

Enterprise Risk Management Best Practices for Improvement Financial Performance in Manufacturing SMEs in Cameroon

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Abstract- *The aim of this study is to determine the relationship between the best practices of risk management and the financial performance among 86 manufacturing small and medium enterprises in Cameroon. To achieve this objective, we will carry out a Multivariate Analysis; and the results based on correlation analysis highlight a positive and significant impact of risk culture on financial performance of these enterprises and also show that the independence of the board of directors by itself is not sufficient to increase the firm's performance.*

Key Words- *Risk Management best practices; Financial Performance; Manufacturing SMEs*

1. INTRODUCTION

While risk management within the companies is far from being a new concern, the exposure of companies to risks is increasing. Financial scandals, natural disasters and political crises are many different events which seem to highlight the urgency and the need to control risk. ERM is defined by COSO (2004, 2) as: "...a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risks to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives." We know that Enterprise Risk Management can be defined as a systematically integrated and disciplined approach in managing risks within organizations to ensure that companies achieve their objective which is to maximize and create value for their stakeholders. Based on Mikes (2005)[31], Enterprise Risk Management can be defined also as a systematic approach for managing risk. By effectively managing risk, companies and organizations could possibly achieve their objectives and eventually create value for their stakeholders. However, the only way of dealing with this problem effectively is through the implementation of a risk management system within the company. This is true even if the Conference Board has found that many companies are beginning to use it as a tool of strategic management (conference board of Canada, July 2005)[7]. However, the purpose of this paper is to examine to which extent the good practices of enterprise risk management influences the financial performance of manufacturing SMEs in Cameroon. We believe that our work is important and timely. Moreover like other studies, it underlines the advantages of the implementation of risk management on business

performance. But also there are many disagreements as for the impact of this one on financial performance. Based on these facts, more research on this subject is needed. Thus, we will analyze up to which level the practice of risk management within a company can determine the financial performance of the latter. Our research objective is to study the relationship between risk management best practices and financial performance of manufacturing SMEs in Cameroon.

2. LITERATURE REVIEW

2.1. Financial performance

Firm performance is a concept explaining success of a company or a reflection on of the achievement the objectives of the organization. It described how a company carried out performance over a period of time (Miller and Cardinal, 1994)[32]. In other words, the performance difference between the actual result and expected results has been presented. The performance measurement is an important management tool for continuous improvement. It can improve the productivity and quality (Aguinis, 2009)[2], a competitive advantage (poyhart et al., 2006)[35], in recognition of the performance gap, Agrawal and Knoeber (1996)[1]. Economic theory suggests that performance measurement should include not only financial measure but also nonfinancial measures that reflect different dimensions of managerial actions. Most of the time Business performance is focused on the use of simple financial indicators is intended to show the performance of the company's economic objectives. This concept is known as the financial performance, which is the dominant model for empirical research, Hofer (1983)[19]; but very often criticized in the literature for its lack of predictive ability, and focus on the short term. The financial performance is more easy to determine, and also allows us to see the

immediate impact. By contrast, the non-financial measurements often focused on the long term and do not have immediate impact to the company Ittner and al. (2003)[21]. It is probably that the non-financial indicators are often not used or used more narrowly than financial measures.

In addition, said et al. (2003)[38] said companies which use performance measurement systems based on non-financial data have a higher level stock market performance than other, confirming that the non-financial measures reveal a suitable informative for performance management. The results of others authors also confirm that the use of non-financial measurements is related to the degree of innovation of the company and its strategic direction in terms of quality. With this in mind, we have decided to measure the performance in the context of this research through financial measurements.

To apprehend the financial performance, the literature presents various points of view which are based on the perception that the authors have of the performance and on their objectives in view. This resulted in an absence of unanimity on the indicators to be used to measure financial performance. Lise Chrétien and al., (2005)[29] measured the financial performance by the average rate of the project, Josée St-Pierre et al (2005)[24] have used the return on assets, return on equity, efficiency of production, gross margin, net margin and the average sales growth. As far as we are concerned, we use the Return on Equity (ROE). In fact, the ROE is a measure of the profitability of shareholders. .

2.2. Analysis of the Relationship between Enterprise Risk Management and Firm Financial Performance

Previous studies on risk management have shown some divergence in the relationship between the practice of risk management within an enterprise and its potential impact on financial performance. In the literature we found several authors like Hoyt and Liebenberg (2011)[20]; Waweru and Kisaka (2013)[40]; Gates, Nicolas and Walker (2012)[12]; Nocco and Stulz (2006)[33]; which establish a significant link between ERM and the creation value for the companies. However, the studies of other authors, such as Pagach and Warr (2010)[34]; Ballantyne (2013) [4] have shown that there is no significant relation between adoption of risk management and business performance. So we can say that further studies on the risk management should be carried out to confirm that risk management has an impact on the performance of enterprises.

2.2.1 Significant relationship between ERM implementation and Firms Financial Performance

Based on 117 insurance companies in the U.S, Hoyt and Liebenberg (2011)[20] examine the implication of ERM programs on firms' value. The study found a positive association between firms' value and the use of ERM. The study is supported by Waweru and Kisaka (2013)[40]

who examine the level of ERM implementation in firms listed on the Nairobi Stock Exchange. The results show that an increase in the level of ERM implementation in companies positively contributes to the value of the companies. Giorgio and al., (2013) [15] as for him examines the impact of adoption risk management on the value of company and on the determinants of the choice of risk management. Based on a sample of 200 companies in the financial and non-financial sector; their results showed that risk management has a positive impact on the value of the European companies. Another survey carries out by Gates, Nicolas and Walker (2012)[12] examines the practical value of ERM implementation. The study found that a positive relationship between enchanted management and improved perceived performance; also, management are willing to implement ERM to improve perceived performance; ERM improves risk management more visibly in medium and smaller firms and better management leads to increase ability to meet strategic goals, reduce earnings volatility and increase profitability. However, there are studies that found no significant relationship between ERM and firm financial performance.

2.2.2 No significant relationship between ERM implementation and Firms Financial performance.

Ramlee and Ahmad (2015)[37] analyze the financial performances of the nonfinancial companies on a sample of 74 companies among which they were companies with a board of risk management and others without board of risk management. The financial performance was measured by the ROE, ROA and Tobin Q. The studies showed no significant effect of risk management on the performance of the non financial businesses in Malaysia. According to this study, the companies applying risk management are not more efficient than those not applying the risk management.

Ballantyne (2013)[4] analyses ERM and firms' financial performances based on a sample of 134 U.S. publicly traded companies using online survey and through public disclosure of the financial statements. The study found that ERM adoption is not associated with firm's financial performance. Similarly, in Malaysia, Tahir and Razali (2011)[39] predict the relationship between ERM and firms' value based on a sample of 528 firms in 2007 using OSIRIS database. The firms' value is measured by Tobin's Q and is tested against the ERM variables, namely: firm sizes, leverage, ROA, international diversification and majority of ownership. The study evidences no significant relationship between ERM and firms' value.

For Pagach and Warr (2010)[34] which examine the effect of adopting ERM principles on firms' long-term performance. They examine how financial assets and market characteristics change around the time of ERM adoption. Using a sample of 106 firms that announce the hiring of a Chief Risk Officer (CRO), they found that some firms that adopt ERM experience a reduction in

earnings volatility. However, there is little impact of the ERM adoption on a wide range of firms' variables. Invariably, their study fails to support the proposition that ERM is value creating.

3. BEST PRACTICES IN ENTERPRISE RISK MANAGEMENT

3.1 Risk Culture

The most important aspect of risk management practice is the integration of risk into a company's culture and values. Obviously, risk needs to be considered an integral part of corporate strategy. Unfortunately, this integration is one of the most difficult aspects of risk management to implement. The study realized by Green and Jennings-Mares (2008) states that the most important aspect in the risk management is the growth of a coherent and consistent risk culture. An education program aimed to spread this culture should be consolidated by all the managers and employees of the company (Nambiar, 2006). A weak risk culture is one in which employees have little sense of the importance of risk management and their role in it. For Economist Intelligence Unit EIU (2007), the key of success in risk management has become the need to ensure that a strong culture and awareness of risk permeates every layer of the organization. It means that risk management is seen as a central part of daily operations in enterprise. Protiviti (2006) [36] also shows that the absence of a common language and awareness prevents to sharing the good practices across the organizations. It can generate a great uncertainty. Therefore:

Hypothesis 1: There is a positive and significant relationship between risk culture and SME financial performance.

3.2 Presence of Chief Risk Officer

The presence of a CRO is the most common practice among all. Its reason is debated by many authors in the literature. According to Kleffner, Lee and McGannon (2003) [26], the influence of risk manager is a key factor for driving and facilitating the ERM process in companies. For (Daud Yazid and Hussin, 2010) [9] and (Liebenberg and Hoyt, 2003) [28], the appointment of a CRO is a sign of a ERM program and his quality and skills promote ERM importance for all the executives and influence the whole company. In the EIU survey (2007), CROs are already in place at 38% of those organizations represented in the EIU, and 21% have plans to appoint an individual to this role over the next years. For Trying to be neutral, the study of Beasley, Pagach and Warr (2007) [5] do not show any financial benefit for the shareholders in those companies that hired CRO.

the Practice of appointing a Chief Risk Officer to carry out the responsibility for implementing and developing the risk management framework is reaching maturity, with most of those companies that favor the approach having already adopted it. This approach is most popular

in the financial sector where firms have appointed, or plan to appoint a CRO. Therefore:

Hypothesis 2: The relationship between presence of a CRO in SMEs and financial performance is positive and significant.

3.3 Independence of board of directors

One of the most important changes in corporate governance practice concerns the issue of board independence. This independence is to ensuring that the board is objective enough to act in the best interests of the company's stakeholders. Furthermore, independence is a key in ensuring that the board is able to exercise its primary responsibility of oversight of the company without being overly involved in its day to day management.

A board of directors is considered more independent if it has a number of non-executive directors (John and Senbet, 1998) [23]. The presence of independent directors can improve the quality of supervision, as it is not affiliated with the company so freely in the decision making process. This theory is often referred to as the theory of control effect (Fama and Jensen, 1983) [11]. Thus we can say with Anderson and Reeb (2004) that outside directors can provide monitoring expertise that contributes to business performance. Alternatively, risk behaviours may increase to the extent that the outside directors have greater expertise in the sector and are under pressure from external investors to improve performance (George et al., 2005). According to Beasley et al., (2007) [5], an independent board is more objective to comply with the management's actions and strategies than companies that do not possess this independence. Therefore

Hypothesis 3: There is positive and significant relationship between independence of board and SMEs financial performance.

3.4 Separation of CEO and Chairman

The best practice of corporate governance requires that the positions of CEO and the chairman should be held by different individuals. According to Jensen (1993) [22], when the CEO also holds the position of the chairman of the board, internal control systems may fail, as the board committed cannot effectively perform its functions including those of evaluating and firing CEO. Similarly, Fama and Jensen (1983) [11] argue that concentration of decision management and control decision in one individual reduces an effectiveness of board in monitoring top management. Comparing the performance of firms that combine CEO and chairman duties with those firms that separate them, Brickely et al (1997) [6] show that firms combining the duties perform no worse than those that do not combine them. In addition, Goyal and Park (2002) [17] find that the sensitivity of top executive turnover to company performance is significantly lower for firms that acquire the titles of CEO and chairman in the same individual.

According to Desender (2007), companies with independence of board and segregation between CEO and the chairman present the highest level of risk management. BODs and the CEO are responsible for strategic direction of the firm and the creation of an environment for an effective risk management system. An effective ERM implementation requires the strong commitment from the BODs and top management. Therefore:

Hypothesis 4: There is positive and significant relationship between separation of CEO and Chairman and SMEs financial performance.

4. RESEARCH METHODOLOGY

We will adopt for our study a hypothetical-deductible approach that will allow us to test our hypotheses. To verify our research hypotheses, we used the database of the National Institute of Statistics of Cameroon which contains information on manufacturing SMEs with a very varied profile. From this database, 86 companies were selected to constitute our sample. The sample of our study

is constitute of manufacturing SMEs with a turnover greater than or equal to ten million FCFA.

To answer our research question, what is the impact of the good practice of enterprise risk management on the financial performance of manufacturing SMEs in Cameroon? We will carry out a regression analysis and bivariate correlations using the model: The following regression is used to understand the link between risk management good practices and financial performance. Our model will be expressed as:

$$FinP = \beta_0 + \sum_{k=1}^n \beta_k ERM \text{ practices} + \epsilon$$

ROE: Return on Equity is the preferred way for shareholders to measure the profit that pays their contribution. It is expressed by the ratio of net profit to equity;

Debt coefficient: It measures the level of indebtedness of the company. Its value indicates the number of year's necessary of the total refunding of the debt.

Table 1: Independent Variables

Items	Initial	Description	Source
Risk Culture	RCUL	Measured by the 5 items (Strong, enough strong, Fair, Weak, None)	Green and Jennings-Mares (2008)
Presence of CRO	CRO	A dummy variable with 1 representing the existence of a CRO and 0 indicating non existence of a CRO	Liebenberg and Hoyt (2003) Pagach and Warr (2007)
Independence of Board	INDOB	A variable for Board independence and will be measured by the percentage of independent board directors.	Kleffner et al (2003) George et al., 2005 Beasley et al., (2007),
Separation of CEO and Chairman	SCEOC	A dummy variable with 1 if the CEO is also the Chairman 0 Otherwise.	Fama and Jensen, 1983; Desender, 2007

5. RESEARCH RESULTS

5.1. Bivariate Correlations Analysis

The objective of our research is being to highlight the impact of the best practices of risk management enterprise on the financial performance of manufacturing SMEs in Cameroon. To this effect, in order to better understand the relationships two by two, we have related the independent variables and the dependent variables.

For the correlation between two quantitative variables, we used the Pearson correlation coefficient which allowed us

to measure the intensity of the co-variation between the two variables.

For the analysis of variance for a quantitative dependent variable and qualitative variables, we used the comparison test of means (One-Way ANOVA).

In order to be able to test our research hypothesis, we have set:

H0: there is no relationship between the two variables;

H1: there is a linear relation between the two variables.

Thus, the H0 hypothesis is accepted when P-Value is higher than 5%, in contrary case, we accept the alternative hypothesis H1

Table 2: Coefficient of Correlation 2012

		ROE 2012	Debt Ratio 2012	Independence of board directors	Separation of CEO and Chairman	Presence of Chief Risk Officer	Level of risk culture
ROE 2012	Pearson Correlation	1	.293(**)	-.467(**)	-.539(**)	-.378(**)	.528(**)
	Sig. (2-tailed)		.006	.000	.000	.000	.000
Debt Ratio 2012	Pearson Correlation	.293(**)	1	.039	-.076	.013	.046
	Sig. (2-tailed)	.006		.723	.484	.905	.675

Independence of board directors	Pearson Correlation	-.467(**)	.039	1	.264(*)	.306(**)	-.388(**)
	Sig. (2-tailed)	.000	.723		.014	.004	.000
Separation of CEO and Chairman	Pearson Correlation	-.539(**)	-.076	.264(*)	1	.330(**)	-.271(*)
	Sig. (2-tailed)	.000	.484	.014		.002	.012
Presence of Chief Risk Officer	Pearson Correlation	-.378(**)	.013	.306(**)	.330(**)	1	-.301(**)
	Sig. (2-tailed)	.000	.905	.004	.002		.005
Level of risk culture	Pearson Correlation	.528(**)	.046	-.388(**)	-.271(*)	-.301(**)	1
	Sig. (2-tailed)	.000	.675	.000	.012	.005	

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

According to Bivariate correlations analysis, R² measures the proportion of the variation of a variable which is explained by the other. According to our research hypotheses, we have:

The null hypothesis H₀: there is no relationship between these two variables (R=0)

The alternative hypothesis H₁: there is a relationship between these two variables (R≠0)

According to table 2, the P-value is less than 5%, so we can reject the H₀ hypothesis with less than 1% or 5% of chance to being mistaken and the Pearson coefficient is strong and significant. This leads us to conclude that there is the existence of a linear relationship between the two variables.

But we also note that the correlation between the ROE and the risk culture is positive, strong and significant. This leads us to say that the variable risk culture is an important factor that improves the financial performance of manufacturing companies in Cameroon (We accept the hypothesis H₁).

According to table 3, we could note that we can reject the hypothesis of the existence of the relationship between the independence of the board and ROE in 2013 with the P-value more than 5%. The coefficient of Pearson is weak and insignificant. We conclude that there is no relationship between independence of the board and performance of manufacturing SMEs in Cameroon (we reject the hypothesis H₃).

Pearson correlations in table 2 and 3 are small in magnitude, this suggesting that the multicollinearity is not likely to pose a problem in the multivariate analysis.

Table 3: Coefficient of Correlation 2013

		ROE 2013	Debt Ratio 2013	Independence of board directors	Separation of CEO and Chairman	Presence of Chief Risk Officer	Level of risk culture
ROE 2013	Pearson Correlation	1	.693(**)	-.173	-.281(**)	-.257(*)	.381(**)
	Sig. (2-tailed)		.000	.111	.009	.017	.000
Debt Ratio 2013	Pearson Correlation	.693(**)	1	-.075	-.189	-.031	.250(*)
	Sig. (2-tailed)	.000		.493	.082	.774	.020
Independence of board directors	Pearson Correlation	-.173	-.075	1	.264(*)	.306(**)	-.388(**)
	Sig. (2-tailed)	.111	.493		.014	.004	.000
Separation of CEO and Chairman	Pearson Correlation	-.281(**)	-.189	.264(*)	1	.330(**)	-.271(*)
	Sig. (2-tailed)	.009	.082	.014		.002	.012
Presence of Chief Risk Officer	Pearson Correlation	-.257(*)	-.031	.306(**)	.330(**)	1	-.301(**)
	Sig. (2-tailed)	.017	.774	.004	.002		.005
Level of risk culture	Pearson Correlation	.381(**)	.250(*)	-.388(**)	-.271(*)	-.301(**)	1
	Sig. (2-tailed)	.000	.020	.000	.012	.005	

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

5.2. Correlations Analysis (Multivariate Analysis)

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.755(a)	.570	.543	.42170

a Predictors: (Constant), Debt Ratio 2012, Presence of Chief Risk Officer, Level of risk culture, Separation of CEO and Chairman, Independence of board directors

According to the correlation analysis in table 4; in 2012, the independent variables explain at 57 per cent the ROE, the relationship is strong with R=75.5%

Table 5: Significance of Correlation Model

ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	18.867	5	3.773	21.220	.000(a)
	Residual	14.226	80	.178		
	Total	33.094	85			

a Predictors: (Constant), Debt Ratio 2012, Presence of Chief Risk Officer, Level of risk culture, Separation of CEO and Chairman, Independence of board directors

According to table 5, the F test is associated with a probability of error less than 5 %. The model is globally significant and strongly explains the financial performance of the Manufacturing companies.

b Dependent Variable: ROE 2012

Table 6: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.749(a)	.561	.534	.42803

a Predictors: (Constant), Debt Ratio 2013, Presence of Chief Risk Officer, Independence of board directors, Separation of CEO and Chairman, Level of risk culture

In 2013, the independent variables explained 56.1% the ROE, the relationship remains always strong, with R= 74.9%

Table 7: Significance of Correlation Model

ANOVA(b)

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	18.751	5	3.750	20.469	.000(a)
	Residual	14.657	80	.183		
	Total	33.408	85			

a Predictors: (Constant), Debt Ratio 2013, Presence of Chief Risk Officer, Independence of board directors, Separation of CEO and Chairman, Level of risk culture

null hypothesis. in fact, the values 21.220 and 20.469 are significant at $p < 0.001$, which indicating that we have less than 0.1% chance of being mistaken by affirming that the models contribute to better predicting the financial performance.

b Dependent Variable: ROE 2013

We note at the reading in tables 5 and 7 that, according to F value obtained for the two models, we could reject the

Table 8: One-Way ANOVA

Variables		2012		2013	
		F	Sig.	F	Sig.
Independence of Board	Between Groups	23.403	.000	2.600	.111
	Within Groups				
Separation of CEO and Chairman	Between Groups	34.472	.000	7.222	.009
	Within Groups				
Presence of Chief Risk Officer	Between Groups	13.984	.000	5.940	.017
	Within Groups				
Level of risk culture	Between Groups	13.403	.000	9.453	.000
	Within Groups				

The F statistics is the ratio of the sum of squares inter and intra-groups and Sig indicates the probability of finding

this value of F when the null hypothesis is true and is smaller than 0, 0005 and is less than 0, 05 %.

In this case, we have sufficient evidence to reject the null hypothesis and to say that it is unlikely probable that ROE either the same one in each group or the same one in the population.

But also, we reject the hypothesis H3 of existence the relation between independence of board and financial performance of manufacturing SMEs in Cameroon.

6. DISCUSSION AND IMPLICATIONS

The good practices of risk management enterprise within manufacturing SMEs in Cameroon have been apprehended through several variables which are: the independence of the board, the presence of risk officer or risk manager, Separation of CEO and Chairman, and the level of risk culture.

The results of this research led us to identify the level of risk culture as a factor which has a positive, strong and significant impact on financial performance within manufacturing SMEs in Cameroon and others factors have a negative but significant impact. These results are in conformity with Giorgio et al., (2013) [15] who found that the management of risks has a positive impact on the value of European companies. This result confirms also the assertion of Green and Jennings-Mares (2008) which stipulates that the most important element in risk management throughout firms is a cultivation of a consistent risk culture. That means without a strong risk culture, companies cannot have a good risk management practices and developing a strong risk culture may help companies in the way to operates across the board with accountability for risk management being a priority and therefore enhance the financial performance of these companies. We confirm in this case our first hypothesis.

But, to the question to know if the independence of board directors has an effect on financial performance? We rejected the hypothesis knowing the existence of the relationship between the two variables. This result is in conformity of Desender (2007) which in his study show that board independence by itself is not sufficient to induce higher levels of ERM. Shuker et al., (2012) confirm this assertion and their results found no evidence that companies having more independence directors are able to increase firm value because there is no personal interest. This is explained by the fact that outside directors are no familiar with the local business environment and also local business culture. In this way they cannot take actions to improve the business performance, even the suitable strategies to manage the risks within these companies.

The presence of risk managers is associated with the financial performance in Manufacturing SMEs in Cameroon. This finding suggests that the presence of risk manager between the management team have an significant impact or increase the risk management practice inside the enterprise, but in our study and taking into account the small number of enterprise hiring a risk manager, we found a negative association but significant.

Manufacturing with a separation of CEO and chairman have a significant impact on financial performance and show also a highest level of risk management practices. In this case hypothesis H2 and H4 is partially confirmed

According to the influence of control variable on ROE, the regression analysis found a positive and significant relationship; this means that the augmentation of indebtedness tends to increase financial performance. This confirms the results of Shapiro and Young (2005) who find a positive influence between financial performance and debt. But André and Schiehl (2004); Kolsi and Ghorbel (2011) found a negative and significant influence.

7. CONCLUSION AND LIMITATIONS

We examine in this research if the best practice of risk management have an impact on financial performance in manufacturing SMEs in Cameroon. Based on our results, it is found that there is a significant and positive impact between risk culture and financial performance while board independence does not affect financial performance.

It is also found the significant and negative impact between the presence of risk management and the separation of CEO and chairman with the financial performance. The result of this study is mostly consistent with previous studies and its shows that the most important factor to improve financial performance in manufacturing SMEs in Cameroon is to cultivate a strong and consistent risk culture within these companies.

Our results are limited, because this study focuses only on manufacturing companies in Cameroon. Therefore, our result may not be generalized to others industries or companies. Also we use a secondary data to show the financial performance in these companies. It is also suggested further analysis based on primary data.

The limitation of our study is also based on the determinants of financial performance which in this study take into account that the ROE and according to the low number of years of data in our disposal, we have opted for multiple linear regression instead of the panel model which would have been more responsive to our study.

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