

Enterprise-Wide Risk Management (EWRM) as a Value Added Tool in Enhancing the Economic Value of Business Enterprises

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Abstract

In recent years, Risk Management in respect of Enterprise-Wide Risk Management (EWRM) has become more important and highly critical to major corporations worldwide including Malaysia. In fact, it is interesting to note that when the Government of Malaysia passed the Code of Corporate Governance in the year 2000, most of the Public Limited Companies (PLCs) in Malaysia was struggling to implement the Risk Management program for their respective companies. The Malaysian Code of Corporate Governance (MCCG) actually holds the Board of Directors of these companies responsible to manage risks related to their businesses. Today, it is rather convincing to note that many of these companies have gradually moved from the Traditional Risk Management (TRM) approach to an Integrated Risk Management approach namely, Enterprise-Wide Risk Management (EWRM). The main objectives of this scholarly study are two-fold: (a) to examine the extent of EWRM practices by these PLCs and (b) to examine how EWRM could possibly enhance the overall economic value of these companies.

This particular study incorporated an industry survey which included personal interviews with the Risk Managers or Chief Risk Officers (CROs) of twenty (20) PLCs under the Malaysian Bourse (previously known as the Kuala Lumpur Stock Exchange). These companies were selected based on the extensiveness of EWRM program undertaken. It must be mentioned that this study is the first study of its kind in Malaysia. Thus, the findings would undoubtedly provide an important insight into the EWRM practices within the industry concerned in terms of how EWRM actually contributed to the

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overall enhancement of economic value within the business enterprises of Malaysia.

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1. INTRODUCTION

1.1. RISK MANAGEMENT AS A STRUCTURED RESPONSE TO RISK

The world we live in today has changed drastically. A noticeable feature is the global business environment which is ever changing with increasing complexities of business operations internationally. Competition too has become more intense with companies and organizations attempting to outperform each other for market dominance.

The borderless world had undoubtedly facilitated the innovative process of international networking and business ventures. But, such a breakthrough does come at a price. Risks are becoming more sophisticated than ever before and this calls for new approaches and methodologies including Risk Management tools and technologies in managing a global business world which is full of surprises (Hussin, 1996).

Companies and organizations are therefore not free from surprises and the potential impact of risks and uncertainties. Numerous incidents worldwide which resulted in major crises and financial ruin to corporate entities concerned are testimony to the extent of potential damage that occurred. Such element of surprise must be therefore be foreseen and undoubtedly brings about disastrous results on corporate entities which often struggle in their eventual process of business recovery.

Nevertheless, time and again, companies and organizations worldwide have to carefully consider and manage all forms and sources of risk, regardless of their types and whether or not they are favorable. Among the various types of risk exposures include the ability of business enterprises especially to improve company returns through value-based management (Hoyt & Liebenberg, 2006). This includes the enterprises' ability to enhance capital allocation, protect company's image and reputation, achieve a standard of best practices, understand and carefully evaluate strategic risks, understand the full range of risks faced today, avoid personal liability (the personal fear factor), comply with corporate and governance standards, handle potential crises and the capability of business recovery, and equally important is the ability to maintain continuous business protection and ultimate security of the shareholder value.

It is useful to highlight another important observation that relates to the complexities of today's global business environment which undoubtedly brings about the change in terms of risk being perceived, notably so when risk is now considered and managed in a portfolio-bias in order to create value. Thus, Risk Management, as a structured response to risks, has been recognized as a vital component for companies and organizations especially business enterprises to achieve eventual success. Such a view is well supported by a statement made by Crockford (2005, p.5) which emphasizes that "risk can be considered as a function of change, and Risk Management may thus be described as a technique for coping with the effect of change."

In view of the above, essentially, there are five (5) basic steps in the Risk Management process, which is a similar view shared by most authors (Waring & Glendon, 1998; Harrington & Niehaus, 1999; D'Arcy, 2001; Rejda, 2001; Theil & Ferguson, 2003; Treischmann et al., 2005). These steps include risk identification, risk measurement, examination of alternative Risk Management techniques, selection of the appropriate Risk Management technique and finally, implementation of the Risk Management program.

1.2. ENTERPRISE-WIDE RISK MANAGEMENT (EWRM) CONCEPT

As a matter of concept, the nature of Risk Management that has been widely adopted by companies and organizations in different sectors of industry and commerce relates closely to the traditional concept of managing risk exposures. The so-called Traditional Risk Management (TRM) concept is being perceived as an approach which is rather limited in terms of scope and application (Hussin, 1996). This particular concept appears to be lacking in terms of total integration and that risk exposures are being managed in silos hence the incompleteness of such an approach (Lam, 2000; Davenport & Bradley, 2001; Ernst & Young, 2001; Barton, Shenkir & Walker; 2002). In essence, TRM appears to focus more on matters relating to safety and security rather than value creation.

In view of this, a new concept of increasing popularity emerged in the name of Enterprise-Wide Risk Management (EWRM). Such a new concept appears to be a new approach which ensures that risks are being managed on an enterprise-wide basis with total integration of all activities within the entire company or organization (Lam, 2003).

Interestingly, Enterprise-Wide Risk Management (EWRM) has been a topic of interest with increased attention in recent years among major corporations and business enterprises worldwide. On a positive note, many

companies and organizations have actually embarked and eventually implemented EWRM program with various consulting firms providing the necessary expertise. In the academic world, universities have also been equally interested in such a concept and moved to develop Risk Management and EWRM-related courses within their academic curriculum.

Essentially, EWRM is a process which provides the required mechanism for companies and organizations to effectively assess, control, exploit, finance and monitor potential risk exposures from all sources possible. The thrust is to ensure that the corporate goal of increasing short and long term value for stakeholders is successfully achieved.

Therefore, it is worth highlighting that the gradual realizations in relation to the shortcomings of TRM capabilities especially in today's environment of risks, many companies seem to be adopting the integrated EWRM approach which provided the link to organizational vision, mission, and strategies (Whitfield, 2003).

1.3. EWRM AS A VALUE-ADDED TOOL

Indubitably, business enterprises have profit-maximization as the bottom line. Being able to achieve such a bottom-line would in a way guarantees the ability of these business entities in maximizing shareholders value at the same time. This is highly important because EWRM should only be adopted and implemented if only such a program contributes to the eventual increase of expected shareholder wealth (Manab, Hussin & Isahak, 2006).

Thus, it is important to note that companies and organizations with a wide range of investment opportunities are likely to benefit from being able to select investments based on a more accurate risk-adjusted rate application of EWRM compared to what was available under the TRM approach (Hoyt & Liebenberg, 2006). Equally important, a critical study by Smithson and Simkims (2005) provided a thorough review of the literature in relation to the value-relevance of Risk Management in particular.

In essence, EWRM drives value creation through Earnings, Growth, Capital, Efficiency, Volatility of Earnings & Capital, Management Competence and Shareholder Value. Thus, EWRM is a multi-step process that involves both the upside and downside impact of all potential sources of risk and also serves as an integrated enterprise-wide correlation-adjusted approach of managing risks (Hoyt & Liebenberg, 2006).

As a value-added tool, EWRM provides an essential framework for better management of shareholder value. In addition, EWRM provides the

vital mechanism to business enterprises for better understanding, management and communication of risk appetite and potential exposures facing the business entities on the whole. Also, EWRM is not just about responsibilities. It is primarily about the way how people work and the way how they relate to the strategy and growth in order to achieve the company's objective (Pickett, 2006).

It is rather important to note that the underlying concept of EWRM is to enhance shareholders/stakeholders value and this relates to each type of organization whether profit, non-profit, or government agency, provides value for its stakeholders (COSO, 2003). This had been stressed in the definitions of EWRM and in the EWRM concept itself. Miller (1992), Deloach (2000), Stroh (2005) and Panning (2006) all agreed that the function of EWRM is to drive value creation, either in terms of financial and non-financial aspects.

2. METHODOLOGY

This research work examines the adoption and eventual implementation of Enterprise-Wide Risk Management (EWRM) as a value-added tool in enhancing the economic value of business enterprises. In this respect, the main objective of such a study is to find out the extent to which the specific corporations in selected sector of the Malaysian industry have actually implemented the increasingly popular EWRM program and also to assess the value implications of this program. This research work undoubtedly provides a valuable insight of EWRM as an important concept of managing risks on an enterprise-wide basis among major corporations in Malaysia. For this, a qualitative approach (including personal interviews) was adopted and reference was also made on annual reports available.

2.1. Research Methods

In order to ensure this research is in line with the objectives, the following features explain the methodology used with some relevant criteria in selecting the participants for this study.

2.1.1. Research Criteria

The main criteria set for selecting the twenty (20) companies for this research work are the companies which were selected that meet the diverse varieties of Main Board companies in the Malaysia Bourse [formerly known

as Kuala Lumpur Stock Exchange (KLSE)]. Such diversities include Consumer products, Industrial products, trading and services, Construction, Property, Mining and Plantation. In addition, these companies comply with some criteria of major corporations as defined by Yazid (2001) whereby these companies have branch(s) or subsidiary(s) overseas or joint venture in with overseas partners.

Also, these companies are exposed to several risks, among which include strategic risks, operational risks, credit risks and market risks. Importantly, these companies are more likely to respond to the survey. More importantly, these companies were carefully selected based on their good reputation and are well established including data on these companies which are easily obtainable.

2.1.2. Data Collection

For the purpose of this study, data was gathered through:

- Annual reports

The annual reports seem to be the best way to obtain true and fair view information. It provides a true account of the company's structure and organization (such as the nature of business, annual turnover and Risk Management approach) in order to create value to the business entities

- Personal interviews

Industry surveys which include personal interviews were conducted based on the twenty (20) companies selected. Personal interviews were undertaken in order to ensure that all relevant information gathered are valid, non-bias and reliable in terms of accuracy and reliability. In this regard, the Risk Managers for these companies were selected to reduce bias information.

3. FINDINGS

The overall study confirms that Risk Management as a structured response to risks and EWRM as an integrated enterprise-wide risk mitigation approach has been widely accepted and applied industry-wide, more so after the adoption and implementation of the Malaysian Code of Corporate Governance (MCCG). Following the implementation of MCCG, Risk Management as a discipline became more important especially among the Public Limited Companies (PLC) of Malaysia.

In this particular study, a total of twenty (20) PLCs representing various industry sectors were identified. Personal Interviews were conducted to find out the ways in which EWRM serves as a value-added tool to the corporations involved in the industry surveys. Those involved were either the Risk Managers or Chief Risk Officers (CRO) concerned.

Findings showed that the respondents on the whole agree that EWRM as a value-added tool does contribute to the enhancement of economic value of their business enterprises in the following ways:

- There was commitment and transparency from the top management
- The top management drives toward a more systematic management of risks
- Executive leadership and support were more visible
- There was a positive move to develop competency within the entire entity
- A serious attention on education and training of staff on risk management
- Culture-creation towards a risk-conscious society within the entity concerned

3.1. Commitment and Transparency from the Top Management

On the whole, the respondents surveyed agree that EWRM truly added value to the work environment whereby messages and directions for implementing the EWRM Program did come from the highest level of the companies' organizational hierarchy namely, the Board of Directors and Top Management. They also agreed that strong commitment of the Board and Top Management is very important and highly critical to ensure the successful implementation of the EWRM program on the whole.

Obviously, Risk management initiatives do take up lots of resources. Therefore, it is important for the Board and Top Management to have the right attitude in the first place and secondly, attempt to carefully understand and eventually appreciate the notion that the EWRM Program could possibly add value to their companies.

An interesting point to note is that the Board and Top Management of the entities surveyed were positive about EWRM as a value-added tool and were therefore, more willing to allocate a considerable amount of money and also human resources to ensure the successful implementation of the EWRM Program for the overall benefit of the corporate entities.

Findings also showed that since the implementation of the EWRM Program, the Top Management concerned was readily available and willing to spend more time to listen to the staff and fellow employees in ensuring that high moral is constantly maintained across the board within the entire organizations. The EWRM Program in a way encourages the Top Management to commit some funds necessary to train and develop the right work ethics and good attitude among the staff on the whole to ensure the successful implementation of such risk management initiatives.

3.2. Drive towards a Systematic Management of Risks

Objectives

Before implementing any Risk Management program, a company has to be clear about the objectives of Risk Management. These objectives are highly essential as they assist the company in deciding on the resources which are required for the purpose of risk mitigation.

From the interviews conducted, the respondents suggested that the eventual implementation of the EWRM Program provided value in the sense that they were able to identify and associate better with the company objectives. This means that the staff and fellow employees were able to:

- a) ensure that company's assets and resources are safeguarded;
- b) maintain the company's reputation and integrity;
- c) optimise company's return and minimize the potential impact of future losses, and subsequently protect shareholders' interest;
- d) meet regulatory requirement;
- e) improve strategic competitiveness and operational effectiveness that would enhance the long term value of shareholders;
- f) fulfil the company's strategic objectives;
- g) identify and manage risks in a structured manner within the entire company;
- h) strengthen Risk Management approaches and capabilities;
- i) provide reasonable assurance against material misstatement or loss;
- j) promote a more innovative, less risk averse culture in which the taking of calculated risks in pursuit of potential opportunities to benefit the company on the whole.

Risk Management is not just seen as one of the requirements of the Malaysian Bourse (Bursa Malaysia) or the Malaysian Corporate Code of Governance. In fact, Risk Management could possibly add value to a company (Smithson and Simkins, 2005). In this regard, the corporations

involved in the survey believe that by practicing Risk Management in a more structured manner, they would be able to achieve their Key Performance Indicators (KPIs) and corporate objectives. Besides that, Risk Management would increase quality, accuracy and integrity of information for decision making. Thus, the respondents asserted that the overall value of EWRM Program should be shared among all employees irrespective of their positions.

Values

An important finding is that some corporations actually define the value of Risk Management through both non-quantifiable and quantifiable aspects. For the non-quantifiable aspect, it covers a company's image and reputation whereas; the quantifiable elements could be defined in terms of monetary value. On the other hand, a few respondents define values as the ability to effectively manage uncertainty and change, thereby creates opportunities that would eventually provide the economic value to the entire business entity.

On the whole, the respondents surveyed agree that the value EWRM as a useful value-added tool for managing risks is apparent in view of the fact that the staff and employees are better informed, more decisive and pursue growth opportunities with increased confidence. This is necessarily true because the business entities were able to identify the potential risks and mitigate them on a holistic or integrated approach in the form of EWRM Program.

An interesting point to note about EWRM as a value-added tool is that the entire staff and fellow employees could now have periodic risk sessions with senior or middle management levels. They also asserted that monthly bulletins or newsletters are being issued and circulated within the entire organization to ensure that all parties concerned are fully aware about the various risks facing their business entities.

Findings also showed that through the EWRM Program, Internal Control is much better. On a positive note, the relevant findings of the Auditors are very important in ensuring that all staff concerned actually follows the established Risk Management Framework and Guidelines, thus protecting the interests of the company and shareholders. In addition, such internal control mechanism also provides the independent assurance that all Risk Management related activities are properly performed. Finally, the value of EWRM Program is that better internal control undoubtedly provides the needed assurance on the Risk Management activities.

3.3. Executive Leadership and Support

It is interesting to know who in a company actually provides the leadership or champion the Risk Management initiatives. Findings show that several parties in a company champion the cause for the management of risks. Certain number of companies interviewed suggested the Chief Executive Officer (CEO) or Managing Director (MD) who actually leads the Risk Management initiatives.

Interestingly, other companies that responded suggested that the Head of Risk Management unit and the Head of unit actually provide the leadership required in Risk Management. A few companies suggested that the Risk Management committee leads the Risk Management activities.

Nevertheless, findings showed that through the EWRM Program, there is someone assigned to the job of leading the company's Risk Management initiatives and activities. It does not matter who actually does the job. But, it's important to have someone within the entire company or organization championing the cause so that risks can be dealt with effectively in ensuring the ultimate survival of the company whilst at the same time enhancing shareholders' value.

The lines of authority are clear and the executive leadership is there to ensure that directives are followed and rules adhered to at all times. At the same time, support is always there coming from the very top hierarchy of the organization which undoubtedly boosts the morale of the staff on the whole. On the whole, the respondents surveyed express their satisfaction with regard to executive leadership and the kind of support much needed by the staff concerned in carrying out their duties and responsibilities in managing risks effectively within their corporate entities.

3.4. Development of Competency

The study reveals that for some time companies and organizations surveyed suggested that they have managed risks in a conventional way without any structured approach in doing so. After exploring, these companies were able to acquire and adopted a more structured approach in dealing with risks. In this respect, most companies tend to have a framework for managing risks. Some of these companies used the AS/NZ framework while others tend to use the Committee of Sponsoring Organisations (COSO) framework. However, there are other companies which applied the combination of these two approaches and came up with their own standard.

Through EWRM, the companies and organizations were able to establish the appropriate Risk Management framework which clearly spells out the policy, objectives, risk identification and assessment methodologies, risk response and mitigation strategies, monitoring procedures, responsible parties and reporting structure.

Apart from such a framework, the respondents confirm that in the process of competency development within the entire entities, staff and fellow employees were sent for further training through Executive Development Program. In this regard, the Top Management was committed and highly supportive especially on staff education and training. Apart from training, Risk Management Committees were set-up at various levels throughout the companies and organizations to handle risk and insurance related issues.

In the effort of continuous improvement and better management of risks, findings also showed that the companies and organizations surveyed did spend on Risk Management software for the purpose of managing risks more effectively. For this, the Top Management ensures that selected staffs were sent for further training especially competency training on Risk Management.

3.5. Education and Training

According to the respondents, when their companies first started Risk Management activities, they hired Independent Risk Management consultants to do the job. The consultants provided the expertise in coming up with some Risk Management Framework. They also provided relevant training to staffs who are directly involved.

Later on, when the EWRM Program has been successfully implemented, most companies have the confidence in conducting their own training program. To the middle managers and supporting staffs, training is considered to be extremely important. In addition, they emphasized on education with the provision to pursue for higher education and qualification made available by the companies concerned.

It is interesting to note that with the level of confidence, knowledge and skills acquired from trainings provided, the companies were able to develop their own Risk Management software which caters for the specific needs of the entities. Different kind of software is required as the standard software available in the market do not match certain aspects which are different in nature and circumstances.

3.6. Culture-Creation

The respondents surveyed also asserted on a critical point in relation to the 'Risk-Conscious Culture' that prevails within the companies and organizations. To them, 'management buy-in' is vital. Only when the top management is receptive to the whole idea of Risk Management, the onward implementation of the Risk Management program will be successful.

In view of this, the staffs believe that the perception and attitude of those personnel in the top management group is vitally important. In addition, the respondents believe that the attitude of all staff towards risks is also crucial in ensuring that risks are well managed throughout the entire business operation.

It is rather interesting to note that some companies actually indicated that establishing the appropriate culture is perhaps more important than developing policies or framework. But, a note of reminder is that if the staffs on the whole are more concerned with risk then they should be well trained and better prepared to manage the various risk exposures of their corporate entities.

In this regard, the respondents feel that it is very important for the Board and Management to cascade down the EWRM-related knowledge and information throughout the entities concerned. They also asserted that this is the task and responsibility of the Chief Executive Officers (CEOs) who instructs the Risk Managers to convey the same message to other staffs in the respective units.

In this manner, it is expected that a good Risk Management culture would be developed eventually if all parties in the company understand thoroughly the values and benefits of Risk Management and EWRM Program especially as a value-added tool for enhancing economic value on the whole whilst maintaining organizational performance at the level expected or desired.

One interesting finding from this study is that all initiatives under the EWRM Program is translated into Key Performance Indicators (KPIs) of every individual executive officer and monitored through the performance planning appraisal method. Even though this is not a common practice yet among the Malaysian PLCs but this is something that each company would expect to do.

4. CONCLUSION AND RECOMMENDATIONS

This study provides a valuable insight of EWRM as an important concept of managing risks on an enterprise-wide basis among major corporations in Malaysia. Such a concept is considered as a value-added tool in enhancing the economic value of the business enterprises involved in the industry survey conducted as part of the overall research work.

It must be emphasized that the Risk Management framework and policy is considered to be a must for any company that is engaged in Risk Management activities. The framework could provide the necessary guidelines for the management to follow. Furthermore, the framework and guideline make it easier for the management to convey all necessary Risk Management messages to other parties in the company.

Findings from this study also showed that commitment and support from the top management must be made clear to all parties concerned. The respondents involved in the survey strongly suggested that the management on the whole must be able to demonstrate their concerns on various Risk Management issues. Importantly, they have to develop and promote an environment of support and be more conscious about risks. An acceptable risk culture should be developed for better management of risks.

The respondents surveyed also suggested that all Risk management activities which are being carried out by companies should be structured and ought to assist them in minimizing future expected losses. Companies should be able to appreciate the justification of adopting and implementing the EWRM Program as it undoubtedly adds value to the company and shareholders. They asserted that the practice and application of EWRM should not be done just for compliance purposes only.

An interesting finding is that these respondents believe that there are intangible aspects of value-creation. Although the bottom line is money and the overall financial stability of the business entities, the respondents suggested that high morale among staffs and fellow employees, motivation and continuous desire to excel at workplace are attributes of EWRM Program as a value-added tool. By having such a program in place, management attention and concern on manpower as valuable asset and human capital is much greater in ensuring that high morale at workplace prevails at all times.

Another interesting finding is that all respondents agreed that risk communication is a key feature for the eventual success of implementing the EWRM program and initiatives within the entire business entities.

Companies and organizations must be able to cascade down all EWRM-related messages and initiatives to all levels of employees. Failure to communicate effectively the EWRM-related messages and initiatives to all employees would result in negative feelings or resistance from them.

Findings also showed that the appointment of Chief Risk Officer (CRO) or the Risk Manager is also another critical factor in driving the EWRM-related messages and initiatives among staffs and fellow employees. In addition, the respondents surveyed strongly asserted that any person within the company who is directly responsible for the set-up of EWRM program and eventual undertaking of all EWRM-related activities must possess the relevant Risk Management background in terms of qualifications and expertise. With such concerns, companies and organizations were found to be supportive in providing necessary provisions and funding for staffs to pursue higher education and related knowledge on Risk Management.

Other important findings revealed that the advantages and benefits are there although they are not easily measured when companies decide to implement the EWRM program. Equally important, the respondents agreed that people namely, the staffs on the whole together with systems and processes are valued as the current foundation for the company to move towards a more systematic management of risks.

Thus, this particular study affirms the confirmation that EWRM as a value-added tool actually improves the level of company performance and at the same time enhances the economic value of the business entities in tangible and intangible forms. All the respondents agree that the benefits are there although they are intangible and not easily quantifiable. An important point to note is that all respondents involved in this study agree that the availability of the EWRM framework and initiatives within their companies actually provides them with the level of motivation and confidence required in managing their risk exposures effectively.

On a final note, this particular study is a valuable source of reference with regard to the adoption and implementation of EWRM in terms of critical factors and/or features that supposedly add-value to the selected corporations as provided by respondents involved in the survey. As a matter of fact, such a study provides some useful evidence on the relation between EWRM and the firm value to the major corporations concerned.

Future researchers could possibly extend this study by applying a similar approach or methodology to other sectors/industries. In addition, it is also useful to examine more robust measures of EWRM use within the companies and organizations selected in future studies.

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