ENTERPRISE RISK MANAGEMENT AND CORPORATE GOVERNANCE

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Abstract: *Enterprise risk management is a topic that converges corporate governance and risk management in a way that managers and stakeholders of the company can have a clear path to assessing dealing with risk within an appropriate corporate governance system. The present paper, while not keen to provide an introduction into the terminology, definitions or classifications – since our goal is much past this – attempts to build up a viable framework for managers to deal with enterprise risk management in their relationship with the wide array of stakeholders. Therefore, the purpose of the paper is to compact and correlate the available information from literature, policy makers, case studies, in order to achieve a considerate framework for both the needs of management and stakeholders. Without disregard to the complexity of the topic, the author attempts to summarize a basic framework that can further be expanded in accordance with the company's requirements and takes into consideration the general expectations from stakeholders that can further expand into more specific ones and then result in a tailor made plan for dealing with risk. Starting from a literature review focused on several policy maker views and experts' inputs on enterprise risk management, the papers manages to put together and create synergies between the steps that a company should take in its risk management initiatives. Without leaving aside the corporate governance principles, we make an effort to illustrate the ideas that should be at the centre of risk identification and evaluation and further we dedicate risk evaluation output – a risk report – and risk mitigation to ensuring communication with the stakeholders in a transparent and appropriate manner. Due to the fact that risk management can be viewed in a variety of ways, as companies are widely diverse, the proposed framework does not benefit from fixed measures, they have to be adapted both in terms of array of details implied as well as assigned interest and importance.*

Keywords: *enterprise risk; corporate governance; risk management.*

JEL classification: *G31; G34.*

1. Introduction

The literature reviewed for the present paper indicates a unanimously accepted approach to risk management process being split into four sequential steps: risk identification, risk analysis, risk evaluation and risk mitigation. Starting from a comprehensive selection of literature reviews, case studies and frameworks from global policy makers, the author emerges into a paper dedicated to the theoretical aspects of the correlation between corporate governance and risk management. Reviewing a significant number of literature on the topic, we have agreed on using the term enterprise risk management, as used by many peers who have studied the

exchange between the two fields. This term complies with our goal of correlating practices of corporate governance with managing risk in a company.
While being short on terms origins or definitions, since our purpose lies much past such an introductory phase, the paper could be considered a support for diving into the process of enterprise risk management. It offers to a considerate extent an ordeal of frameworks and process descriptions so that the case study represents a well-informed framework suggestions, which can be considered a centralizer for many views and approaches under the umbrella of the same goal. Many of the referenced material in the final section of the paper contain themselves a significant array of referencing to further material, the limitation of length leading to the choice of the most complex literature and studies. The reference system ranges from the ones aiming to define and display standardized measurements and actions to the opinions and recommendations expressed globally that represent the strength of the work.
Since countries' frameworks are different in their perception and application of corporate governance systems and management and stakeholders may have quite a wide array of approaches to risk management, the originality of the paper comes from the attempt to unify the views under the same framework. The output framework is adaptable and adjustable so that it can subscribe to preferences and particularities of corporate governance systems, managers and stakeholders. The adaptability lies in assigning degrees of importance and/ or excluding factors from the analysis. In an application of the theory presented, one would account for these specificities by modelling the analysis on a defined range: a corporate governance system, companies adhering to that (country's) corporate governance system, indicators relevant for the selection and an appropriate way of looking at the analysis. The way of looking at the application is, of course, from a stakeholder perspective and such choice should subscribe to the aforementioned ones.
The article is composed of a literature review comprising the most influential work for the output the author has come to, followed by a case study dedicated to presenting with the most significant details the unified framework proposed for a stakeholder view of enterprise risk management. The paper is completed with a pertinent conclusion summarizing the results and laying ground for further development of the topic, and a list of references.

2. Literature Review

Kaen Fred R (2003) connects meaningfully the concepts of risk management and corporate governance depicting that they intertwine having at center the purpose of value creation for shareholders. In the book, there is comprehensively depicted how important it is that the perspective of management does not exclude or underestimate the significance of risk management in the company's environment, for it is a contributor to correcting market imperfections caused by several factors. While confronting with asymmetric information, fluctuations in rules and regulations and discrepancies in interests of stakeholders, risk management represents for the company a mean of ensuring the proper corporate governance actions with the purpose of scrutiny, supervision and risk rewarding. The author goes one step further and draws attention to the implications of risk management as a ripple not only in the company's own environment but also in the society as a fully interconnected mechanism.

UK's Financial Reporting Council has defined in their latest corporate governance code published in 2016 the concept of corporate governance as a sum of processes and structures employed in the enhancement of shareholder value and firm performance. Having trust, transparency and accountability at the center of any corporate governance system one can turn the intersection of the concept with risk into 'risk governance', a phrase that has been used in most of the recent literature to depict the strong connection between the two concepts and avoid their divergence from the common purpose they share.

Pirtea M. and Nicolescu C. (2013) state that "Corporate governance cannot be considered a fixed number of regulations and procedures, but an innovative process by which the most crucial decisions in companies are managed, values and cultures are redefined, and the leaders are assessed".

In 2014, the ' Committee of Sponsoring Organizations' (COSO) has published its latest 'Integrated Framework', a remarkably comprehensive enterprise risk management set of guidelines to support a holistic approach to enterprise risk management. In the committee's view, the notion of risk management entails the following areas: convergence of opinion on risk appetite and strategy between management and stakeholders, continuous improvement in combating risk and operational difficulties arising from loss, awareness about risk complexity internally and in the industry environment and, last but not least, improvement of predictive mechanisms and unbiased decision making.

OECD's 2014 Risk Management and Corporate Governance report, based on OECD's Principles of Corporate Governance, has identified though a widely applied questionnaire to both state and private owned companies that while risk is a fundamental driver of evolution, the cost of risk management is widely misjudged. Risk governance, as the report pins it, is a topic nested in corporate governance practices that must ensure a transparent, accurate and appropriate communication to both internal and external stakeholders. With the BOD as the responsible for setting out risk minimums and maximums for the company, the process of setting these limits is yet unclear as to how to split it by types of risk and how to ensure the correlation between these targets, the risk management system and the company strategy.

A 2010 survey of Manifest Information Services, commissioned by the OECD, shows that across the OECD countries there is quite a limited presence of specialized risk committees in enterprises. Moreover, a matrix compiled to show where risk falls in as a responsibility reinforces the statement that the most common practice is to have risk governance under the umbrella of a department that contain no reference to risk in title.

ISO31000 standard, published by the International Organization for Standardization, provides an array of generic guidelines that can be adopted across industries or countries, with an appropriate update of specificities. This standard is a source of structure for most published literature as it outlines the process of risk management step by step: risk identification, risk analysis, risk estimation and risk treatment. In the process, the focus is not only on the measures taken but also on designing the framework on which a company can rely, with continuous improvement, to predict, deal with and learn from risk events.

The Financial Stability Board (FSB) has qualified in 2013's Thematic Review on Risk Governance the practice of having an independent risk committee represents a good case practice, a proactive measure, which further brings to discussion whether the audit committee should or should not have the risk topic under their responsibilities. The New York Stock Exchange (NYSE) guidelines for risk management place the topic under the umbrella of senior management and the audit committee, the latter being responsible for guidelines, practices and final risk assessment and management. The survey applied in 2014 by OECD has shown for Sweden, for example, that audit committees are more active analytically but there was reduced follow up intent showing that more often than not data is processed, actions are taken but the follow up to ensure the appropriateness and adjust is poor.

A policy paper published by ACCA's Corporate Governance and Risk Management Committee in 2008 outlines a set of principles defined as fundamentals to corporate governance practices globally. While the list starts with the basics – common understanding of the purpose across boards, shareholders and stockholders, leading by example, strategies rewarding risk and inquiries to balanced power distribution – it ends with what seems to be the most important pillar in a corporate governance policy – the evolving nature of this concept. One can easily accept differences across sectors in industries on almost any topic, on corporate governance and risk management it is by far the most important to differentiate and adopt a flexibility that fosters progress and innovation.

Culp C. (2002) emerges into the risk management process by taking steady steps in constructing arguments with the support of illustrative examples that outline several directions of his work. On one hand, the author deals with strategy related topics and how they have the potential to add value to stakeholders and on the other hand, the direction of tactics lay ground for clearly defined steps in risk management. The focus of the book is to construct a picture of risk control that includes a set of processes which are broken down into ex ante and ex post actions that aim at combating risk. Leaving aside the impossible target of risk elimination, the author gets closer to the core processes and displays a concentrated bundle of five steps for a risk control procedure. The five steps are to be easily adjusted and completed with specificities of the company, industry, country or any other potential source of unicity. The steps are as follows: identify risk and determine tolerances, measure risks, monitor and report risks, control risks and oversee, audit, tune and realign the risk management process. All steps enumerated construct a base for the approach of the case study.

Brunnermeier M. and Yogo M. (2009) make an insightful paper on the means of combating liquidity risk through a well-balanced debt structure and a sufficient but not harmful cash reserves. Dealing with 'rollover failure' brings to question both short and long term financing – the former being sought out timely and allowing for dynamic changer while the latter is more likely to be sought prior to major difficulties. The author further describes at large a model for hedging liquidity risk with focus on timeliness and quality – the choice of maturity should account for worthy creditors.

Amberg A. and Friberg R. (2016) approach the following methods of risk management that companies may use: financial hedging through portfolios of futures, options or both; operational hedging where companies locate production with consideration of currency advantages and insured access to external financing. The author bases the research on a wide assessment through means of survey on non-financial Swedish companies, the results showing that 95% of companies using financial derivatives are also employing operational methods. In addition, companies expressed inclination to secure access to external financing sources as they approached it as a mean of ensuring against cash flow downturns that can prevent cutbacks in investment.

Lucic L. (2014) provides an excellent framework for business risk assessment with the use of financial ratios, an approach that yields great support for the present paper's case study in the selection of ratios and benchmarks to determine the influential factors of risk management. Risk assessment, as pointed out by the author, regardless of the stakeholder is carried out furthermost through financial ratios analysis. Pointing towards several groups of ratios and explaining the output reflected as a standalone information or as one subjective to benchmarking, makes this paper an important source for a measurable analytical approach towards risk management.

3. Case Study

The purpose of this paper's case study is to construct a broken down framework for risk management that can be employed further on in analyzing the reaction of different stakeholders to risk undergone by a company. It is important to mention as a hypothesis that:

- Stakeholders are interested in different aspects of risk (financial, environmental, social etc.) and are subject to different risk affinities (from risk adverse to risk takers)
- Stakeholders can use any framework to the extent they see it appropriate and increase or decrease levels of achievement or assigned benchmarks according to their expectation, a behaviour that allows the company to have different types of stakeholders in all areas.

To begin with, the presented process flow for risk management holds the structure of ISO31000 and divides it in the four sequences: risk identification, risk analysis, risk estimation and risk treatment.

The second layer of the process involves dealing with different types of risk and assigning benchmarks or bottom line actions as main deliverables which can be further translated into key performance indicators (KPIs) for assessing the risk as an empirical construct.

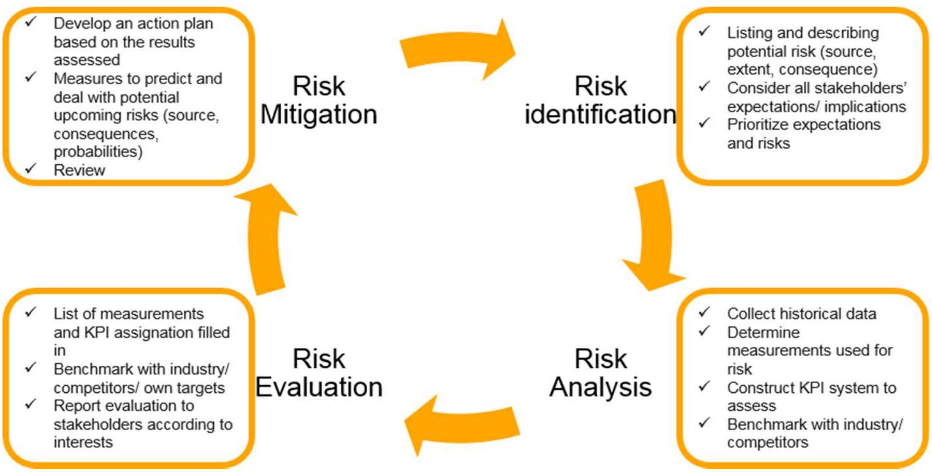

Figure 1: Risk management framework

Last but not least, the process cycle can be closed within the sequence of risk treatment with a conclusion drawn as a result of aggregating the factors identified, analysed and estimated. Therefore, the importance of the KPIs being measurable and easily comparable (across companies, industry, countries etc.) is stressed.
Having at centre a long list of enterprise risk management frameworks from the literature consulted, the author has developed the following matrix and risk evaluation framework that includes all aspects to be considered in estimating risk from the position of any potential stakeholder. The differentiation amongst stakeholders can be accentuated in assigning the importance in the sections of the evaluation model so that for example, a risk adverse stakeholder (namely, a bank) can put a greater weight on the company's solvability while a risk taker stakeholder can assign more to the financial performance of the enterprise.
As shown in *Figure 1*, the risk management framework proposed by the author is a cyclical one and does not necessarily close with risk treatment. This is the result of changes in the conditions of the framework, updating of benchmarks, changes and/or evolution of stakeholders and any other factors that are subject to change that therefore demand a continuous adaptation of the framework for an accurate status quo output.
To begin with, the process of risk identification is the phase in which a company has to gather information from the entire environment of the company: shareholders, stakeholders, market segment, industry, country etc. Listing all sources of risk may be an industrious task since there are so many variables to consider but it is rather relevant to enlist those that are actually in the attention of stakeholders and those that can affect the shareholders. This step requires data about the source of risk, outcomes of risk and consequences of risk that can be translated into an outcome for any potential stakeholder. For example, a manufacturing enterprise can list as risk sources the price of raw materials and labour shortages. Then, outcomes of risk are increases in production expenses and decreasing the manufacturing capacities which have as potential consequences an increase in price of the product leading to decreased sales and lower manufacturing output leading to decreased volumes and decreased sales.
Further, risk analysis deals with processing the data that was marked as being of importance in the assessment of the risks determined. Measurements of risk should be taken from each category of risk identified. For example, the same manufacturing enterprise can assess the impact that the supposed price increase would have on its returns. Then, in the system of KPIs the company should assign a certain weight to each risk, according to the weight it would have in the company not achieving its goals. Therefore, if the manufacturing enterprise from our example considers this a minimal risk then it should assign a low weight and should it consider it an important imminent risk then a higher one, leading to a clear assessment of how much this raw materials price increase would affect the expected results of the company.
The third step, risk evaluation, should mainly focus on making the connection between the stakeholders' expectations and the analysed risks. As a result, the benchmarking assessment should lead to an overall result as to where the company is positioned in terms of the expectations of its stakeholders' interests. The most important action in this process is reporting such results transparently so that stakeholders' can assess the company's analysis and express their opinions on the results achieved.

Risk mitigation closes the cycle and must represent a solid basis for restarting it due to the fact that the action plan puts together all implications of the framework. This plan should comprise not only measures for dealing with risk or its identified effects but also include actions that can forecast and ensure predictive measures for potential risk. Most importantly, it is of great importance for future risk mitigation to continuously review and update the identification, analysis and evaluation steps as conditions perpetually change for the company. Nevertheless, changes should be in aligned in such way that it would allow for a year to year comparison which would be necessary in assessing the company's evolution.
All in all, the risk management framework aims at providing a cyclical view on the actions that companies should take in order to ensure that they are continuously aware of and dealing with risk and its effects. To ensure the stability of a company in terms of risk management the continuity in approach and the perpetual improvement of means, measurements and processes is implied.

4. Conclusion

In conclusion, enterprise risk can be managed through a strong model that takes into account stakeholders interests and affinities and that can quantify risk measurements according to such preferences with an output that can indicate to the company's management how the status quo is positioned in respect to expectations from stakeholders.
The quality of the company's assessment lies in its continuous improvement, value of communication with stakeholders and its ability to ensure predictive and responsive actions. Setting priorities shows potential to deal with risk systematically and it should not deter the company from achieving good results in terms of risk management KPIs.
The present paper represents an attempt to present briefly the importance of having in place a risk management system and attempts to deal with several aspects of this process that converge with the field of corporate governance. Despite the limited view upon the process, this frame can successfully be a starting point for building up a risk mitigation system that connects the management's interests to those of shareholders and a wide array of stakeholders. The inclusive nature of this framework ensures that it allows for this basis to be used by a wide variety of companies which take different interests and deal with different expectations from their shareholders and relationship to stakeholders.
The author identifies as further potential steps applying the developed framework to a number of listed companies, with available data, and assessing whether the behaviour of several types of investors can be predicted with such a framework estimation. A further inquiry into the topic will be, more concretely, assessing whether historical data on this framework can predict investor behaviour and if so what are the KPIs worth aggregating for a risk behaviour predictive measurement.

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