Full Length Research Paper

Enterprise risk management: A managing ‘partner’ for business success

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Research has shown that small, micro and medium enterprises (hereafter referred to as SMMEs) are crucial in promoting international economic growth and development; along with the overall reduction in current unemployment levels. In South Africa, this phenomenon is no exception as the concept of SMMEs was introduced to alleviate poverty and improve overall living conditions through job creation in the country. For SMMEs to be successful they have to survive all forms of risk, especially in their start-up phase. The aim of this study was to determine to what extent SMMEs engage in enterprise risk management (ERM) activities. In order to achieve the above empirical research was conducted on non-franchised retail SMMEs, operating in the Cape Town City Bowl. A questionnaire was used to glean data that was further quantitatively analysed using descriptive statistics. From the findings, relevant recommendations and conclusions were made.

Key words: Risk, risk management, ERM, SMMEs, success, sustainability.

INTRODUCTION

According to Roberts (2006), SMMEs play a significant role in the global economy, especially in that of developing countries. Nieman (2001) mentions that the objectives of SMMEs in South Africa (a developing country) include the creation of jobs (to reduce the unemployment rate), the alleviation of poverty and the overall stimulation of the national economy. The South African Small Business Act No. 102 of 1996 define SMMEs as: “a separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one or more owners which, including its branches or subsidiaries, if any, is predominately carried on in any sector or subsector of the economy” (South Africa, 1996).

Albeit the above it is Giliomee (2004) whom avers that over 80% of these entities fail within their first five years of existence; translating to the fact that the predestined objectives (as mentioned above) are not being efficiently met to a great extent. According to Brink et al. (2003) it is estimated that the failure rate of SMMEs range between 70 and 80%; which essentially result in millions of Rand being lost to the national economy. As a result Bizbooks (2008) states that South African SMMEs are branded as being ‘risky’ due to their high failure rate. This is further backed with a recorded increase in the unemployment rate of 2010 (24%) to the unemployment rate of 2011 (24.9%). In essence this transforms into an approximate 835,135 more South African citizens being listed as unemployed (Indexmundi, 2012).

Howard and Jawahar (2002) mention that risk management plays a crucial role in small business success as a single, poorly managed risk can threaten its survival as to some extent one can attribute the high failure rate of these entities to a mere lack of risk management practices.

Knox (2012) mention that many small businesses take that enterprise risk management (ERM), is only relevant and implementable in large organisations. McDonough (1992) supports the latter when expressing the view that smaller firms are beginning to become aware of the necessity of risk management programs, however very little actually implement such programs.

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From the above the authors of this paper formulated a perception which gave rise to the following research problem “SMMEs are not as successful as they ought to be due to the limited utilisation of ERM activities”. In essence, the latter lead to the following research question being asked: “To what extent do SMMEs engage in ERM activities?”

LITERATURE REVIEW

South African SMMEs and their success

Luiz (2002) is of the opinion that SMMEs have a heightened relevance in emerging countries and that strategies have been developed worldwide, to some extent, to expand and integrate these entities into the mainstream of economic activities. Bruwer and Watkins (2010) explain that the South African SMMEs were implemented by the South African Government in an attempt to decrease unemployment, decrease poverty and improve the national economy altogether.

According to Kesper (2001) although South African SMMEs are currently at the forefront of local economic development in Africa and are alleged to resolve socio-economic problems, these entities still face a wide spectrum of constraints which restrict them from achieving and maintaining a competitive position in their respective industries. This is supported by Verduyn (2011) when stating that, on average, approximately 80% of South African SMMEs fail within their first year of existence.

Wright (2011) implies that possible reasons for the high SMME failure rate include that of inadequate business education and training, lack of financial support and unstable business environments. Another reason for the high SMME failure rate in South Africa according to Bygrave and Minnitti (2000) is the lack of managerial skills, which, as a consequence, evidently impacts any new business adversely. Managerial skills pertain to skills where an enterprise leader has to plan, lead, organise and control – fundamentally relating to critical elements of risk management. These critical elements are described by Deloach (2012) as identification of risk (plan), sourcing and measurement (lead), evaluation and mitigation (organisation) and monitoring of risk (control).

The term ‘business success’

According to Gerber (2009) the term ‘business success’ has different meanings to different people: From a business perspective, a true sense of success can stem from the process of building a business that functions so such an extent so that it achieves financial prosperity (as per the vision, mission, objectives and values of a business). In essence business success can also be relative to the owner’s personal goals for their business. Witbooi et al. (1990) affirmed that the defining and creation of the term ‘business success’ is purely based on the personal expectations and perceptions of a business owner. This is further sustained by Nieman et al. (2003) when mentioning that small business success can be attributed to personal characteristics being fulfilled (e.g. creativity, innovation, orientation, leadership, attitude, etc.), and managerial skills being perfected (e.g. planning, customer satisfaction, service, quality, financial education, etc.).

Enterprise risk management

Manu (2005) explains that a risk can be regarded as a chance of something happening that will impact upon objectives of an organisation. According to Ayinde et al. (2008) risk is everywhere and is, to a large extent, unavoidable. For this very reason, SMMEs should continuously assess their risk as Shahzad et al. (2011) explain that it is strongly believed that risk identification, particularly, is an ongoing process. This is further elaborated upon by Peterson (1996) when stating the view that risks are inherent in any business and need to be managed effectively to ensure business success. McDonough (1992) asserts that every organisation is exposed to some sort of risk and should develop adequate strategies to avoid, share, mitigate and/or control the effects thereof. These strategies pertain to that of risk management. Controls to manage these risks are also essential to ensure that a business remains being classified as a ‘going concern’, should the unexpected happen.

ERM relates to the identification, evaluating, control, monitoring, reviewing, reporting and handling of all the risks and opportunities that an entity may face; both internally and externally, that are related to past, current and future events (IRMSA, 2005). According to Jacobus (2010) ERM enables any small business to prepare a better strategy in terms of operational planning: to manage operation in a more efficient and effective way. ERM further assists with the avoidance of any expected and unexpected losses and also helps with the establishment of a sound culture of high performance within an organisation.

Baker (2011) claimed that the global economic downturn has exposed poor risk management practices of many organisations, especially in the case of SMMEs. The afore-mentioned is further described as “something” which is practiced only by large organisations as opposed to SMMEs (Winks, 2008). Moreover, Baker (2011) explains that ERM is underutilised by SMMEs as it (ERM) is perceived to be a complex and abstract practice; a realm of specialist expertise that has only a passing connection to large businesses.
Eslyn (2007) expresses the opinion that many SMME owners should be motivated to use ERM as it will cause a reduction in taking uncalculated risks, which often ends in disastrous consequences. According to Henschel (2011) the establishment of a risk management system such as ERM is essential to both business survival and business sustainability. Havenga (2006) provides the following list of benefits which may arise from making adequate use of ERM as an adequate risk management system:

1. Assistance with the compliance of applicable laws and regulations.
2. Identification and management of multiple and cross-enterprise risks.
3. Provides a broader understanding and recognition of risks throughout the enterprise through increased communication on the topic.
4. Reduce and/or minimise possible financial losses.

According to Beaasley et al. (2005) ERM has emerged as the ‘new paradigm’ for managing a “portfolio of risks” which organisations are faced with; which should, in essence, holistically improve corporate governance and risk management practices. Beaasley et al. (2006) further express the view that ERM is a necessity to identify risks in and around an organisation to ensure that they are managed effectively as a whole, as opposed to being managed independently. D’Arcy (2001) argues that since ERM involves many different aspects of an organisation’s operations, and integrates a wide variety of different types of risks, it is critical that the management of risks take the form of an orderly, open-minded and shared approach. Apart from minimising potential losses, ERM is also a tool which can assist SMMEs to exploit new business opportunities; ultimately enhancing its chances for survival (Yilmaz and Flouris, 2010).

MATERIALS AND METHODS

Research design

According to Mouton (2001) a research design is plan of how one intends to conduct research. This research study was empirical in nature and was also regarded as descriptive research which is described by Collis and Hussey (2009) as research that describes certain phenomena as it happens.

This research also fell within the ambit of the positivistic research paradigm as quantitative research methods were used. The study further relied on deductive reasoning as the authors formulated a perception (based on a certain phenomenon) from theory, where afterwards it was tested by means of practical application in a general environment. The main intention of this study was to shift the focus of a phenomenon from a generalist point of view to a specific point of view.

Research method

The research method deployed was that of survey research. Leedy and Ormrod (2010) describe survey research as a type of research where information is acquired about a certain group of people, with regards to their general perceptions, by means of structured questions in the form of a questionnaire. The group of people selected for this study were owners and/or managers of SMMEs which operated in the retail industry; situated in the Cape Town business district (CBD).

Sampling and data collection

The general size of the population was unknown to the authors, and in an attempt to glean better insight (for future studies), pertaining to the identified research problem, a sample size of 30 SMMEs was chosen. The sampling method deployed was that of non-random sampling, specifically that of purposive sampling (as the authors did not know the actual size of the population), since the main intention of the authors was to glean rich data.

Essentially a total of 43 small businesses were visited in the CBD as it was the closest situated area to the authors (during 2011), however only 30 responses were regarded as valid. All respondents were assured of confidentiality and anonymity and all responses were voluntary in nature as respondents could withdraw from the study at any point in time.

Data analysis

The relevant data that were collected were analysed accordingly by using descriptive statistics.

Delineation

All respondents should have owned and/or managed their respective SMMEs which, in turn, should have existed for at least 1 year. Only responses from owners and/or managers that were actively involved in business operations, of these firms, were taken into consideration.

RESEARCH FINDINGS AND DISCUSSION

Respondents were asked to rate their perception regarding their overall business success (no indicators were given as to what they describe success as since the authors did not want to impair respondents’ pure perceptions). The dispensation that arose is revealed in Table 1. It is clear that majority of owners and/or managers of SMMEs perceived their businesses as successful. At present time the South African economy is still recovering from the recent global recession, hence small businesses were still optimistic about their future in terms of overall success. If this same level of optimism (with regards to success) by owners and/or managers of SMMEs can be consolidated with the implementation of adequate risk management processes, the South African economy should recover quite rapidly.

Furthermore, respondents were asked to indicate which risks they perceive to potentially result in business failure. The summary of responses is evident in Table 2. Majority of small businesses perceived financial risk to be the main risk that causes business failure (84.25% of respondents shared this perception). The elements of
Table 1. SMME owners’ and/or managers’ perception of business success.

<table>
<thead>
<tr>
<th>Success rating</th>
<th>Response (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very little</td>
<td>0</td>
</tr>
<tr>
<td>Little</td>
<td>10</td>
</tr>
<tr>
<td>Average</td>
<td>36.7</td>
</tr>
<tr>
<td>Quite</td>
<td>30</td>
</tr>
<tr>
<td>Very much</td>
<td>23.3</td>
</tr>
</tbody>
</table>

Table 2. SMME owners’ and/or managers’ perception on risks that cause business failure.

<table>
<thead>
<tr>
<th>Risks</th>
<th>Average perception (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial risk</td>
<td>84.25</td>
</tr>
<tr>
<td>Management risk</td>
<td>70.75</td>
</tr>
<tr>
<td>Strategic risk</td>
<td>67.50</td>
</tr>
<tr>
<td>Operational risk</td>
<td>65.75</td>
</tr>
</tbody>
</table>

Table 3. Methods of risk management methodologies deployed by SMME owners and/or managers.

<table>
<thead>
<tr>
<th>Usage</th>
<th>Average (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mitigate</td>
<td>75.75</td>
</tr>
<tr>
<td>Termination</td>
<td>75.75</td>
</tr>
<tr>
<td>Transfer</td>
<td>64.25</td>
</tr>
<tr>
<td>Tolerate</td>
<td>44.25</td>
</tr>
</tbody>
</table>

financial risk includes weak liquidity, weak cash flow, immense financial obligation (liabilities, etc.) and insolvency, just to mention but a few.

Management risk was also regarded as a probable risk that could adversely impact a business rate of sustainability (70.75% of respondents shared this perception). Mismanagement pertains to aspects such as failure to plan, incompetent leadership, lax controls, among other.

Strategic risk (e.g. inadequate marketing, unreliable debtors, lack of infrastructure, etc.) and operational risk (e.g. incompetent staff, unreliable suppliers, etc.) were also regarded as probable risk that could affect business sustainability negatively (67.50% and 65.75% of respondents shared this perception respectively).

When respondents were asked to indicate which risk management methods they make use of to combat risk in their respective businesses, the following dispensation emerged in Table 3.

Interesting is the fact that on average most SMMEs use mitigation methods (75.75%) and termination methods (75.75%) in dealing with risk. The mitigation of risk entail the reduction in the extent of exposure to a risk and the likelihood of its occurrence (placing controls in place to stop a certain type of risk from happening), while the termination of risk include the elimination of all possible threats that may cause potential loss (avoiding a certain type of risk at all costs).

The transfer of risk (outsourcing a certain type of risk) was also used by 64.25% respondents, but not to the extent that the previous risk management methodologies. Strangely enough, only 44% of respondents tolerated risk (live with the risk).

Lastly respondents were asked which processes they make use of within their business (relevant to similar processes in ERM). The collaborative view of respondents is tabulated as shown in Table 4.

From Table 4 data it is clear that (on average) 68.75% of SMMEs made use of risk management processes which related to ERM. The five biggest risk management processes that were used by SMMEs included that of: Setting of objectives (used 78.25% of the time), evaluating the internal environment (used 77.50% of the time), obtaining risk responses (used 75.75% of the time), control activities (used 74.25% of the time) and risk assessments (used 72.25% of the time).

Ironically when respondents were asked whether they make use of ERM only 48.25% of respondents indicated that they do so.

LIMITATIONS OF THE STUDY

Both monetary constraints and time constraints played an important role in the formulation of this study. In essence this paper forms part of a mini-research project consisting of conducting a literature review, data collection and data analysis among other which had to be conducted by the authors in a maximum period of 9 months.

DELIMITATIONS OF THE STUDY

Due to the fact that Cape Town is regarded as one of
biggest tourist attraction destinations of the modern world, the authors decided to investigate the perceptions of owners and/or managers of SMMEs, with regards to a specific phenomenon, which operated within the ‘heart’ of Cape Town. This ‘heart’ is deemed as the CBD and in essence the authors believed that the information attained through this study would be of great benefit for future research avenues with relation to the utilisation of ERM activities in the greater Cape Town region.

Conclusion

From the literature review, it was evident that majority of SMMEs do not have knowledge, nor do they implement ERM activities. Based on the research conducted it is clear that most SMMEs unknowingly engage in ERM activities albeit that they do not have formally implemented ERM processes in place (informal use of ERM activities).

REFERENCES


