

Developing Risk Management as a Competitive Capability*

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This study explores how Small and Medium Enterprises (SMEs) develop their risk management capabilities beyond the start-up phase. A case study drawn from a SME based in Sri Lanka formed the basis of the research. The firm referred to in this study as ‘Firm A’ has been operating in the diversified financial services industry since 1991. The study finds that at an individual level, parameters such as heuristics and firm- risk maturity levels do influence risk perception beyond firm start-up. At the level of the firm, three major parameters are found to influence the ability of SMEs to develop risk management competencies; these are enterprise risk management (ERM), internal control and risk culture.

Keywords: Sri Lanka, Developing countries, Risk management, Firm.

Introduction

What interests us in this study is the question of risk and its management as a competitive capability by Small and Medium Enterprises (SMEs) beyond the start-up phase; this interest is driven by a number of studies. First are studies (Gatewood *et al.*, 1995; Witt, 2000; Zahra *et al.*, 2009) which suggest that for a number of reasons including risk culture, the entrepreneurial behaviour of a firm will change over its lifecycle. Thus, while it might be perceived that risk behaviour at the start-up phase of a new venture is largely driven by individual owner-manager entrepreneurial orientation, at a more established phase, the risk behaviour of an enterprise will be largely driven by firm-level determinants. More specifically, scholars (e.g. Aloulou and Fayolle, 2012; Covin and Wales, 2012) have shown that entrepreneurial orientation, which articulates consistent tendencies towards entrepreneurial behaviour, comprises three distinct behavioural components - innovativeness, risk-taking and proactiveness. Our interest in risk management is, however, driven by literature (Kreiser *et al.*, 2010; Gao *et al.*, 2012; Podoyntsyna *et al.*, 2012), which suggests that risk management is a critical aspect of value creation in SMEs.

Although risk is a critical aspect of management for SMEs, it still remains under-researched (Blackburn and Kovalainen, 2009; Herbane, 2010; Gao *et al.*, 2012). The risk challenges faced by SMEs is further compounded by the reality that lessons for best practice remain largely drawn from knowledge developed from adjacent disciplines, thus creating a situation where contexts specific to SMEs are not captured (Ruefli *et al.*, 1999). Another challenge faced by SMEs relates to the broadness of the entrepreneurship field (Janney and Dess, 2006). Taking these two challenges into consideration, the primary objective of this study is to gain an understanding of risk management imperatives that impact on SMEs beyond the start-up phase. To meet the objective of the study, a case study focussing on 'Firm

A', a diversified financial services organisation established in Sri Lanka in 1991 (with its head office in Colombo) is undertaken.

Sri Lanka represents an interesting case for the study of risk management within the context of SMEs and risk management. The country's economy had been literally crippled as a result of a twenty-six-year civil war that ended in May 2009. Following the end of the civil war, however, the economy has undergone sustained recovery with foreign reserves of over US\$ 6.1 billion and economic growth in 2011 estimated at 8.3% (Central Bank of Sri Lanka, 2011). Although economic outlook for the country generally appears positive, Sri Lanka has generally been unable to fully exploit economic growth because of its inability to fully transform corporate governance and control structures which still remain below expected global standards. In recognition of such challenges, in April 2012, the Central Bank of Sri Lanka issued a set of guidelines articulating robust risk management practices to serve as a means of enforcing good governance within financial organisations.

In order to achieve the research objective, the remainder of the paper is organised as below. Following this brief introduction, in the second section of the paper, we present the review of literature. The third section articulates/describes the research methodology adopted, while the fourth section presents the results and analysis of the findings. While the penultimate section presents a discussion of the implications of the study, in the final section, we conclude the study. An examination of the literature on risk follows.

Literature review

Risk and risk culture

According to scholars such as Slovic (1999) and Ben-Ari and Or-Chen (2009), there is inherent complexity and confusion surrounding the term '*risk*'. Slovic (1999) for example

had suggested that the conflicts arise mainly as a result of varying definitions of the overall concept. This is not surprising as even the terms ‘risk’ and ‘risks’ have different meanings in scholarship. According to Leitch (2008), ‘*risk*’ is a measure of the importance of some certainty, whereas ‘*risks*’ describe events that might happen. Ben-Ari and Or-Chen (2009, p.872) suggest that the confusion over the terms ‘*risk*’ and ‘*risks*’ is largely driven by those seeking to understand the term “independent of its social and cultural contexts”.

Studies have shown that there is considerable concern over how difficulties associated with developing risk management capabilities may be best overcome. Internal resistance (Gray, 2002), cultural imperatives (Kreiser *et al.*, 2010) and misalignment of priorities as relates to innovation (Marshall and Ojiako, 2010) are just some of the identified challenges that SMEs face. Literature indicates that, to deal with the challenges of developing robust risk management capabilities, SMEs could consider a number of approaches which may include empowerment (Scott *et al.*, 2012), training (Ekanem and Smallbone, 2007), enacting of appropriate human resources policies (Bacon and Hoque, 2005), the establishment of clear control frameworks (Das and Teng, 2001) and the articulation of firm values and a culture of trust (Welter and Smallbone, 2006).

A prerequisite for the successful development of risk management capability within SMEs is to understand its competencies; hence the need for prudence in the identification of a firm’s risk culture. We draw upon earlier work by Bozeman and Kingsley (1998) which defines risk culture as “the organization's propensity to take risks as perceived by the managers in the organization” (p. 111); however we depart from Bozeman and Kingsley’s assertion that such culture is created by perceptions as tangible and documented decisions, and instead we posit that beyond the start-up phase of an SME, risk culture will in fact be determined by the existence of tangible and documented actions. This position is adopted by drawing upon earlier cited work by Witt (2000) and Zahra *et al.* (2009), which suggest that at

a more established phase in its life-cycle, the behaviour of a firm is likely to be largely driven by firm-level determinants. Noting that risk perception is culturally constructed (Douglas and Wildavsky, 1982; Douglas, 1990), entrepreneurial orientation is therefore not only linked to risk culture (George and Marino, 2011; Covin and Wales, 2012), but also is critical to the understanding of a firm's (in this case, SME) behaviour.

Entrepreneurial and enterprise-level risk management

A number of scholars (Sitkin and Pablo, 1992; Sitkin and Weingart, 1995; Forlani and Mullins, 2000; Keh *et al.*, 2002; Mullins and Forlani, 2005; Janney and Dess, 2006; Gao *et al.*, 2012; Podoyntsyna *et al.*, 2012) have examined the risk behaviour of SMEs. Sitkin and Pablo (1992) for example suggested that the risk preference of an individual may be mediated by their risk propensity. Expanding this, Sitkin and Weingart (1995) had found empirical evidence to suggest a relationship between the way problems were framed and how risks were perceived. Forlani and Mullins (2000) on the other hand found substantial evidence to support establishing a relationship between the way risk was perceived and an individual's propensity to risk. As relates to entrepreneurial behaviour, Mullins and Forlani (2005) had found evidence to support the view that the choices entrepreneurs made relating to the magnitude of possible gains and losses were influenced by their risk.

As articulated above, scholars such as Zahra *et al.* (2009) had suggested the existence of heterogeneity in entrepreneurial activity across different stages of a firm's life cycle. Thus, it may be expected that, at an earlier stage of their life cycle, firms will have in place a risk culture and associated processes and systems that are driven from the "bottom up", with individual employees playing a substantial role in establishing and enacting risk management procedures. However, as the firm becomes more established, its processes and systems become more formalised and in most cases, they then become driven by the organisation (as

against the individual), leading to the development of a “top-down” risk management culture. To counter the possible negative impacts of such a “top-down” risk management culture, firms have sought to adopt various risk management approaches. One such approach is Enterprise Risk Management (ERM).

Unlike the traditional ‘silo-based’ approach, ERM is a value-adding process which looks across the entire firm and measures its success or failure with reference to the eventual impact on value (Gordon *et al.*, 2009). ERM allows firms to create such value through its ability to establish synergies that relate to risk (Liebenberg and Hoyt, 2003). Enterprise Risk Management also facilitates the reduction of unnecessary duplication of risk management processes within firms. To best implement ERM, firms will generally seek to benchmark their risk capability. According to Gumbus and Lussier (2006), such benchmarking may be implemented by referring to standard levels of maturity, which in turn provides guidelines that may be used to diagnose current levels applicable to firms.

Internal control mechanisms

A critical antecedent of risk management is control. Green and Welsh define ‘control’ (1988, p. 291), as ‘a cybernetic, regulatory process that directs or constrains an interactive activity to some standard or purpose’. Its purpose is to ensure that value can be created through the firm’s ability to manage unexpected outcomes. Thus, internal control mechanisms (or systems) are measures which are employed by firms to complement the risk management strategies they have adopted. Firms will employ risk management to identify and prioritise risk, while control mechanisms represent processes designed to provide a reasonable measure of assurance regarding the effectiveness of the risk management strategies. Based on this, internal control mechanisms are of critical importance to the success of risk management in

that they play a critical role in the management of knowledge flow within firms (Turner and Makhija, 2006).

For SMEs, beyond the start-up phase, the utilisation of internal control mechanisms is associated with two major challenges. In the first place, the transition of the firm previously driven by individual owner-managers to a phase in the lifecycle where it is now being driven by firm-level determinants (processes and systems) may lead to a situation where a high level of entrepreneurial orientation is not being sustained. This can lead to an increasing aversion to risk among the staff. Secondly, if the internal control mechanism is inappropriately designed, it may end up serving as a ‘gate-keeper’ rather than an ‘enabler’ of innovation. We however emphasise the need for caution when discussing risk and innovation. Studies by Marshall and Ojiako (2010), for example, highlight the tendency by scholars to uncritically juxtapose both terms. On one hand, such juxtaposition appears reasonable, particularly when one assumes that ‘risk’ and ‘innovation’ together describe change or novelty; the reality, however, is that they do not. Not all innovations involve an element of risk, while at the same time, not all action which is considered risky is innovative. Thus, because innovation ultimately involves change, and risk involves uncertainty (a possibility), risk does not correlate to innovation.

Following this review of the literature, the study methodology is presented below. We commence by presenting the research philosophy. This is followed by a description of the case organisation. The sampling procedure is then described followed by empirical testing of the data.

Research Methodology

Research philosophy

The unit of analysis of this study is the case firm, ‘Firm A’; thus confirming the adoption of a case study as the preferred research methodology (Eisenhardt and Graebner, 2007). The process structure for the case study was based on Stuart *et al.*’s (2002) five-staged research framework, shown in Figure 1.

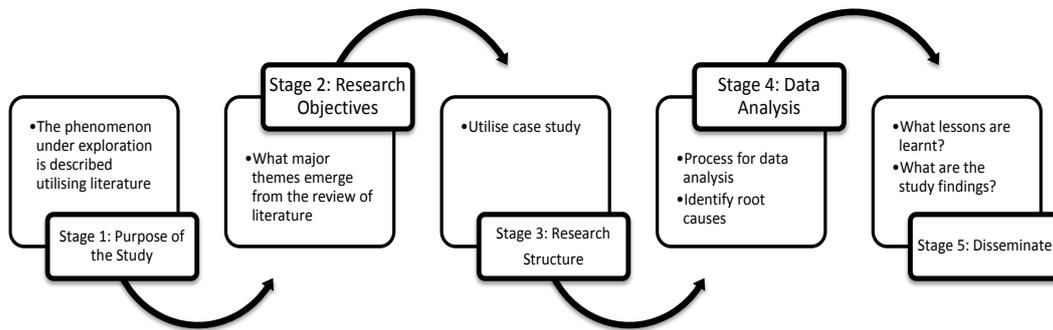


Figure 1. Research Framework

Data were obtained from a mixed-method approach consisting of a survey and examination of publicly available company documentation; in this case, the firm’s annual reports between 2006 and 2012. The use of a case study was considered appropriate for a number of reasons; including ease of access due to the fact that one of the researchers was a former employee of the case firm, and to foster trust, which McCutcheon and Meredith (1993) highlight is essential for successful case study research. Thus, the unit of analysis was jointly agreed between the authors and the management of the case organisation.

The case organisation

The case organisation is 'Firm A', a diversified financial services organisation based in Sri Lanka. The company was established in 1991 and presently employs about 150 staff, all located at its head office in Colombo.

'Firm A' provides a range of financial services to both individual and institutional customers primarily within Sri Lanka, although it does have a growing customer base in the Maldives. The company's primary business is stock brokering and securities investments. It is also engaged in finance leasing and advisory services, particularly in acquisitions. Driven by an ability to attract investments from venture capitalists keen to cash in on Sri Lanka's emerging tourism industry, the company also has an interest in this sector. In addition to its core business, the company operates three distinct diversified investment portfolios in multimedia and digital entertainment, manufacturing (specifically the blending, packaging and bagging of tea) and software solutions.

'Firm A's risk management strategy has been driven by a number of factors. For one, although the World Bank (Fonseka *et al.*, 2012) suggests that post-conflict economic recovery is expected to continue in the country, sustaining such high growth is likely to be challenging due to high public debt and a weak investment climate. Secondly, the security situation in northern districts such as Jaffna and Mullaittivu continue to be of concern to investors.

The study

To gather data, a self-administered, web-based questionnaire was constructed online using the *isurvey* web package. Over a period of 10 consecutive days, a link to the web-based

questionnaire was emailed to all 150 staff¹ of ‘Firm A’ utilising contact details provided by management of the firm. The questionnaire consisted of eight questions (sections) presented sequentially, and respondents were asked to rank each question. Question 1 focused on general demographic information. Question 2 on the other hand allowed for the identification of the impact of education on risk perception (see Sjoberg, 2000). While Question 3 focused on identifying risk culture within individual departments of the case organisation, Question 4 sought to establish employees’ perceptions of the importance of risk management (see Sitkin and Pablo, 1992; Sitkin and Weingart, 1995; Forlani and Mullins, 2000; Mullins and Forlani, 2005).

In the case of Question 5, a range of information was sought. In the first place, as earlier highlighted in the literature review, when left undefined, risk will mean different things to different people. A suitable risk culture should accept risk to be both an opportunity and a threat (Slovic *et al.*, 2004). Related questions thus show whether the employees had a clear understanding of the definition of risk. Marshall and Ojiako (2010) had earlier linked innovation with risk taking; thus the related question sought to establish the extent to which employees were encouraged to take on calculated risks. Questions on individual responsibility and risk taking are linked to the superlative risk culture discussed by Kreiser *et al.* (2010). Then, feedback from Question 6 was used to triangulate the information obtained via secondary data relating to the current risk management practices within the firm. Question 7 on the other hand emerged from earlier work undertaken by Douglas (1978) in the area of Grid Group Theory. This question sought to establish which of the four dimensions (i.e. fatalism, hierarchy, individualism and egalitarianism) were most applicable to employees. The final question (Question 8) sought to explore risk maturity, a first step in the development of risk management capability (see Gao *et al.*, 2012).

¹ We mean management and operational staff.

Data analysis

Microsoft Excel software was utilised for quantitative analysis. To address the research objectives, we analysed data in the following manner. The first step was to check the data for consistency and omissions, following which data were entered into a spreadsheet on Microsoft Excel. The measurement scales applicable were ratio and nominal measurement whilst the option of weighting was kept open to be used if deemed necessary. Weighting might be necessary when analysing the results by differentiating between the various operational departments within the case organisation as it is possible that some departments would be over-represented while others are under-represented due to the random sampling employed. The Likert (1932) scale used in the questionnaire was expected to be decomposed as follows:

- ‘*Strongly agree*’ and ‘*Strongly disagree*’: The person is certain about being aware/not being aware of a particular issue.
- ‘*Agree*’ and ‘*Disagree*’: The person is aware/not aware about a particular issue but does not have enough information to be certain about it.
- ‘*Neutral*’: The person has no knowledge regarding a particular issue.

Information extracted from the secondary data was then used to triangulate the findings obtained through the questionnaire.

In order to determine the risk maturity level of the firm, a model was built on Microsoft Excel based on earlier work by Hopkinson (2011). Depending on the feedback received for each question, responses are ranked on a scale of ‘A’, ‘B’, ‘C’, ‘D’ or ‘E’ where ‘A’ = naive, ‘B’ = Novice, ‘C’ = ‘Normalised’, ‘D’ = Natural and E is taken to mean not

applicable. Table 1 (which is drawn from Hopkinson, 2011) shows the question rankings to ensure their input into the risk maturity model built on Microsoft Excel.

Table 1. Ranking Systems

| Level | Implication |
|-------|---|
| E | Not applicable |
| D | The firm's senior management make little or no use of the risk management process |
| C | The firm's senior management has initiated some actions concerning risk management but does not yet make full use of the process |
| B | The firm's senior management has a written policy on risk management, but practice may to some extent be at variance with this policy |
| A | The firm's executive board has approved a written policy on risk management and all operational, decision-making and reporting processes are fully consistent with the policy |

As indicated above, secondary data used for analysis were obtained from the firm's annual reports between 2006 and 2012. An ordinary least squares regression (OLS) of profits on risk management activities was performed. The variables under consideration were:

- Dependant variable: Quarterly profits obtained via quarterly financial statements from 2006- 2012.
- The Independent variable was also a control variable in this case.
- D1: Dummy variable for risk management. It takes the value of '1' if Firm A was practicing risk management during that particular quarter and '0' otherwise.

The standard regression equation was used. That is, $y = x\beta + \varepsilon$, where y is the dependant variable, x is the independent variable, β is the coefficient and ε represents an error term. This test was applied to assess the impact risk management has on the case firm's profitability.

Results and Analysis

Results and analysis of the survey data

Of the 150 staff sampled, data were obtained from 132 staff members; however, a further 32 questionnaires were omitted from the final count due to missing values. These were cases where more than four of the questions were not answered, or the survey was not completed. This meant that on final count, we had a total of 100 useable questionnaires. Table 2 shows a summary of the results.

Table 2. Summary of Results

| Summary of Quantitative Research Findings | Agree (%) | Don't know (%) | Disagree (%) |
|---|--------------|----------------------|-----------------|
| Effective risk management can improve my firm's performance | 60 | 40 | N/A |
| I am aware of the company's risk appetite | 43 | 57 | N/A |
| I know exactly who is responsible for risk management within my firm | 20 | 80 | N/A |
| The attitude on risk has been documented for the benefit of all staff | 19 | 61 | 20 |

| | | | |
|---|----|-----|-----|
| The accountability for risk management is documented and communicated | 10 | 24 | 66 |
| The company requires an independent Chief Risk Officer | 65 | 35 | N/A |
| Risk ownership has been effectively distributed between multiple parties | 10 | 43 | 47 |
| Risk management is at a high level within my firm relative to other firms | 56 | 44 | N/A |
| The company promoted individual responsibility and is supportive of risk taking | 68 | 32 | N/A |
| The management is reluctant to pass on bad news | 64 | 36 | N/A |
| Warning signs of internal and external risk are communicated and shared | 67 | 33 | N/A |
| The company is immune from risk because of its superior position or people | 70 | 30 | N/A |
| There is room to challenge each other's attitudes, ideas and actions | 71 | N/A | 29 |
| The company is in denial; innovation and change is therefore too slow in reacting to external changes | 25 | 22 | 53 |

As indicated above, Douglas' (1978) Grid-Group Theory had categorised group risk culture into four dimensions, '*fatalism*', '*hierarchy*', '*individualism*' and '*egalitarianism*'. The adoption of these categories was considered appropriate to this study, because they address firm-level imperatives. Thus according to the findings, the Legal department has no staff exhibiting '*fatalism*' or '*individualism*' behaviours, the Accounts department had no staff exhibiting '*hierarchy*' behaviour while the Human Resources & Administration (HR&A) department has no staff exhibiting '*hierarchy*' or '*individualism*' behaviours.

Perhaps as expected, the Research department was dominated by staff exhibiting ‘*fatalism*’ behaviour; arguably this result was expected because those working in this department have little or no control over risk-taking decisions within the firm. In Table 3, we show the Ways of Life by individual operating departments within the firm.

Table 3. Ways of Life by operating departments

| Department | Way of life | | | |
|---------------|-------------------------|--------------------------|------------------------------|-------------------------------|
| | ‘ <i>fatalism</i> ’ (%) | ‘ <i>hierarchy</i> ’ (%) | ‘ <i>individualism</i> ’ (%) | ‘ <i>egalitarianism</i> ’ (%) |
| Research | 58 | 8 | 8 | 13 |
| Stock broking | 17 | 8 | 67 | 0 |
| IS | 8 | 8 | 17 | 6 |
| Legal | 0 | 76 | 0 | 17 |
| Accounts | 4 | 0 | 8 | 61 |
| HR & Adm | 13 | 0 | 0 | 3 |

Results and Analysis of Secondary Data

A simple regression analysis shown in Table 4 was performed on the quarterly financial results of the case organisation between 2006 and 2012 in order to measure the impact of risk management on the company’s profitability in the past.

Table 4. Relationship between Profitability and Risk Management

| Regression | | | | | | | | | |
|---|-----------------------------|------------|---------------------------|----------------------------|-------------------|----------|-----|-----|---------------|
| Model Summary | | | | | | | | | |
| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate | Change Statistics | | | | |
| | | | | | R Square Change | F Change | df1 | df2 | Sig. F Change |
| 1 | .541 ^a | .293 | .262 | 182,800.3193 | .293 | 9.542 | 1 | 23 | .005 |
| Coefficients ^a | | | | | | | | | |
| Model | Unstandardised Coefficients | | Standardised Coefficients | t | Sig. | | | | |
| | B | Std. Error | Beta | | | | | | |
| 1 (Constant) | -35236.062 | 45700.080 | | -.771 | .449 | | | | |
| Risk_Management | 235277.840 | 76166.800 | .541 | 3.089 | .005 | | | | |
| Where ^a is dependent variable: Profits | | | | | | | | | |

The results given in Table 4 show the regression model to be:

$$y = -35,236.062 + 235,277.840x_1$$

The coefficient of the intercept, LKR ² (Sri Lankan Rupee) 35,235.062 represents the profitability (y) for the company in the absence of risk management practices. It is evident that in the absence of risk management the company's profits would drop by LKR

² 1USD=131LKR

35,235.062 per quarter. The coefficient of x_1 which represents the dummy variable for risk management practices shows that when risk management is in place (i.e. $x_1 = 1$) it increases the company's profitability by LKR 235,277.84. Furthermore, the coefficient of determination (*R-Square*) shows that there exists a positive correlation between profitability and risk management and that 29.3% of the variation in quarterly profits between 2006 and 2012 could be explained by the risk management practices. However, the *R-Square* has the drawback of having its value increase as the number of independent variables increases. Thus, a more appropriate measure is the 'adjusted *R-Square* value' which overcomes this limitation. As such the most accurate statement would be that, at present, risk management can only explain 26.2% of the variation in quarterly profits and not 29.3% as suggested by the *R-Square*. These results suggest that risk management is a value-adding process which can enhance - and has enhanced - Firm A's profitability. However, it is important to find whether the '*adjusted R-Square*' is low due to any shortcomings in the current risk management processes employed at Firm A which could be hindering the true potential.

Discussion

The three themes that have emerged from the study are now examined; these are (i) risk culture, (ii) Entrepreneurial and enterprise-level risk management and (iii) internal control mechanisms. These themes have emerged from our cross-mapping of primary SME risk capability themes identified in the literature.

Risk and risk culture

In terms of risk culture, when the Grid-Group Theory by Douglas (1978) was applied to the case organisation, it showed staff to exhibit different risk culture. This finding raises

concerns, particularly in relation to the ability of the firm to foster a shared risk culture that will support the development of a shared risk management capability. Research (Gao *et al.*, 2012) has already shown that SMEs lack appropriate risk management capability; thus the existence of varying genres of risk culture raises considerable concerns. One primary reason is that research (Boholm and Corvellec, 2011) had already shown that risk culture is primarily a social process characterised by relationship networks. For this reason, fostering and maintaining a shared culture of risk is of paramount importance to an SME, particularly at the point of transition from start-up, when perhaps the earlier over-arching influence of the owner-manager has begun to wane and firm-level imperatives in the form of processes and frameworks have become more important. As earlier alluded to, at such a point, the role of individual staff members of the firm begins to play a more critical role in entrepreneurial orientation.

Entrepreneurial and enterprise level risk management

In terms of entrepreneurial behaviour, clear articulation of the company's risk behaviour should be followed by the identification of sources of risk so that the company can establish risk limits for the different categories of risk. On the other hand, it might be pertinent for enhanced management effectiveness for 'Firm A' to articulate a clear risk management policy which was not necessarily in existence. Such articulation requires management to articulate the critical risks facing the firm. In effect, there is a need to develop an enhanced capability for enterprise risk management and a clear mandate, and support from executive leadership should be demonstrated. In line with an earlier study (Liebenberg and Hoyt, 2003), successful utilisation of ERM may also require the appointment of an independent Chief Risk Officer to the company's board, a role which did not exist in 'Firm A'. The independence aspect is vital

in this respect as otherwise there could be serious issues pertaining to conflict of interest. The role of the Chief Risk Officer is discussed in greater detail in the next section.

Internal control mechanisms

The notion of internal control requires integrity and ethical behaviour among staff (Stansbury and Barry, 2007). Studies by Li *et al.* (2011) have shown that control mechanisms for operability will generally require clarity in terms of the firms' goals and objectives. However, although the market orientation of 'Firm A' appears flexible, thus negating the need for such formalised internal control mechanisms, risk management literature (Gumbus and Lussier, 2006) suggest that SMEs are less likely to utilise formal risk management frameworks due to the limited availability in required expertise. This is because, although a large number of formalised control systems are available, the majority appear to be designed more for use in larger-sized firms than in SMEs; thus the use of these systems is likely to be expensive for SMEs. The important caveat at this juncture is to acknowledge that although Gao *et al.* (2012; p. 2), suggest that "*inappropriate existing RM approaches and solutions and high cost*" may provide some indication that formalised risk management may be inappropriate for SMEs; we posit that this is not true in all cases. Although the case organisation, 'Firm A', can be described as an SME (based on firm size) with an issued share capital of LKR 1 billion on the Colombo Stock Exchange, the company is able to meet financial obligations associated with operating a formalised risk management framework.

Although the formalised position of Chief Risk Officer did not exist within 'Firm A', one could infer from the company documentation examined (annual reports between 2006 and 2012) that this role was performed on an ad-hoc basis by the Chairman of the firm's Audit Committee, who served on the board in a non-executive capacity. However, as studies - for example - by Norman *et al.* (2010) have ascribed significant importance to the issue of

audit independence in risk management, it may be advisable for the firm to revisit the current independence of the company's Audit Committee. This is particularly advisable in light of the substantial evidence found by Norman *et al.* (2010) suggesting that the existence of independent internal auditors greatly enhances not only the integrity of the entire audit process, but also all the mechanisms of internal control.

Conclusion

The exceedingly competitive, increasingly complex and dynamic global financial markets have further increased the demand for robust risk management frameworks and processes. There are a number of reasons for this including the fact that firms are now being faced by unparalleled levels of not only economic volatility, but also increased competition. In addition, economic growth, particularly in Europe, has been decelerating thus exposing financial institutions around the world to increased risk. As a result, firms are inclined to seek to enhance their managerial abilities in order to ensure that they are capable of not only surviving what is an extremely volatile market and also minimise or prevent threats, but also that they are able to capitalise on opportunities. Developing risk management capabilities according to Henkel (2009) represents a viable comprehensive solution which can ensure that such stated strategic business objectives are met. Despite the fact that the criticality of best-practice risk management to firm effectiveness is generally well researched and articulated by scholars such as Knight *et al.* (2001) in developed economies, there is little (if any) evidence to suggest such articulation within the smaller developing economies of Asia, such as Sri Lanka. There appear to be a number of reasons for limited awareness of such best practice in developing countries such as Sri Lanka, with possible reasons being the lack of qualified expertise in the field of risk management (Chhetri, 2003), and risk management practice

being misconstrued as time consuming and expensive, and which would only impact negatively on the firm's bottom line (Wang *et al.*, 2004).

In order to explore how firms develop their risk management capabilities, this research employed a case study focused on 'Firm A', a diversified financial services company based in Colombo, Sri Lanka. This study analysed Firm A's organisational culture towards risk, prior to identifying the challenges for developing a competitive risk management capability. The findings demonstrated an interest among the case organisation's management seeking to promote a sturdy risk culture; however a number of firm parameters such as poor communication and the lack of a single champion for risk management within the organisation appeared to be hindering the organisation's ability to develop a competitive risk management framework. The study showed serious deficiencies in the company's risk culture; for example, we found that the majority of staff were likely to exaggerate risk which threatened their outlook.

In terms of managerial implications, What emerges from the study in terms of managerial implications is the need for the case organisation to not only reinforce a shared culture of risk management, but also to ensure that *appropriate* control mechanisms exist within the firm. Perhaps most importantly, the design of both the risk management framework and internal control mechanisms must be pragmatic enough to ensure strategic fit to the needs of the firm. In order to enhance its risk management capabilities, it may also be imperative for the organisation to establish not only a dedicated risk management unit staffed by qualified and experienced risk management analysts (noting that the results of the regression analysis serve as evidence of the importance of risk management to the company's operational effectiveness, or profitability). Thus, the rationale (based on literature evidence) for the possible need at board level for the appointment of a Chief Risk Officer is supported. This study has been able to facilitate the development of a clear understanding of

how staff members identify and report risks. Such an understanding may thus be taken into account to develop an appropriate risk management policy that, once aligned to its risk maturity level, will enhance risk capabilities. Finally, the organisation could seek to incorporate ERM into the business while paying much closer attention to the identified challenges in literature for developing risk management capability via ERM.

As expected, the study is not without limitations. The most significant limitation relates to the design and distribution of the questionnaire. Of particular importance is that a 5-point Likert scale was utilised to gather data. Although English is widely spoken in Sri Lanka, most businesses are conducted in Sinhala or Tamil. It became clear, however, during the analysis that due to grammatical, idiomatic and syntactical differences between Sinhala and Tamil, it was necessary to regroup the responses into three (from five) categories for easier analysis. This limitation provides a platform for future work. For example, future work may seek to repeat the study; however in this case, noting the impact of culture and language on perceptions (O'Sullivan *et al.*, 1994), such a study may seek to disseminate questionnaires to case study respondents in their own native language. Such a study will ensure that not only is the effect of grammatical, idiomatic and syntactical differences mitigated, but also from a measure of national cultural disposition, it might be possible to assess how individual national cultural differences of staff influences not only *their* risk culture, but also influences overall *organisational* risk culture.

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