

## The Effects of Organizational Culture and Enterprise Risk Management on Organizational Performance: A Conceptual Framework

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**Abstract:** Value creation to stakeholders is determined, as the main objective of every organization. However, the environmental changes affect to take many risks. Risk affects to achieve organizational performance and stakeholders. Enterprise risk management is different from traditional risk management in order to create challenging opportunity, eliminate failure and create benefit for all stakeholders. Enterprise risk management is a part of management control system. Also, organizational performance is come from management control system that associated to contextual factors. From previous studies, organizational culture is identified, as a crucial key in contextual factors to the success of enterprise risk management. Unfortunately to study of the linkage among organizational culture, enterprise risk management and organizational performance is rare. The purpose of this study, is to propose the conceptual framework of organizational culture and enterprise risk management affect to organizational performance in Thailand. The contribution is mainly beneficial for private sectors and government to support organizational culture associated with enterprise risk management. It is also advantage for organizational performance. Moreover in academic aspect, it can contribute the relationship of organizational culture, enterprise risk management and firm performance.

**Key words:** ERM, organizational culture, organizational performance, government, risk management

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### INTRODUCTION

The operation of all organization has a similar purpose to create value for its stakeholders (Moeller, 2011). However, the changes of environment caused organization faced many kinds of risk. These risks are not only affect the achievement of organization (Collier, 2009) but also wide affect its stakeholders, for example the collapsed of Enron (Sridharan *et al.*, 2002) and explosion of the BP oil rig in the Gulf of Mexico (BP plc., 2013).

Over decade ago, organization faced risks which had more various and complex (Shenkir and Walker, 2006) and had a linkage to each other (WEF, 2013). In these situations, Enterprise Risk Management (ERM) is stated that it will help contributing the best practice, reduces undesirable events and uncertainty and makes organization meets good opportunities which can create value for organization (Collier, 2009). Moreover, Committee of Sponsoring Organizations of the tread way commission (COSO, 2004) suggested that if ERM is implemented effectively, it will help organization accomplished its goal and leads to value creation of organization with long growth. Similarly, Gordon *et al.* (2009), Hoyt and Liebenberg (2011) and Nocco and Stulz (2006) who described that ERM will lead to better value of organization.

ERM is an integral part of Management Control System (MCS) (Gordon *et al.*, 2009). Both ERM and MCS

have similar goal with taking organization to their strategic objectives (Mikes, 2009; Subramaniam *et al.*, 2011). Furthermore, Chenhall (2003) mentioned that MCS is affected by the contextual factors and will affect accomplish outcomes or organizational goals. Therefore in the context of ERM, it is tended to affect by contextual factors and will affect accomplishment organizational goals likewise.

Organizational culture is one of contextual factors which has important role to the success of management in organization (Koompai, 2010). A study by Kimbrough and Compton (2009), revealed that organic culture tended to create progress to ERM; however the studies that shown the linkage among organizational culture, ERM and organizational performance is rare.

Therefore, it is an interesting aspect to investigate in this study, especially in Thai context which has quite more changed from the last 10 years, for example economic crisis, political crisis and the crude oil spill recently at KohSamet. Furthermore, the ASEAN free trade agreements will be coming soon effecting. These may affect Thai businesses both negative and positive side.

This study aimed to study the effect of organizational culture on ERM and to study the relationship between ERM and organizational performance. The result from this study was expected that there was benefit for private sectors and government to support proper organizational

culture with ERM that it is advantage for organizational performance. Moreover, the academics could benefit from contribution on the relationship of organizational culture, ERM and organizational performance.

### LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

**Risk:** The scholars and professional organization mentioned about risk in similar aspects. According to Knight (1921), risk is uncertain events that may happen in the future but can estimate likelihood the occurring of it. Furthermore, Financial and Management Accounting Committee (IFAC, 1999) stated that risk is an uncertainty that influenced to achievement of organization objective. Likewise, International Organization for Standardization (ISO, 2009) defined that risk is the impact of uncertainty on organization objective that deviates from the expected both positive and negative side. Moreover, COSO (2004) mentioned that risk is events that results in a negative by diminish value creation or existing value of organization. In summary, risk is an uncertainty of the future events which can estimate likelihood to occurring of it. The effect of risk can be both positive side that is the opportunity to benefits and the negative side that is a threat to accomplish organization objective.

**Enterprise risk management:** Risk management has evolved >4 decades. From 1970-1980s, risks had been managed by traditional (Shenkir and Walker, 2006) as silo-based that is separated to manage risk for each function or business units (Collier, 2009). However as the business environment had changed, risk management was proposed new model as enterprise risk management which aimed to help organization gets better benefits.

McShane *et al.* (2011) suggested that ERM is the integrated management all risks of organization which can create organization's value better than manages risk independently. Similarly, Liebenberg and Hoyt (2003) mentioned that ERM is the methods that can help organization integrated manage all risks face. Moreover, COSOERM (COSO, 2004) that is cited in most of literature (Arnold *et al.*, 2011; Beasley *et al.*, 2005; Collier 2009; Daud *et al.*, 2010; De Zwaan *et al.*, 2011; Tahir and Razzali, 2011) defined ERM 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 risk to be within its risk appetite to provide reasonable assurance regarding the achievement of entity objectives

To summarize, ERM is the process associated with the strategy and operation at all levels by cooperation of all individuals throughout the organization to identify and manage uncertain events that may affect organization to assurance reasonably for achieve organization objectives. **Management control system:** MCS is the process that the executives lead organization to achieve its strategic objective (Anthony and Govindarajan, 2003) by management tools, such as budgeting and balance score card (Chenhall, 2003; Woods, 2008). MCS relates several activities that are planning, coordinating throughout entity, communicating and evaluating the information, deciding and influencing people in organization to change their behavior according to overall organization strategic objective (Anthony and Govindarajan, 2003).

Gordon *et al.* (2009) stated that ERM is an integral part of MCS. It involves process for identifying, managing and communicating about future uncertain events which occurs by collaborating throughout organization to achieve organization objectives. These are consistent with the activities in MCS (Gordon *et al.*, 2009; Mikes, 2009; Subramaniam *et al.*, 2011).

MCS is important for outcome accomplishment or organization goal. The result of MCS is influenced by organization contextual factors (Chenhall, 2003, 2007). The appropriate between contextual factors and MCS would enhance better organizational performance (Fisher, 1998; Jermias and Gani, 2004; Tsamenyi *et al.*, 2011).

As mentioned earlier, it is revealed that ERM is under MCS extent. The context around the organization has critical role for MCS which it can enhance organization meets its goals.

**Contingency theory:** Based on contingency theory, there are not any management techniques which fit in all organizations (Cunliffe, 2008; Modaff *et al.*, 2008). Due to each organization faces different context, management for each organization depends on contextual situation that organization is facing such as people, task, technology and so on (Cunliffe, 2008).

According to Chenhall (2007), the study over the past 25 years of contingency based research was found that better organizational performance was the result of the appropriate context and MCS. Similarly, Gordon *et al.* (2009) found that better performance of organization was a result of the consistency of contextual factors and ERM.

From the literatures earlier, it is revealed that the role of contingency theory influenced the relationship of contextual factors, MCS and outcome. Therefore, it can be concluded that within situation of appropriate between contextual factors and MCS, the performance is better.

**Organizational effectiveness:** The effectiveness has been interested from organization theory for long times ago.

Henri (2004) defined organizational effectiveness, as the outcome of activities in organization which can evaluate the success by comparing with its goal.

There are many concepts to measure effectiveness but 3 models are most mentioned, namely; goal, system and strategic-constituencies model. According to goal model, effectiveness will occur when the output can achieve goals (Cameron, 2005; Henri, 2004; Meng, 2009). System model believed that effectiveness is considered from inputs, acquisition of resources and processes within organization (Henri, 2004). The last one, strategic-constituencies model state that effectiveness is ability to response stakeholders interest (Cameron, 2005).

Form models as mentioned earlier, not all of these models can be used to all situations, each model is appropriate to implement differently (Meng, 2009). It depends on objectives and constraints of the study (Cameron, 2005). A study by Henri and Journeault (2010), applied multiple concepts to investigate organizational effectiveness.

In summary, there is not all of effectiveness concept can be used in all situations. To implement effectiveness models, there should be considering to what study.

**Organizational performance:** There are arguments that have not been concluded about definition, measurement and description of effectiveness. These arguments are similar with performance (March and Sutton, 1997). Therefore, effectiveness and performance have been viewed that they are same concepts (Henri, 2004) and they have been used instead to each other (March and Sutton, 1997). As found in previous researches, effectiveness is measured by dimension of performance (Govindarajan, 1988; Govindarajan and Fisher, 1990; Henri and Journeault, 2010; Tsamenyi *et al.*, 2011).

A study by Subramaniam *et al.* (2011), proved outcome from ERM in some dimensions such as planning, reporting and the relation with stakeholders while Tseng (2007) suggested that effective of risk management should be evaluated from aspect of operation, reporting and compliance. Because the extent of risk management in current has variety and complex, risk management performance should be evaluated for many sides. From previous studies, there was measurement of effectiveness in many dimensions (Govindarajan, 1988; Govindarajan and Fisher, 1990; Henri and Journeault, 2010; Tsamenyi *et al.*, 2011) which can reflect performance extensively. This research applied many effectiveness models to define organizational performance that are goal, internal process and strategic-constituencies model. Therefore, organizational performance can be defined, as level which organization achieves goals on dimension of outcomes, processes and need of dominant stakeholders.

**Organizational culture and enterprise risk management:**

Organizational culture is one of contextual factors which are associated with MCS (Chenhall, 2003). Definition of culture has been various discussed. According to Daft (2010), culture refers to group of values, norms, believes and understanding which members of organization think which is a good things and it is relayed to new members. It may be observable artifacts (such as symbol, story, behavior and ritual) or underlying values which difficult to observe (such as believe, feeling and attitude).

Moreover, there are other scholars that defined culture variously. Phanphae (2011) mentioned that organizational culture is the practice approach of organization which is collected and developed for long times, through social process both formal and informal. In addition, Schein (2010) stated that culture is a pattern of basic assumptions are shared for learning by a group which is a correct things to perceive, think and feel. It can be passed on to new members for coordination within organization and adapted to external environment.

Based on the earlier, organizational culture is the ways that members in organization accept, use to perform and pass onto new members that would create agreeably ways operating in organization. Moreover, it can help organization adapting to external environment that result organization to survival.

There are different cultures in each organization. The culture which people share learning and adapt to changing is an important characters for learning organization culture. Senge (1990) stated that learning organization is organization where people can continuously expand their ability to accomplish desirable goals. New and wide ideas of people are fully supported and people in organization continuously desire to share learning. Furthermore, Chermack *et al.* (2006) and Yang *et al.* (2004) defined the learning organization similarly that it is an organization which shows learning continuously and can adapt to environment appropriately.

According to earlier notes, learning organization culture can be referred to organization that has continuously shared learning culture and has adapted to environment changing for accomplish goal.

Organizational culture will affect operation of employees about their feeling, cooperation and decision of management (Cunliffe, 2008); therefore patterns of culture in organization are important to create the success or failure of organization's management (Koompai, 2010). Prior researches showed that the organizational culture is important to ERM. The study of Muralidhar (2010) found that organizational culture is one of challenges to implement ERM. Moreover, Kleffner *et al.* (2003) found that 48% of respondents indicated that an organizational structure or corporate culture which is not provided to

ERM is important barrier to its implementation. In addition, Kimbrough and Componation (2009) found that organic culture trend to the progress of ERM.

Organizational culture that has ability to encourage on ERM should have characteristic of continuously learning can adapt to dynamic environment and communicate collaborative to accomplish organizational goals due to ERM need to collaborate cross functional to analysis and finding the ways to manage uncertain events in the future within dynamic environment that will help organization achieve goals by reasonable. Organizational culture that appropriate to enhance ERM as mentioned is the culture that similar characteristic to learning organization culture. Therefore, this study hypothesized that:

H<sub>1</sub>: There is a positive relationship between learning organization culture and ERM

**ERM and organizational performance:** There are advantages from risk management by integration across organization. It can help reducing the shortcoming from TRM which may cause failure from considered risk management in each function or division (Collier, 2009) and disregarding the effect to each other (Hoyt and Liebenberg, 2011). Moreover, it is assumed that it will help reducing every risk of organization which will lead to enhance performance and organization value (Gordon *et al.*, 2009).

Although, there are the literatures found a positive relationship between ERM and organizational benefit (i.e., organizational performance), there is a finding which has relationship opposite direction. McShane *et al.* (2011) used risk management rating which made by Standard and Poor (S&P) to measure risk management implementation of an insurer. The result from this study found that organizational value did not increase for the firms which achieved a higher ERM rating. On the other hand, most of studies found opposite result.

The evidence from Pagach and Warr (2011), indicated clearly that firms adopted ERM were motivated by economic benefits. In addition, Gordon *et al.* (2009) found that the relationship between ERM and performance depended on accordance of ERM and its contextual factors. Moreover the study by Gates *et al.* (2012), found significantly that the process of ERM implement resulted in organizational value both enhanced management and improved organizational performance. Likewise, Hoyt and Liebenberg (2011) found a positive relation between ERM adoption and performance which reflected by organizational value.



Fig. 1: Conceptual framework

According to literature mentioned earlier, it revealed the importance of ERM on performance which most of the studies found that ERM affected and enhanced performance. Therefore, this study hypothesized that:

H<sub>2</sub>: There is a positive relationship between ERM and organizational performance

### PROPOSED FRAMEWORK

Based on the literature discussed earlier, a conceptual framework is suggested as presented in Fig. 1 that showed the relationship between learning organizational culture, ERM and organizational performance.

### CONCLUSION

From the review of literatures, this conceptual framework suggested that the organization which had context of learning organization culture encouraged the ERM and it could lead to enhance the organizational performance. Therefore, this proposed framework was needed to examine.

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