Actors in Risk Governance: An Upper-Echelons Perspective

Univ.-Prof. Dr. Martin Hiebl

Universität Siegen

5th Annual Conference Risk Governance

Siegen, October 5, 2017

Outline

- Motivation
- Upper Echelons Theory and Risk Governance
- Present Findings in the Literature
- Suggestions for Future Research

Motivation

Issues in the current literature on risk governance (RG) and ERM

- Insufficient understanding of what drives the adoption and sophistication of RG/ERM (Bromiley et al., 2015; Stein and Wiedemann, 2016)
- Existant research often rests on "optimal conditions" and an insufficient understanding of how firms behave when it comes to RG/ERM (Bromiley et al., 2015)
- Top managers play a highly important role in responding to other actors' demands on RG/ERM (e.g., government, regulators, stock market) and in implementing RG/ERM (Bromiley et al., 2015; Cohen et al., 2017; Mikes and Kaplan, 2014)
- As put by Mikes and Kaplan (2014): Firms with mature risk management systems have the active support of top management

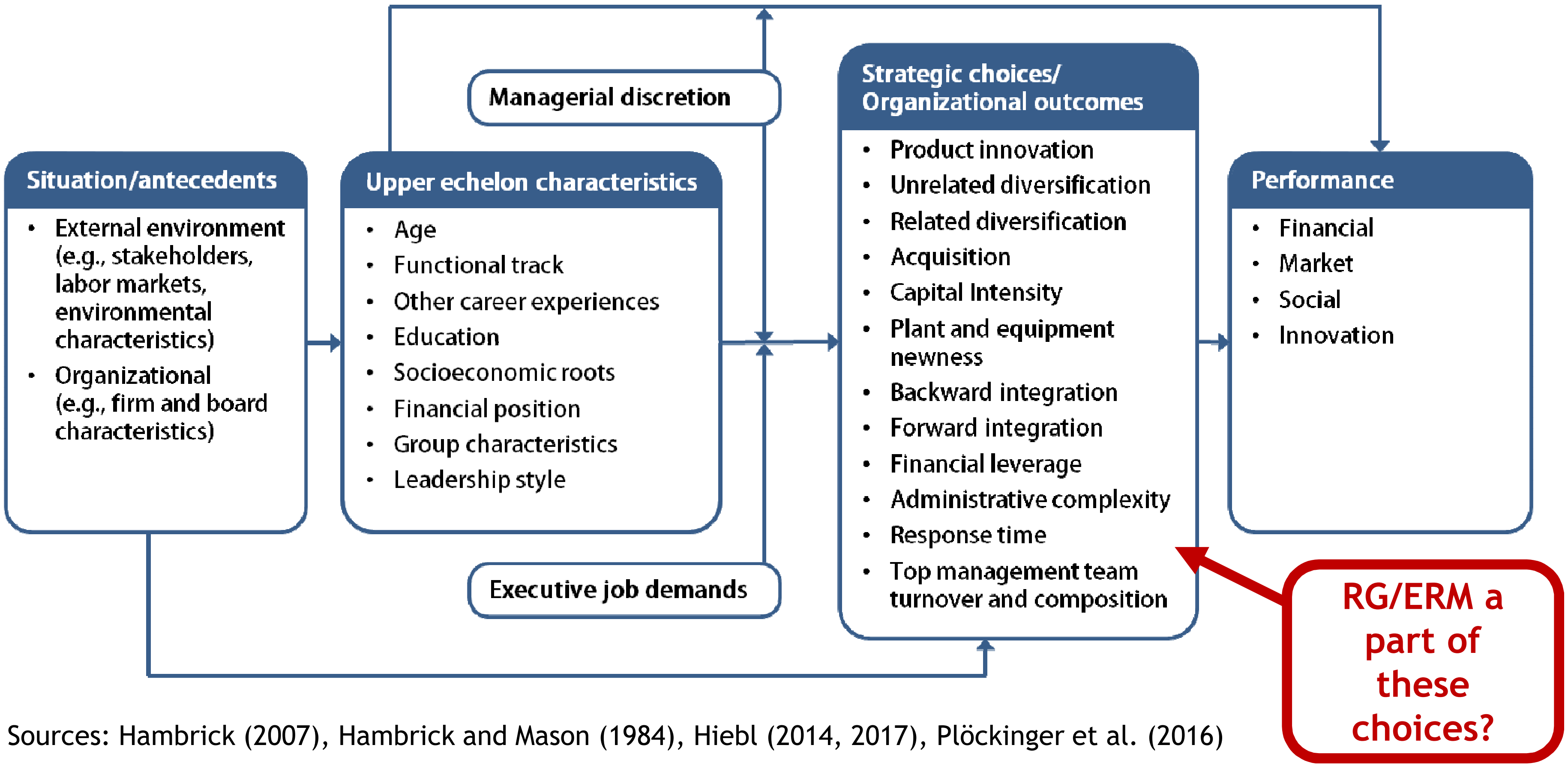
An upper-echelons perspective on RG/ERM

- The role of top managers for explaining the adoption, sophistication and effectiveness of RG/ERM seems paramount, but has so far been under-researched
- Upper echelons theory provides a useful and well established frame to guide future research on RG/ERM
- This paper aims to synthesize what is known empirically and what needs knowing on upper echelons and RG/ERM

Outline

- Motivation
- Upper Echelons Theory and Risk Governance
- Present Findings in the Literature
- Suggestions for Future Research

Upper Echelons Theory



Sources: Hambrick (2007), Hambrick and Mason (1984), Hiebl (2014, 2017), Plöckinger et al. (2016)

RG/ERM as Strategic Choices/ Organizational Outcomes

Conceptual arguments in the literature

- Some parts of a firm's overall approach to risk management are not subject to managerial discretion, but are demanded by government, regulation, etc. (Bromiley et al., 2015; Viscelli et al., 2017)
- Even firms which are subject to the same regulation show significant variation in terms of RG/ERM adoption and sophistication (Mikes and Kaplan, 2014; Zhao and Singhaputtangkul, 2016)
- Hambrick and Mason (1984): Strategic choices are "choices made formally and informally, indecision as well as decision, major administrative choices (e.g., reward systems and structure) as well as the domain and competitive choices more generally associated with the term 'strategy'."

RG/ERM as strategic choices

Since not all firms show the same level of RG/ERM adoption and sophistication, this level seems to depend – at least in parts – on strategic choices made → **RG/ERM can be interpreted as a facet of strategic choices in line with upper echelons theory**

Outline

- Motivation
- Upper Echelons Theory and Risk Governance
- Present Findings in the Literature
- Suggestions for Future Research

Identification of Relevant Studies

Keywords search in electronic databases

Only 10 papers found so far

- Search string (built on earlier review papers on upper echelons theory such as Hiebl, 2014, 2017): ("chief financial officer*" OR "CFO*" OR "Chief executive officer*" OR "CEO*" OR "top management*" OR "top manager*" OR "upper echelon*" OR "leadership*") AND ("enterprise risk manage*" OR "risk governance* OR "ERM*")[1]
- Used for Scopus, Clarivate Web of Science, plus analysis of citations and references
- Only included articles that are listed in the latest edition of the Association of Business Schools' (ABS) Academic Journal Guide 2015 or have been awarded an Impact Factor by Clarivate as of 2017
- More than 50 search hits, but only 10 papers identified as relevant
- Relevant papers from three academic fields: Accounting (4), Finance (4), Operations and Technology Management (2)
- 8 out of 10 papers published in last 5 years

[1] Chief Risk Officers (CROs) were excluded since their presence is often viewed as a proxy for ERM adoption (e.g., Aebi et al., 2012; Pagach and Warr, 2011).

Preliminary Findings (1/2)

Overall observations

- Little empirical research so far on UEs and RG/ERM, but growing quickly in the last 5 years
- No paper explicitly drawing on UET
- Existent papers lend support to UEs' significant influence on RG/ERM

UEs and governance arrangements

- If the CEO sits on the board of directors, firms are less likely to invest in RG (Lundqvist, 2015)
- When CEO compensation packages are more sensitive to stock volatility, there is a higher likelihood of hiring a CRO (as a proxy for ERM) (Pagach and Warr, 2011)
- Firms with a management-level risk committee which regularly discusses enterprise-level risks show more mature ERM systems and higher levels of perceived benefits from ERM systems (Beasley et al., 2015)

Preliminary Findings (2/2)

UEs' demographic characteristics

- Firms with top managers who have received formal training and guidance on risk management show more mature ERM systems and higher levels of perceived benefits from ERM systems (Beasley et al., 2015)
- If top managers hold a controlling share in the firm (i.e., owner-managed firms), firms have a less mature ERM system (Paape and Speklé, 2012)

UEs' psycho-logical and motivational characteristics

- CEOs' higher risk-taking propensity is associated with higher ERM adoption rates (Ludin et al., 2017)
- Top managers' commitment to ERM and taking leadership is critical to ERM implementation (Beasley et al., 2005; Zhao et al., 2013, 2014)

Outcomes of UE involvement in RG/ERM

- Firms where the CRO (as a proxy for ERM) reports directly to the board of directors and not to the CEO perform better (Aebi et al., 2012)
- ERM adds to financial performance if dedicated risk manager reports directly to CEO, CFO or board of directors (Grace et al., 2015)

Outline

- Motivation
- Upper Echelons Theory and Risk Governance
- Present Findings in the Literature
- Suggestions for Future Research

Suggestions for Future Research (1/2)

Fit between UE characteristics and RG/ERM

- Do some UE characteristics fit better with certain RG/ERM characteristics?
  - For instance, it could be assumed that **top managers with a business-related educational background** are more used to "complex administrative systems" (Hambrick and Mason, 1984) than executives with other backgrounds → business background plus mature RG/ERM systems leads to better risk-related performance and firm performance?
  - **Leadership style:** Are top managers with an "initiating structure" leadership style more prone to mature RG/ERM? Does such a leadership style better fit with well developed RG/ERM systems? Or does an "initiating structure" leadership style compensate for more advanced RG/ERM systems?
- Is **higher managerial discretion "better"** (for risk-related and overall performance) when it comes to RG/ERM implementation? How do UE characteristics interact with discretion in RG/ERM adoption?

Suggestions for Future Research (2/2)

Implications for regulation?

- Do we need more advanced **regulation for small, owner-managed firms** since they use RG/ERM only to a little extent (Paape and Speklé, 2012), but at the same time also account for most insolvencies worldwide?
- Do we need **more advanced training requirements** for top managers since such training apparently leads to higher RG/ERM adoption and effectiveness (Beasley et al., 2015)? If so, how should such trainings look like?

Interaction with other control systems

- The management control literature suggests that employee behavior is contingent to the entire "package" of controls, not to individual controls (Malmi and Brown, 2008; Otley, 2016) → Can **other controls complement "low fit" UE characteristics** when controlling risk?

Questions/comments?

Review Sample

Paper	Field (as of ABS)	Journal
Aebi et al. (2012)	Finance	Journal of Banking & Finance
Beasley et al. (2005)	Accounting	Journal of Accounting & Public Policy
Beasley et al. (2015)	Accounting	Journal of Accounting & Public Policy
Grace et al. (2015)	Finance	Journal of Risk & Insurance
Ludin et al. (2017)	Finance	Risk Management
Lundqvist (2015)	Accounting	Journal of Accounting & Public Policy
Paape and Speklé (2012)	Accounting	European Accounting Review
Pagach and Warr (2011)	Finance	Journal of Risk & Insurance
Zhao et al. (2013)	Operations & TM	Construction Management and Economics
Zhao et al. (2014)	Operations & TM	Journal of Construction Engineering and Management

References (1/2)

Aebi, V., Sabato, G., & Schmid, M. (2012). Risk management, corporate governance, and bank performance in the financial crisis. *Journal of Banking & Finance*, *36*(12), 3213-3226.

Beasley, M., Branson, B., & Pagach, D. (2015). An analysis of the maturity and strategic impact of investments in ERM. *Journal of Accounting and Public Policy*, *34*(3), 219-243.

Beasley, M. S., Clune, R., & Hermanson, D. R. (2005). Enterprise risk management: An empirical analysis of factors associated with the extent of implementation. *Journal of Accounting and Public Policy*, *24*(6), 521-531.

Bromiley, P., McShane, M., Nair, A., & Rustambekov, E. (2015). Enterprise risk management: Review, critique, and research directions. *Long Range Planning*, *48*(4), 265-276.

Cohen, J., Krishnamoorthy, G., & Wright, A. (2017). Enterprise risk management and the financial reporting process: The experiences of audit committee members, CFOs, and external auditors. *Contemporary Accounting Research*, *34*(2), 1178-1209.

Grace, M. F., Leverty, J. T., Phillips, R. D., & Shimpi, P. (2015). The value of investing in enterprise risk management. *Journal of Risk and Insurance*, *82*(2), 289-316.

Hambrick, D. C. (2007). Upper echelons theory: An update. *Academy of Management Review*, *32*(2), 334-343.

Hambrick, D. C., & Mason, P. A. (1984). Upper echelons: The organization as a reflection of its top managers. *Academy of Management Review*, *9*(2), 193-206.

Hiebl, M. R. W. (2014). Upper echelons theory in management accounting and control research. *Journal of Management Control*, *24*(3), 223-240.

Hiebl, M. R. W. (2017). Finance managers in family firms: An upper-echelons view. *Journal of Family Business Management*, *7*(2), 207-220.

Ludin, K. R. M., Mohamed, Z. M., & Mohd-Saleh, N. (2017). The association between CEO characteristics, internal audit quality and risk-management implementation in the public sector. *Risk Management*, forthcoming.

Lundqvist, S. A. (2015). Why firms implement risk governance–Stepping beyond traditional risk management to enterprise risk management. *Journal of Accounting and Public Policy*, *34*(5), 441-466.

References (2/2)

Malmi, T., & Brown, D. A. (2008). Management control systems as a package—Opportunities, challenges and research directions. *Management Accounting Research*, *19*(4), 287-300.

Mikes, A., & Kaplan, R. S. (2014). Towards a contingency theory of enterprise risk management. Working paper, Harvard Business School.

Otley, D. (2016). The contingency theory of management accounting and control: 1980–2014. *Management Accounting Research*, *31*, 45-62.

Paape, L., & Speklè, R. F. (2012). The adoption and design of enterprise risk management practices: An empirical study. *European Accounting Review*, *21*(3), 533-564.

Plöckinger, M., Aschauer, E., Hiebl, M. R. W., & Rohatschek, R. (2016). The influence of individual executives on corporate financial reporting: A review and outlook from the perspective of upper echelons theory. *Journal of Accounting Literature*, *37*, 55-75.

Stein, V., & Wiedemann, A. (2016). Risk governance: conceptualization, tasks, and research agenda. *Journal of Business Economics*, *86*(8), 813-836.

Viscelli, T. R., Hermanson, D. R., & Beasley, M. S. (2017). The Integration of ERM and Strategy: Implications for Corporate Governance. *Accounting Horizons*, *31*(2), 69-82.

Zhao, X., & Singhaputtangkul, N. (2016). Effects of firm characteristics on enterprise risk management: Case study of Chinese construction firms operating in Singapore. *Journal of Management in Engineering*, *32*(4), 05016008.

Zhao, X., Hwang, B. G., Pheng Low, S., & Wu, P. (2014). Reducing hindrances to enterprise risk management implementation in construction firms. *Journal of Construction Engineering and Management*, *141*(3), 04014083.

Zhao, X., Hwang, B. G., & Low, S. P. (2013). Critical success factors for enterprise risk management in Chinese construction companies. *Construction Management and Economics*, *31*(12), 1199-1214.