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ENTERPRISE RISK MANAGEMENT, CORPORATE GOVERNANCE AND SYSTEMIC RISK: SOME RESEARCH PERSPECTIVES

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Abstract

The general goal of Enterprise Risk Management (ERM) processes is to generate economic value through the coverage of firm business risk, on the one hand, and by exploiting the positive side of uncertainty conditions, on the other hand.

The increasing attention attributed to ERM in the creation of economic value has led to even greater interactions between risk management mechanisms and the corporate governance system.

In other words, in the last two decades, the relationships between corporate governance and ERM increased since the ERM processes have been considered more and more as critical drivers to combine strategic objectives with relative low volatility of company performance. The basic idea is that a good corporate governance system must deal about specific risks along with their interactions and, at the same time, the firm's business risk as a whole. Moreover, an efficient and effective ERM system provides clear information about linkages between strategic opportunities and risk exposure and offers tools able to manage in an optimal way the negative side of business risk (or downside risk) as well

as its positive side (or upside risk).

Accordingly, extant studies concerning the relationships between ERM and corporate governance have been focusing on a micro-level of analyses (i.e., the individual organization) and, specifically, on a firm's benefits that stem from the adoption of proper ERM processes that are consistent with corporate governance goals and are able to sustain the increase of economic value while maintaining a bearable business risk over time.

From our initial analyses, a gap in literature arises. We argue that the interdependence between ERM and corporate governance may be analyzed from a broader point of view as well (i.e., the firm and its task environment composed by its suppliers, customers, and partners). In particular, our research idea is to enlarge traditional studies about interrelations between corporate governance and ERM taking into account whether such interrelations could be a driver of risk transfer from the focal organization to other organizations that belong to its task environment. Moreover, this study aims to deepen the mechanisms by which the transfer of risk from a focal organization to its task environment may foster the emergence of systemic risk, i.e., a macro risk coming from domino and/or network effects.

Therefore, our paper aims to find new research areas by combining micro and macro issues tied to corporate governance, ERM and systemic risk.

The starting point of our work is the three following assumptions:

1) The compliance of a firm to ERM processes as well as to corporate governance rules implies the reduction as much as possible of firm business risk;

2) The reduction of the firm business risk leads to externalizing the firm business risk through risk-sharing mechanisms;

3) The risk-sharing may arise like a driver of systemic risk especially in those industries featured by strong network interrelations.

Starting from the above assumptions, the paper goal is to open a new research area which combines four academic fields (ERM, corporate governance, corporate finance, and macro-finance). So far, our initial findings tell us that the following research questions arise:

RQ₁: What are the conditions under which the transfer of business risk towards organizations that belong to a firm task environment is likely to become a source of systemic risk in a specific industry?

RQ₂: How does the capital structure of a focal firm affect its propensity to transfer business risk not only to commercial but also to financial stakeholders included in firm task environment?

RQ₃: How does the transfer of business risk influence the capital cost of the focal firm as well as of the organizations that absorbed such risk?

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