

# Effect of Employees' Competency, Risk Culture and Organizational Innovativeness on Enterprise Risk Management Implementation

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Enterprise Risk Management (ERM) is an important tool in assessing risks within the organization. As such, most organizations would like to have a proper risk management policy, but often do not have one. Competency, risk culture and organizational innovativeness are highly broad areas that are related to the implementation of enterprise risk management in an organization. The level of successful implementation of ERM can give a high impact on the profitability of the organization. Therefore, in order to achieve a successful implementation of ERM, it is important to know the core factors that affect the implementation of the ERM in an organization. This study aims to assess the factors that influence ERM implementation among public listed companies in Malaysia. Specifically, this study examines the influence of employees' competency, risk culture and organizational innovativeness on ERM implementation in public listed companies. Based on the 640 responses received from various public listed companies under the manufacturing companies in Malaysia, this study shows that employees' competency and organizational innovativeness have a positive relationship with the successful implementation of ERM. On the other hand, risk culture was shown to have an insignificant relationship with the implementation of ERM. In this regard, the management of the public listed companies should focus more on organizational innovativeness for successful ERM implementation and provide more training for their employees in order to develop the potential in each of their employees.

**Key words:** *Enterprise risk management, employees, competency, risk culture, organizational innovativeness.*

## Introduction

The failure of some leading world organizations has made the shareholders accuse board members of being greedy, reckless and dysfunctional in their monitoring role (Dabari & Saidin, 2015). A good management should have reacted effectively to the risks that affect their companies and manage them well before they could lead to other problems. Studies such as Mohammed and Knapkova (2016) noted that “corporate failures, such as Enron and WorldCom in 2001 and 2002 respectively, had exposed the inadequacies of corporate governance practices, the integrity of financial reporting, inadequate compliance and monitoring as well as poor risk management initiatives of these great corporate entities”. A majority of companies are still unaware of the importance of ERM’s implementation that could have a significant impact on their organizational performances. This is supported by the argument made by Galloway and Funston (2000) that many scholars have described risk management awareness amongst companies as low and inadequate. Malaysia is not an exception to this scenario. The Malaysian Code of Corporate Governance stated that there are poor regulatory forces for compulsory adoption of ERM but it only recommends ERM adoption by firms listed on Bursa Malaysia. Thus, the lack of such regulations drove the non-implementation of ERM in Malaysian public listed companies even though they are aware about the importance and need to have such risk management policies within their organizations.

This study aims to examine the factors influencing the adoption of ERM in public listed companies in Malaysia. The findings of this study provide better understanding of the importance of implementing enterprise risk management in the companies and the factors that can influence the implementation. The next section provides the literature review. This is followed by Section 3 that presents the research design. Section 4 provides the results and discussion. The last section, Section 5 summarises and concludes this study.

## Literature Review

ERM is important for every level of business and life since it determines organizational success. According to Harner (2010), a business has four objectives, namely strategy, operation, reporting and compliance. Therefore, in order to achieve those objectives, enterprise risk management is seen as a top-down approach that helps the manager to understand better in the identification, assessment and response to strategic, operational and financial risks. The term enterprise risk management had been defined differently by authors

and institutions. Soltanizadeh, Abdul Rasid, Golshan, Quoquab and Basiruddin (2014) defined enterprise risk management as a fully integrated approach in which managers can use to recognize risks and select the appropriate response based on the enterprise's risk appetite. ERM is a broad framework that helps organizations to eliminate risks by identifying the crucial areas in the organizations that have a high possibility of risks, assessing the seriousness of the risks and responding accordingly to the risks.

ERM is believed to be an effective tool for an organization to manage their internal and external risks. Based on previous studies (Kleffner, Lee & McGannon, 2003; Manab & Kassim, 2012), the implementation of ERM in an organization has a significant effect on the organization's performance. Thus, it is necessary for an organization to take into consideration the factors that influence ERM adoption and implementation. One of the factors is competency. Hamel and Prahalad (1994) defined 'competence' as "collective learning in an organization especially on the how-to co-ordinate diverse productions skills and integrate multiple streams of technologies". In addition, competency does not limit to the leaders but also to the other employees of various levels of management (Kleffner et al., 2003; Manab & Kassim, 2012). According to Dooley and Fryxell (1999), scholars agreed that the competence of the team members have an influence on the decision making of the organization. An organization needs to proactively invest in the professional development of its staff and provide a career progression path to enhance the staff ability and competency to deliver their job well. Furthermore, research on ERM implementation shows that one of the hindrances towards the ERM implementation in various industries is inadequate training on ERM (Xianbo, Hwang & Low, 2015). Thus, the following hypothesis is developed:

*H<sub>1</sub>: There is a positive relationship between employees' competency and ERM implementation among the public listed companies.*

According to Cameron and Quinn (2011), "culture is the component that holds an organization, strengthens the relationship among its units, and reflects the norms that spur the stability and future success of the organizations". Ernst and Young (2014) argued that most of the financial disputes within organizations are somehow related to the culture of the organizations itself. Risk culture is being used as one of the factors that drives the implementation of the ERM in an organization because it may serve as one of the obstacles for the organization (Kieffner et al., 2003). Buchler, Freeman and Hulme (2008) stated that the precondition for a successful risk strategy is an effective risk management culture. As cited in Altuntas, Berr-Stolzle and Hoyt (2011), a risk management culture describes the way in which the organization handles its individual risk and is affected by the corporate culture.

The results of the empirical studies are mixed. Farrell and Gallagher (2014) found that the embedded risk culture, ERM integration within the organization, and the view of ERM as a

component of strategy and planning activities can lead to higher organization value. The goal of building a risk management culture is to influence employees and other stakeholders to almost automatically consider risks in their decisions (Altuntas et al., 2011). Interestingly, Altuntas et al' study found that, based on positive feedback from the employees, the employees are actually considering risks in making decisions. On the other hand, a negative relationship was found in that ERM activities (driven by the board, senior management and internal audit) have often developed within a culture of ethical compliance rather than within a culture of effective management of risk to improve organizational performance (Demidenko & McNutt, 2010). Cameron and Quinn (2011) mentioned that culture holds an organization together, strengthens the relationship among its units, and reflects the norms that spur its stability and future success. Thus, culture has a significant role in shaping the collective attitudes of organizational members and how the organizations respond to the market (Kimbrough et al., 2009). Risk managers need to ensure that a high culture is upheld by their organizations in order to understand the dynamics and level of ERM implementation. Lack of high-risk culture within the organization might lead it to operate against its policies. Due to the mixed results, this research attempted to examine the influence of high-risk culture in an organization as one of the success factors in ERM implementation by developing the following hypothesis:

*H<sub>2</sub>: There is a positive relationship between risk culture and ERM implementation among the public listed companies.*

Hurley and Hult (1998) and Wang and Ahmed (2004) referred organizational innovativeness as the degree at which an organization and business organization develops and launches new ideas faster than their competitors. The fall of leading companies worldwide has opened the eyes of other companies to launch new ideas on how to react to such risk management inadequacy. Hyrsky and Tuunanen (1999) stated that an organization requires new idea and strive for the best ways in everything that they do in order to achieve a successful risk management. Suliyanto and Rahab (2012), in their study, found that innovativeness of an organization has a significant influence on the organization's performance. Galloway and Funston (2000) stated that organizations with high turnover constantly innovate by taking business and strategic risks successfully by managing their entire process effectively at low risk and low cost to preserve and create value. Galloway also suggested that every organization should become a risk capable organization whereby it could react to its risk quickly and effectively.

A risk capable organization characteristic can be expressed as FAST (Focused and Simply Transparent). A study by Zumitzavan and Udchachone (2014) in Thailand found that there is a significant relationship between organizational innovativeness and implementation of enterprise risk management. This result is consistent with Mbizi, Thondhlana and Kakaya

(2013) that found a significant positive relationship between sustainability of small and medium enterprises (SME) in manufacturing and innovativeness of an organizations. Thus, the following hypothesis is developed:

*H<sub>3</sub>: There is a positive relationship between organizational innovativeness and ERM implementation among the public listed companies.*

## **Research Design**

### ***Sample Selection***

The employees of the public listed companies in the manufacturing industry are chosen as the target respondents. This is because this industry often involved diversified portfolios such as manufacturing and distribution of technical compounds and property development. Thus, allowing this study to capture the implementation of ERM in the various departments. The targeted respondents were from various departments including executive office, finance, human resources, incoming warehouse, logistics, engineering, safety, purchasing, sales and distribution. The respondents were also from various levels of employment ranging from non-executive to management levels. These employees were chosen because, according to the Institute of Risk Management, “risk management should be embedded in the general management of an organization – it should not be practised in isolation but integrated fully with other functions such as finance, strategy, internal control, procurement, continuity planning, human resources and compliance”. This study employed probability sampling in which the units in the population has a known and non-zero chance of being chosen. A total of 1000 employees were invited to participate in the survey but only 640 responses were received by the end of the data collection period. Thus, representing a response rate of 64%.

### ***Research Instrument***

The research instrument in this study is the questionnaire survey. The questionnaire comprises of five parts. The first part of the questionnaire requests the respondents to provide their demographic information. The second part of the questionnaire required the respondents to provide their understanding of ERM. This second part intends to measure the level of ERM implementation in the public listed companies. There are eight questions asked in this part. This part used a 7-point Likert scale from ‘1’ as ‘strongly disagree’ to ‘7’ as ‘strongly agree’. The third part of the questionnaire requests the respondents to provide their perception on how employees’ competency can improve the effectiveness of ERM implementation in their organization. There are eight questions asked in this part. This part also used a 7-point Likert scale from ‘1’ as ‘strongly disagree’ to ‘7’ as ‘strongly agree’.

The fourth part requests the respondents to provide their perception on how risk culture can improve the effectiveness of enterprise risk management implementation in their organization. There are three questions asked in this part. This part relies on a 7-point Likert scale from '1' as 'strongly disagree' to '7' as 'strongly agree'. Similar to the other variables studied, in the final part of the questionnaire, the respondents are requested to provide their perceptions on how organizational innovativeness can improve the effectiveness of ERM implementation in their organization. There are seven questions asked in this part. This part used a 7-point Likert scale from '1' as 'strongly disagree' to '7' as 'strongly agree'.

## Results and Discussion

### *Descriptive Statistics*

Table 1 presents the details of the descriptive statistics for ERM implementation. The results show a high overall mean score of 5.21 for the dependent variable. This implies that the respondents have a clear picture about the existence of ERM implementation in their organization. The items that have low mean scores are 'the Chief Risk Officer report to Chief Executive Officer', 'Risk Management committee has clear and documented charters' and 'existence of dedicated risk management division within the organization' with a mean score of 4.64 each. This may be due to the unfamiliarity of certain employees about the respective reporting chart in the organization and the documented risk management charters not being properly made known to the employees.

**Table 1:** Descriptive Statistics on ERM

List of Construct and Measures	N	Min	Max	Mean	SD
Existence of CRO	640	4	6	5.64	.601
CRO is reporting to CEO	640	3	7	4.64	1.022
Existence of RM in organization values, goals or mission	640	4	6	5.64	.601
Existence of established RM committees	640	4	6	5.64	.601
RM committee have clear and documented charters	640	3	7	4.64	1.022
Existence of dedicated RM division	640	3	7	4.64	1.022
Existence of RM portal/ webpage	640	4	6	5.64	.601
<b>TOTAL</b>	<b>640</b>			<b>5.21</b>	

The highest mean score for ERM implementation would be the 'existence of Chief Risk Officer', 'existence of risk management in the organization's values goals and mission', 'existence of established risk management committee' and 'existence of risk portal or webpage for the risk management team' with a mean score of 5.64. The lowest mean score of 4.64 is still considered as a high score. Thus, the results indicate that this organization has a

very strong risk management team and its existence is made known to the employees regardless of their departments. It is a positive sign that the employees of this organization are well versed on what enterprise risk management is all about.

### *Employees' Competency*

Table 2 presents the descriptive statistics for employees' competency. The results show a high overall mean score of 5.49 for this independent variable. This implies that the respondents can deliver better in discharging their risk management function. Most of the employees have strong knowledge about enterprise risk management and know what is to be done in the event of risk occurrence. The items that have a low mean score of 4.64 for employees' competency are 'knowledge about enterprise risk management', 'consider evidence to support every conclusion and decision made', and 'employees make full use of their knowledge and experience in discharging their responsibilities'. Even though these items are considered as having the lowest mean score, the overall mean score is still high. The highest mean score of 6.30 for employees' competency is for 'identifying linkage, relationship and power structure', 'never cut corners or jeopardize risk management', and 'know who to contact in the event of risk occurrence'. Most of the employees have critical thinking in delivering their jobs and responsibilities. They follow the risk management standard operation procedures that had been setup by the organization to ensure that there would be no non-compliance issue arising.

**Table 2:** Descriptive Statistics on Employees' Competency

List of Construct and Measures	N	Min	Max	Mean	SD
Knowledge about ERM	640	3	7	4.64	1.022
Confident in making decision	640	4	6	5.64	.601
Considering evidence to support conclusion	640	3	7	4.64	1.022
Use of knowledge and experience	640	3	7	4.64	1.022
Identify linkage, relationship and power structure	640	5	7	6.3	.701
Never cut corners or jeopardize RM	640	5	7	6.3	.701
Know contact in risk occurrence	640	5	7	6.3	.701
<b>TOTAL</b>	<b>640</b>			<b>5.49</b>	

### *Risk Culture*

Table 3 presents the results of the descriptive statistics of risk culture. The results show a high overall mean score of 5.68 for this independent variable. This implies that the respondents are well versed about the organization's risk culture and risk appetite. Thus, this can ensure that they can act accordingly towards any risk events to suit their organization's

risk appetite. The items that have a low mean score of 4.64 for risk culture are ‘existence of own risk management philosophy, risk appetite, integrity and ethical values in their daily operations’, ‘existence of proper policies and procedures and implemented to help in ensuring that the risk response are effectively carried out within the organization’ and ‘in any event of risk occurrence, risk are analysed considering the likelihood and impact as a basis for determining how the risk should be managed’. Even though the mean score for these items are considered as the lowest mean score, the overall mean is still high. The highest mean score of 6.30 for risk culture is for ‘existence of clear identified objective and goals’, ‘response accordingly towards risk to align with organization’s risk appetite and objectives’, ‘take into account both internal and external risks and opportunity that could affect the achievement of organization’s objective’ and ‘the organization monitors risk management and modifications made regularly and as necessary’.

**Table 3:** Descriptive Statistics on Risk Culture

List of Construct and Measures	N	Min	Max	Mean	SD
Existence of own RM philosophy	640	3	7	4.64	1.022
Clear objective and goals	640	5	7	6.30	.701
Responsive towards risk	640	5	7	6.30	.701
Take into account internal and external risks	640	5	7	6.30	.701
Existence of proper policies on RM	640	3	7	4.64	1.022
Proper management of risk event	640	3	7	4.64	1.022
Effective communication about RM	640	5	7	6.30	.701
Monitor and modify RM	640	5	7	6.30	.701
<b>TOTAL</b>	<b>640</b>			<b>5.68</b>	

### *Organizational Innovativeness*

Table 4 presents the descriptive statistics on organizational effectiveness. The results show a high overall mean score of 5.44 for this independent variable. This implies that most of the respondents agree that their organization is continuously seeking for improvement and opportunities and let their employees suggest ideas. The items that have a low mean score of 4.64 for organizational innovativeness are ‘generates practical and commercially/financially viable ideas for improvement that align with business objective and strategy’ and ‘leaves no stone unturned in seeking inspiration for viable ideas for improvement’. Even though these items have the lowest mean score, the overall mean is still high.

**Table 4:** Descriptive Statistics on Organizational Innovativeness

List of Construct and Measures	N	Min	Max	Mean	SD
Identify innovative and insightful solutions	640	4	6	5.64	.601
Foster environment for suggesting ideas	640	4	6	5.64	.601
Maintain systematic but flexible approach	640	5	7	6.30	.701
Generate ideas for improvement	640	3	7	4.64	1.022
Quick to spot and capitalize emerging trends	640	4	6	5.64	.601
Seek inspiration	640	3	7	4.64	1.022
Encourage to seek opportunities	640	4	6	5.64	.601
<b>TOTAL</b>	<b>640</b>			<b>5.44</b>	

The average mean score of 5.64 for organizational innovativeness are for ‘identifies innovative and insightful solutions from disparate areas of business that consider stakeholders’ culture’, ‘motivates and foster an environment where changes are welcomed and people feel confident about suggesting ideas’, ‘quick to spot and capitalize on emerging trends that may affect an organization’s future growth’ and ‘alerts others to the implications of decisions, issues and developments’ and ‘encourage others to seek opportunities for improvement and adopt others’ ideas. The highest mean score is 6.30 which is for ‘the organization maintain a systematic but flexible approach to problem solving and decision making using past lessons to take informed future action’.

### *Pearson Correlation Coefficient*

In order to determine and identify the linear relationship’s strength between the dependent variable and the independent variable, the correlation coefficients derived from Pearson’s correlation coefficient matrix were analysed. Pearson correlation analysis is suitable for this study as the data for all the variables were normally distributed. The coefficients are presented in Table 5.

**Table 5:** Pearson Correlation Coefficient Matrix and Level of Significance

Variable		DV	IV1	IV2	IV3
DV	Pearson Correlation	1	.637**	.132	.943**
	Sig. (2-tailed)		.000	.243	.000
	N	640	640	640	640

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

Key:

IV1 = employees’ competency

IV2 = risk culture

IV3 = organizational innovativeness

The results in Table 5 indicates that employees' competency (IV1) significantly influence ERM implementation since the value is  $p=0.000$  which is less than  $0.05$  ( $p<0.05$ ). The coefficient of correlation ( $r=0.637$ ), suggests that there is a positive moderate relationship between employees' competency and ERM implementation. On the other hand, risk culture's (IV2) significance value is  $0.243$  which indicates that the variable is not significant as the value is higher than  $0.05$  ( $p>0.05$ ). The coefficient of correlation ( $r=0.132$ ), indicates that the relationship between risk culture and ERM implementation is a positively weak relationship. Organizational innovativeness significantly influences the ERM implementation since the significant value is  $0.000$  ( $p<0.05$ ). The coefficient correlation ( $r=0.943$ ), indicates that there is a positively strong relationship between organizational innovativeness and enterprise risk management implementation. Since the results in the above table show that there is a linear relationship between the dependent variable (IERM) and each of the independent variables, the use of simple linear regression analysis is justified to test the hypothesis.

### ***Hypothesis Testing***

Table 6 presents the results of testing hypothesis 1. The results show that employees' competency has a significant influence on ERM implementation since the  $p$ -value is  $0.000$  which is less than  $0.05$  ( $p=0.000$ ,  $p<0.05$ ). The coefficient correlation ( $R=0.637$ ) indicates that there is positive moderate relationship between employees' competency and ERM implementation.  $R^2=0.406$  indicates that  $40.6\%$  of the total variation in the ERM implementation can be explained by employees' competency and the remaining  $59.4\%$  explained by other factors. At  $0.05$  level of significance, with degree of freedom  $df$  of  $78$ , the  $t$ -critical value is  $2.000$  while  $t$ -statistics value is  $7.298$ . Since the  $t$ -statistics value ( $7.298$ ) is greater than  $t$ -critical value ( $2.000$ ), the null hypothesis is rejected. Therefore, this study concludes that there is a positive significant relationship between employees' competency and ERM implementation. As such, hypothesis 1 is supported. Such findings are consistent with Kleffner et al. (2003) and Manab and Kassim (2012) that indicated staff and leaders have a significant role in the implementation of ERM.

**Table 6:** Regression Analysis Result for Employee's Competency

Variable	Enterprise Risk Management				
	Sig.	R	R <sup>2</sup>	B <sub>0</sub>	t
Employee's Competency	0.000	0.637	0.406	1.005	7.298
Risk Culture	0.243	0.132	0.017	0.197	1.177
Organizational Innovativeness	0.000	0.943	0.889	1.288	25.004

Table 6 also presents the results of testing hypothesis 2. The results show that variable risk culture is not a significant influence to ERM implementation since the p-value is 0.243 which is more than 0.05 ( $p=0.000$ ,  $p>0.05$ ). The coefficient correlation ( $R=0.32$ ) indicates that there is positive low relationship between risk culture and ERM implementation. The coefficient of determination ( $R^2=0.017$ ) means that only 1.7% of the total variation in ERM implementation can be explained by risk culture and the remaining 98.3% explained by other factors. At 0.05 level of significance, with degree of freedom  $df$  of 78, the  $t$ -critical value is 2.000 while  $t$ -statistics value is 1.177. Since the  $t$ -statistics value (1.177) is lower than the  $t$ -critical value (2.000), the null hypothesis is accepted. Thus, this study concludes that there is a no significant relationship between risk culture and ERM implementation. In other words, hypothesis 2 is not supported.

Table 6 also presents the results of testing hypothesis 3. The results show that organizational innovativeness has a significant influence on ERM implementation since the p-value is 0.000 which is less than 0.05 ( $p=0.000$ ,  $p<0.05$ ). The coefficient correlation ( $R=0.32$ ) indicates that there is positive strong relationship between organizational innovativeness and ERM implementation. The coefficient of determination ( $R^2=0.889$ ) indicates that 88.9% of the total variation in ERM implementation can be explained by organizational innovativeness and the remaining 11.1% explained by other factors. At 0.05 level of significance, with degree of freedom  $df$  of 78, the  $t$ -critical value is 2.000 while  $t$ -statistics value is 25.004. Since the  $t$ -statistics value (25.004) is higher than the  $t$ -critical value (2.000), the null hypothesis is rejected. Hence, this research concludes that there is a strong significant relationship between organizational innovativeness and ERM implementation. Therefore, hypothesis 3 supported. Such findings are consistent with Suliyanto and Rahab (2012), Zumitzavan et al. (2014) and Mbizi et al. (2013) that found that positive relationship between organizational innovativeness and ERM implementation.

### Summary and Conclusion

This study examines the factors influencing ERM implementation among the public listed companies. Specifically, this study examines the influence of employee's competency on enterprise risk management. The results indicate that the employees of the public listed companies are well versed with the ERM policies and that there is a positive relationship between employee's competency and ERM implementation. This study also examines the influence of risk culture on enterprise risk management implementation. This study shows that the relationship between risk culture and ERM implementation is not significant. Finally, this study examines the influence of organizational innovativeness on ERM implementation. This study shows that there is a positive relationship between organizational innovativeness and implementation of ERM in organizations. The findings in this study indicated that there



is a significant positive relationship between organizational innovativeness and ERM implementation. Thus, the objective was achieved and H<sub>3</sub> was supported.

This study is not without limitations. The number of respondents in this study is only 640. As public listed companies often have large number of employees, the data from 640 respondents may not lead to concrete findings. Hence, it is suggested that, in future research, a greater number of respondents should be involved which would allow the findings to be generalizable to the entire population of the selected group of the respondents. The findings of this study provide better understanding to the management of the public listed companies on the importance of ERM implementation and the factors influencing such implementation.

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