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The Impact of Total Risk Management on Company's Performance

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Abstract

Traditionally risk management used to be considered as a means to alleviate perhaps eliminate negative outcomes of exposures. However, the result of this and other empirical studies shows the ability of risk management to go beyond this and respond to market factors which are out of management control in order to control volatilities in earning which ultimately improve corporate performance. The empirical study investigates the relationship between total risk management and company's performance. The result reviled that there is a positive relationship between total risk management and company's performance in companies which have invested higher level of intellectual capital. The result of the empirical study is consistent with other studies in different economic phenomenon.
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1. Introduction

The current globalization and complex business environment leads many business to think beyond just profitability only. The domino effect of world incidences lead the future to be more dynamics and unpredictable than it was before. Factors such as perpetual perplexity and dynamics in social, political and economic environment (Luo, 1999), strong competition (White and Frame, 2004), rapid technological advancements (Baldwin and Li, 2002), and methodological changes in the value chain are among other issues urging for companies to establish strong risk management system.

The collapse of big and trust worthy public companies such as Enron and Lehman brother bank due to accounting fraud and the expansions of systematic corporate scandals were not only a shock for investors, professionals and even academicians but also creates doubt on the traditional Risk management and Internal control mechanisms.

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Risk management is a process by which firms identify measure, prioritize and mitigate the adverse effect of uncertainties (Chapman and Ward, 1997). Accordingly, risk management is a systematic approach to alleviate negative consequence of any specific phenomenon. The approach that defines risk from only down perspective could leads to risk aversion.

Risk aversion can be an individualistic behavior but in business it is impossible to avoid all kinds of risk. Most risk taking activities associated with opportunities. Hence, companies need to be intelligent enough in managing their risks not only to grasp the benefit out of it but also to survive in business.

Risk management has strong inspirational effect on the major shareholders to invest more on the organization. This investment is a weapon for the company to provide better business opportunities which ultimately leads to long lasting competitive advantage. Ineffective risk management results in extra costs and costly lower tail outcomes on both the company and stockholders (Andersen, 2008).

Traditionally risk management had two broad concepts. Risk management is the management of adverse effect of risk rather than the opportunities associated with it. The other view is independent management of risks by classifying risk in to different silos (Lam, 2001 and Davenport & Bradley, 2001). For example the occurrence of one event can have a negative impact on one unit of the entity, but also be an opportunity for another unit of the organization. Traditional risk management however, manages the treat without considering the offsetting effect of the opportunity.

To the contrary to traditional risk management total risk management deals with both potential down turns and exploitation of opportunities due to dynamic phenomena (Miller and Waller, 2003). Hence, in this sense it is possible to define risk management as a systematic and practical method that attempts to holistically understand, measure, evaluate and manage entire risks faced by the company.

Though the topic of risk management is an important issue among higher level corporate executives; due to conceptual complexity of risk management, the area has not been explored enough. There are very few empirical studies that have studied the relationship of company performance and total risk management risk management, mostly depending on companies listed on very advanced and highly developed stock markets (Jafari et al, 2011).

On the other hand most articles on the area of risk management focus on measuring the effectiveness of different risk management systems by only examining risk management effectiveness in protecting down turn (Andersen, 2008). This might lead to see risk management as an end by itself, rather than taking it as a means for higher corporate performance. Therefore, this empirical study attempts to contribute in the literature by taking different economic climate which has not been tested.

1.1. Risk management concept

In recent decades the dynamicity and complexity of business environment put up the risk management issue to be the major concern of stakeholders. Risk management is the fastest growing discipline. However, the concept and concern of risk management, the practical and functional behavior of risk management and the major purpose of it, differ based on different perspectives. The concept of risk management in business and considering it as a strategic issue emerged in 19th century (Bernstein, 1996). Firm's ability to manage risk, identifying risks which are to be assumed or to be mitigated and making calculated and concrete decisions in this regard, lift up not only the strength of the firm but also the entire economic system of the country. Risk management is an effective method, applied in order to alleviate unwanted effects of exposures and earn optimum benefit from risky situations (Essinger and Rosen, 1991).

Effective Risk management aimed at providing reasonable assurance as to the achievement of company's objectives and helps the company in achieving its financial targets. Effective risk management continuously assesses and identifies risks and reduces surprises that affect the organization. So that, effective and integrated risk management is part and parcel of good organizational governance (Pezier, 2002). On the other hand risk management activity includes providing executives and personnel at different levels of the organization with continuous, relevant and reliable information, and designing practical frameworks and systems to establish the risk management decisions on solid ground. However, the aim of risk management is not limited only to minimizing risks and risky situations. Rather, having the fact in mind that business is always associated with exposures, the aim of effective risk management is also to maintain balance between risk and return. This enables the risk management process to be both defensive

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