

THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND RISK MANAGEMENT

Ionuț Riza Ph. D Student
Dincă Aurel Ph. D Student
Camelia-Maria Olari Perju Ph. D Student
University of Craiova
Faculty of Economics and Business Administration
Craiova, Romania

Abstract: Corporate Governance is the branch of the economy that studies how companies can become more efficient by using institutional structures as constitutive acts, organizational charts and legislative framework. This branch is, in most cases, limited to studies on how stockholders can provide and motivate company managers to receive the expected benefits on their investments. Corporate governance ensures improved economic efficiency and an interactive investment climate. The risk is an essential element of every business and must be considered from the point of view of corporate governance. All organizations are confronted with uncertainties and challenges and are, therefore, exposed to a certain degree of risk. Depending on how they are addressed, risks can erode or increase the value of an organization. Organization-level implementation of a system based on the relationship between corporate governance and risk management contributes to increasing the performance of any organization's activity.

JEL classification: M19, M21

Key words: corporate governance, risk management, control environment, risk assessment, control activities, monitoring, information and communication.

1. INTRODUCTION

Risk management has been informally practiced ever since the beginning of human history. People have gathered in communities since ancient times in order to conserve resources, share their responsibilities, and protect themselves against the insecurity of life. The history of formal risk management practices in organizations, however, has a shorter life duration and a narrower application field (Griffiths, 2005). Otto von Bismarck, the German Chancellor, introduced, in 1881, the first law on compensation for workers in the event of an accident, and Germany was the first country to create, in 1891, the social security system for elderly people. During 1905-1912, the United States introduced the laws on compensation for workers (following the model established by Bismarck in 1881). These events marked the shift from individual responsibility to the organizations and governments responsibility in the matter of risk management (Murray-Webster, 2010).

In 1920 was established Tanker Insurance, the world's first 'captive insurer' (a captive insurer is an insurance company established by the insured enterprise and owned

by it). 'Captive' insurance companies illustrate the idea of internal risk financing instead of transferring them to an outside insurer. There are currently over 4000 companies in the world who receive annual premiums worth more than \$ 20 billion (Murray-Webster, 2010). In the early 1950s, the organizations that formally operated risk management had an insurance chief whose primary task was to place and manage funds destined for various types of business insurance. This responsible person could be found in the finance, procurement or, later on, when concerns about employee insurance became important, in the human resources department. The concept of risk retention was poorly developed; the vast majority of organizations preferred to transfer the risks. Risk managers (as many as they existed) dealt exclusively with insurable risks; the other risks (market risk, operational risk, legal risks, etc.) were the responsibility of specialists from various departments of the company (Murray-Webster, 2010). The 1960s could best be defined as a time when risk managers struggle to build their own professional identity. The beginning of this period marked an important point in the evolution of risk management, namely the decrease of traditional insurance products as a means of financing the risks (Hull, 2015). Risk management goes into a phase of internationalization and globalization starting with the 1970s and 1980s. Risk management techniques are becoming more and more sophisticated at this time; is the period in which there is a particular interest in internal (or retention) risk financing techniques - self-insurance plans, captive insurance companies, risk-retaining companies, etc. (Vose, 2008). During the 1990s, risk management practices continued to evolve. Risk management is not a mature field yet, such as marketing, finance, or accounting. The term corporate governance is increasingly used in the economic environment in recent decades in the world, becoming an important concern at national level in recent years. The etymology of the word comes from the Greek word 'cyber', meaning the helmsman of a ship understood as a leader. Developments in the corporate environment and the complexity of managing multinational companies have led, in the context of globalization, to the need for standards, guidelines and codes of governance (Love and Klapper, 2002).

In specialty literature, corporate governance comprises the set of rules and principles under which a company operates, the relationship between managers and accountants, how they deal with the various challenges that arise in conducting business within the enterprise (Ghiță, 2008). Under the conditions of the world today, under the economic crisis effects, people with a complete vision of the surrounding reality are needed, people that are able to identify the problems faced by the organizations and provide the solutions needed to solve them. Through their work, internal auditors have the responsibility to implement an adequate internal control system and to keep risks at a low level in order to get the best performance from the organization they are part of. Thus, internal audit contributes to the implementation of efficient processes and structures of corporate governance within them (Onofrei, 2009). Governance is a very broad concept that includes sound and effective supervision of how something is done, managed and controlled in order to protect the interests of the respective area, organizations or institutions (Morariu et al., 2008). The term *governance* is synonymous, in Romanian, with the term *administration / management processes*. The term *governance* in Romanian also means *leadership* and involves all the activities within an entity that comes within the sphere of management. The Anglo-Saxon system uses the concept of Corporate Governance, a term in auditors' practice, which is also provided by International Standards on Internal Audit. If the term *governance* means *leadership*, it results that the term

corporate governance brings something extra. In this regard, the term "corporate" comes from "body", which implies the idea of an ensemble, a whole, a unit, an organization (Feleagă et al., 2001). Corporate governance has its origins in corporate mechanisms and bankruptcy laws in each country, and in the mechanisms of judicial sanction, which establish the basic rules of internal relations between different participants in a corporation (Ghiță, et al., 2010). The concept - corporate governance - means the overall management of the entire organization by accepting all internal components that work together, which will ultimately be integrated within management, and the implementation of risk management within the organization and the financial management and internal control system (Hermanson and Rittenberg, 2003) We specify that in practice, although incomplete, the synonym for governance is control.

The concept of corporate governance is supported by internal auditing, which plays an important role in helping to reorganize the internal control system and to advise general management. An organization's risk management is among the newcomers to the concept of corporate governance that brings a holistic perspective as an integrating factor to the parts of a whole, which is the organization. Together with governance, risk management and internal control are the three major components of corporate governance.

2. OBJECTIVES

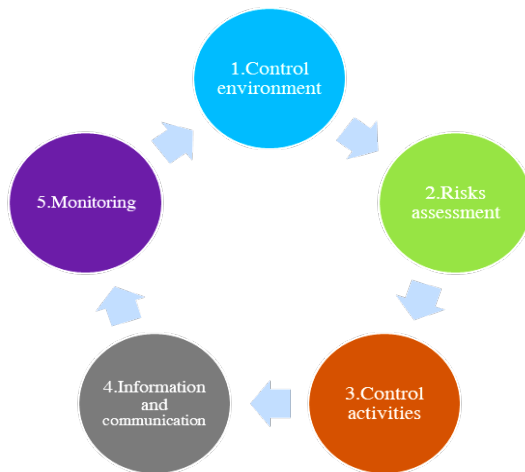
The present study aims to be a theoretical but also empirical one, on the approach to the relationship between corporate governance and the importance of the risk manager at the organization level, based on rules or principles.

3. METHODOLOGY

The present research involved over 100 managers from different organizations. The research study was based on questionnaire and the sample size was the simple random sizing. In order to determine the validity of the questionnaire, the alpha-Kronbass calculation method was used, whose value was equal to 0.86. There were used statistic methods for data analysis, as Friedman, Pearson and Spearman methods. In the data analysis process, the relationship between corporate governance and risk management - as a system composed of five inter-related components that are part of the managerial process (Figure no. 1) was approached:

1. Control environment: "sets the tone" in an organization decisively influencing people's attitude towards control. In other words, the control environment is the foundation of all other components, ensuring discipline. Among the factors that influence the control environment we mention: integrity, ethical values, competence of personnel, management philosophy and its manner of action, designation of authority and responsibilities, etc;

2. Risk assessment: each organization is exposed to risks whose probability and impact should be assessed. A prerequisite for risk assessment is establishing the correlated objectives vertically and horizontally within an organization. Risk assessment involves identifying and analyzing them in light of the danger they pose to the organization's goals. This is what we call the risk fund to be managed. Some organizations, especially the large ones, have created a distinct operational structure to carry out this complex process, known as the organization's risk management. Simultaneously, given the fact that economic, legislative circumstances, etc. are constantly changing, new mechanisms are needed to identify and control the risks associated with these changes;



Source: the author's own concept

Figure no. 1 The the management process system

3. Control activities: reflect the policies and control procedures applied throughout the organization including, for example, approvals, authorizations, examinations, reconciliations, etc;

4. Information and communication: information systems produce the necessary information for the day-to-day running of businesses, such as reports on financial, operational issues, etc. Without effective communication, both vertically and horizontally, any information system is worthless;

5. Monitoring: internal control systems must be monitored in the sense of being assessed in terms of performance over time. In the absence of such monitoring, the efficiency and effectiveness of internal controls would not be known and, as a consequence, deficiencies could not be corrected, as its strengths could not be strengthened. The coverage and frequency of these assessments depends on the risk assessment process and on the effectiveness of the monitoring procedures.

4. ANALYSES

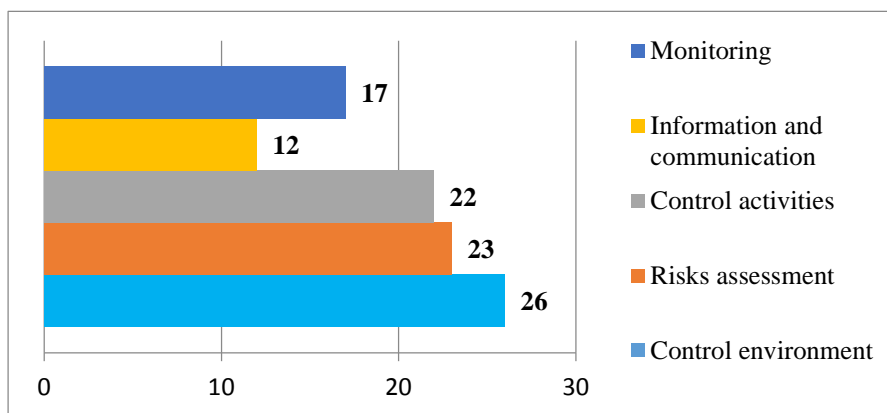
All the elements that make up the system are in a continuous interdependence. Changing one, leads, most of the times, to changing the others. This fact must be known by the general manager and be in his permanent care. It is important for all managers to know, be responsive and take these elements into account so as to ensure the increase of the potential to achieve the objectives of the organization.

The main results indicate that managers consider, depending on importance, first control environment (26%), risk assessment (23%), control activities (22%), monitoring (17%), and, in the last Information and Communication (12%) - Figure no. 2.

The study concludes that the main benefits of corporate governance and risk management, as considered by managers, are:

- ✓ Protecting the reputation;
- ✓ More satisfied customers;
- ✓ More attention to doing the right things in a proper manner;
- ✓ Greater opportunity to achieve business objectives;
- ✓ Less complaints;

- ✓ Increased opportunity for change initiatives;
- ✓ Take risks and adopt more informed decisions.



Source: the author's own concept

Figure no. 2 Assessment of the importance of system elements

The objectives of approaching corporate governance and risk management by organizational managers are to ensure that: risk management is a key part of the company's strategic management; there is a positive approach to risk taking; risks are taken into account when adopting any decision; opportunities are maximized by actively managing the risks and threats that can prevent success.

In order to achieve these goals, managers will adopt the following approach:

- Clear responsibilities, roles and reporting lines for risk management will be established and maintained within all functions and departments;
- A training program and learning opportunities will be introduced to provide the managers the needed skills and expertise to manage risk;
- Risk analyzes will be incorporated and considered as part of the decision-making process, business planning and process review of the company;
- Measures taken to manage individual risks will be appropriate to the potential and potential impact of these risks on achieving the company's objectives;
- An updated register - that can be easily accessible to all who may need it - will identify all strategic and operational risks, provide an estimate / fix / appreciation and record of ongoing measures to manage these risks;
- The performance of the risk management activities will be measured against the goals and objectives of the company;
- An understanding of risk and its management will be attempted at all levels of the organization, with major partners and shareholders, combined with risk treatment within the organization.

5. CONCLUSIONS

Good corporate governance and a robust risk management system ensure the improvement of economic efficiency and the establishment of an interactive investment climate. Among the most important benefits of implementing high corporate governance standards we mention: resource use efficiency, lower cost of capital, increased investor

confidence due to sensitive discretionary discretion of managers and reduced corruption. At the opposite end, poor corporate governance distorts the efficient allocation of capital to the economy, hinders foreign investment, reduces the confidence of capital holders, and favors corruption. Managing risks in compliance with corporate governance codes and policies represents the assurance of integrity, sincerity, transparency and accountability, in terms of performance. The personnel, regardless of their hierarchical level, must be aware of the importance of risk management in achieving their own goals and carry out monitoring and control based on efficiency and effectiveness principles. Clearly knowing the threats makes it possible to prioritize them depending on the eventuality of their materialization, the extent of their impact on the objectives and the costs involved in measures designed to reduce the chances of occurrence or to limit unwanted effects. Establishing hierarchies is the support of introducing a priority order in resource allocation, in most limited cases, as a result of a "cost-benefit" or, more generally, "effort-effect" analysis. It is essential for the organization to focus its efforts on what is really important, not to disperse its resources in areas that are irrelevant to its goals. At the same time, the regular risk assessment, as set out in the standards, leads to reallocations of resources, in line with changing hierarchies and, implicitly, priorities. In other words, risk management involves concentrating resources in the areas of current interest.

REFERENCES

1. Feleagă, N., Feleagă, L., Dragomir, V., Bigioi, A.,
Ghiță M., Boghean F., Halanciuc E., Ghiță R.,
Ghiță, M., Griffiths, P., Hermanson, D., Rittenberg, L., Hull, J.C., Love I., and Klapper L.F., Morariu A., Suci G., Stoian F., Murray-Webster, R., Onofrei M., Vose, D.,
Guvernanța corporativă în economiile emergente: cazul României, Economie teoretică și aplicată, 2011
Guvernanța corporativă și auditul intern, Ed. Tipo Moldova, Iași, 2010
Guvernanță corporativă, Ed. Economică, București, 2008.
Risk-Based Auditing, Gower Publishing Limited, England, 2005
Internal Audit and Organizational Governance, The Institute of Internal Auditors, 2003
Risk Management and Financial Institutions. 4th Edition. New Jersey: Wiley, 2015
Corporate governance, investor protection, and performance in emerging markets, Ed. The World Bank Development Research Group, Washington D.C, Aprilie 2002
Audit intern și guvernanță corporativă, Ed. Universitară București, 2008
Management of risk: guidance for practitioners. 3rd Edition. London: The Stationery Office Ltd., 2010
Guvernanța financiară corporativă, Ed. Wolters Kluwer, București, 2009
Risk Analysis: A Quantitative Guide. 3rd Edition. New Jersey: Wiley, 2008