Enterprise Risk Management (ERM) Practices Among SMEs in Malaysia: A Conceptual Framework

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Abstract

In developing countries, SMEs represents more than 90% of all firms and such firms contribute significantly to GDP. Similarly, SMEs in Malaysia also contribute significantly to the economic development especially in creating new job opportunities. SMEs involvements in business expose themselves to risks. Hence, SMEs need risk management. The concept of risk management evolves over the years and now being referred as Enterprise Risk Management (ERM). ERM can be defined as an integrated approach of mitigating risk. ERM involves aligning firm’s risk to achieve business objectives and attain competitive advantage. A review of current literature showed that the practice of ERM would benefit business enterprises. However studies that have been conducted to examine ERM adoption among SMEs are still lacking. Furthermore, SMEs involvement in risk management is not encouraging. Although ERM is known as a tool to increase shareholders’ value, still not many firms have adopted this new tool to manage risks. Thus, the main objective of this paper is to propose a conceptual framework using Thong’s DTOE Model (1999) in the context of ERM practices among Malaysian SMEs. The framework consist of four (4) variables namely decision makers, technology, organization and environment. From the review of various literatures, the four variables proposed do supported by many researches but yet still can be explore to enhance SMEs performance in Malaysia.

Keywords: Enterprise Risk Management (ERM); ERM effects; ERM adoption; ERM practices; Malaysian SMEs

1. Introduction

Small and Medium Enterprises (SMEs) play a vital role in most countries especially developing countries. According to Malaysia Economic Census 2011, although SMEs accounting for 97.3 percent of total business in Malaysia, the share of SMEs to gross output was only 28.5 percent. However, SMEs contribute significantly to employment sectors. They represent 3.7 million out of 7.0 million workers or 52.7 percent of total employment (J. P. Malaysia 2011).

According to Malaysia Economic Census 2011, Profile of Small & Medium Enterprises, the definition of SMEs in Malaysia generally are: i) manufacturing sectors with turnover of less than RM 25 million or full-time of employees less than 150; and ii) services and other sectors with sales turnover of less than RM 5 million or full-time employees less than 50.

SMEs need to compete and overcome stiff competition from larger counterparts. Usually SMEs lack of qualified and skilled workforce and limited capital. Hence, exposing themselves to various types of risk such as strategic, turnover of staff and reputation. Therefore in order to manage risks, Enterprise Risk Management (ERM) could be a solution to SMEs. Given the size and managerial structure of SMEs, the process of establishing and using ERM is relatively simple given the close relationship between owners, managers and operators of the enterprise (Yolande Smit 2012).

The main objective of this paper is to propose a conceptual framework on the determinants of ERM practices in SMEs using Thong’s DTOE Model (1999). This theory
was extended from Tornatzky and Fleischer’s TOE theory (1990) where Thong argued that SME have highly centralized structured, and the CEOs or owner-managers make most of critical decisions. As such, Thong (1999) conceptualized and verified the importance of a fourth dimensions (besides technological, organizational, environmental) which has been classified as CEO’s characteristics or decision makers (D) (Wan Nur Syahida and Azwadi 2013).

2. Problem Statement

In Malaysia, ERM practices still at early stages. The research on risk management in small business also is limited. They tend to put this matter aside even though the real problem such as fraud does exist in the Malaysian business environment (Shanmugam et al. 2012). However the importance of risk management is well recognized among the European SMEs. The current financial crisis has highlighted the need for improved risk management procedures for SMEs from emerging economies (Anton 2011). Although, enterprise-wide risk management (EWRM) concept is still new in many parts of Asia, there are positive indications that EWRM is beginning to receive attention (Manab, Kassim, and Hussin, n.d.). In Malaysia context, the Malaysian Code of Corporate Governance 2012 requires the board of private listed company in Bursa Malaysia to identify principle risks and ensuring the implementation of appropriate internal control and mitigation measures (S. C. Malaysia 2012). These indicate that risk management is become more acceptable in Malaysia business environment.

The vulnerability in global financial market, global political instability, rising cost of energy and frequent global natural disaster seem to become the greatest challenges that would directly affect the future direction and growth of SMEs. Only SMEs that are able to operate within the resent context of uncertainty and possess the competitive edge with a high degree of resiliency are the likely to propel the economy towards achieving the national aspiration to be a developed status nation by 2020 (M. Said, 2012). Hence, it is important to study ERM in the context of SMEs in order to understand the practice of ERM.

3. Literature Review

In the literature the name ERM is sometimes replaced by synonyms like Enterprise-Wide Risk Management, Holistic Risk Management, Integrated Risk Management and Strategic Risk Management. Enterprise Risk Management (ERM) has emerged as a new risk management technique aimed at managing the portfolio of risks facing an organization in an integrated, enterprise-wide manner. Unlike traditional risk management, where individual risk categories are managed from a silo-based perspective, ERM involves a holistic view of risks allowing business to take into account correlations across all risk classes (Monda and Giorgino 2013)

ERM can be defined as a systematically integrated and discipline approach in managing risks within organizations to ensure firms achieves their objective which is to maximize and create value for their stakeholder (Razali and Tahir; 2011). Many organization are implementing ERM process to increase the effectiveness of their risk management activities, with the ultimate goal of increasing stakeholder value (Beasley, Clune, and Hermanson 2005)

3.1 Relation of decision maker in adopting ERM towards performance of SMEs

Commitment of decision maker towards implementation of SMEs is crucial. At the level of SMEs, decision maker will be the owner of the firm. Although some firm will establish a risk management team, the mandate from the top management is needed to make sure the organizational goal is achieved (Burnaby and Hass 2009). Within the limits
of the risk owner's accountability, the risk owner decides either to accept the risk as is or to take further steps to mitigate it. If the risk owner accepts the risks as is, the risk is monitored and reviewed in the normal future course of risk management processes. If the risk owner decides to mitigate the risk, the process of risk mitigation is defined (Aabo et al. 2001). Furthermore, strategic risk management enables SME owner-managers to objectively evaluate their actions (Yolande Smit 2012). Committee for Sponsoring Organization of the Treadway Commission (COSO) notes that value is created and performance is enhanced by management decision. Examples of the decisions made by management include considering the risk appetite, setting objectives, identifying risks, identifying risk responses, considering risk alternatives, and assessing capital needs for the risks (Gates, Nicolas, and Walker 2012).

3.2 Relation of technology in adopting ERM towards performance of SMEs

Technology provides relative advantages to SMEs. Nowadays one of the important technologies that possess by business owner is information communication technology (ICT). The use of ICT has grown and changed with increasing rapidity, its adoption can be related to not only multinational corporation but also SMEs (Maguire, Koh, and Magrys 2007).

In ERM, information and database of risks is important and part of the need to top management makes sound decision associated with risks. For an inventory of risks to be useful, the information possessed by people within the organization must be collected, made comparable, and continuously updated. Organizations that have grown through acquisitions or without centralized IT departments typically face the problem of incompatible computer systems. Companies must be able to aggregate common risk across all of their businesses to analyze and manage those risks effectively (W.Nocco and M. Stulz 2006). The complexity of technology also keeps changing. Technology change leads to the introduction of new products, changes in methods and organization of production, changes in the quality of resources and products, new ways of distributing the products and new way of storing and disseminating information.

Technology has a very big impact upon the world of small business in all of these areas and has an important effect on the level and type of investment that takes place in an economy and therefore the economic growth (Philip 2011).

3.3 Relation of organization in adopting ERM towards performance of SMEs

Organizational readiness is a requisite to make sure ERM can be implemented and practices efficiently. As an organization’s size increases, the scope of events threatening it is likely to differ in nature, timing, and extent. In addition to having a greater need for more effective enterprise-wide risk management techniques, larger entities may have greater ability to implement ERM due to greater resources (Beasley, Clune, and Hermanson 2005). Employees’ knowledge of ERM is important as they are part of the organizations. As one of distinctive features of ERM is its integrated approach, adequate organization choices are fundamental to spread the risk culture, to gain commitment to the program from the personnel, and to guarantee that the ERM process is effected in the correct way and policies and procedures are respected (Monda and Giorgino 2013).

3.4 Relation of environment in adopting ERM towards performance of SMEs

Uncertainty about environmental and organizational variables reduces the predictability of corporate performance, that is, increases risk. The general environmental uncertainties correspond to factors that affect the business context across industries. General environment uncertainties include political instability, government policy instability, macroeconomic uncertainties, social uncertainties, and natural uncertainties (Miller 2013). The environment is what gives SMEs their means of survival; satisfied
customers are what keep an organization in business. However the environment is also the resource of threat. For example hostile shifts in market demand, new regulatory requirements, revolutionary technologies or the entry of new competitors (Philip 2011).

4. Conceptual Framework

Enterprise risk management practices among SMEs in Malaysia can be seen through the adoption and extended use of ERM in the organizations. From the review of literature, a conceptual framework using Thong’s DTOE model will explain clear determining factors of ERM adoption by SMEs.

![Figure 1: Framework of adopters of ERM in SMEs](image)

5. Conclusions

Previous literatures discussed ERM and SMEs but yet there is no further study being proposed especially ERM practices among SMEs in the Malaysian context. From the review of literature, a conceptual framework proposed shows the relationship between decision maker, technological, organization and environment towards ERM adoption by SMEs that lead to better performance. This study is very significant in enhancing understanding of ERM adoptions among SMEs Malaysia.

6. References


