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Risk Management and Corporate Governance: A Global Perspective

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Abstract

Risk is one of the key factors that determines the success of a business. Though taking risks is important for the business to succeed but too much of risk can also hamper the business. Proper risk management is necessary for a business to succeed. Taking this matter into consideration the corporate governance norms in various countries have included the concept of risk management under their purview clearly defining which level of management will undertake risks, how the risks will be managed and what role auditors will play in risk management. This paper gives a detailed theoretical view of the risk management practices across Singapore, Norway and India. The data for the study has been mainly collected from secondary sources. The findings of the study reveals that all the three countries had different board compositions but the corporate norms in all the three countries paid attention to risk management and the auditors played the major role in these practices.

Keywords: *Risk, Corporate Governance, Management*

JEL Classification: *G15, G32, G34*

Introduction

Risk management is one of the fundamental driving forces in any organization. With the changes in economic conditions around the globe the focus on risk management is becoming more and more evident. The cost that an organization has to bear due to failures in risk management practices are often underestimated by the companies, as of which along with monetary losses an organization also has to waste a long time in controlling the situation. Therefore, it becomes necessary that risks are properly estimated, calculated and managed so that organizations do not have to face adverse situations later on. With the growing concern regarding risks many guidelines on corporate risk management have been included in the corporate governance standards. Risk in terms of business is the uncertainty of deviation from expected earnings in the future. Risk management is the future actions or the processes that an organization takes into action in order to minimize the likelihood of failure and increasing their chances of success in the business endeavors. Effective risk management by an organization increases it's profits, this in turn confirms to

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the shareholders, customers, employees and society at large that a business is being managed effectively. It also helps the company to confirm its compliance with the corporate governance guidelines. It has also been observed that there exists a considerable difference between the risk management practices in the listed companies and the State Owned Enterprises (SOE's). Though the SOE's should try to implement the risk management practices in line with the listed companies, the same cannot be seen in practical applicability as the SOE's often state difference in corporate governance codes as their cause of non adherence. It is also seen that they often tend to state risk management as the duty of the board, or the duty of audit committee, the risk management committee or external auditors. The factors that affect the decisions are the size of the company or the sector in which it is operating. Whether a listed company or a SOE compliance with the risk factors becomes essential for them in the long run.

The risk theory was explained in much greater detail by Nassim Nicholas Taleb in his Black Swan Theory. This theory emphasizes on factors that came as a surprise, are rare in character and has a major impact on the business. The main aim of the theory was not to predict unpredictable events but to be strong against events which exploit the positive events. Banks and trading businesses are most importantly vulnerable to hazardous events. Black swan events also depend on the psychology of the observer as the risk which may come as an unpredictable event for one may not be the same for the other person.

Dr. David Hillson often referred to as the risk doctor pointed out that one of the common failures in managing risks is the risk identification. It is very essential to identify risks and distinguish them from uncertainties as risks are termed as uncertain events but all uncertain events are not risks. Only those uncertainties can be termed as risks which will affect one or more objectives of a business.

Few of the governance standards on risk management are listed as follows:

The UK Corporate Governance Code Main Principle C.2 Risk Management and Internal Control states:

'The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems ' (ICAEW, n.d., para. 4).

Code Provision C.2.1 provides:

'The board should, at least annually, conduct a review of the effectiveness of the company's risk management and internal control systems and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls'(ICAEW, n.d., para. 5).

UK Corporate Governance Code Main Principle C.3 states:

'The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditor' (ICAEW, n.d., Para 6).

Although few governance standards have been incorporated for management of risks, it can be seen that most of these standards relate to internal controls and financial risks. Very few standards have been developed by taking into consideration external risks faced by the business, also the risk governance standards tend to be very high level, thereby limiting their applicability and are mainly related to financial institutions.

The Organisation for Economic Co-operation and Development (OECD) has conducted various studies on the area of risk management during the year 2009-2010 and has passed numerous guidelines in this area. In the study "Corporate Governance Lessons From The Financial Crisis" the organization has clearly pointed out the importance of a corporate governance framework in risk management.

The responsibility of the board both in case of State Owned Enterprises as well as listed companies is important. The board should set out clear lines of duties and accountability in case of corporate risk policy throughout the organization with the oversight of the top management, the line managers of a company should not be only responsible for the risk management practices.

Review of Literature

The researcher while conducting the present study has taken into account the following studies:

Sharukh Tara & Sorab Sadri (2015) discussed the case studies of two big companies, i.e., Enron and Satyam, which failed to succeed in their respective businesses due to their unethical practices, which were against the governance norms of the country. The debacle of these two companies were mainly due to wrong corporate culture, the CEO and CFO of the companies put their own self interest before the interest of the companies, the malpractices in audit reporting, incorrect financial statements.

Audit Committee Institute (2008) in a poll conducted across various respondents in India found that there is a weak oversight regarding governance practices in India. It was also reported that the system of protecting the minority shareholders is yet to be developed in India, also it is seen that the independent directors are yet to be conferred with powers. The study also revealed that majority of the board practices are yet to be revived in India.

Andrew Ellul (2015) reviewed the literature on risk management and corporate governance. It emphasized on the relationship between risk practices and governance norms in various countries. The study found that that the governance pattern in few countries were unable to control the risk mechanism. Further suggestions were discussed as to how the governance mechanisms will be able to control risks in the businesses.

Karatzias Vassileios (2011) discussed risk management against the backdrop of global credit crisis. The study found that some of the major loopholes in the relationship between corporate governance and risk management are that risks were often not linked to the overall business strategies, the Boards of the companies often failed to take risks under their purview. A study conducted by the Risk Metrics Group found that most of the people affected by the global crisis believed that inefficient risk management was one of the key indicators of the crisis.

Research Gap

Though it can be seen that numerous studies have been conducted in the field of risk management and Corporate Governance but most of the studies are related to risk management practices in companies, risks in banks, comparison of literature on risk management but very few studies have focused on risk management across various countries around globe. Thus, the present study is an attempt to fill the gap in the existing literature and bring to light new observations in this field.

Objective of the Study

The objective of the present study is to make a review on the corporate governance framework related to risk management in Singapore, Norway and India.

Methodology of the Study

The present paper is a theoretical study on the given problem. The data related to the study has been collected from secondary sources i.e. from various books, journals, reports on corporate governance etc. The countries selected for the study are Singapore, Norway and India. The countries were selected by the simple random sampling technique.

Risk Management Practices in Singapore

The ownership structure in the companies in Singapore reflects two patterns i.e. the state owned enterprises and the family owned enterprises. Though the presence of government linked company tends to be high in the country. The Singapore Exchange (SGX) comprises of two boards the SGX main board and the catalist.

The corporate governance code for the companies in Singapore was first enacted in 2001 and the laws were revised in the year 2005. In May 2012, the Monetary Authority of Singapore issued a revised code on Corporate Governance. This code acts as the major guideline for corporate governance practices in the Singapore listed companies and is applied on a "comply or applied" basis. The Singapore Exchange (SGX) Listing Manual requires the companies to explain any deviation from the set codes of governance. Certain organizations like the financial institutions are subject to more stricter corporate governance regulations.

The stock exchanges in Singapore have undertaken various measures to enhance the risk management guidelines. The SGX updated the listing requirements in 2011 to bring into light the internal control guidelines and the opinion of the board on the compliance with audit committee and their opinion on operational, financial and compliance risks. The review of the code in 2012 brought into light the perspective of integrated risk management and the need for increasing accountability of the board and management on risk governance.

Regulatory framework for risk management in Singapore

Responsibilities of the board: The Singaporean Corporate Governance code recommends a unitary structure for the board. Independent directors should comprise at least one-third of the board. The SGX has fixed the responsibility of the board towards risk management as mandatory. The new provisions requires the board to give their opinion on

the audit committee, matters of internal control and the three areas of risk namely operational, financial and compliance risk.

Enterprise wide risk management: It is observed that majority of the companies in Singapore have implemented the Enterprise wide risk Management (ERM) in their framework though they have not clearly outlined the associated risk related functions. The Corporate Risk Governance guidelines of the country clearly sets out the main characteristics of the ERM process namely- the risk management process, the risk strategy and policy and the organization structure.

Whistle blowing policy: The whistle blowing policy of a company recommends that appropriate actions are taken against illegal actions being done in the companies. The policies and their procedures should be reported in the annual reports of the companies. The KPMG report stated that 95% of the companies in Singapore have whistle blower policies and they are duly reported in the annual reports of the companies.

Assessment of risk governance in Singapore: Independent assessment of risk is important for proper maintenance of risk in the long run. The main components involved in the assessment are:

Internal auditors*:* The internal reporting system in an organization plays a vital role in managing the internal monitoring system. The governance code of Singapore also abides by these laws and realizes the importance of internal monitoring. Therefore, it has been made mandatory to appoint an internal auditor for auditing functions and they should report directly to the board.

External auditors: Though there are no statutory requirements that a listed company have to get their internal audit verified but the Companies Act of the country prescribes that a good audit being reviewed by external auditors will improve the corporate governance practices and will help in better risk management in the country. It also mandates that it is the duty of the auditor to report any accounting fraud that may hamper the company or the employees of the company.

Risk Management Practices in Norway

Norway's equity market presents certain distinctive features which makes it an interesting study for observing risk management practices. Its market is characterized by a large proportion of public ownership and a limited proportion of private ownership. Though the duty of risk assessment is entrusted on the board but it is also seen that the state plays a active role in managing the risk.

The Public Limited Companies Act in Norway do not clearly set out the duties for risk management but the board is entrusted with certain responsibilities which act as the torch bearers of risk management. This includes a responsibility that the board of directors should be at all times informed about the status of the business at all time including it's capital management, its liabilities. In addition special mention was made about the audit committee of a business including internal audit, its role in risk management and external auditors.

The Accounting Act of the country was amended in 2011 and it requires that the annual report of listed companies should include a corporate governance report. The Norwegian Code of Practice for Corporate Governance provides the basic guidelines for interpretation of the broader governance practices. The Code includes 15 major topics and one of the main topic is risk management and internal control. The code emphasizes that the company should include sound risk management practices and system of internal control. There are numerous versions of the Norwegian Code and the risk management and internal control part was undertaken in the year 2006. The Code was first formed by the Norwegian Corporate Governance Board.

One aspect in which the Norwegian Code differs from most of the European countries Code of Corporate Governance is that it does not specify the role of an internal auditor; moreover it is observed that only around 10% of the listed companies in Norway have an internal auditor. In Norway, the Corporate Governance Code recommends that the Boards should be single tier and neither the Chief Executive Officer nor any other executive should be the member of the board. The amended Code in Norway in 2006 passed a regulation and implemented it in 2008 that each gender should have at least 40 percent presence in the Board of Public Limited Companies. This in turn had an effect on risk management as studies show that boards with better gender equality had a more balanced risk management procedure.

With regard to reporting by the board, the board of directors according to the laws of a company must give a full view of their internal control and risk management in the company's annual report. The reporting must be done in such a way that it gives a detailed view of the company's internal reporting to all the shareholders. A review conducted by EY in 2012 gave an insight into the fact that though a majority of the companies in Norway are seen to comply with the recommendations of the code of governance but the compliance level varies from company to company.

It has also been observed that the CEO has an important role to play in the risk management practices of Norway. The role of the CEO extends to the establishment of risk management practices based on the current risks, continuous monitoring of the firm's risk and ensuring that the risks are met in accordance with the board practices, proper documentation of the company's risks, etc. Most of the companies in Norway establish Management Co-ordination System to report risks across the company. This system also brings in the expertise of various persons on managing risks. For example the CFO of a company may be made responsible for financial risks, the legal officer for matters relating to compliance with legal matters etc.

Another emerging issue in the Norwegian structure is the growing importance of corporate social responsibility. Under the Norwegian Accounting Act, companies are required to report on the social responsibility practices. There has also been a growing interest among various investors on the issues relating to social responsibility and the Norwegian companies whether public or private are seen to comply with these provisions.

Assessment of risk in Norway: The Norwegian companies are expected to report on the issue of risk annually and show the reporting standards on the financial statements

as well. The role of the external auditors and shareholders on this issue are discussed below:

External auditors: In the Norwegian Code the external auditor has an important bearing on the risk management practices and they must participate in all the annual meetings of a company. The auditor must also show his findings in the annual report and should hold routine meetings with the audit committee. There should also be a provision that the auditor should hold at least one meeting with the board in which no one from the executive body should be present.

Shareholders: The role of the shareholders in risk management is a matter of debate as the state as a shareholder takes active interest in risk management practices but the same cannot be said of the other shareholders as few of them may have questions on the risk practices particularly those with long term interest on the company and few others may not have any sort of interest on the risk practices.

Risk Management Practices in India

The regulatory framework in India recognizes the importance of the Board in decisions regarding risk management. The issue of risk management has been issued by experts since the early 2000's. The Narayan Murthy Committee Report in the early 2000's included an detailed discussion on risk management wherein it stated that it is important for company boards to be aware on the topic of risk management.

The Companies Act 2013 emphasized the importance of risk management and identification of various risk by the companies. But it does not mandate the companies to set up a separate Risk Management Committee. Section 134(3) (n) of the Act requires that the board must include a statement that indicates the development of a risk management policy and identification of various risks therein. Section 177(4)(vii) of the act entrusts the audit committee to assume the responsibilities of a risk evaluator.

The SEBI listing Regulations 2015 states that one of the main responsibilities of the board is to analyze that the company's risk management policies are in place. It also requires the top 100 companies determined by market capitalization to set up a risk management committee.

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) in 2009 released an Enterprise Risk Management review which states that the members of a Company's Board must understand the risk philosophy of a company, must review the company's risk portfolio and must understand the most significant risks faced by a company and whether the members of a company significantly dealing with them. India too is one of the countries following the COSO recommendations, though the form of follow up may vary from company to company.

Findings

The researcher in the current study went through the practices of three countries i.e. Singapore, Norway and India. The study revealed that though the composition in the board varied from country to country as it was seen in Singapore there were more family businesses as compared to Norway where state- owned enterprises dominated but the root

of risk management remained the same in all the three countries. All the three countries related risk management as a part of governance norms of the country and the Boards of the companies were entrusted with responsibilities of maintaining proper codes of risk management. The audit committee played a central part in the risk practices of the country and it was entrusted with the key role of managing these practices both the internal and external auditors. In India, it was seen that the Companies Act 2013 and the SEBI listing Requirements 2015, came up with new clauses as to how to manage risks in the business.

Conclusion

Risk in business is one of the key components that determine the fate of the business. If not taken into account properly this might have a long term impact on the business. Though the manner in which risks are tackled in various countries differ but the main aim in all the countries around the globe is to keep at bay. It is seen that the strength of the governance practices defines risk in business and thus all the countries as well the authorities concerned with framing the policies should build a strong base for mitigation of risks.

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