The Risk Management in Financing Decisions in Corporate Governance

Adrian-Cosmin Caraiman
West University of Timisoara, Timisoara, Romania
adrian_caraiman@yahoo.com

Abstract

In corporate governance, in any entity, risk management is necessary because both in the company and in the environment in which it operates, there are uncertainties about the nature of threats in achieving objectives, or the nature of opportunities. Any manager must ask himself the problem of managing threats, because otherwise, failing to achieve his goals, he would be disqualified, or to take advantage of opportunities for the benefit of the organization, proving his efficiency. If uncertainty is an everyday reality, then the reaction to uncertainty must also become a permanent concern.

Over time, risk management should be incorporated into the organization's operations and procedures and become a component of its culture but also its decision-making processes and structures, with substantial possibilities for performance monitoring.

In this article I will analyze the conceptual framework on risk management in financing decisions in corporate governance.

Key words: risk, risk management, corporate governance, organization, uncertainties.
J.E.L. classification: G30, M40, M41, M42.

1. Introduction

Before facing the issue of financial risks (currency, interest rate, systematic risk), an entity in general, but especially in corporate governance, in my opinion, must manage with priority the risks of an economic nature, which are more evident and more stringent: the evolution of demand for own goods or services, modification of consumer preferences and increased market competition, price dynamics for raw materials and finished products, lack of qualified personnel, etc. Once a mechanism for the management of these economic risks is implemented, attention can also be pointed on financial risks, less visible and often less aware.

2. Literature review

The risk-based decision has always been important in business. Enterprise risk management is the latest approach to risk management faced by an organization from the view of a system (Wu et. al., 2015), probably becoming the main objective of the strategic management of organizations, mainly due to multiple factors - the aversion of representative personnel to uncertainty, the volatility of the current market and the mandates of compliance, as the authors said Arnold et. al. (2015).

The risk management of an organization is to define the risk, identification and assessment of the impact and likelihood of materialization and subsequently laying down appropriate ways of managing significant risks (Ghiţă, 2008, p.239)

As the author said, the risk management of an organization is among new arrived in the context of the concept of corporate governance, which brings a holistic perspective, as the integral factor of the parts of a whole, which is the organization. So was Oliva (2016) mentioning, that the enterprises risk management was a recurring theme on the organizations daily issues and as Fraser and Simkins (2016) said, was generally recognized as an expectation of good management and good corporate governance. Moreover, as the authors of Bromiley et al. (2015) said, risk management suggests integrated management of all the risks faced by an organization and which inherently require alignment of risk management with corporate governance and strategy, which can lead, as the authors claim, to the conclusion that a critical review of risk management research allows us to identify certain limitations and shortcomings that management specialists are more entitled to solve them.

3. Research methodology

In corporate governance, in any entity, risk management is necessary because both in the company and in the environment in which it acts, there are uncertainties of the nature of threats in achieving objectives, or the nature of opportunities.

Any manager must question, on the one hand, to manage threats, because otherwise by not achieving his goals, would disqualify, or, on the other hand, to capitalise on opportunities for the benefit of the organization, proving his efficiency. If uncertainty is a daily reality, then the reaction to uncertainty must also become a permanent concern.

My work presents a positive and at the same time constructive view on risk management in corporate governance. To achieve the purpose and objectives of the research we have proposed a descriptive research of the concepts in the specific literature.

Through qualitative research, we analyzed the conceptual framework on risk management in financing decisions in corporate governance. Thus, I will not neglect the method of observation, which will gradually emerge as the main method used to collect data and will include both passive observations, namely spontaneous observations, made by chance, and provoked observations, necessary to verify an idea.

In order to carry out research on risk management in financing decisions in corporate governance, I propose to consider both the theoretical and the applied component using:

-methods of research (collection, processing and interpretation of data),

-research techniques (bibliographical selection, data synthesizing study),

-research processes (reading, gathering, building and synthesizing data).

4. Findings

In other terms, considering financing decisions and risk management in corporate governance, the structure of risk and profitability examples in financial literature underlines that, in the case of any investment, the expected profitability will depend mainly on the degree of undiversified risk associated with getting underlying asset. However, it is necessary to clarify that the market, through investors, will not remunerate all the risks assumed by an entity but only those that cannot be eliminated by prevention or primary techniques, as Zoicaş-Ienciu said (2013, p.192) it goes without saying that investors will not encourage by financial support unforeseen entities or those that completely ignore the risks, putting in their decisions the emphasis on intuition, luck or resolutions at the right time. But, however, if desired, the entities are free to speculate on price, currency or interest rate developments. Moreover, there are many cases where such entities record a profitability above average but both theory and corporate experience have shown that this excess of profitability cannot be achieved consistently, being only the effect of the moment.

Furthermore, as the author also said, the voluntary assumption of risks that could otherwise be covered and avoided, will lead sooner or later to substantial losses, able to completely cancel any extra-profits.

In general, we can say that uncertainty and risk are part of the activity of any entity; but over time, performance, dynamic, or even survival differentiations at entity level come from the way the risk is managed. Before facing the issue of financial risks (currency, interest rate, systematic risk), an entity in general, but especially in corporate governance, in our opinion, must manage with priority the risks of an economic nature, which are more evident and more stringent: the evolution of demand for own goods or services, modification of consumer preferences and increased market competition, price dynamics for raw materials and finished products, lack of qualified personnel, etc. Once a mechanism for the management of these economic risks is implemented, attention can also be pointed on financial risks, less visible and often less aware.

In this respect, one of the most valuable contributions that financial management in an entity can have is to promote preventive behaviour; the usefulness of such an attitude becomes evident whenever there is a question of making an important decision. In such situations, nothing can substitute a competent analysis of potential risks resulting from the decision or finding preventive solutions before a direct confrontation with the damage. On the other hand, exposures to systemic risks cannot be prevented, in their case requiring the use of transfer techniques (insurance) or some coverage.

As a rule, financial risks are generated with the conduct of various transactions involving specific flows: acquisitions of immobilized assets in investments, bond issuance, bank loan contractions, commercial credit, export-import operations, mergers and acquisitions, etc. In most situations, the factors leading to the manifestation of financial risks come from the macroeconomic sphere: the sequence of economic cycle phases, monetary policy, fiscal policy, market developments, currency markets, social and political dissension, military conflicts, natural disasters, etc. Therefore, many of the generator factors are not under the control of entity management.

Thus, from a political perspective, on the factors that cause risk-like manifestation in general, and by referring to mitigating these risks, investigating risk mitigation strategies for multinational companies in emerging markets, Zhu&Sardana (2020), based on the institutional perspectives and theoretical concept of March's to form a 'political coalition', the authors point out that risk mitigation at multinational companies cannot be limited to passive compliance and/or demonstration of good corporate behaviour, but should also extend to collective efforts by building a political coalition and working with company representatives to manage the potential of risk and achieve favourable results in complex institutional environments.

As Lundqvist (2015), quoting Kirkpatrick (2009), and entity’s representatives have also made efforts to manage the risks of the enterprise (ERM) in response to faulty risk management systems and corporate governance. The author argues that risk management should be seen as a component of traditional risk management and risk governance, each having its own determinants, and that the implementation of risk governance is the active stage beyond the traditional risk management to risk management. The author, approaching the complexity of risk management, dividing it into its traditional risk management and risk governance components and investigating determining factors separately, but simultaneously, argues that the level of governance of risks in an entity is linked to the size of that entity, the different levers, dividends and the influence of the executive manager on the management board. This may suggest that corporate governance reasons, such as the need for governance, existing governance and executive manager's control over governance decisions, determine the decision to step towards the implementation of management risk. Finally, the author concludes that entities implement risk management in line with the wishes of the representatives to better govern the risk management system.

Moreover, Naciti (2019) states that one of the approaches to engaging the sustainable practices of companies also focuses on the composition of the board of directors, a composition that influences a company's financial performance. However, as the author states, cooperation between the composition of the boards and the sustainability practices of companies have not been empirically examined for a due period. As a result, focusing on the key characteristics of corporate governance – namely the diversity of the management board, the independence of the management board and the duality of executive management – the author discovers that entities with more diversity in the council and a separation between the functions of president and executive management lead to greater sustainability performance. At the same time, a greater number of independent managers lead to a lower performance of sustainability, and finally, as the author claims, the composition of the board affects an entity's sustainability performance. In another context, the authors Al-Hadi et al. (2019) argue that, in corporate governance, the independence of managers and the dual roles of the general manager and the chairman of the board of directors reduce the importance and quality of market risk disclosure.

Otherwise, Kovermann&Velte (2019) analysing the specific literature on the impact of corporate governance on corporate tax avoidance, applying a representatives oriented perspective, authors discover that various aspects of corporate governance, such as aligning incentives between management and representatives, board composition, ownership structure, capital market monitoring, auditing, enforcement and government relations, and pressure from other representatives have strong pressure/influence on the avoidance of corporation tax in particular. The authors point out that effective corporate governance mechanisms lead to the avoidance of taxes at the optimal entity level, so that, in the authors' opinion, good corporate governance does not only have the potential to increase avoidance more cost-effective entities, but also limits tax avoidance to a level where the risks that arise do not exceed the benefits.

In view of the above, we also believe that, especially in corporate governance, a concrete knowledge of the hedging techniques against the various risks is absolutely necessary for financial management within an entity, in volatile conditions of the contemporary business environment.

In any case, as the author states (Zoicaş-Ienciu, 2013, p.192), given the complexity of the facts, risk management is not a subject that can be treated with indifference by an entity manager; this is because risk coverage solutions are often difficult to implement even when the risk is correctly identified beforehand and the steps to follow are precisely known.

Thus, we also agree with the author that a general conclusion can be drawn on the objective of risk management, namely to avoid the achievement of events that threaten the survival of the entity, and not to increase sales or reduce costs in no case being reccomended the removing of protection measures against the relevant risks, based on the cost savings, that expenditure is not less necessary than those of raw materials or salaries.

However, if there are more alternative risk coverage, we are also of the opinion that they need to be analysed in detail, and the solution that is least costly should be selected in the end. But, regardless of the situation, we can talk, including corporate governance, about a subordination of risk management to the fundamental objective of maximizing the worth of the entity.

In other terms, the express of risks at the entity level will affect both the size, stability and succession over time of future cash flows and the cost of the capital used to update them and as stated by Zoicaş-Ienciu (2013, p.195) risk management, as part of financial management, aims at eliminating (as appropriate, reducing) the risk exposure of the entity but also reducing the likelihood of risk.

Basically, by transferring and covering the risk, the entity ensures that when its cash flow depreciates as a result of the risk, amounts will be collected from different third parties in values similar to the decrease that compensate for the negative impact. This gives a certain degree of safety in maintaining financial parameters in the projected direction of management and preserves the market value of the entity; and in this respect any expense considered to cover the risk must be perceived as a common investment, the assessment of its opportunity being carried out by applying the classic criteria, as the author claims, only risk solutions leading to a positive net present value. At the same time, as authors, Ali et. al. (2018) say in corporate governance, entities that are better governed are associated with a lower level of default risk and that association is stronger among entities with more opportunities growth.

Moreover, investment decisions play a key role in achieving any entity's strategic plan. Due to the involvement of a large amount of money, these decisions are the most important for all compay representatives. Thus, investigating the impact of corporate governance and investor confidence in corporate investment decisions in two different countries, Shahid&Abbas (2019) confirms that there is a significant impact of investor confidence corporate investment decisions in both countries. The authors also argue that the level of investment is higher in entities with good corporate governance practices; the latter stimulating the impact of investor confidence on corporate investment decisions. Also, good corporate governance practices improve the monitoring function of board members, so they moderately control the interests of representatives, and that is why, as the authors claim, firm/determined managers make decisions effectively. However, the authors conclude that in the presence of rigorous corporate governance practices, however the impact of investor confidence on corporate investment is mitigated.

However, as the authors Bhaumik et al. (2019), said, in corporate governance, foreign investment by emerging economy entities, led to improved governance capacities. Thus, these entities have also become supporters for policy reforms in their native country that have required the development of similar capacities for local entities.

In other words, in terms of risk management strategies, we mention that corporate governance is an attempt to implement risk analysis, verification, evaluation and control systems, which contribute to achieving effective management for the operation of them. Therefore, as Ghiţă (2008, p.18) considers, the concept of corporate governance must be approached together with the risk management of the entire organization and with the evolution of the financial management and internal control system.

Risk is a level of exposure to the uncertainties that a company needs to understand and manage effectively in order to achieve its goals and create value for stakeholders. In any business process, achieving goals involves a certain level of uncertainty, and in any business process there are factors that stand or can stand in achieving these goals. (Crenicean, 2013, p.61)

The author considers that risk management is the manipulation, control and management of situations that jeopardize the operation of the business, assets, costs, and business objectives and results. At the same time, risk management uses a holistic approach to identify, quantify and mitigate risks, developing effective control systems and early warning systems, to monitor changes in risk factors and reduce them to reasonable levels. Given the above, we also believe that in the face of ongoing globalization, entities need a comprehensive risk management system that is flexible, systematic and long-lasting to identify, measure and monitor corporate risks self-monitoring tools.

In corporate governance, risks affect the ability to organize, survive, compete successfully, or maintain adequate financial strength, an adequate public image, or the quality of the goods and services provided. Thus, financial groups, organizations or entities in general need to identify and control all the risks they face; because otherwise they cannot achieve their strategic objectives. As the author said, this process is a risk analysis, which, in fact, we believe that it can be said that it is understood to track the occurrence of risks (for which there must be methods to identify and measure the consequences of risks) and management (making decisions to minimize their impact on the organization's activity). In turn, risks can involve positive consequences, known as opportunities or negative consequences, known as threats.

Crenicean (2013, p.62) states that the alignment of processes and systems with the organization's objectives essentially means that, at this stage, management makes decisions about how to act within the organization, in order to achieve the objectives and risk management suitable.

As such, as the author said, there are different risk management strategies, both in theory and in practice, which can be classified as follows:

-the elimination. In this strategy the management trying to abandon the process in question, given that the risks of those processes cannot be properly managed.

-retention. Through this strategy, the management tries to maintain the process in question, accepting the risks involved.

-reduction. This strategy aims to reduce risks to an acceptable level.

-transfer. In this strategy, the management aims to attract, to involve a third person / entity in the management of its own risks.

-exploration. In this strategy, the management aims to transform the risk, as a negative effect, into a future development opportunity for the organization.

Regarding the human behavior of managers in various organizations, regarding risk management, Crenicean (2013, p.63), citing Likert, concluded that there are in fact four management systems, which directly influence the efficiency of the organization, as follows:

• authoritarian-exploitative, where the place and role of employees is to respect exactly the decisions taken by those at the higher hierarchical level. Thus, the primary purpose of the organization is to achieve its objectives, ignoring the participation of employees in any way in decision making; even more, certain methods of coercion (through threats, fear, etc.) of employees will be used to achieve the expected results;

• authoritarian-bureaucratic, where, as in the previous model, decisions are made at the top level of the organization, but, this time, employees are motivated by certain rewards rather than being constrained or threatened;

• advisory. This type of management system involves motivating employees through various rewards, they have a certain degree of involvement in decision making, management constructively using their ideas and opinions. However, there is a limited involvement of the enforcement staff, who can only expose certain situations, but cannot participate in the direct decision-making.

• participatory management. In this system Likert assumes that managers can have full confidence in their subordinates, thus both parties being fully involved in the decision-making process. Subordinates freely express their ideas and communicate perfectly between work groups.

At the same time, risk management involves taking into account ethical risk because new business concepts show that managers have a legal and fiduciary obligation to manage social, environmental and governance risks.

Thus, as the author said, managers must be informed and prepared to be able to manage these references in the long term, along with typical corporate directives; and by effectively addressing these risks, management can manage its business in such a way that it thrives financially and ensures the long-term functionality of the entity.

Otherwise, respectively in case of failures, the administrators undermine the authority of the companies they run; that is why internal control is being extended to more and more companies, precisely in order to detect in a timely manner the ethical and integrity issues that may arise, respectively. In many entities, many investment managers examine the rigor and quality of these controls, precisely to ensure that entities use sound and well-managed business practices.

In these conditions, in conclusion, we are of the same opinion that the rules of an effective risk management in corporate governance must be manifested and be permanently observed in the activity of a socially and economically environmentally responsible entity through the following:

-adoption of corporate values to be communicated both within the entity and the market;

-adherence to the codes of good practice in matters of corporate governance;

-the inclusion in the Internal Code of Conduct or in the Internal Regulations of clear rules and procedures of ethics and independence, which should be applicable to all staff;

-recruitment of employee profiles that correspond through capabilities, skills and experience to the expectations of ethical professional conduct;

-implementation of systems for educating and improving employees from the very beginning in order to establish the landmarks and limits of action on behalf of the entity;

-introduction of the obligation to declare annually, by each employee, the conformity with the ethics and independence policy;

-extending the rules of ethics and integrity as requirements of good practice to suppliers, customers, subcontractors, contractual partners of any kind;

-observance of public procurement rules;

-organizing an internal audit activity;

-implementing effective testing and internal control methodologies, including in terms of avoiding conflicts of interest, acts of corruption or other inaccuracies regarding independence;

-encouraging a transparent work environment, with the organization of a help-desk, designating a person responsible for risk management, so that quick and relevant solutions can be found to any problem or situation that arises;

-implementing and monitoring a procedure for informing, investigating and resolving any potential inaccuracies regarding certain inappropriate practices;

-promoting the principles of ethics and independence in the public and business environment by practicing the best standards, contributions to awareness of direct and indirect benefits for any type of entity, regardless of size, type of business or stage of development, consultations between the main actors of different platforms for dialogue in the business community or with the authorities;

-supporting opinion leaders and projects that seek to modernize local practices to European or international customs and standards;

-delimiting as much as possible from incorrect, illegal or ethically inappropriate practices, etc.

5. Conclusions

As a rule, financial risks are generated with the conduct of various transactions involving specific flows: acquisitions of immobilized assets in investments, bond issuance, bank loan contractions, commercial credit, export-import operations, mergers and acquisitions, etc. In most situations, the factors leading to the manifestation of financial risks come from the macroeconomic sphere: the sequence of economic cycle phases, monetary policy, fiscal policy, market developments, currency markets, social and political dissension, military conflicts, natural disasters, etc. Therefore, many of the generator factors are not under the control of entity management.

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