level challenge. This brings into light that the budgetary constraint to implement an ERM function is not perceived as a challenge for the observing firms.

Strategies for ERM effectiveness

ANOVA significant value is 0.0001; P value is less than 0.05. Then at 95% confidence researcher can say that at least one Mean values of successful ERM implementation strategies is differ from other strategies. In order to check whether what strategies for ERM implementation is differ from others, researcher use Homogenize sub set analysis and the relevant statistics is presented in table 4.

Table 4: Means for groups in homogeneous subsets - Strategies.

<table>
<thead>
<tr>
<th>ERM implementation Strategies</th>
<th>N</th>
<th>Subset for alpha = 0.05</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Developing risk appetite statement</td>
<td>129</td>
<td>3.7375</td>
</tr>
<tr>
<td>Building a dedicated ERM function</td>
<td>129</td>
<td>3.8378</td>
</tr>
<tr>
<td>Engaging consultants</td>
<td>129</td>
<td>3.9629</td>
</tr>
<tr>
<td>Appointment of a Chief Risk Officer (CRO)</td>
<td>129</td>
<td>4.2256</td>
</tr>
<tr>
<td>The commitment of Board of Directors and top management ERM</td>
<td>129</td>
<td>4.3004</td>
</tr>
<tr>
<td>Building a strong risk culture in the organization</td>
<td>129</td>
<td>4.3118</td>
</tr>
<tr>
<td>Sig.</td>
<td>.399</td>
<td>.166</td>
</tr>
</tbody>
</table>

According to the statistical output with respect to the Homogenize sub set relating to the ERM implementation strategies, the researcher can rank the most effective ERM implementation strategy to the least effective strategies of ERM implementation.

Rank 1: The effective strategies for ERM implementation;

i. Building a strong risk culture in the organization

ii. The commitment of Board of Directors and top management on ERM

iii. Appointment of a Chief Risk Officer (CRO)
Rank 2: Least effective ERM implementation strategies;
   i. Building a dedicated ERM function
   ii. Developing risk appetite statement
   iii. Engaging ERM consultants

The analysis suggests that building a strong risk culture within the organization that facilitates the good ERM supportive environment is the most effective strategy for ERM success. Then, it suggests that the board of directors and the top management commitment and support is a vital factor for the successful implementation of ERM system. The presence of a designated position dedicated for overseeing the ERM function that can extend the leadership for the risk management is also perceived as a good strategy for ERM success. Nevertheless, the strategies to; build a dedicated ERM function; developing risk appetite statement; and engaging consultants are the strategies respondents perceived as the least relevant for the operational success of ERM implementation of an organization.

Conclusion

This study finds lack of availability of adequate information to make risk-based decision; the need for ensuring that all decisions are made within the organization’s risk tolerance level, and the lack of top management support for the ERM implementation are the most influencing challenges for business organizations that obstruct effective implementation of a sound ERM system.

In order to overcome these challenges this study suggests that organizations should build a strong risk culture to facilitate and ensure ERM supportive environment within the organization. It is also recommended to extend the senior managers support and commitment to be corporative with firm’s ERM function without making the ERM is the sole responsibility of the finance department. Further, it is suggested to have a designated position dedicated to overseeing the ERM function and to provide an executive leadership for its effective implementation.

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Data Availability Statement: The data presented in this study are available on request from the corresponding author. The data are not publicly available due to privacy.

Conflicts of Interest: The author declares no conflict of interest.

References


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