



# **Influence of Enterprise Risk Management Success Factors on Firm Financial and Non-financial Performance: A Proposed Model**

**Idris Ahmed<sup>1,2\*</sup>, Norlida Abdul Manab<sup>3</sup>**

<sup>1</sup>School of Economics, Finance and Banking, Universiti Utara Malaysia, Malaysia, <sup>2</sup>Department of Business Administration, Ahmadu Bello University Zaria, Nigeria, <sup>3</sup>School of Economics, Finance and Banking, Universiti Utara Malaysia, Malaysia.  
\*Email: [iahmedng@gmail.com](mailto:iahmedng@gmail.com)

## **ABSTRACT**

Corporate scandals and the fall of world leading business organizations have triggered scholars and professionals to re-examine the link between risk management initiatives and the performance of business organizations. The objective of this paper is to propose a research framework that intend to examine the influence of enterprise risk management success factors on firm financial and non-financial performance. The factors are selected based on critical risk management issues affecting the Nigerian Financial Industry. The study will have practical implications to business leaders, regulatory agencies, rating agencies and government.

**Keywords:** Enterprise Risk Management, Enterprise Risk Management Success Factors, and Firm Performance

**JEL Classifications:** G01, G31

## **1. INTRODUCTION**

The issue of managing risk has taken a center stage in organisations. Investors have continuously grieved from the matters of intermittent business performance (Chapman, 2012). Scholars have described the risk management practices of the majority of organisations as weak and inadequate (Spedding and Rose, 2008). The corporate failure of Enron and WorldCom in 2001 and 2002 respectively had exposed the inadequacies of corporate governance practices, the integrity of financial reporting, inadequate compliance and monitoring as well as poor risk management initiatives (Chapman, 2012) of these great corporate entities. A report by the Economist Intelligence Unit (2014) indicated that a large number of businesses have perceived a rise in risk and its severity in their operation, due to the interconnectedness of the global business environment. Before this ugly phenomenon, Rod Eddington, the former Chief Executive Officer of British Airways once reported that firms need to have a broader perspective of risk management practices in place (McCarthy et al., 2004). In fact, the failure of some leading world organisations has made the

shareholders accuse board members of being greedy, reckless and dysfunctional in their monitoring role. Chapman (2012) argued that management and board of directors failed to appreciate the interconnectedness of business environment and their potential domino effect on business failure. Recent global events have doubts about the efficiency of “silo-based” approach as even the most sophisticated companies suffered heavily in the 2008/2009 economic meltdown causing tremendous destruction to the US financial markets (Hoyt and Liebenberg, 2015).

Traditionally, risk management has been fragmented and used in “silos.” This fragmented approach has arisen because of the traditional management function of organizing which simply group activities into functional areas for better and efficient decisions. In that regard, there is always the tendency for organisations to classify risks into distinct mutually exclusive categories just as managers design organisational activities. In fact, the interconnectedness between risks under the categories of operational, financial and technical risk have usually been ignored with adverse consequences (McCarthy et al., 2004). Hence, to counter the effect of traditional risk management

approach, enterprise risk management (ERM) came up as a response to the inadequacies of using a silo-based approach (Chapman, 2012). One of the primary objectives of implementing ERM in spite of the vast resources needed is to improve business performance. A sizeable number of organizations have either implemented or are preparing to adopt ERM as a comprehensive risk management risk strategy. As an effort to encourage ERM implementation, rating agencies have begun to incorporate ERM in their rating process (Hoyt and Liebenberg, 2015). Hence, Nigeria as part of the global economy is not relegated in that regard.

Nigeria had for several years been experiencing one form of financial distress or the other. The series of poor performance experienced by financial institutions in Nigeria were attributed to risk management inadequacies, poor monitoring systems and ineffective board members (Dabari and Saidin, 2015). Soyemi et al. (2014) argued that the precarious positions of financial institutions require them to be more assertive in embracing a more robust risk management strategy. For example, the Nigerian financial sector control about 45% of the total market capitalization of the Nigeria stock market. From 2008 to 2009, the Nigerian stock market lost approximately 70% of its value (IMF, 2013). Subsequently, from 2009 to 2012, the market capitalization of the financial institutions experienced an annual decline of 17.42% (SEC, 2012). The CBN audit report classified eight banks in serious financial grief (Sanusi, 2010). In all these instances, inadequacies of the risk management programs were cited as the primary causes of poor firms' performance in Nigeria (IMF, 2013).

Despite the hypothesized benefits of ERM in organisations (Gates et al., 2012), scholars believed that very few organizations succeed in the practical implementation of ERM (Yaraghi and Langhe, 2011). Hence, there is a surge in the risk management literature to develop a body of knowledge in the area of critical success factors (Yaraghi and Langhe, 2011). Studies are yet to demonstrate consistent benefits from ERM (Hoyt and Liebenberg, 2015). In the context of Nigeria, there is a paucity of studies on ERM implementation and the key factors that influence its operation (Dabari and Saidin, 2015). Consequently, this study is proposing a research framework that incorporate some key ERM success factors (i.e. risk culture, compliance, risk knowledge sharing, risk information system, innovativeness, staff competence and leadership) into ERM framework to further enhance the robustness of risk management systems. The paper shall be of immense value to the academia, regulators, and other stakeholders in providing the key factors that will ensure high business performance. The rest of the paper proceeds as follows: Section 2 reviews previous studies related to the topics, while section 3 concludes the paper.

Rochart (1979) asserted that critical success factors refers to those performance factors which organisations must get it right and need to receive the attention of the top management and board for an organisation to remain effective and competitive.

## 2. ERM SUCCESS FACTORS

Drucker (1979) contended that what is sure about the future is its uncertainty and risks. As such risks taking is the main crux

of economic activity and businesses produce greater economic performance through more considerable change and risk taking. Consequently, risk management function has become a central issue for business firms having the objective to identify, analyse and control causes and effects of uncertainty and risks in a company (Ciocoiu and Dobrea, 2010). At present, organizations have come to the conclusion that even the minimal risks because of interaction with other events can cause considerable damage to organisations (Ciocoiu and Dobrea, 2010). As such, suggested the implementation of ERM.

Kloman (1992) asserted that ERM emanates from the idea that risk managers should manage risk "holistically." This view is purposely similar to the total quality management principles and relies heavily on the language and concepts of engineering and operations management. The main reason for risk management is to enable an organization achieves its pre-determined goals and objectives (its mission) in the most direct and efficient way. Also, Lam (2000) defined ERM as an integrated framework for managing operational risk, credit risk, market risk, economic capital, and risk transfer to maximize constant value. This definition further highlights the concept of a holistic approach to risk issues in organisations. Casualty Actuarial Society (2003) defined ERM as a discipline that enables an organisation to assess, control, exploit, finance and monitor risks from all sources for the purpose of increasing the stakeholder value. Similarly, COSO (2004. p. 2) defined ERM as:

"A process, effected by entity's board of directors, management and 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."

This definition has further articulated all the components of ERM and what is needed to ensure the effectiveness of ERM in various firms. Specifically, it identifies the role of management and other personnel in providing reasonable assurance regarding the achievement of entity's objectives. It has also emphasized the role of employee involvement throughout the entire process of ERM implementation and enforcement (Togok et al., 2014). Similarly, ISO 31000 (2009) viewed ERM as a coordinated activity meant to direct and control an organization concerning risk. ERM is a strategic business initiative that facilitates the achievement of organizational objectives. ERM integrates all aspects of risks an organization exposes to, which intrinsically requires management to align risk management with corporate governance initiatives (Bromiley et al., 2014).

To ensure robust implementation of ERM in organisations, scholars have called for the identification of factors that facilitates the efficient operation of ERM in organisations. Hence, the issue of critical success factor. In essence, firms ought to have a systematic way of identifying the key areas, or signposts, that require the constant and careful attention of management to achieve higher firms' performance (Ram and Corkindale, 2014). Rockart (1978) defined success factors as the limited number of areas in which results if they are satisfactory, will ensure competitive firms' performance. Specifically, companies need to identify few key

areas where things need to go right for the business to flourish. ERM initiative requires the integration of some critical factors that will enhance its effectiveness. Below are some factors that firms need to pay attention:

### 2.1. Compliance

Compliance with regulations and standards is an important risk management factor that determine its success (Martens and Teuteberg, 2011). Berenbeim (2004) opined that compliance is an essential component of ERM; as such an effective ERM implementation requires a substantial reinforcement of compliance systems. According to Martens and Teuteberg (2011), compliance relates to both regulatory (external) and efficiency checks (internal). In many countries, regulators encourage firms to improve both their risk management initiatives and risk reporting process (Collier et al., 2007). Examples of such regulatory laws include the NYSE Corporate Governance Rules, the Sarbanes-Oxley Act in the US; the Security and Exchange Commission corporate governance code in Nigeria. Most of the provisions of these regulations apply to listed firms, and require companies to maintain a sound risk management framework. These laws typically encourage organisations to implement a comprehensive risk management initiative. In fact, some scholars are of the view that firms adopt ERM to guard against regulatory pressure (Paape and Spekle, 2012). Studies have confirmed the importance of having sound relationships between corporate governance, risk management and compliance to achieve organisational goals, enhance shareholder value and improve performance (PricewaterhouseCoopers, 2004). Hence, compliance is considered an essential ingredient for ERM to achieve firm performance. Hence, the study proposes the following hypothesis:

Proposition 1: There is positive relationship between compliance and firms' performance.

### 2.2. Risk Culture

Culture plays a significant role in shaping the collective attitudes of people within an organization. Barnabei (2008) reported that culture has a greater influence on how business organisations take investment decisions. Culture has been reported to play a critical role, ranging from how firms design programs to how quickly the organization respond to market changes (Kimbrough and Componation, 2009). According to Bruno and De-Sousa (2009), the term organisational culture can be traced to Hofstede cross-cultural study. Hofstede examined the results of a worldwide survey of employees' values and norms conducted by the IBM Computer Hardware Company in the 1970s. The study examined the effect of cross-culture on the effectiveness of management process and techniques in organisations. Since then some authors have attempted to examine the influence of organisational culture on the success of business firms. In fact, culture is a component that hold an organisation, strengthen the relationship among its units; and reflect the norms that spur the stability and future success of firms (Cameron and Quinn, 2011). Similarly, a study in the context of Thailand, proposed a conceptual model that basically examined the effects of organizational culture and ERM on the organisational performance (Thomya and Saenchaiyathorn, 2015). It is important for managers to consider the culture of their organisations for them to understand the dynamics and the efficiency

of ERM practices. Organisation that lacks high culture may find itself operating against its policies (IRM, 2012).

Thus, risk culture provides an opportunity for an enterprise to maintain a competitive advantage, and by extension higher performance (Drew, 2007). Ernst and Young (2014) believed that most of the challenges that continue to plague the financial industry globally are in a way related to culture. Despite the claim that culture is relevant to the organisational success, some studies have a different view concerning the role of culture in organisations. Davidson (2003) explored the relationship between the corporate culture and financial performance of a South African investment bank. The study did not find a significant association between organizational culture and firm performance. Similarly, De Caluwé and Van (2013) opined that corporate culture has no significant effect on performance. However, Kleffner et al. (2003) have argued that organizational culture may serve as an obstacle to ERM implementation. Particularly to organisations that resist change. This study makes the following proposition:

Proposition 2: There is positive relationship between risk culture and firms' performance.

### 2.3. Risk Management Information System

The importance of information in the management of risks cannot be overemphasized. Finance sector globally has been committing an enormous amount of resources in recent times to develop their information management systems. Technology is becoming affordable, making it easier for firms to assemble risk information data bank (Gibson, 1998). For example, in 2010, US businesses spent over \$562 billion on information systems hardware, software, and telecommunications equipment (Mohammad, 2014). Gibson (1998) opined that firms operations are likely to improve with technology in place. The central issue regarding risk management information is to reduce the information gap between managers and employees so that information could be readily available for effective risk management decisions (Kornkaew, 2012). The risk management information system improves capital allocation decisions, create market discipline and reduces the cost of getting information; thereby reducing asymmetric information between insiders and outsiders (Gibson, 1998). Integration of risk management information system with ERM activity would improve firm performance (Arnold et al., 2014). Hashim et al. (2012) reported a significant positive relationship between the information management system and the efficiency of the organisation in Pakistan. Al-Gharaibeh and Malkawi (2013) examined the effects of management information systems (MIS) on the performance of governmental organizations in Jordan. The study established that the information management system has a significant impact on firm performance. Altaany (2013) used a sample of 100 staff members to examine the influence of the information management system on performance. The study revealed that management information has positive effects on the performance of municipalities in northern Jordan. Given the fact that information system either directly or indirectly influences firm performance, it is possible that it will further strengthen the



efficiency and effectiveness of the risk management programme of an organisation. This study makes the following proposition:

Proposition 3: There is positive relationship between risk management information systems and firms' performance.

#### 2.4. Risk Knowledge Sharing

The study of knowledge sharing, which is the means by which an organization have access to new knowledge has become topical in management literature. Knowledge sharing is a process designed to influence the exchange of knowledge within societies or organisations so as to improve their competitive advantage, intelligence and intellectual wealth (Rodriguez and Edwards, 2009). Improvement in knowledge sharing increases the organisational abilities to manage fortuities. Dickinson (2001) asserted that knowledge plays a role in reducing uncertainties and contributing effectively to formulating sound business strategies and underwriting processes. As such, for organisations to effectively manage risks, risk knowledge sharing as a knowledge management strategy is crucial to organisational success (Anthropopoulou, 2005). In support of this view, Rodriguez and Edwards (2008) saw ERM as a process that rely on the application of specific knowledge in an attempt to control possible deviations from strategic objectives, shareholders' values and stakeholders' relationships.

Risk knowledge dissemination typically increases the visibility of education to enhancing risk management capabilities; so that operating efficiency of firms can improve (Bayer and Maier, 2007; Horton-Bentley, 2006). For the knowledge to influence firms' performance, it must be shared among employees. Hampton (2006) asserted that for organisations to succeed in its risk management initiative, it needs to focus on skills and knowledge sharing. This study makes the following proposition:

Proposition 4: There is positive relationship between risk knowledge sharing and firms' performance.

#### 2.5. Staff Competence

Globally business firms are facing increasing stress as a result of intensive competition, rising customer demands and technological advancement (Eicker et al., 2008). Thus, for companies to build a strategic advantage, they have to concentrate on staff competencies, which are significantly influenced by the skills and the knowledge of the employees (Eicker et al., 2008). Competence increases through the experience gathered from work, and the determination of workers to achieve organisational objectives. In their study, Dooley and Fryxell (1999) reported that the competence of a team member has significant positive effect on team decisions commitment. Sweeting (2011) asserted that for risk management to be effective in organisations staff needs to be sufficiently qualified to carry out certain important risk management tasks. As such for business firms to remain competitive in the presence of global challenges, staff competence is a critical success factor that requires the attention of the management (Sweeting, 2011). Corporations are required to pay more attention to developing employee capability to acclimatize to a rapidly changing and highly turbulent environment (Hase, 2000). For a business firm

to continuously advance and gain competitive advantage, staff competence is indispensable (Chich-Jen and Wang, 2010). To underpin the importance of competence to firm's survival, Risk and Insurance Management Society (2007) reported that risk managers need to know the dynamics and operational capability of their staff. Hence, they proposed a model that consists of three skill sets that include competency skills, technical skills and conceptual skills. These three skills play a significant role in the practical implementation of the ERM programme in organisations. Hence, the study proposes the following hypothesis:

Proposition 5: There is positive relationship between staff competence and firms' performance.

#### 2.6. Organizational Innovativeness

For a company to achieve a milestone in its risk management initiative, it requires new ideas and subscribe to the best ways of doing things (Hyrsky and Tuunanen, 1999). Organisational innovativeness refers to the degree to which a business firm develops and launches new ideas faster than its competitor (Hurley and Hult, 1998; Wang et al., 2004). Weerawardena and O'Cass (2004) defined innovativeness as the use of ideas that are new to the firm to increase the value of the firm either directly or indirectly. The value could be entrenched either in the products, processes, work organization, management or marketing systems. Dugguh and Diggi (2015) argued that innovative management may enhance the management risk management capability.

Again, studies have discovered that the most innovative organisations are those that can genuinely deal with risk, in the long run. The essence of risk management is to seek out significant uncertainties and address them proactively (Hillson, 2009). Sulyanto and Rahab (2012) formulated a structural analysis to demonstrate the influence of innovativeness as a success factor to performance in technology-intensive organisations. The results of the study indicated that innovativeness has a significant effect on performance. Consistent with this, Mbizi et al. (2013) examined the relationship between innovativeness and the sustainability of small and medium enterprises in the manufacturing sector. The findings of their study indicated that innovativeness is one primary attribute that aid firms to remain competitive. A recent research effort in the Thailand context (Zumitzavan and Udchachone, 2014) examined the relationship between styles, organizational innovation, and firm performance. The findings indicated that innovativeness has a significant effect on firm performance. Based on these positive outcomes, it is suggested that organizational innovativeness is expected to improve ERM processes and impact positively on firm performance. Hence, the study proposes the following hypothesis:

Proposition 6: There is positive relationship between organisational innovativeness and firms' performance.

#### 2.7. Leadership Role

Effective leadership has been adjudged as a critical factor for firms' survival. It enables companies to achieve their missions. They set the conditions for followers to carry out their duties effectively (Niskanen, 2015). Burns (1978) defined leadership as

a process through which a person persuades other individuals to act according to values and beliefs. Thus, a leader is somebody who has the authority to change the mind of other individuals and get them aligned with the goals of groups, societies or companies (Kreiner and Kinicki, 2008). Leadership relates to a process through which employees that are in a position of authority influences the behaviour of other personnel to achieve a predefined set of objectives (Morsing and Oswald, 2009). Support from the top leadership is helpful to get the proper motivation, resources and devotion for ERM adoption in organisations (Frigo and Anderson, 2011). In fact, advocates of the comprehensive risk management systems concurred that firms need effective leadership to ensure the success of ERM. Also, to protect the business operating efficiency, Kleffner et al. (2003) argued that the effective board leadership have the primary obligation to initiate ERM programme. Payne (2010) asserted that strong commitment from the board of directors and the top management is key to the efficient operation of ERM. In a Malaysian context study, Manab and Kassim (2012) reported that adequate leadership factor strengthened the relationship between ERM adoption and the success of ERM practices. In fact, the ISO 31000 (2009) asserted that risk management requires strong leadership commitment for it to be effective. In support of this, Hohan et al. (2015) stressed the importance of leadership in establishing an integrated management system in the organisation. Hence, the study proposes the following hypothesis:

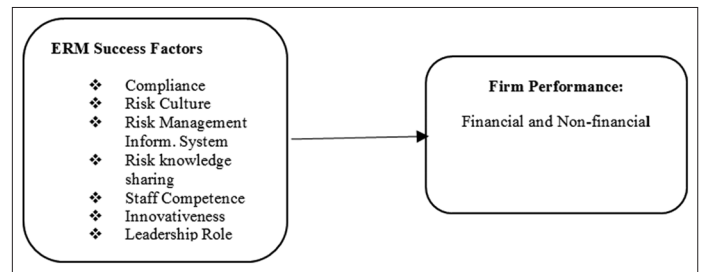
Proposition 7: There is positive relationship between factor leadership related to the firms' performance.

### 3. FIRM PERFORMANCE

Performance is one of the major indicators that explain the level of development of any society. Recently, the challenges of the global business environment have re-echoed the need for corporate organisations to have more concerns about the success of business firms. Firm performance is one of the most important variables that attracted the attention of researchers in both finance and management literature (Gavrea et al., 2011). Firm performance is a concept that explains the extent to which an organization achieves objectives. It indicates how organisations have been peering overtime (Saeidi et al., 2014). Firm performance is an indicator that helps to evaluate and measure how an organization succeeds in realizing business objectives to all its stakeholders (Antony and Bhattacharyya, 2010). Firm performance refers to firms' ability to achieve its goal through the application of available resources in an efficient and effective manner (Asat et al., 2015).

Some studies have used different types of performance indicators to measure firm performance. For example, Murphy et al. (1996) identified 71 performance parameters that have been used by researchers to measure both financial and non-financial performance. In most situations, researchers use financial measures to explain firm performance. For instance, measures such as return on investment, return on sale and return on equity are some of the commonly used parameters to measure performance (Saeidi et al., 2014). Thus, for a more comprehensive assessment, organisations have resorted to the utilization of both financial and non-financial performance measures. For example, Judge et al. (2003) have

Figure 1: Research framework



used both financial and non-financial indicators such as process improvements, customer satisfaction, capacity utilization and product service quality to measure firm performance. A study conducted by Hakkak and Ghodsi (2015) revealed that implementation of nonfinancial performance measures have a significant positive effect on firms' competitive advantage and sustainability.

Moreover, researchers have opined that the current emphasis on traditional performance measures such as return on investment or net earnings diverts firm's attention from non-financial factors such as customer satisfaction, product quality, productivity and business efficiency (Hussain and Hoque, 2002). There is a perception that non-financial measures are better forecasters of a long run firm's performance, as well the business leaders to monitor and assess their company's efficiently (Hussain and Hoque, 2002; Kaplan and Norton, 1996). Even though nonfinancial performance metrics may have lower measurement accuracy, but they focus on components that directly relates to operations that are within the control of the management (Chow and Van Der Stede, 2006). Recent scandals had revealed situations where firms engaged in unethical accounting strategies to omit relevant information about firms' financial data (Cohen et al., 2012). These and several other reasons have justified the need for organisations to emphasize firm performance (i.e., both financial and non-financial) (Figure 1).

### 4. CONCLUSION

This paper put forward a conceptual framework in respect of an ongoing research effort to investigate the influence of ERM success factors on the performance of financial institutions in Nigeria as illustrated in the above shown framework. The proposed model will have some implications. First, validating the model will make business leaders to appreciate the impact of implementing holistic risk management approach in organizations. It will further allow firms to appreciate and identify the strategic factors that will enable efficient implementation of ERM in the context of Nigeria. Finally, the findings of this research will provide a substantial contribution to ERM literature, business leaders, and regulatory agencies.

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