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Enterprise Risk Management (ERM): Assessment of Environmental and Social Risks from ERM Perspective

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Literature Review

1. Introduction

In this chapter, the study seeks to review academic literature to understand the evolution of ERM, the organisational dynamics of ERM, the program quality, determinants and value relevance, the approaches and focus of professional groups that formulated the frameworks and how corporate social responsibility can improve the risk management processes. The researcher also deemed it appropriate to include the write-ups of proponents of various ERM frameworks as part of academic literature on the subject, as it would help to examine the contents of the major frameworks and the perspective of their proponents; by review of their respective executive summaries and relevant academic papers that have offered comments on the viability or otherwise of the frameworks.

2. Evolution of ERM

In the early days, there was no major academic work in the field of risk and risk management. The earliest known reference to risk management was said to have appeared in 1956 in an article by Russel Caltgar in the Harvard Business Review magazine.

According to Lupton (1999), in the past, the term risk was used broadly in lieu of hazards, threats or harm. This definition indicates a pre-disposition of risk as a negative outcome of a threat or hazard. To date, this view persists in our day to day understanding of risk in common parlance as well as in the context of business, where business risk is defined as the unpredictable variability or volatility of returns, including potential for worse than expected returns.

According to Watson and Head (1998) the development of probability calculations in the insurance business during industrial revolution impacted upon ideas of risk management. Economists developed this idea of uncertainty to deal with situations where probability was not available (Reddy, 1996).

According to Robert D. Irwin, Irwin Mehr & Bob Atkinson Hedges were said to have published a landmark book to address the subject of business risk management in 1963, entitled 'Risk Management in the business enterprise'. They are rightly referred to as the 'fathers of risk management'. They explained how effective risk management could maximise efficiency and result in greater productivity in an enterprise. They were also of the view that as far as possible all business risks should be managed in a comprehensive manner and not simply insured. They remarked that if only hazards are to be insured, insurance brokers should call themselves hazard risk managers!

Thus the modernist view of risk incorporates both positive and negative outcome of events. This contrasts with the pre modern era where risks were solely considered to be bad.

3. Evaluation of ERM Frameworks

The ERM frameworks that are currently in vogue, such as COSO, COCO, Turnbull, RIMS and CAS, ISO 31000, seek to cover all types of risks in a comprehensive manner – irrespective of the industry or region. However, the existence of these ERM frameworks contribute to an overall uncertainty regarding the essential components of ERM. According to Sara A. Lundqvist (2015), this uncertainty carries forward to empirical studies of ERM implementation. By using inconsistent indicators and measures of ERM implementation, it is impossible to compare "apples with apples" and arrive at convincing and conclusive results regarding ability of ERM to create value.

She adds that as the attention towards ERM implementation increases, the number of frameworks emerged which contribute to the overall uncertainty regarding the essential components of ERM. Each framework identifies its own specific component structure indifferent components in varying number and definition; while the underlying ideas regarding ERM remain consistent, dissatisfaction with existing guidance on ERM implementation is apparent. Many of the dimensions and underlying ideas

She cites empirical studies of ERM by Beasley, Branson and Hancock (2010) who find that that the COSO framework, the most cited and debated framework is ambiguous and overly theoretical in nature. Existing frameworks tend to be conceptually similar, but they differ in structural representations, pertaining to how dimensions and aspects of ERM are grouped and how they define the integral parts of ERM.

3.1. Shortcomings of COSO framework

When ISO started to gain traction and better acceptability, defenders of COSO stated that ISO31000 is nothing but COSO wrapped in a new format. Norman Marks a practitioner and thought leader on Internal Audit, RM and corporate governance, author of several books on RM, including “Governance, RM, and audit”, sought the opinion of Grant Purdy, who chaired the initial committee that drafted the AS/NZ standard and has also been on the advisory committee that came out with ISO 31000. Purdy elaborated why he did not like COSO Framework, as under:

Grant believes that the COSO product has a number of good points but that overall he finds it complex and unwieldy, and can clearly see how many companies would just give up and pay someone to tell them how to implement risk management. He also thinks the cube and the need to keep some alignment going with the Internal Control Framework diagram compromises the flow of the processes given there.

Olson and Wu Ac (2008) claim that that there were over 80 RM standards across the globe, research has consistently identified coco ERM as the best known and most widely diffused RM standard.

However, Grant notes there are some big technical flaws that will mean the process being followed will always be deficient and inefficient.

1. “When identifying events, the code mentions external factors; but the majority of the discussion is focused on internal factors, systems, culture etc. The COSO process starts with the internal environment, not the external ones and this fails to reflect the influence that the business environment, regulatory conditions, and external stakeholders have on the risks an organisation faces, its organizational culture, and how they influence its risk appetite and risk treatment priorities. This can easily lead to organisations just focussing inwardly and not actively identifying risks that reflect external factors and circumstances.”

2. “Stakeholders, particularly external ones, are not mentioned and stakeholders’ objectives and their influence on decisions about the significance of levels and types of risk are omitted. This is a critical omission and means the organisation effectively insulates itself from external opinion and stakeholder objectives. Most

of the risks we face are caused by an incompatibility between stakeholders' and our own objectives."

3. "COSO ERM says that risks are described as events, and events are described and illustrated by examples of sudden, acute occurrences. There is no appreciation of the slow changes in circumstance and situation (for example a deterioration in internal culture or market sentiment) that give rise to some of the most critical risks."

4. "COSO measures risk in terms of the probability of an event and its "typical" consequences. However, we will not always get the "typical" consequences every time an event occurs. For example, not every time my house is hit by lightning will it burn down. If I estimate the level of risk as the product of the likelihood of the event (being hit by lightning) and the worst consequences (losing my house), I will overestimate it. In fact, there are multiple possibilities: my house could be hit and not be damaged; it could be hit with slight damage; and so on all the way up to being burned down. Each potential consequence would have a different likelihood of occurring.

"Of course, this all sounds rather academic until you actually observe how, in workshops and in life, people who follow the COSO code use a rating system to estimate the level of risk; and they always seem to get it wrong and omit the conditional probabilities that should be applied to the event probability. This means that they always overestimate the level of risk, which prevents individual risks being properly distinguished and compromises any realistic modelling of the effectiveness of controls. The COSO approach to estimating the level of risk reduced the credibility and usefulness of the risk management process because significant consequences are predicted to occur much more frequently than is credible based on historical experience."

1. "Throughout the document, the term 'risk likelihood' is used, but risk does not, *per se*, have a likelihood. Likelihood is one of the attributes used to measure the level of risk. This is a philosophical trap that can lead the unwary to see a risk as an event and then to use language such as "when the risk occurs". Risks don't occur when events occur, risks only 'exist' whenever we make objectives. If there are no objectives, then there are no risks. The level of risk (not risk) is described in terms of what can occur (consequences) and how likely they are."

2. "While there are some concessions to what are called 'opportunities', in COSO ERM risks are mostly about losses and risk treatment (response) is about reducing

the likelihood and severity of losses. The thinking in the COSO document is not mature enough to appreciate and explain that risk is just the effect of uncertainty in what you set out to achieve and that outcomes can be beneficial, detrimental or both. Certainly, the document does not promote taking risks that have beneficial consequences because you are confident you can treat or tolerate any potential downsides which is, after all, the basis of enterprise: the undertaking of risk for return."

3. "I find the whole thinking about 'risk responses', 'control activities' and 'monitoring' most confusing and confused and I think most people who read and try to use the code do as well. For example, if you institute an audit regime, this is a good form of risk treatment to reduce the likelihood of unfavourable consequences. However, audit could be required as a matter of policy, could be part of a management process, and could also be part of a monitoring strategy. ISO 31000 clears this all up. Risk treatment refers to the actions you take that lead to the creation of and improvement in controls, and controls are what you employ to modify risk. These controls then require monitoring and review by assurance processes. That's it."

4. "The problems with the concept of inherent risk are well-known and the COSO document does not explain why you need to use this artificial, theoretical state where no controls exist, to justify tolerating the present level of risk or doing something more to modify it. In risk analysis it is useful to understand what worse-case consequences could occur if existing controls fail so that we can focus our assurance activities on checking those controls, but this is best dealt with by using the Potential Exposure (inherent consequences) value that does not require any consideration of likelihood."

5. "The whole area of risk appetite and what COSO ERM calls risk tolerance is handled in a mechanistic and naive way. The thought that before you even do a risk assessment, a board can identify the material risks and tell you how much they are prepared to tolerate puts them on a par with the Gods. What this means in practice is that some Boards may have the ability to think about different types of consequences (not risks) and in some cases they can say how much loss they are prepared to sustain over a period of time compared with the balance sheet and cash flow of the company. However, these are not measures of risk, they are only measures of consequence. For non-monetary consequences, the statements that Boards can make start to get very vague. For example, they might say they

never want to kill someone, but they will rarely want to agree on what individual risk of fatality they are prepared to expose their employees to such risk.

6. Lastly, the COSO document confuses and mixes the framework together with its organisational structures, with the processes used for RM, particularly for risk assessment, treatment and monitoring. Framework operates at the organisational level, whereas the process which the framework seeks to integrate operates at the level in the organisation where decisions are made for every business activity

3.2. Disparity in ERM frameworks

Researchers in several disciplines have shown that organisations often respond to introduction of new strategies and ideas by loose coupling or even de coupling. ERM introduction was no different Researchers are now concerned that ERM practices are now implemented on a superficial level merely to 'window dress' to meet corporate governance and/or regulatory requirements and appease stakeholders (Power 2009, Soin and Collier 2013). Accordingly, to them, with box ticking approach to RM, there is a real danger that ERM would fail to make the expected impact on business empirical studies focussing on the link between ERM implementation and firm value are so far inclusive, leaving the value proposition of ERM uncertain (Lundqvist, 2015).

According to Giovanni, Quarchioni, and Ricabonni (2005), control of risk information flow and organisation culture can explain a risk managers influence on the organisation by engaging in sense-giving efforts ERM function as a sense- givers vertically and horizontally influence meaning construction among decision makers in an organisation. Two processes of influence used over time triggers a change in the ERM function's influence on decision making. In one process, ERM function attempts to vertically influence top management's decision regarding acceptance of RM technologies. Second process, ERM function attempts to horizontally influence decision makers to use RM in decision processes.

(Sense-giving is an interpretative process in which actors attempt to influence each other, and is used by organ leaders, stakeholders and middle managers (Martin and Lawrence, 2007).

AS far as COSO is concerned, as a practice RM and its associated accoutrements of risk frameworks, executive positions, committees and information systems, have been increasingly embraced by organisations across the globe. (Power 2013).

According to Scarborough (2002), there are professional groups of actors – comprising accountants, auditees, academics, researchers and consultants able to perform multiple roles and support the construction and diffusion* of COSO's ERM.

(**diffusion refers to the process by which an innovation is communicated through certain channels over time among the members of the social system (Rogers 1995).*

According to Spira and Page (2003), changes in technology and auditing encouraged devolution of control downwards and rigidly enforced compliance with policies and procedures was replaced BY THE RHETORIC OF RISK. As it became increasingly believed that risk could be measured and managed, demand for new and meaningful frameworks intensified.

Oliviero (2001) pointed in a number of failings including the absence of implementation guidance and clear allocations of responsibility, as well as, the imperative of enterprise wide approach.

Because of the clout and sheer number of the members of organisations comprising the COSO (AICPA – 386,000, FEI – 15,000, IIA – 180,000 members, IMA 65,000 members, AAA -8,500) spread around the globe, and PWC as the author of the COSO ERM report, COSO became a standard. The background, expertise and reputation of the bodies caused people to look at it as the place to go for gaining insight and direction on how to build an ERM architecture in their organisations (Rick Steinburg).

As an author, PwC did not have the formal responsibility beyond writing the framework; however, they also helped to develop and promote the framework after its launch by continuing to support it publicly and by developing aligned corporate tools. Mark martens recognised the applied use of the framework.to develop a range of commercial products. PwC flew in and met executives from several countries to market and implement and apply COSO and develop a methodology for how they could go to market COSO.

Together, PwC and other Big-4 from the professional accounting industry generally supported the COSO adoption and implementation. Meanwhile risk management consultants also jumped in the fray by complementing of COSO with other proprietary frameworks, branded them as their own. This highlights the interpretive viability of COSO (Benders and Van Veen, 2001). According to (Protiviti, 2006, 2007), parallel to the accounting community, consultancy community too served to embed the framework through a diverse range of services to compete for the consulting dollars. The presence of a hybridised consulting group meant that the policing and deterring forms of institutional works were not required to keep the pre-eminent status of COSO.

The role played by COSO in disruption, the devolution of internal control led to inadequacies and failures of internal control systems in a way that the COSO model was problematized as insufficient to deal with a growing array of risks. A majority of studies investigating the diffusion of RM tools suggest that the individuals responsible for creating the practice tend to be different from the individuals who promoted and distributed COSO. (Ax and Bjornenak, 2005)

4. ERM – Developing Capability Through Prioritising Risks

The challenge in RM is the existence of unlimited amount of risk a firm faces and the limited ability to foresee these risks. Further it is neither feasible nor economical to address all potential risks (Bromily and Rau, 2016). Management needs to identify and focus on potential threats with the greatest impact on the firm and applying a resource based view to focus on such risks.

A lot of RM theories and practice focus on ex ante identification of risks, such as compliance and due diligence. Nevertheless, there will always be circumstances where firms cannot foresee all risks, especially a large number of low probability-high impact ones. This makes ex ante management of each such event not feasible (Bromily and Rau). According to them, under such circumstances, by applying a dynamic capability ERM, and providing managers with appropriate tools, the firm can recover from the impact of such strategic and operational risks more easily

Several studies have advocated that ERM implementation improves firm's performance, like the study by Hoyt and Liebenberg (2011), investigate the relationship between ERM adoption and a firm's performance. He used the firm's value as a dependent variable and used Tobin's Q to measure it.

Benefits of ERM implementation: ERM implementation has several tangible and intangible advantages (Lai and Azizan, 2010). Organizations should implement ERM to improve decision making, efficient gathering of information, and strengthen corporate governance. Findings from different studies have stated that risk management is the process through which the organization can minimize earning volatility, encourage job and financial security and improve the value of their shareholders. Overall, risk management is a process that enables firms to grow economically and financially as it reduces the risk of business activities and cost of capital.

Uncertainty relating to ERM carries forward to empirical studies of ERM undertaken by Beasley, Clune and Harmanson (2005a and 2005b), Beasley Pagach and Warr,(2008), Desender (2007), Gates, Nicolas and Walker (2009), MC Shane, Nair and Rustambekov

(2009), where results regarding value creation and its determinants are unclear and inconclusive. Consequently, there exists no real consensus about what an effective ERM framework looks like and/or what are the principal components of such a framework.

5. Corporate Social Responsibility (CSR)

When the term ERM is mentioned, the tendency is to focus on operational, business and financial risks only. In today's economy, there are other risks that are gaining centre stage, namely, Environmental risks (ER) and Social risks (SR). This has led to the emergence of Corporate Social Responsibility (CSR) and the aspect of corporate citizenship.

According to Greg De Persio, many good companies, like individuals, believe in abiding by a set of ethical principles to guide their business operations. They appreciated that good business ethics kept them within the parameters of the law, as well built goodwill and brand equity.

Investopedia traces the evolution of CSR - In the 1960s, due to fierce competition, companies were driven by the pressure to perform and generate profits. Cultural values were shifting, with individualism and dedication to social issues such as environmentalism and world peace coming into vogue. Young workers, who were idealistic and wanted to make the world a better place looked upon their employers with disdain. Managements saw this as a possible threat to the employer- employee relationship. Professional companies responded by establishing mission statements and codes of conduct and embracing social responsibility. 1960s saw companies trumpet environmental friendliness and found ways to give back to their communities.

In 1970s and 1980s, companies revamped their HR strategies to focus less on compliance with employment contracts and more on values – management philosophy shifted from pure authoritarianism to more of collaboration and working on equal footing.

1990s saw a further thrust to environmentalism and graver legal ramification for ethical missteps. Class action suits rose as tobacco and junk food manufacturers faced heighted scrutiny. Oil and chemical companies had to contend with public pressure.

In the 2000s, business ethics entered the online internet realms. In an era of unprecedented public and consumer advocacy, scrutiny and activism through internet, businesses were under pressure to demonstrate that their entities stood for something more than profits.

CSR involved incurring costs, diversion of staff and management focus. Several large corporates saw a way to circumvent this trend by attempting to take advantage of globalisation by strengthening their supply chain for cost benefits –

Use of cheap labour, including availing of services of sweat shops and child labour.

Indiscriminate mining, logging, deforestation of rain forests and over fishing, poor disposal of waste, etc led to corporate profits at the cost of permanent damage to eco-systems through oil spills, climate change, etc.

News of oil spills and harm to environment and to vulnerable communities, such as indigenous groups in the amazon region that have been wiped out to make room for oil and gas drilling and hydro power generation, made headlines in the media.

When this information entered the public information domain, some areas of corporate culture began to embrace a philosophy that balanced pursuits of profit with a commitment to ethical conduct. Some companies saw the adverse impact such environment and social risks could have not only on the image and bottom line of their companies, but threaten the very sustainability of their companies. In order to account for the importance of the social and ecological considerations in doing business, these organisations advocate the concept of triple bottom line – social, environmental and economic – or people, planet, profit.

CSR involves incurring short term costs that do not provide immediate financial benefit to the company, but instead promotes positive social and environment change. According to Abigail Mc Williams, there is a considerable debate on and research efforts into the question of whether improving corporate sustainability performance is not only beneficial for social and environmental well -being, but also for the financial well -being of the company.

6. Improving ERM through CSR

According to Kytle and Ruggie (2005), CSR is morally discretionary rather than morally obligatory. They indicate that CSR is related to ERM in 2 ways – one, by providing intelligence about what those risks are and two, by offering effective means to respond to them. In both cases, it leads to effectively managing stakeholder relationships by addressing environment protection, human resources management, work health and safety, local community relations and customer/supplier relationships.

Paul c. GODFREY of Brigham University contends that:

1. corporate philanthropy and CSR generates positive moral capital among communities and stakeholders;
2. moral capital can provide shareholders with insurance like protection for many of the firm's intangible assets.
3. such insurance protection contributes to shareholders wealth.

According to him, the above assertions constitute a pathway that leads CSR to CFP (corporate financial performance). He adds that whereas CSR activity anchors one end of the pathway, shareholders' wealth the other.

Wood and Logsdon, 2002, state that the voluntary and discretionary nature of CSR activity (i.e. doing the ethically right deeds above and beyond the explicit transactional interests of the firm) should create shareholder wealth.

According to Post and Waddock (1995) debates the question as to how can a firm further its strategic goal of creating wealth through profits by expending resources with nothing tangible in return. They argue that CSR activity can generate positive moral capital when the organisation and its actors receive positive evaluations from affected communities. Positive moral capital can protect a firm's relationship based intangible assets as it works to mitigate negative assessments.

Rindova and Fombrun (1998) claim that reputation in itself has no cash value, but reputational capital arising as an outcome of CSR has economic value because it disposes stakeholders to hold beliefs or engage in actions that potentially create wealth for shareholders. A global reputation of a firm is a function of reputational assessments of various attributes of the firm, including the moral dimension of a firm's performance. This moral dimension is represented by positive moral capital. Paul Godfrey avers that positive moral capital acts as an insurance, since it protects relational wealth. By creating economic value through influencing stakeholders perception regarding relational wealth. Many of a firm's resources are relation based, because the earning potential of these assets depends upon the relationships a firm has with its stakeholders – such as: employees' loyalty through affection and attachment to the organisation, communities through socially constructed system of norms, values and beliefs,

1. vendor trust, based on the expectation that the entity will perform;
2. Brand value with customer – loyalty based on the expectation that the entity will deliver irrespective of the oversight or ability to monitor;

This has led to the emergence of "Stakeholder Theory", championed by REFreeman through various books and articles in 'business ethics journal'.

7. Stakeholder Theory

In an article "new approaches to CSR", R.E.Freeman and.R. Velamuni introduced the concept and application of "stakeholder theory".

Stakeholder theory affirms that those whose lives are touched by a corporation hold a right and obligation to participate in directing it. The theory describes those individuals and groups who will be affected by or will have an impact on the company's actions.

It asks:

"What are these entities legitimate claims on the business?"

"What rights do they have with respect to the company's actions?"

"What kind of responsibilities and obligations can they justifiably impose on a particular business?"

As a simple example, when a petrochemical plant emits pollutants in the air or water, a CSR perspective would accord the onus directly on the plant owners to take measures to control the pollution. By contrast, a stakeholder theorist begins with those living in the surrounding community whose environment might be poisoned and begins to talk about business ethics by insisting that the surrounding community has a right to clean air and water. Hence, the community members, who become stakeholders in the company and their voices must contribute to corporate decisions. It's true that they may own no stock, but they have a moral claim to being involved in the decision-making process. This is a very important point. At least in theoretical form, those affected by a company's actions actually become something like shareholders and owners. Because they're touched by a company's actions, they have a right to participate in managing it.

Who are the stakeholders surrounding companies? If the enterprise produces chemicals for industrial use and is located near a village or town, the stakeholders would include:

1. Company owners, whether a private individual or shareholders
2. Company workers
3. Customers and potential customers of the company
4. Suppliers and potential suppliers to the company
5. Everyone living in the town who may be affected by contamination from workplace operations
6. Creditors whose money or loaned goods are mixed into the company's actions

7. Government entities involved in regulation and taxation
8. Local businesses that cater to company employees (restaurants where workers have lunch, grocery stores where employee families shop, and similar)
9. Other companies in the same line of work competing for market share
10. Other companies that may find themselves subjected to new and potentially burdensome regulations because of contamination at that one Massachusetts plant

The first five on the list—shareholders, workers, customers, suppliers, and community—may be cited as the five cardinal stakeholders.

Once a discrete set of stakeholders surrounding an enterprise has been located, stakeholder ethics may begin. According to this theory, an entity's objective should be to maximize profit on a collective bottom line, with profit defined not as money but as human welfare. The collective bottom line is the total effect of a company's actions on all stakeholders.

Company managements are primarily charged not with representing the interests of shareholders (the owners of the company) but with the more social task of coordinating the interests of all stakeholders, balancing them in the case of conflict, and maximizing the sum of benefits over the medium and long term.

It requires engaging with other stakeholders about their interests: they ask for input from local environmentalists about how pollution could be limited, they seek advice from consumers about how product safety could be improved, and so on. At every turn, stakeholders are treated (to some extent) like shareholders, as people whose interests need to be served and whose voices have real power.

Transparency is an important value for those promoting stakeholder ethics. The reasoning is simple: if you're going to let every stakeholder actively participate in a corporation's decision making, then those stakeholders need to have a good idea about what's going on.

What's certain is that stakeholder theory obligates corporate directors to appeal to all sides and balance everyone's interests and welfare in the name of maximizing benefits across the spectrum of those whose lives are touched by the business.

Jacob Hörisch, R. Edward Freeman, Stefan Schaltegger (2014) identify three challenges of managing stakeholder relationships for sustainability:

1. Strengthening the particular sustainability interests of stakeholders,

2. Creating mutual sustainability interests based on these particular interest,
3. Empowering stakeholders to act as intermediaries for nature and sustainable development.

To address these challenges three interrelated mechanisms are suggested: education, regulation, and sustainability-based value creation for stakeholders.

8. Importance of Communication in RM

When RM universe is considered in its entirety, the aspect of communication can be broken into 3 distinct areas:

1. Top down: Board /Top management downwards to business units and operating staff;
2. Down up: From operating level to top management & Board;
3. Board to stakeholders

There is a lot of clarity in the first two areas, as far as ERM frameworks are concerned. E.g. When one looks at the COSO cube, the front facet that has 8 components. The first component, Internal Environment pertains to governance, structure, culture and philosophy of RM. Blakely, 2009, Drew and Kendrik 2005, Kirkpatrick 2008, Stulz 2008, all emphasise the importance of establishing, communicating and understanding the firm's structure, culture and philosophy of RM and risk appetite. So, the tone needs to be set at the top and communicated down the ranks. The second component, objective setting covers the strategic objectives of the firm's operations, reporting and compliance activities. This too has to be communicated from the top management / Board down to the ranks.

The eighth component of COSO, namely monitoring, deals with the manner in which communication should exist throughout the organisation to ensure that each of the other components are linked and functioning properly, that there are no material weaknesses; if any risks exist, to ensure that these are within the risk appetite; if not, to bring them to the fore to the top management Board.

One must appreciate that introducing an ERM framework within an entity is to accord a benefit to the shareholder through the ability to create value. However, there no guidance in the major ERM frameworks for communicating to the stakeholders, the nature and extent of risk faced by their entity and how and whether these are appropriately managed. Further, there are no regulatory requirements in this regard.

Philip M Linsley and Philip J Shrives (2005) mentioned in their article in the British Accounting Review that American Accounting Association (AAA) and Financial Accounting Standards Board (FASB) lamented that UK companies were providing insufficient risk information within their annual reports. The Institute of Chartered Accountants of England and Wales (ICAEW) noted the risk information gap and issued discussion documents encouraging UK company directors to report on risks in greater depth. Securities and Exchange Commission (SEC) Financial Reporting Release (FRR) has also sought disclosures on specific financial risks, such as derivative exposure.

According to Linsley and Shrives (2005), the major obstacle to increased risk disclosures is the reluctance of directors to release information on operational, project and financial risks they deem too commercially sensitive and to provide forward looking risk information without safe harbour protection.

However, the same argument does not hold good with respect to reporting for CSR, to demonstrate how the entity is dealing with environment and social risks. According to Donald Siegel, for decades, the perception has been that the sole responsibility is to maximise returns to shareholders and very often adopted business models that have been harmful to certain communities and resources. Now organisations aim to mitigate or reverse this damage, by embracing a philosophy that balances the pursuits of profit with a commitment to ethical values. They are demonstrating that the same money and influence allows them to effect positive change, thereby enhance their sustainability levels. This sustainability level becomes a source of competitive advantage.

Investors and shareholders tend to look upon companies which embrace CSR with a hign degree of respect. Hence companies are eager to report on the manner they have tackled environment and social risks. Chris Murphy enumerates reasons why companies are increasing reporting on ER and SR:

1. Company's brand image is bolstered when the public perceives a positive image when it projects itself as financially profitable and socially conscious;

2. Customer engagement – companies engaged in CSR can impact the buying decisions of customers. Some customers are willing to pay more for a product if they know that a portion of the profit is going to worthy cause.

3. Retain top talent – employees of CSR want to feel that they are part of something bigger. Social responsibility empowers employees to leverage corporate resources at their disposal to do well. Being part of a strategy that helps the greater good can boost employee morale and lead to greater productivity among the workforce.

4. Competitive edge – companies involved in CSR for community benefit stand out from the competition.

Chris Murphy also dwells on the subject of Socially Responsible investment (SRI). SRI investment theme excludes investments in companies that produce addictive/ harmful substances like tobacco, alcohol or companies that run casinos. They seek out companies engaged in social justice, environment sustainability, clean technology, etc.

This demonstrates that mitigating ER and SR through CSR lends financial benefits to organisations.

There is yet another aspect in corporate reporting. Atkins (2006) claims that what the investing public understands by social responsibility is transparency in firm's financial reporting. Firms that implement CSR to meet expectations of stakeholders are more like to provide investors with transparent and financial information. According to Paul Godfrey, transparency means that the firm discloses its activity and results as they occur, thus allowing stake holders to create a stock of positive moral capital. This transparency facilitates moral capital formation in advance of need; for when the firm needs positive moral capital, it may be too late to build it. Another way to look at it is that it creates a kind of risk management mechanism.

Talking of competitive advantages, according to (Barney, 1991), physical resources can be easily acquired by competitors, whereas tacit or team based socially complex intangible assets, such as reputation, are less easily replicable. According to Russo and Fouts (1997), intangible reputation based assets are becoming more important contributors to firm performance and such resources are more likely to be valuable and inimitable when society demands a cleaner environment; improving the firm's reputation creates goodwill and a positive effect on market value. Graves and Waddock (1997) believe that risk-averse institutional investors are likely to respond positively to improving social performance.

Paul G. Godfrey discusses the aspect of reporting through the principle of transparency and recommends that firms should publicly disclose details of their CSR portfolio. Shareholders and community members need to be informed of CSR activities, the level of funding, the goals and rationale that underpins these decisions. Accordingly, transparency facilitates moral capital formation in advance of need.e.g. Target Stores stablise funding at 5 % of profits, which provides evidence to its commitment to CSR is genuine, not opportunistic, Firms with higher CSR may be characterised as having improved relationship with primary [employees, customers, suppliers, etc] and secondary [local communities and legislative branches] In modern capitalistic society, managerial actions in the best interests of shareholders require fair treatment and support to all stakeholders –(Berman, Wicks, Kotha, Jones, 1999). CSR includes environment assessment, which allows firms to anticipate stakeholder concern. By addressing these actions proactively, firms can be in a position to decrease the variability of business returns – i.e. risks.

Alexander and Buchholz (1978) explain their hypothesis through an association between CSR and financial risk. Market reactions to CSR investments, will be more immediate and stronger than internal accounting return fluctuations. In other words, market investors will have a DIRECT response to CSR than accounting measures of capital use. Reasons: corporations with more stable stakeholder group relations probably encounter fewer difficulties in attracting new equity investments. Conversely, low investment in CSR may be interpreted as lack of managerial skills, because the firm has not acquired a progressive reputation. As a corollary to this argument, CSR needs to be visible to have an effect on financial risk. Without visibility of CSR, stakeholders cannot use CSR as an informal signal of a firm's successful attempts at satisfying stakeholder groups. (Fombrun and Stanley,1990).

CSR policies of a firm can also have a positive effect on its HR in terms of retention of workforce and attracting new recruits.(Turban and Greening, 1997) point out that environmental policies are probably much less visible to investors and consumers, than are other CSR actions. That explains why the latter is often a more integral part of a firm's PR efforts by featuring on their websites frequented by job seekers.

Marc Orlitzky and John D.Benjamin (2001) concludes that the higher the firm's corporate social performance, the lower the financial risk incurred by the firm. Hence, being a good corporate citizen tends to reduce firm risk. Investment in CSP appears to lower external market risk relatively more than internal accounting –based risk.

Institutional theory sees CSR as the consequence of political process whereby NGOs, states and other stakeholders put pressure on firms to adopt given social practices and apply social and economic penalties to non-adopters.

According to Nicola Misani, (in his article titled "Convergence of CSR practices" in Management Research Review, vol. 33, 2010) mentions that high profile accidents damage the reputation of the entire industry, and players can find themselves tarred with the same brush.one of the ways to avoid this is to privatise reputation. Socially responsible firms may try to distance themselves from the rest of the pack by cultivating uniqueness by allying themselves with reputed stakeholders or forming elite clubs

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with above average performers. Alternatively, they need to impress upon other firms in the industry to improve their performance standards, through benchmarking and information sharing. This will help laggards to adopt best social practices.

Nicola adds that private regulation on socially responsible behaviour can prevent socially responsible firms being put at a financial disadvantage, because the regulation forces all firms to adopt the same practice anf sustain costs at the same level. The result is that a CSR convergence emerges which is socially motivated.

The aftermath of the Bangla Desh Apparel industry tragedy vividly explains this phenomenon. Bangla Desh was the world's second largest manufacturer and exporter of apparel and garments. Because of the international buyers' pressure to lower their cost and speed up deliveries, they paid low wages and factories had abysmally low standards of safety and worker welfare. Fire and collapse of Rana plaza group of factories in Dacca, killed 1134 workers and injured several thousand others. Judy Gearhart of ILRF (International Labour Rights Forum) spearheaded the movement to build a coalition similar to the one that occurred in the Triangle Shirtwaist Factory in N. York over a 100 years ago. She encouraged major buyers from B Desh factories to sign an accord "Fire and Bldg safety and workers' standards in B Desh". Those who signed the accord and created a AFL _CIO fund for improvement in apparel factory bldg. standards in terms of installation of fire rated doors and enclosed stairwells. H & M led this movement and prompted other famous names such as GAP, WALMART, JC PENNY, and over 100 other buyers joined the effort to ensure that the factories from whom they buy their goods adhere and uphold highest standards of labour and safety practices.

Kim Bhasin reported that Ralph Lauren (RL) refused to sign this accord even as they continued to buy from B Desh factories. When this issue was raised at the RL Annual Shareholders Meeting, RL responded that "participating in such an accord would be an unnecessary and potential diversion of corporate resources, with no commensurate benefit to shareholders". At that moment, NY City Pension Fund, who held $23 million of RL stock, threatened to sell their stake. RL relented and have now joined the accord, signalling a clear case of convergence of CSR.

Researchers have looked extensively at the CSR risk relationship. Fombrun and Stanley, 1990, provided a very good meta analytical review of literature on CSR-firm risk and found support for a negative relationship. Bowman (1980) mentions CSR as a means for reducing business risk. According to him, firms with proactive csr engage in proactive assessment of environment and social risk management tend to develop a culture to anticipate and reduce potential sources of business risks, such as changes in govt. regulations, growing labour unrest or environment damage. This has resulted in the development of 'real option' theory and CSR is a kind of real option.

McWilliams and Siegel (2001) argued that an analyses of the costs and benefits of CSR using traditional financial NPV (net present value) technics of valuation, would often lead to decision to forego such investments. As a result, economists have traditionally expressed scepticism about CSR, because of its failure to contribute to the goal of maximising shareholder value. Unfortunately, NPV approach fails to take into account, the value of strategic flexibility that certain investments create.

Johnson and Johnson (JNJ) illustrates how proactive CSR can create the option to call upon the support of stakeholders in times of crisis. In 1982, when the crisis of Tylenol poisoning occurred, JNJ undertook the option to recall the entire inventory at a cost exceeding $100 million. When a technical solution to the problem was found and it was determined that the product could be marketed safely, it was re-introduced in 1992 and by 1993, it regained its market share. This was due to the fact that JNJ generated the trust among customers by the company's quick reaction provided by their strategic csr option flexibility. In recent times, automobile companies have realised the vaue of this option when they undertake mass recall of vehicles when a serious flaw is detected that could jeopardise the environment and or safety of passengers

Compare this to the Exxon Valdez incident when the oil tanker struck a reef and the resultant oil spill resulted in huge damage to the marine environment. The cause was due to the fact that the third mate, who took over from an intoxicated skipper was not licenced to steer had to take over. Exxon had down sized their workforce, eliminated the emergency response crew and officers like the third mate were routinely required to take responsibility. Hence the spill could not be contained. Exxon saved the cost of CSR option but lost the flexibility to respond and consequently, lost more than $8 billion in clean-up, penalties, liability and risk to reputation.

Byran W Husted (2005) concludes that currently, methods of measurement of value of risk needs to take into account avoidable costs, hedonic pricing, contingency costs, etc – in short cost of ER and CSR. Hence, the real option logic of CSR provides a sharper focus on relation of risk to CSR.

The perspective of CSR as a real option has an implication for risk management as, it brings downside risk into focus, especially ex ante risk, which is the perception of risk before the event takes place (Mcgrath, 1999).

9. Research Questions

Based on the foregoing, the researcher intends to address the following research questions:

- Is the company's environmental and social risk management and performance communicated to stakeholders through the company's official disclosures and reports?

- By reviewing the archival and current data to facilitate a comprehensive study of the company's risk management system, is the company's adopted ERM framework e.g. ISO31000 or COSO, being effectively utilised in the management of environmental and social risks?

10. Conclusion

In order to gain a better understanding of risk and risk management the research focussed on literature relating to popular ERM frameworks to ascertain their respective key attributes to determine the kay factors and gaps that have hindered their successful implementation.

Accordingly, a wide range of academic papers and literature were reviewed along with the executive summaries and write-ups by the promoters of different ERM frameworks. A large part of the literature described the key components of ERM and the disparity between frameworks which are cause of lack of a common understanding and uniform approach towards ERM implementation. As a result, the research leads to a conclusion that any two identical firms implementing two different frameworks, would look totally dissimilar and the risk inventory of these two firms would be different. This would make comparison and benchmarking impossible.

Secondly, most of the literature and the guidelines issued for various frameworks are descriptive rather than prescriptive in nature. For example, most literature emphasises the fact that risk need not carry a negative connotation; that when risk management is undertaken, both hazards and opportunities should be given due regard. But very little or no literature exists to demonstrate the methodology of risk management of opportunities. Again. There is a lot of mention regarding, setting of risk appetite and risk tolerance criteria, there are no professional guidelines or literature on the subject. This leaves a very important component of RM to the hunches and gut feelings.

ERM implementation is a complex and costly exercise, which can drain an entity of a lot of its monetary and human resources. In the absence of adequate literature on the subject to measure benefits of RM and an empirical evidence of the value added by

RM, Boards and top management do not have any means to verify whether the cost is commensurate with the benefits. Accordingly, in places like UK, RM is undertaken more out of compliance requirement rather than for adding value for its stakeholders.

All said and done, the whole rationale of ERM implementation for an entity is to give stakeholders a sense of risk exposure and sustainability. None of the ERM frameworks contains a detailed guideline or guidance for communicating risks to the stakeholders. Also, there is no academic research that covers this aspect of communication. Yes, in UK and some other countries, the code on corporate governance does make it mandatory for Boards to report on various topics, including risk. But in actual practice it is done very superficially, which has prompted ICAEW and American Accounting Association to lament that the risk reporting needs to be done. There is no research paper that provides the guidelines for a balance between a detailed report on risk that scares ordinary shareholders and key indicators on risk for comfort.

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