Enterprise Risk Management and Corporate Governance
Strategic: Emerging Firm Value
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Abstract

As of late, a change in outlook has happened with respect to the way organizations view risk management. The pattern now is to take a holistic view of risk management instead of looking at it from a silo-based perspective. An enterprise risk management (ERM) is commonly referred as holistic approach toward managing an organization’s risk. For decades, risk management has been a fundamental focus for top managements, particularly in multinationals. Given the benefit of creating greater awareness on the risks potentially faced by the firm, the proponents of enterprise risk management (ERM) also allows for decision-makers to gauge the firm’s ability and resilience towards such risks and subsequently enables the formulation of strategies to mitigate such issues. In today’s dynamic global environment, the importance of enterprise risk management has accelerated and expanded to include enterprise of all forms and sizes.

Keywords: enterprise risk management, whistleblowing, code of ethics, sustainable development, firm performance

1. Introduction

Risk management has been a fundamental focus for top managements, particularly in multinationals. To cater for the variations in business dimensions and industries, this budding field of study underwent a paradigm shift in the views of risk management. In comparisons with the conventional stove-pipe perspective, in which each segment leader is entrusts with risks within their scope of expertise, the new approach suggests a comprehensive strategy in risk management in which the inclusivity of risk factors is magnified from the overall business. In contrast with the possibility of risks left undetected as a result of distinctive segmentation independence, the ERM approach is hence able to loop in significant risks on the horizon and ultimately enhances the firm’s risk oversight.

Generally, it is argued that the introduction of ERM contributes to firm’s performance and this approach has gaining momentum in top businesses across industries. While this is reflected from the increased adoption of ERM as one of the key measurements of firm’s performance along with conventional quantitative data, the implementation of this approach varies across firms and industries and there is a lack of empirical data to support the relationship between ERM and the performance of firm to this date [1].

Subsequently, the prime objective of this paper is to establish the relationship between ERM and firm’s performance for the selected ten conglomerates listed on Bursa Malaysia. To maximize inclusivity and the relevance of the study, these ten companies were selected to represent firms from different industries with performance indicators ranged within the industry benchmark. The following sections in this paper outlines the basic argument and research design of the study to test the above argument on the selected sample.
2. Basic Arguments

Prior to the 21st century, ERM was considered to be unimportant and provides little to no strategic value to the firm. Some may even consider it to be a waste of manpower, money and time [2]. However, over the years, firms have begun to understand the importance of ERM in enhancing the values of the firm. Various past literature has also shown a positive relationship between the adoption of ERM practices and the improvement in the firm’s value for instance [3]-[4]. Considering that multiple literatures have confirmed similar results, there must exist some semblance of relationship between ERM and its impact on the firm’s value. A similar study has been conducted on European firms taking a few firms from each from various industries. In [4] has shown results of positive relations which raises a question on if the same holds within the Malaysian context. ERM practices in Malaysia are still considered relatively new and at the infancy of development [5]. There are also few studies done on the effects of ERM on business in the Malaysian context. Several literatures have stated a gap exist in examining the impact of ERM in increasing the firm’s value or performance [6]. Though a similar research has been conducted, it produced insignificant results due to utilizing a one-year period as well as using different variables. As such this research will fill the gap and enhance the understanding of the impact of ERM to businesses in Malaysia.

2.1. Whistleblowing and Firm’s Performance

Within the context of an organization, whistleblowing is defined as the act of reporting any illegal or unethical behavior within the organization by an employee or former employee. This can be done internally via reporting to a superior or externally via reporting to a public authority [7]. In 2015, a survey conducted by Ernst & Young indicated about a third of the senior executives expressed that bribery and corruption occurs widely in their country. Shockingly, half of them can justify these actions to meet financial goals [8]. This implies that fraudulence and other various illegal activities are common within organizations which raises an issue on internal auditing and control. Whistleblowing becomes increasingly important not only to complement existing systems but as a means to further deal with illegal or unethical activities within an organization. It provides employees a means of correcting inappropriate behaviors and illicit activities. Most individuals would fear to whistle blow due to the possible backlash they may face however with the establishment of the whistleblower protection act 2010, whistleblowers in Malaysia are provided various rights and protection. Section 7.1 of the whistleblower protection act 2010 states the protection granted toward a whistleblower are as per the following: anonymity of identification, protection from detrimental action and lastly immunity from both civil and criminal liability (Whistleblower Protection Act 2010). Though whistleblowing may reduce the number of illicit acts, there is the possibility of hindering business operations or creative negative impact on the organization especially those that are involved in unethical conduct. This can be mitigated by encouraging more employees to whistle blow through internal channel allowing employers to prepare and plan for any adverse effects.

2.2. Risk Management Framework

ERM is said to improve the performance and the value of the firm through its implementation. Different businesses have their different ideas and strategy to implement in order to achieve this. To illustrate, YTL Corporation Berhad has implemented various internal control centered towards limit authority and authorization procedures. This shows that YTL is concern about employee misappropriated authority in order to commit fraud and derive personal gains from it. By limiting the authority of employees and implementing stricter procedures,
employees are deterred from committing fraud due to the difficulties and constraints. This effectively prevents fraud from occurring within this area. Another aspect can be seen in Top Glove Corporation Berhad’s strategy. Top Glove has established training programs for its director as well future succession for future management. The primary focus for these is the sustainable development of senior management. This ensures that Top Gloves executives retain if not improved the level of skills.

2.3. Code of Ethics

The code of conduct, also referred to as the code of ethics, is a set of compiled policies and procedures standardized for consistency in management across the organization. The aim of the code of conduct is to set out obligations, establish standards of behavior and support in building organizational culture. The code of conduct consists of various items from interaction with the public to workplace ethics. It even consists of disciplinary action in the case of breaching the code of conduct. Having a code of conduct allows both employee and employer to gain a better understanding of the expected mannerisms that should be observed. It clearly lays out how an employee should behave or act for example Top Glove’s employee code of ethics outlines employees’ conduct within the workplace environment which consist of maintaining one’s wellbeing to avoiding any inappropriate conducts such as threatening others, discrimination, sexual harassment. While various companies have different sets of guidelines set forth most of them consist of similar items forming a basis for a standardized code of conduct. The code of conduct also contains within, disciplinary actions and repercussions in the event of breach from being reprimanded with a fine to suspension or in some cases immediate dismissal. The code of conduct is an important element in ERM as it ensures a standard of practice across the organization. With standardization, it is easier to dispute any conflicts as well as identify issues that occur. This allows the organization to quickly remedy the issue and develop or improve upon the system to prevent similar incidents from occurring in the future. As a result, the organization’s overall efficiency improves and the risk of incidents occurring reduces.

2.4. Compliance and Firm’s Performance

Compliance is defined as the act of adhering and to act in accordance to the rules and regulations set forth [9]. Compliance in the context of ERM, is one of many internal controls used to manage risk within an organization. Compliance deals with diligently documenting internal policies, standards and procedures ensuring these adhere with the relevant laws and regulations. It also handles annual performance review, disciplinary matters, recruitment and selection, learning and development, leave and grievance matters. In essence, compliance ensures that everything runs smoothly whilst adhering to the rules and regulations set forth. In most organizations, a separate and independent body is established within the organization to handle compliance. This has become ever more important in Malaysia especially after the 1MDB escapade. With well-developed compliance systems in place, organizations will be exposed to less risk involved with operating procedures and documentations. This further decreases the likelihood of fraud and illicit activities from occurring due to routine checks.

2.5. Risk Governance

Internal controls are mechanisms implemented by an organization to ensure the integrity of the accounting and financial information [10]. Establishing a key performance index (KPI) is a form of internal control that allows the measurement of the key department’s performance such as but not limited to financial, internal
business processes, organizational learning, customer and growth. Another example of an internal control is the separation of an organization’s administrative function from its operational function. Additionally, no employee should have the authority to access warehouse inventory and record transactions. Both regulations will help the organization deters the possibility of theft as it makes it harder for the employee to commit such fraud. Besides being a preventive measure acting as a deterrent for fraud, internal control can help improve overall efficiency for the firm. A solid framework for internal control will ensure the firm’s resources are allocated appropriate where needed, minimizes the risk of resources being misused. Additionally, internal control helps identify issues quickly. This allows for swift resolution preventing it from becoming worse. Lastly, a strong internal control will help protect employees from incrimination as procedures and operations are standardized. Having a standard operating procedure ensures that employees are adhering to the rules and regulations set forth. As such, the employees are not a fault for any irregularities so as long as they adhere to the procedures. This allows for quicker conflict resolution. In essence, internal control contributes to providing value to an organization through improving efficiency and preventing fraud.

2.6. Sustainable Development and Firm’s Performance

Sustainable development encompasses the economic, environmental and socio-political spheres. It includes a variety of areas from sustaining internally such as human capital retention, minimizing resource use and product development to external factors such as the air and water quality, wildlife preservation and various stakeholders. Sustainable development, as the name implies, aims at taking actions to achieve goals without compromising long-term aspect [11]. Due to its broad spectrum, sustainability goal may largely differ from firms to firms depending on their priorities. Take Sunway for example, one of their key sustainability goals is to develop a sustainable city whilst Hong Leong focuses on long-term sustainability in financial performance. Sustainable development plays a vital role not only in protecting the environment but enhancing the value of the firms and its longevity. Development and environmental preservation have gone against one another. It is difficult to develop without damaging the environment whilst it is hard to preserve the environment without hindering progress. However, improvement in technology may affect the environment but more often than not these technology helps reverse the very effect. As such, one of the key areas of sustainable development is the improvement in technology. Solar panels, wind turbines and hydroelectricity provide us with renewable energy reducing carbon footprint in comparison to fossil fuel. If these technologies are to be improved upon to be cheaper, more efficient and compact, it would greatly reduce cost whilst preserving our environment.

3. Literatures

3.1. Contingency Theory and Risk Management

The perspective of contingency theory towards enterprise risk management has been previously examined by a number of studies. Some researchers stated that contingency view of enterprise risk management systems is more related to management control system [12]-[16]. However, there is no exact model that can predict the key factors influencing the relation between a firm’s ERM and its performance. Studies have examined the power of boards and executive teams to ensure the implementation of enterprise risk management [17]-[19] Such studies represent early contingency work in management and accounting science, simply evaluating whether specific possible contingent factors (drivers) interacted with the control mechanism in question [20]. Therefore, this study emphasizes the relation
between corporate governance elements which are whistleblowing, code of ethics, compliance, risk governance and sustainable development with enterprise risk management in firm performance.

4. Methodology

For the data analysis, a regression model will be made using the Least Square Method. This will be generated using the aid of Microsoft Excel Analysis Toolpak 2018 version to investigate the relationship between the value of the firm, equity (E), with the independent variables: Return on Equity (ROE), Return on Assets (ROA), Earnings Per Share (EPS), Debt Ratio (DR) and lastly Debt-to-Equity Ratio (D/ER). In order to evaluate the performance ERM has on the value of the firm, a sample of 10 companies across various sectors and sizes have been selected. Regression will run the dependent variable against the independent variable formulating the following formula:

\[ \text{TEA} = \beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROA} + \beta_3 \text{EPS} + \beta_4 \text{DR} + \beta_5 \text{D/ER} + \epsilon_t \]

Furthermore, to properly examine the effectiveness of ERM on increasing the firm’s value several indirect factors will be considered: whistleblowing, enterprise risk management, code of conduct, compliance, internal control and sustainable development.

H1 = Whistleblowing will significantly improve the value of the firm
H2 = Enterprise Risk Management will significantly improve the value of the firm
H3 = Code of Ethics will significantly improve the value of the firm
H4 = Compliance will significantly improve the value of the firm
H5 = Internal Control will significantly improve the value of the firm
H6 = Sustainable Development will significantly improve the value of the firm

5. Results and Discussion

5.1. Regression Analysis

<table>
<thead>
<tr>
<th>Banks</th>
<th>Pharmaniaga</th>
<th>Top Glove</th>
<th>Hap Seng</th>
<th>Sunway</th>
<th>Hong Leong</th>
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<tbody>
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<td>0.99859753</td>
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<tr>
<th></th>
<th>Return on Equity</th>
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<th>Earnings per Share</th>
<th>Debt Ratio</th>
<th>Debt-to-Equity Ratio</th>
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Figure 1. Label Multiple Regression Data for Pharmaniaga, Top Glove, Hap Seng, Sunway and Hong Leong using TEA = $\beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROA} + \beta_3 \text{EPS} + \beta_4 \text{DR} + \beta_5 \text{D/ER} + \varepsilon_t$

<table>
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Figure 2. Multiple Regression Data for Alliance, Tenaga Nasional Berhad, YTL, Inari, and MyEG using TEA = $\beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROA} + \beta_3 \text{EPS} + \beta_4 \text{DR} + \beta_5 \text{D/ER} + \varepsilon_t$

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Figure 3. Significance of $p$-Value for Pharmaniaga, Top Glove, Hap Seng, Sunway and Hong Leong using TEA = $\beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROA} + \beta_3 \text{EPS} + \beta_4 \text{DR} + \beta_5 \text{D/ER} + \varepsilon_t$

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Figure 4. Significance of $p$-Value for Alliance, Tenaga Nasional Berhad, YTL, Inari, and MyEG using TEA = $\beta_0 + \beta_1 \text{ROE} + \beta_2 \text{ROA} + \beta_3 \text{EPS} + \beta_4 \text{DR} + \beta_5 \text{D/ER} + \varepsilon_t$
5.2. R-Squared

From the results in Table 2 and 3, Hong Leong has the highest R-Square while Top Glove has the lowest. R-square is a statistical measure which shows the proportion of the variance for a dependent variable using the independent variables in the regression model. A higher R-Square between the values of 0.85 to 1.00 indicates that the correlation between the variables are strong, most of the companies are above 0.95 with the exception of Top Glove and Tenaga Nasional Berhad which has values lower than 0.8 but higher than 0.7. Although these two companies have lower values comparative to the other companies, their R-Square is still higher than 0.7 which indicates the reliability of testing the independent variables specifically Return on Equity, Return on Assets, Earnings per Share, Debt Ratio and Debt-to-Equity Ratio, on the dependent variable which is Total Equity.

5.3. Adjusted R-Squared

In comparison to R-Square, adjusted R-Square compares the power of the regression model which comprises of numerous predictors. An increase of the numbers of predictors, increases the value of the R-Square and never lowers the value, thus a model with a higher amount of terms will have a higher value whereas the adjusted R-Square compensates for the addition and the value of the adjusted R-Square only increases if the terms enhances the model. Hong Leong also has the highest adjusted R-Square which further reflects the magnitude in which Total Equity is affected by the independent variables. Adjusted R-Square has to be more than 0.75 to indicate that the independent variables is suitable to be used in the regression and is fit to measure the dependent variable. Although most of the companies has an adjusted R-Square, the companies that had R-Square values lower than 0.8 also has negative adjusted R-Square which means the correlation is weak and the factors used is not deterministic to the dependent variable.

5.4. p-Value

In addition, the p-value is used to test the significance of the independent variable on the dependent variable. It tests the null hypothesis, which is that all values are significant, referencing Table 3 and 4, values deemed significant are values above 0.05 which accepts the null hypothesis and reject the alternative hypotheses. While most of the company’s values are significant, Hong Leong and Alliance both have a few insignificant values. Hong Leong’s Earning per Share is the only variable that significantly affects their Total Equity. On the other hand, earning per Share and Return on Equity for Alliance bank has an insignificant effect on their Total Equity.

5.5. Regression Coefficient

Furthermore, the regression coefficient that expresses the change in value of the dependent variable that corresponds to every change in unit of the independent variable. Overall, it is preferable for the coefficient to be positive as a negative coefficient is likely to have a negative effect on the outcome. All of the companies have at least one negative coefficient which shows the inverse relationship between the dependent and the independent variable. Hong Leong’s results show that they had the highest coefficient among the other companies for the independent variables Return on Assets, earning per Share and Debt-to-Equity Ratio, however, they have the lowest coefficient values for Return on Equity and Debt Ratio. YTL has the highest coefficient value for Return on Equity but has the lowest for Return on Assets and Debt-to-Equity Ratio. The highest coefficient value for Debt Ratio is 188581157.14 from Sunway and Inari has the lowest value for Earnings per Share. These values signify the effectiveness of the Enterprise Risk Management on the funds’ performance.
5.6. Application of ERM

All the firms selected within this study have established a framework for ERM however, there still exist some level of discrepancies between the results. The initial hypothesis suggested that companies with well-established ERM will observe improvement in the value and performance albeit, room for unforeseen circumstances and uncertainty should be considered. Three companies have shown results different from the rest: Hap Seng, Hong Leong Bank and Allianz. To further understand the results and discrepancy further analysis will be conducted in respect to each company’s employment of internal control within their ERM framework, specifically the whistleblowing policy.

Whistleblowing is one of the internal controls within the ERM framework used to remedy fraud and illicit activities, various companies have their different policies for whistleblowing. Some condone any and all reports and allows for protection against reprisals and retribution whilst other do not condone false reports and enact punishment for said actions.

Both Top Glove’s and Pharmaniaga’s whistleblowing policy are comprehensive and detailed. It provides individuals with an outline to distinguish between a concern and personal grievance. This allows individuals to firmly understand the difference between making reports that are irrelevant. The whistleblowing policy also permits not only employees but for non-employees to make reports thus increasing the likelihood of any, if present, fraudulence and illicit activities occurring. Furthermore, the whistleblowing policies states that the identity of the individual is kept confidential and they are protected against any form of reprisals and retribution. This gives the whistleblower confidence to raise issues outside management lines.

Their whistleblowing policies are not only comprehensive but promotes individuals to engage in whistleblowing. Most employees are afraid of whistleblowing as it may result in reprisals this affecting them greatly. It could even result to immediate dismals are various psychological harm. As such, having the protection of anonymity and reprisals greatly boost the individual’s confidence in stepping out to make reports. Essentially, this will help improve the overall integrity of the firm as it will root out all acts of fraud and illegal behaviors. Consequently, it’ll improve the firm’s overall efficiency and performance. This can be seen by the significance in all five variables for these companies as seen in Table 3: Significance of p-Value.

Other companies like Inari, MyEG, Sunway, TNB and YTL have a whistleblowing policy albeit, less comprehensive than the former two. Their whistleblowing policy comprises of providing a platform for whistleblowing, a contact person, guidelines, anonymity and protection. These are the basic requirements for a solid foundation for whistleblowing framework. It encourages and boosts the confidence in the whistleblower by providing them with anonymity and protection against reprisal. Once the whistleblower has built the confidence to make an approach and report on fraud and illicit activities, they will need an avenue to make the report. By providing whistleblowers with the appropriate channel to communicate, they can now make the report. Lastly, a guideline is necessary and should be made available to the public. This will reduce the likelihood of false report or reports that do not necessitate the need to whistle blow. The effectiveness of strong, solid ERM framework can be seen by the improvement in the firms’ value and all of these companies have shown significance of p-value across all five values.

Although some of Hong Leong’s and Alliance Banks’ p-Values are insignificant, both companies have a prudent whistleblowing policy and implements strategies which are ethical and effective in ensuring the integrity of the company. Similar to other companies they provide whistleblowing channels and Hong Leong does not only encourage internal stakeholders to raise concerns but external stakeholders as well while Alliance Bank only
allows employees. They also allow the person reporting to remain anonymous and protect them from any form of retaliation. These actions allow Hong Leong to increase their profit and subsequently improve their Earnings per Share which generates a significant value and similar for Alliance Banks’ Return on Assets, Debt Ratio and Debt-to-Equity Ratio.

Despite the fact that almost all the companies have a well thought out whistleblowing policy, Hap Seng only mentions that there is an existing whistleblowing policy under their code of conduct without much explanation. Their code of conduct is well thought out clearly defines all boundaries of expected conduct that guides their staff accordingly to minimize conflict and prevent risk. Their code of conduct is available for their staff on their website at all times and is introduced to them as soon as they join the company so that they are provided with proper guidance.

Finally, it can be concluded that all the companies have proper ERM framework established. Having a well-established ERM framework allows for their company to grow with the likelihood of incurring less risk. Internal controls help deter fraud and illicit activities by making it harder for such actions to occur. Additionally, whistleblowing policies it will also expose any, if existing, fraud and illicit activity that have already taken place. In essence, the ERM framework not only protects the integrity of the firm but also allows for the company to improve its overall efficiency thus improves its performance. Essentially, ERM can be beneficial for the company if done properly, else it becomes another mundane task and becomes meaningless. However, it is important to note a few outliers, Hap Seng, Hong Leong and Alliance, which showed insignificant p-value. This could possibly be attributed to unforeseen circumstances that affected their financial performance.

6. Conclusion

In modern times, businesses in most industries are under immense competition to deliver goods and services that are of greater value and choices to consumers. Besides that, the impact of globalization has also sparked general interest and awareness on the debate of environmental sustainability that businesses should comply to. In order to incorporate sustainable practices that are speedier, safer, and superior, the incorporation of the ERM approach is seen as a steppingstone for businesses to leap from mere quantitative measure and strategizing mechanism to a more holistically predictive risk management approach.

In accordance with the 2019 Global Risk Report constructed by the World Economic Forum, the Global Risk Perception focuses on five core themes namely, economic vulnerabilities, geopolitical tensions, societal and political strains, environmental fragilities, and technological instabilities. Following the dispersion of global power, the market has allowed for the emergence of global players with significant influence in global politics and economy. With that, executives are constantly challenged with strategic risks from global changes in conjunction with the traditional circumstantial risks created by the virtue of the business itself that were centered and specific.

As such, risk management at enterprise level calls for a need to formulate a more rigorous and effective risk management blueprint in the process of risk identification, management and mitigation. Besides being receptive to external changes, ERM also emphasizes on the importance of risk measurement and holistic considerations in its implementation to ensure proper governance and sustainability in its actions. In addition, ERM also plays a substantial role in strategic planning and shareholder creation through the integration of risk models and strategic risk management within a robust ERM, subsequently allowing for an extensive strategic planning exercise.
As a critical element affecting a firm’s success, ERM is viewed to be a key component in performance evaluation, ensuring systematic and effective controls necessary for risk management as well as complying to regulatory standards in the new global landscape. Evolving at a rapid pace, businesses are also expected to be receptive to the increasingly driving growth from e-commerce to include relevant technologies such as artificial intelligence, big data, cloud computing, and internet of things (IoT) in business operations. One of the strengths in the ERM approach, this form of data-relevant business model would hence allow for business to manifest maximum potential to flourish globally.

To conclude, businesses should devote significant effort in the implementation of an effective ERM framework across the organization as one of the key factors for business growth and longer-term sustainability.

References


