THE INFLUENCE OF LEADERSHIP STYLE AND ORGANIZATIONAL CULTURE IN THE IMPLEMENTATION OF RISK MANAGEMENT

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Abstract

The impact of the global financial crisis has highlighted the importance of risk management. The role of risk management was also associated with changes in the business environment. The strategy process is divided into two steps, namely the formulation and implementation. Risk management carried out in the strategy formulation process as a project to identify opportunities and risks in accordance with the company's strategy. Implementation of Enterprise Risk Management (ERM), which can effectively help the organization achieve its goals, and lead to the creation of value for the organization. Risk management is an activity which integrates recognition of risk, risk assessment, developing strategies to manage and mitigate risk using managerial resources. From previous research, organizational culture is identified as an important key in contextual factors for the success of the company's risk management. Identifying the individual leader's style is central to evaluating the quality of leadership and effectiveness, especially for organizational goals and manage the risk in the company. The purpose of this study is to propose a conceptual framework of leadership styles, organizational culture and risk management. This study will be discussed at one of the state-owned insurance company with quantitative methods conducted through a survey of middle management and employees. The results of this study will contribute to the company *to determine the influence of leadership style and organizational culture adopted by the company for the implementation of risk management.*

Keyword: *leadership style, organizational culture, risk management.*

JEL Classifications: *M14, D80*

INTRODUCTION

The impact of the global financial crisis has highlighted the importance of risk management. Risk management is a systematic approach that develops a strategy, people, technology, processes and knowledge that has the objective to assess, evaluate and manage the risks faced by the organization. In particular, risk management is done in the process of strategy formulation as a project to identify opportunities and risks in accordance with the company's corporate strategy (Mintzberg, 2003). Most of the risk management approach is still evolving (Kaplan and Mikes, 2014). Enterprise Risk Management (ERM) is a systematic approach to risk management across the enterprise to identify, assess, respond and report on opportunities and threats affecting the company in achieving its goals. In Indonesia, the implementation of risk management in insurance companies must comply with the Financial Services Authority Regulation No. 1 / POJK.05 / 2015.

The quality of leader in making a decision can determine the effectiveness of risk management in the enterprise (Lowell, 2015). An effective leader knows how to improve employee motivation and make employees loyal to the organization (Alkahtani, 2015). Employee empowerment is largely dependent on management's ability to demonstrate leadership style that promotes the participation and the creation of a safe environment, where employees feel comfortable in expression (Huang *et al.*, 2010; Mantere and Vaara, 2008; Moeller, 2007). In addition, organizational culture is also one of the contextual factors that have an important role for the success of management in the organization in addition to leadership (Koompai, 2010). However, research on organizational culture and ERM are still very limited (Thomya and Saenchaiyahon, 2015). Making the culture of the organization became a significant factor in the implementation of ERM (Kimbrough and Componation, 2009). Therefore, the main issue in this study is whether an organization characteristic such as leadership style and organizational culture may affect the implementation of risk management in one of the insurance companies in Indonesia.

The paper begins with a brief overview of the literature on leadership styles, organizational culture, and implementation of risk management. Followed by the discussion of the methodology used in this study and the presentation of the analysis and the results of the research of the submitted questionnaire that correlates the relationship between the two organizational characteristics of leadership style and organizational culture to the application of risk management. Thereafter, there are results suggesting that the relationship between leadership styles and the application of risk management is reinforced by organizational culture. At the end of this paper, the research conclusions are highlighted.

LITERATURE REVIEW

Leadership Style

Leadership is complex and influenced by a wide range of relationships, situations, personalities, and well as additional factors in its field of endeavor (DeCaro, 2005). Leadership is often defined as the process of direct and influence a group of people in an organization. Effective leadership is the leader who succeeded in implementing changes in the organization, especially during critical periods and unexpected changes in the external environment (Littrell and Nicolae Valentin, 2005). The influence of a leadership can lead to improved performance of the company can be viewed directly on the decisions taken and the actions taken by the leader (Cetin, 2012).

Organizational Culture

Culture is considered as the soft side of an organization (Smith, *et al.* 1993; Alvesson 2002). Culture is one of the most powerful influence on decision-making for an organization as well as in determining strategy (Schein, 2010). Organizational culture is the most effective factor in knowledge management and learning within the organization, but also can become a bottleneck in the transfer of knowledge (Rahgozar *et al.*, 2012). Based on the previous description, organizational culture tends then affect both the business processes and decision-making, affecting both the perception and behavior of employees.

Implementation of Risk Management

Every activity in the company will inevitably face a variety of risks that may affect the achievement of corporate goals. Risks may hinder the achievement of corporate objectives (Djohanputro, 2013). Environmental changes that occur making the company uses proactive risk management techniques, namely the Enterprise Risk Management (ERM), which has become a major resource in developing a risk management system (Choi *et al*., 2015; Kaplan and Mikes, 2014; Power, 2009). Definition of Enterprise Risk Management (ERM) by COSO (2004) is a process, influenced by the board of the entity of directors, management and other personnel, applied in setting strategy and across the enterprise, designed to identify potential events that may affect the entity, and manage risk are in risk appetite, to provide reasonable assurance of achieving the entity's objectives. ERM talk about integration in three ways. First, ERM requires an integrated risk structure of the organization. Second, ERM requires the integration of strategy in the aspect of risk transfer. Third, ERM requires the integration of risk management for the company's business processes. Compared with the pattern of the defensive approach or control-oriented in addressing the lower limit of risk and earnings volatility, ERM optimize business performance by supporting and influencing the price, resource allocation, and other business decisions. To summarize, ERM is a process associated with strategy and operations at all levels with the cooperation of all individuals throughout the organization, to identify and manage the uncertain events that may affect the organization, to guarantee sufficient to achieve organizational goals.

METHODOLOGY

Research Model

Based on the literature review, the theoretical framework to determine the influence of characteristics of organization in the implementation of risk management as follows

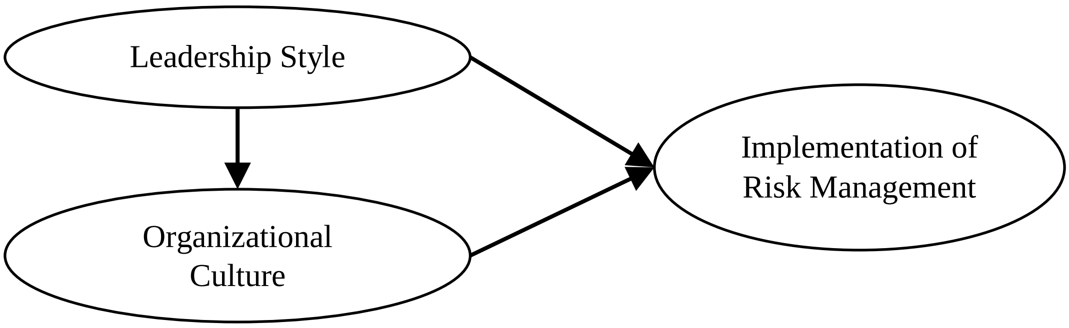

Figure 1. Theoretical Framework of the Study

Research Hypothesis

Leadership Style and Implementation of Risk Management

Research Campbell (2013) states that the effectiveness of risk management national government is largely driven by two factors latent variables that good leadership and governance. The process of risk management, can be a sign of leadership character by showing prudence, wisdom, integrity, honesty, and even the courage to recognize and take actions that have a high level of risk, namely the uncertainty. In the planning and development of strategies, the role of leader is very important (Yukl 2006; Praat, 2004). Strategy formulation is an important aspect in the effective management, this is because the right strategy will provide superior performance results. Effectiveness of risk management seen from the characteristics of leadership that is careful, thoughtful, integrity, honesty and the courage to recognize and take action on risks and uncertainties. This can help in shaping the characteristics of leadership, (Kane and Patapan, 2010).

Based on research conducted by previous researchers, this study will put forward a hypothesis that reflects a causal relationship as follows

H1: *Leadership Style has a positive effect on the implementation of risk management.*

Organizational Culture and Implementation of Risk Management

Overall, the literature on organizational culture is rich and diverse. Culture in each organization will influence decision-making within the company, including the investment decisions that have risks and fraught with uncertainty (House *et al*., 2004). The Company has a risk culture proves that the employees at the company to understand the orientation of the strategy and risk appetite in accordance with the applicable firms (Farrell and Hoon, 2009). Changes in risk perception and strategy is a dynamic process. Strong leadership, commitment and involvement of all elements of the organization can transform the way organizations behave and make decisions (Perrin, 2009). The ability of risk management practices in an organization depends on the extent to which it is embedded in the organizational culture and management decision-making (Cooper *et al*., 2013).

Based on research conducted by previous researchers, this study will put forward a hypothesis that reflects a causal relationship as follows

H2: *Organizational culture has a positive effect on the implementation of risk management.*

Leadership Style and Organizational Culture

The influence of leadership on organizational culture showed a leader who can make a big change in culture, already has a different culture (Schein, 2010). An important component in the implementation of risk management is the leadership needed to create a culture of risk awareness, not in the application of strategic risk management of individual (mitigation plans, hedging, adapt, avoid, and so forth), but to provide transparency, communications and essential support consistent to create a culture of risk (Levy *et al*., 2011).

Based on research conducted by previous researchers, this study will put forward a hypothesis that reflects a causal relationship as follows

H3: *Leadership Style and Organizational Culture has a positive influence on the implementation of risk management.*

Sample and Data Collection

The sample was drawn from participants who are currently working on insurance company which is the object of this study in Indonesia. The sampling technique employed is convenience based non-probability sampling. Subjects were asked to seal the completed questionnaire in the envelopes provided and deposit them to the human resources division. The respondents were assured of confidentiality and anonymity.

Instrument

The primary tool used for data collection was questionnaires. The questionnaire has four sections. Section 1 consists of basic demographic data, including sex, age, the number of years in their present position and educational qualification.

Section 2 is the leadership style measurement. House (1971a) and House and Dessler (1974) measure of leadership style, which in turn was principally based on the earlier work of Fleishman (1957) and Stogdill (1963), was presented as reliable and valid by a number of respected authors and texts (for example, Teas, 1981; Kohli, 1989). This study will use the item the question of research Ogbonna and Harris (2000), which uses 12 questions on the three-dimensional items that participative leadership style, supportive leadership style and instrumental leadership style. A participative leader who provides an opportunity to subordinates to be involved in decision-making and provide ideas and recommendations for improving corporate performance. Supportive is the leader who can show sympathy, friendly and attentive to subordinates in circumstances that require the support of a leader who can provide motivation when in saturation jobs. While the instrumental is a leader who decisive procedures, objectives, and allocating tasks in accordance with the proportions. Subjects indicate their level of valuation with each of these aspects by responding on a five-points rating scale ranging from “strongly agree” (1) to “strongly disagree” (5).

Section 3 is the organizational culture measurement. The principal components analysis of measures of organizational culture adopted from the work of Deshpande *et al*. (1993), Campbell and Freeman (1991) and Quinn (1988). Based on the adjustments to the research to be conducted Organizational Culture Assessment Instrument (OCAI) consists of 24 items of questions with four typologies of organizational culture that clan, adhocracy, bureaucratic and market. In the clan culture, the working environment is open and friendly to enable more people to interact and share. Adhocracy culture focus on the external organization and differentiation that can survive, compete, and grow sustainably in creating creativity and innovation in taking risks. Bureaucratic culture prioritizes stability and control as well as a focus on internal processes and integration. Market culture focused on working relationships and transactions. Subjects indicate their level of valuation with each of these aspects by responding on a five-point rating scale ranging from “strongly agree” (1) to “strongly disagree” (5).

Section 4 is the application of risk management measures. The lack of an ERM measurement instrument that meets these research criteria clearly, new instruments are developed. The questions are generally supported by the literature, reflecting the ERM components of other instruments. The instruments in this study are tailored to the application of risk management in Indonesia. Implementation of risk management in accordance with the regulation of the financial services authority number 1 / POJK.05 / 2015 on the implementation of risk management for non-bank financial services institutions. A key subset of questions based on five components of the financial services authority rules, namely the Internal Environment; objective setting; event identification, risk assessment, risk response, and control activities; information and communication; and monitoring. This measurement uses 20 items of questions. Subjects showed valuation levels with each of these aspects to respond to the five-point rating scale ranging from “strongly agree” (1) to “strongly disagree” (5).

Data Analyst

Following calculation of descriptive indexes of research variables, structural equations model was used for investigating causal relationships between variables. The hypotheses were tested in a structural equation model using SEM software in a two-stage procedure. The first stage involved estimation of the measurement model using confirmatory factor analysis to determine convergent and discriminant validity. The second stage compared the theoretical model with the measurement model. Based on the results of the test, the structural model was used to provide path coefficients for testing the different hypotheses. The equation is formulated to express the causality relationship with the various constructs forming a model of exogenous and endogenous latent construct measurement.

In the structural equation model, the indicator variable is used to form the latent construct. In this study, exogenous constructs are independent variables of leadership style, while endogenous constructs include organizational culture and application of risk management. The parameters that describe the regression relationship between latent constructs are generally written in Latin characters, namely "Beta" (β) for exogenous construct regression to endogenous and "Gamma" (γ) constructs for latent variable constructs to their dimensions. While "Lambda" (λ) to show the value of the relationship between the dimension and its indicator. Additional fit measures, such as the Goodness of Fit Index (GFI) and the Root Mean Square Error of Approximation (RMSEA), were calculated to test the model fit (Gerbing and Anderson, 1992).

RESULT

All correlations between items representing different latent variables are well below 0.6, indicating no multicollinearity problems. In the factor analysis must meet the adequacy of the number of observations (data) for factor analysis with Kaiser Meyer Oikin (KMO) values greater than 0.5. Furthermore, to see the correlation value between multivariate variables, see the output on Anti Image Matrices where here we need to see the side of Measure of Sampling Adequacy (MSA) only that there is a letter "a" it on Anti Image Correlation. Experts suggest that the value of this MSA always ranged from 0 to 1. The $\chi 2$ test of the measurement model was significant. Thus, relying on multiple fit indices rather than on the $\chi 2$ test alone is recommended, and we proceeded to inspect a number of comparative GFIs that measure the proportional improvement of the model fit by comparing the hypothesized model with a restricted baseline model. The fit of the models was tested using the RMSEA and the global comparative fit index (CFI) in addition to the normed fit index (NFI) and the Tucker-Lewis index (TLI) (Hult *et al.*, 2006; Gerbing and Anderson, 1992). SEM does not test for causality and the direction of the effect, the assessed models must be based on theory.

A leadership style that has considerable influence in the current application of risk management is instrumental leadership rather than participative leadership and supportive leadership. This is seen from the value of gamma that is instrumental leadership has value 0.92 whereas participative leadership is 0.67 and supportive leadership is 0.71. In the application of risk management for the risk identification process, good communication from a leader is required to explore the potential risk information of each process performed by the work unit. The type of organizational culture has a major impact on the implementation of risk management. Cultural clan has a great influence compared to the culture of adhocracy, bureaucratic culture and market culture. This can be seen from the value of gamma cultural clan of 0.97, higher than the other three organizational cultures. Variable culture is considered a critical variable for effective strategy making and influencing the various phases of the strategic decision process and consequently influencing the content of corporate strategies. The influence of a good leadership style if it is not supported by appropriate organizational culture will affect the effectiveness of risk management implementation. This is seen from the dominant beta value of leadership style of 0.60 and organizational culture of 0.55.

The CFI consideration sample size and values of 0.90 or better indicate a model with a good fit. The RMSEA is sensitive to the number of estimated parameters in the model, as it considers the error of approximation in the population; values below 0.08 indicate a good fit. The fit characteristics of the measurement model for direct effect of leadership style and organizational culture (NFI=0.92; TLI=0.95; CFI=0.94; RMSEA=0.01). While a focus on ERM presumably has a positive effect on a company's risk performance, Senge (1990) and Moeller (2007) have stressed the need for creating a culture of risk management at all levels in the organization (Senge, 1990, p. 4). The model that using organizational culture as moderating variable as suggested in *H3* the fit of model (NFI=0.94; TLI=0.92; CFI=0.94; RMSEA=0.04).

DISCUSSION

Hypothesis testing was done by looking at the critical value (CR) at the rate of 95% or 5% error, then the value of CR received is equal to 1 (Hair *et al.*, 2006). The results of hypothesis testing the effect of leadership style on implementation of risk management, organizational culture towards the implementation of risk management and leadership style on the organizational culture of risk management in this study was obtained based on the t-values data processing.

Influence leadership style to the application of risk management gain CR value of 3.21 > 1.96, which means the first hypothesis which predicts relationship between leadership style and implementation of risk management is significant. Every leader has to make decisions, and such decisions affect the fortunes of every member of the group or the organization depending on the scale and context of the decision. Therefore, a leader is a risk taker. How well a leader assesses the risks involved and how well the decisions adopt the risk levels to execution will determine the payoffs of every member of the group and the effectiveness of the leader. The risks associated with the leadership decision is bound to generate criticism from subordinates as it may be deviating from their interests or what needed to be done in their perceptions.

The influence of organizational culture on the implementation of risk management gain CR value of 2,45 > 1.96, which means the second hypothesis which predicts relationship between organizational culture and implementation of risk management is significant. As evidenced by the practitioner literature, risk is effectively embedded within organization processes and used in day-to-day decision making when a risk culture is established within an organization (Towers Perrin, 2009). Decisions of management and employees are influenced by risk culture, even when they do not consciously weigh risks and benefits (Farrell and Hoon, 2009). Without a strong risk culture, even a strong ERM program may not influence decision making; thus, it may be considered an important building block of effective risk management (Farrell & Hoon, 2009). If an organizational culture is a complex group learning process (Schein, 2010), then an organizational risk culture is increasingly more complex given the unpredictability and multiple risks faced by an organization. Undoubtedly, one of the most important elements of ERM is creating a risk culture (Lam, 2003).

The influence of leadership style on organizational culture gain CR value of 3,64 > 1.96, which means the third hypothesis which predicts relationship between leadership style and implementation of risk management through organizational culture is significant. It shows that a good leadership style if not supported by appropriate organizational culture will affect the effectiveness of risk management. Implementation of risk management required leadership with characters that are not only concerned with the external factors in the direction of changing the organizational culture but also internal factors to give a subordinate role in the decision. a leader who is able to communicate with either one of them dig up information on potential risks of each process conducted by his unit.

In summary, all the independent factors exert an effect upon performance, although the impact and form of the effect differ. The finding of indirect links between the three forms of leadership style and implementation of risk management supports the proposition developed earlier, leading to the suggestion that sufficient evidence is found to argue that the link between leadership style and implementation of risk management is mediated by organizational culture.

CONCLUSIONS

Perhaps it is not too surprising that a survey of executives in business would view risk management effectiveness from a leadership style and organizational culture. Over the last decade, corporations have been increasingly formalizing and elevating the management of risk from a management issue to a leadership level position. In a world of uncertainties, organizations should be implementing ERM as an approach to better manage risk. ERM is expected to be integrated within the organization so that risks are addressed systematically and consistently, not on an ad hoc basis.

Having a strong risk culture means that employees understand an organization's strategic orientation, and risk appetite; further they can freely discuss about prevailing risk and opportunities. Transforming the perception of risk with the change in strategy is a dynamic process. Strong leadership, commitment and engagement across the organization can change the way an organization behaves and makes decisions. Risk management should be successfully embedded into an organization when the beliefs and behaviors of employees of that organization reflect risk understanding, risk awareness, and the implementation of risk management framework.

Regarding this study's conclusion about the importance of strong leadership for successful ERM, managers should become engaged in fulfilling their risk management roles. This involves leading the way by institutionalizing systematic risk identification, assessment, and response initiatives, along with the supervisory and cultural elements that will support ERM activities. Attention to these aspects of managing risk should help managers not only to prepare for threats to the organization and its assets, but also to take risks more intelligently and productively.

LIMITATION OF STUDY

Limitations in this study is to use only one insurance company owned by state-owned enterprises. In addition, this study only collects opinions from employees, both in middle and lower management who are headquartered. This is because the head office is the place where the policy or decision for the company as whole is made. In addition, this study uses only two measurements of the characteristics of the company to see its effect on the implementation of risk management with leadership style and organizational culture.

Further research that can sample only citizens and additional stakeholder groups could likely yield more insight into what influences a leader's ability to manage its risks. Although the factors maybe the same, it could be that, for example, non-executives would find the leadership style and organizational culture factors more important for perceptions of risk management effectiveness, which would be interesting to compare. Additional question or correlating the data with recent crises in a country might help tease this effect out.

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