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Enterprise Risk Management: Review, Critique, and Research Directions

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Many regulators, rating agencies, executives and academics have advocated a new approach to risk management: Enterprise Risk Management (ERM). ERM proposes the integrated management of all the risks an organization faces, which inherently requires alignment of risk management with corporate governance and strategy. Academic research on ERM is still in its infancy, with articles largely in accounting and finance journals but rarely in management journals. We argue that ERM offers an important new research domain for management scholars. A critical review of ERM research allows us to identify limitations and gaps that management scholars are best equipped to address. This paper not only identifies how management scholars can contribute to ERM research, but also points out why ERM research (and practice) needs management research for its development.

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Introduction

Enterprise Risk Management (ERM) proposes that firms address all their risks comprehensively and coherently, instead of managing them individually. Harvard Business Review listed ERM as one of their "Breakthrough Ideas for 2004" (Buchanan, 2004). Rating agencies, professional associations, legislative bodies, regulators, stock exchanges, international standards organizations and consultants have vigorously urged firms to adopt ERM (Arena et al., 2010). Heeding such calls, leading financial services firms were some of the early adopters of ERM. Yet, the difficulties experienced by some of those firms during the 2008 financial crisis have cast doubt upon the efficacy of ERM. For example, Countrywide Mortgage, praised in 2007 by the Institute of Internal Auditors as an exemplar of ERM, faced bankruptcy in 2008.

While many ERM articles have appeared in the business press, academic research on ERM is still in its infancy. Moreover, such academic research has appeared largely in accounting and finance journals and rarely in management journals. The research in finance and accounting emphasizes tools that apply only to risks with well-defined statistical properties. Moreover, the tools offered in finance and accounting research are often mathematically complex, too obscure for most managers, and have limited application outside finance. With the exception of Miller (1992; 1998) and Miller and Waller (2003), an integrated approach to risk management by management scholars has been rare. Further, regrettably, the evolving discussion about ERM has not been informed by relevant work in management on risk, strategy management, organizational change and other relevant topics.

Practitioners recognize the lack of good information on the management of ERM. Fraser et al. (2010, pp. 399–401) survey of risk managers found:

> "… virtually all literature is silent on how to deal with the myriad cultural, logistical, historical challenges that exist and are unique to all organizations… Many of the articles describe what the process should look like and how it should function, but there are few that provide details of how to get to that step. Many of the articles use great overarching statements that seem very much like motherhood statements. There was a distinct lack of information on how to bring all the silos together… The impact of corporate culture on ERM implementation and practices is not well addressed in the literature."

These omissions, combined with the fragmentation of ERM research and the failures of high profile ERM adopters during the 2008 financial crisis, motivate this paper. The paper addresses two questions. To cut through the conflicting discussions

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Table 1
ERM definitions and descriptions from academic journals

Dickinson (2001)	ERM is a systematic and integrated approach of the management of the total risks a company faces.
D'Arcy and Brogan (2001) Casualty Actuary Society	ERM is the process by which organizations in all industries assess, control, exploit, finance and monitor risks from all sources for the purpose of increasing the organization's short and long term value to its stakeholders.
Harrington et al., 2002	ERM is the idea that emerged in the late 1990s that a firm should identify and (when possible) measure all of its risk exposures — including operational and competitive risks — and manage them within a single unified framework in contrast to the silo approach to risk management.
Meulbroek (2002a)	Integrated risk management is the identification and assessment of the collective risks that affect firm value, and the implementation of a firm-wide strategy to manage those risks.
Barton et al., 2002	Enterprise-wide risk management shifts risk management from a fragmented, ad hoc, narrow approach to an integrated, continuous, and broadly focused approach.
Verbrugge et al. (2003)	ERM is corporate-wide, as opposed to departmentalized, efforts to manage all the firm's risks — in fact, its total liability structure — in a way that helps management to carry out its goal of maximizing the value of the firm's assets. It amounts to a highly coordinated attempt to use the right-hand side of the balance sheet to support the left-hand side — which, as finance theory tells us, is where most of the value is created.
Liebenberg and Hoyt (2003)	Unlike the traditional "silo-based" approach to corporate risk management, ERM enables firms to benefit from an integrated approach to managing risk that shifts the focus of the risk management function from primarily defensive to increasingly offensive and strategic. ERM enables firms to manage a wide array of risks in an integrated, holistic fashion.
Kleffner et al., 2003	In contrast to the traditional "silo" based approach to managing risk, the ERM approach requires a company-wide approach to be taken in identifying, assessing, and managing risk.
Miller and Waller (2003)	Integrated risk management is consideration of the full range of uncertain contingencies affecting business performance.
Sobel and Reding (2004)	ERM is a structured and disciplined approach to help management understand and manage uncertainties and encompasses all business risks using an integrated and holistic approach.

about ERM, and to clarify the scope and meaning of ERM, we start with a basic question: "What is ERM?" To answer this question comprehensively and accurately, we review extant ERM research to identify ways researchers and practitioners define and operationalize ERM.

This review provides the foundation for our second question: "How can management research inform ERM theory and practice?" To answer this question, we draw from the extensive micro/macro management research on risk, agency, strategy, decision making and organizations. The paper identifies areas where management research can contribute to the development of ERM research and practice.

What is ERM?

Authors and regulators disagree on exactly what constitutes ERM. As evidence of this disagreement, Tables 1 and 2 provide definitions and descriptions of ERM from various sources. One of the larger distinctions is between those who see risk as largely defined independently of firm objectives (e.g., Miccolis, 2000; AS/NZS, 1995; S&P, 2008), and those who explicitly defined risk in terms of achievement of organizational objectives (e.g., IIA, 2001; COSO, 2004). Another major distinction is between those who see risk as largely a problem to be mitigated (e.g., S&P, 2008; RIMS, 2011), and those who see risk as a potential source of value creation (e.g., Tillinghast-Towers Perrin, 2001; CAS, 2003a). Addressing the variety of definitions and implementations of ERM, Power (2007) urged caution, asserting that ERM is an "umbrella concept" and managers should not "… assume that ERM refers unequivocally to a coherent set of practices." As regulators pressure firms to integrate risk management into corporate governance, new risk categories and definitions have been created, leading to the "risk management of everything" (Power, 2004), which Power (Power, 2009) ultimately concluded had resulted in the "risk management of nothing."

ERM research: conceptual roots

To understand the ambiguity surrounding ERM's objectives and implementation, we begin with a review of the history of ERM in the practitioner and academic literature. Historically, firms have managed different kinds of risk separately. This fragmentation of risk management occurred because different functions within a corporation handled different parts of risk management. For example, finance often addressed risks associated with currency or interest rate variations, insurance handled natural catastrophes and liability, and operations managed quality and safety risks. In such an environment, each function developed tools and practices largely independent of others.

Beginning with Kloman's (1976), "The Risk Management Revolution," many practitioners have advocated a coordinated approach to risk management. Kloman (1992) described concepts coming out of Europe from the mid-70s to the early 80s that we now associate with ERM. For example, Gustav Hamilton, a risk manager in Sweden, argued for "a new and collective view of risks" (Kloman, 1992). Orio Giarina at the University of Geneva proposed that risk management should reinforce strategic capability. Crockford (1980) argued for multidisciplinary risk management rather than risk management siloed and "fragmented among a number of sects." Bannister and Bawcutt (1981) proposed that risk management

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