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“The integration of ERM concepts in companies’ strategy.

Ivo Hristov¹, Ivan Spirydonau^{2*}

[1] *Department of Management and Law, University of Rome Tor Vergata, e-mail: hristov@economia.uniroma2.it,
phone: 3487753206*

[2] *Department of Management and Law, University of Rome Tor Vergata*

**Corresponding author’s E-mail: ispirydonau@gmail.com*

ABSTRACT

The work aims to analyze the consequences, within a company, of the integration and implementation of strategic tools and methodologies such as enterprise risk management (ERM) and the use of instruments such as the Balanced Scorecard (BSC). Could, a strategic management system like the BSC, have implanted into it, the beneficial concepts related to ERM? If possible, will it be made an improvement in the company performance management? To date, in an increasingly competitive and globally integrated market, in which companies are accountable to a diverse variety of stakeholders, the development of an integrated and well-functioning process of ERM can give reasonable assurance on the achievement of company objectives. The work wants therefore provide an analysis on how a risk-based balanced scorecard may affect strategy and performances of a firm. Recognized then, the possible benefits in terms of performance attributable to the implementation of ERM systems, and affirmed the crucial strategic role that can have the BSC, we wondered to make an additional step. Integrating the two ideas, the two concepts, in order to make additional benefit for the firm.

Keywords: Enterprise Risk Management, Balanced Scorecard, Performance.

1. Introduction

Balanced Scorecard and enterprise risk management (ERM) notions are useful in all those organizations in which managers keep constantly monitored business performance and pay a proper attention to risk and uncertainty. Organizations hence seem to be increasingly interested in the notions of risk and uncertainty that could hit them; as well as, progressively, it was found a need for constant performance measurement in order to intervene in time on any performance gap that can manifest itself. In so many realities then, the desire of willing to interface with the “unknown”, in order to improve business performance and manage it, seem to experience more and more success. For instance, in Italy, various listed companies have shown that they have already undertaken risk management activities even if, sometimes, they are limited only to the first steps of the process in which the risks are identified and assessed. This quite good adoption of ERM concepts is influenced by the desire to develop systematic approaches that lead to accurate and integrated risk management, so that, once installed in the corporate culture, there should be spread as much as possible risk management activities at all corporate levels.

2. Literature Review

Hence, these two facets, if linked together, can give a first insight on how a "risk based" BSC can be used into the business reality. It seems to be substantial then, the circumstance that the top business decision makers fully understand the use of management techniques that go to insert into the business habits, several good risk management practices. (Fraser J. 2010) To this end, a strategic instrument such as the BSC could provide considerable assistance given its ability to help the management in developing an improved tendency toward a raised awareness concerning uncertainty and performances. Moreover, it is useful to take in mind that, the continuous performance monitoring represent a fundamental starting point for every kind of internal audit for the company, in order to go to better identify the so-called “internal environment” as intended by the COSO ERM framework. (DeLoach J. 2014) Therefore, risk management seems to be a process that must lead to guarantee with reasonable assurance the achievement of the corporate’s objectives. Objectives, which are fixed at the strategic level and, based on it, they should be then represented over the four perspectives of the Balanced Scorecard. The integration of efficient risk management systems that really work and go beyond the simple "compliance to the rules" is so nowadays more and more desirable and necessary to compete in the global and constantly changing economy of these years. Increasingly then, nowadays it has been noted that the risk management activities often, in fact, within companies, has been somehow scattered, disconnected with the rest of the company, isolated in a kind of watertight room. The integrated approach to risk, as well as the performance management seems to be therefore more than desirable for organizations that want to succeed. In this, the support given by a new conception of BSC, that goes to take into account the risk, could play a crucial role. While the measures used in the Balanced Scorecard give the company a way to understand their performance, the BSC "risk based" should have embedded inside the so-called KRI (Key Risk Indicators). In doing so, the company could be able, as it already does for the "normal" activities, to monitor

measure and plan its risk management activities, at every level of the organization, according to the four specific perspectives introduced in the Kaplan and Norton model.

In the traditional model of the Balanced Scorecard, along with the performances measures it will be possible (and recommendable) to take in consideration also this new concept of KRIs, indicated in the figure by the yellow rows in each of the four perspective. Because, the main purpose of the "new" ERM philosophy is to instill all through the business, concepts of risk and uncertainty, to ensure that the risks can be well managed and opportunities exploited to time. In addition, the BSC, in its continuous evolution, is needed exactly for this purpose; to improve and to give full implementation to corporate strategy. That, in this case, is a strategy, which also takes into account "risk-based" objectives.

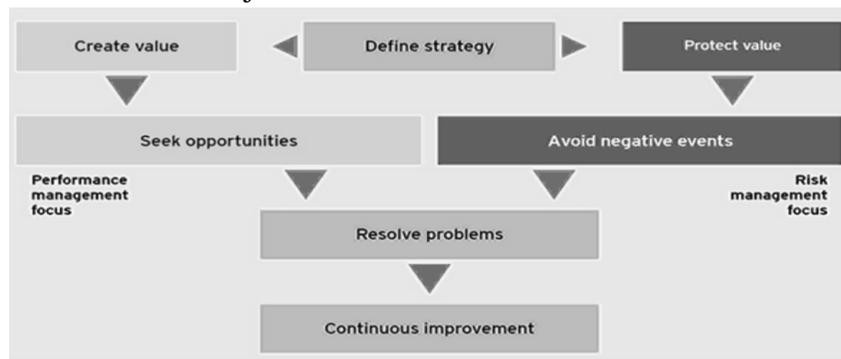


Figure 1: The alignment between performance and risk management

Source: EY advisory

It will therefore be necessary to link key performance to its key risk: in order to develop performance and risk measures (KPI and KRI) that go to identify the degree of acceptability of "performance" and the related risk. The well-thought use of risk-based BSC will therefore ensure that it should be possible to go to explicitly consider risk management and link it directly to company performance. As far then showed, a joined view of the two integrated approaches could bring considerable benefits in what is the creation of value and achieving of successful performance in the enterprise. The two control systems can then, in a very broad sense, be considered as complementary to one another or in any case, do not conflict. So, on one hand, there is ERM with his vision that, instilling concepts of risk in the strategy, will lead to ensure the achievement of the objectives set by it. On the other hand, there is the BSC, which, ultimately, can be considered as a tool to also improve the conception of the strategy within the strategy. Now, noted the benefits that, a strategy based on the ERM framework may have, when the BSC goes to create awareness about an already "benefited" strategy (with respect to a "standard" one), it will be possible to see how the two approaches have every chance of being integrated together to lead remarkable effects for a company.

3. Methodology

In fact, if from a theoretical point of view emerges, with the analysis of the literature, the possibility to use this tool in the above manner, it is necessary to check the feasibility from a practical point of view. To this end, we have developed a questionnaire that has been sent to

prominent actors of a company (without name for privacy) used to realize this paper, to have a good amount of data and to obtain the necessary information for a better understanding of the topics. With the questionnaire we will try to give an answer to the research question, trying to find out evidence from the responses of managers.

4. Finding

The company

The company operates in the food industry, in the production and distribution of frozen food. In order to better position the firm in the current market, it seems useful to recall that, in accordance with the legal provision laid down by Italian legislation, is considered a "Large" enterprise.

Therefore, in view of the premises given from the ERM and BSC applications, I wanted to start a project of collection and combination of qualitative data about the company that gave me the opportunity to have a close-up of the current situation; in such a way, was then possible have a clear enough starting point regarding the proposal of a risk-based BSC. From interviews and questionnaires they are appeared some thoughts fairly perceptible. With regard to risk management perception are emerged two kinds of implications, with a focus that mostly moves between the top-level managers and the people who occupy positions "lower" in the organizational chart, more operational. For all, top and lower members, a certainty was that the risks, understood as events that could occur and could give damage, were something that, throughout the organization, has to be managed and minimized. At the highest level, however, it was also observed a strong interest in the implementation of integrated systems, additionally recognizing the beneficial properties of them as tools to understand what the income opportunities to be exploited are. Most operational levels though, often do not have very clear this "double sense" of risk concept and see it only as something negative and damaging. The risk management actions are evaluated only as something defensive, to be put in place to "take no dangers"; or worse, in some cases, it appears possible to find a certain vision of risk management as simple and pure compliance, something to follow and "having to do" that steals time for more important things. In addition, there seems to be not established within the company an integrated system of risk management as understood by the COSO framework; there is not the role of the so-called CRO (Chief Risk Officer) although the position with regard to compliance and regulatory risks is absolutely well covered over by the Legal Director. Talking about the performance measurements instead, it resulted from the interviews that is very useful and consistently implemented the concept of measuring the activities. Although, even in this case, a real model of BSC à la Kaplan & Norton is not effectively implemented.

Pinpoint the way to go: strategy mapping

Following interviews with the top management members, through the pages of corporate annual reports (both, the one targeted to internal stakeholders and those for the public), and the website of the company, it seemed possible to sum up the business mission in the following sentences: "We create great tasting food to be enjoyed every day, at every meal, by everybody. In the strong conviction that good food make people's life better". Great tasting food, making people's life better (easier), for all consumption moments; these, the highlight of the statement. As mentioned

earlier in this work then, successive basic step for the good implementation of a BSC (would it be risk-based or not), is the first identification of that which is the business strategy and the mission previously identified, related to the "long-term" vision of company provide significant address line for what must be the following actions and behaviors to take in place . The important thing, when stating the vision, is to have clear in mind "where" the company desires to go because only in this way, it will be able to seize all the opportunities not immediately obvious but which can occur over time. It will be the need to periodically make activities of strategic alignment that produces a series of initiatives and projects that will help the company to pursue its goal. The vision then, is a picture of the future; an imagination, a wondering of what would be the company in the long run. To lead and guide others it must transmit an image that is shared among the organization. From meetings and observation within the firm has hence emerged the following vision on the future positioning of the firm: *"We want to grow in a stable manner, thanks to our tasty and nutritious food that makes the lives of consumers easier. Being a relevant frozen food company, leader in the market, who wants to make perceive the passion we put in what we do"*. Having found the vision and mission statements, there is the need to "give sense" to this sum of words, to translate them into something "makeable". The strategy of a company thus, defines the way, the long-term vision, and the idea that one has of the business, an expected and desired point that want to be reached. In the wake of what has been said previously, the strategy then turns out to be applied in all fields of the company in which to achieve a purpose it is needed a number of separate operations, where the outcome is uncertain. The company's strategy, thus, should be represented by a sort of planning necessary to compete on the market and fulfil the stakeholders' requirements; it results consequently to be essentially a "theory" about how to achieve the organization's objectives. Taking into account these considerations, then, and the fact that is now carried on a substantive growth idea in the company that will help to achieve the ambition to become a leading consumer food enterprise, firm's strategy seems to be based on four general and basic corporate strategic pillars (objectives):

- *Create a brand that is distinctive to increase profits;*
- *Innovate through consumer penetration barriers, being drove by them;*
- *Outstand in stores through our sector leadership and enhancement incustomers' relationship;*
- *Driving, leveraging and exploiting our scale.*

The risk-based Balanced Scorecard scheme

Taking account of the pillars of the corporate strategy, forged on the basis of what are known as mission and vision of the firm, it was possible to analyze the four basic perspective inspired by the work of Kaplan and Norton, which can best describe the company facets in terms of "how well is it doing". In a context in which it seems well bygone the idea of "money moneymoney" – citing ABBA - as the only significant magnitude, in the modern world market, a more broad and diverse perception is required in order to ensure the decision makers the most possible efficient, reasoned, structured and (even if not totally impossible) "volatilityfree" results. Plays a key role in this case the right awareness of the firm of inherent risks and opportunities it may face, the

uncertainty that, in the final analysis, hovers and surrounds its actions. It then tries to structure, as suggested by the COSO framework, the objectives and strategic provisions that take into account the uncertainty. Enter then into play the Balanced Scorecard and its relative strategic map, which now seem to represent very useful and appreciated tools capable of providing a first overview on what are the highest goals set by corporate. Imagining thus the occurrence of starting from a already “risk-based” strategic base, the objectives which will be identified on the BSC also will take into consideration the possible threats that could lead to their not reaching. This is the basic idea that led us to build and represent the Balanced Scorecard model shown below.

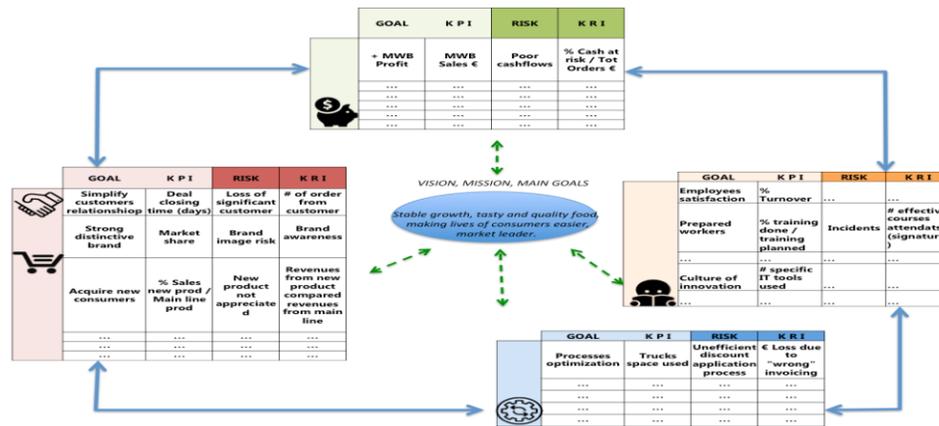


Figure 2: Proposal of BSC embedding risk

In the figure, it is possible, first, to recognize the typical structure of the BSC as initially intended. A scheme in which, bearing in mind what are the macro objectives and guidelines to follow to achieve success according to the company (the blue oval in the center) are then identified areas of interest or rather, the perspectives, that the business should consider to ensure the effective achievement of a solid overall result. The structure does not differ then too much from the original though, some novelty and differences are noticeable.

They are taken into account and displayed in the scorecard the main risk factors with their KRIs. Therefore remembering, how it seems to be of major impact the definition of strategic objectives, which already take account, somehow, of risks they may face; in “risk-aware” companies it seems necessary the structuring of a scorecard that also expresses the risk factors and its measures. A scorecard that thus is even more "balanced", which has to consider not only the economic and financial results, the satisfaction of shareholders in mind, but other, crucial stakeholders. It will therefore be decisive for obtaining a BSC that really can go to support and translate the strategy into actions, to expand those that are (or at least were) the "boundaries" of the traditional responsibilities of the firm. Going to take into account then, other external and internal critical success factors so as to consumers, the brand reputation on the market or the enterprise in its internal view, intended both as internal processes as well as employees, managers, workers; critical factors that can then change from firm to firm and will require, from time to time, evaluation of objectives, risks and different measures, in order to best fit with organizations’ strategies and markets of interest.

5. Discussion & Conclusion

Taking well clear in mind the research question exposed in the introduction of this work (“*Which could be the effects of the integration of enterprise risk management concepts into a tool such as the Balanced Scorecard?*”), the fine and pleasant opportunity that. A creation of behaviors toward risks that will assure to the firms the achievement of desired business performance; sometimes even more effective than the simple non-management of them. From the analysis carried out so far in the work, was then possible to verify how different may be the strategies that a company can employ in the moment in which an undesired event manifest itself; become therefore of fundamental importance the analysis and assessment of risks in order to better understand which should be the right actions to take in their regards. Enterprise risk management, results then as an integrated system that creates a structure composed of people, rules and procedures, suitable for the implementation of adequate risk management activities. The communication and performance systems may be thus have a pivotal role in the right implementation of strategically relevant initiatives of risk management. As mentioned and repeated some times during this work then, achieved this knowledge on the uncertainty management, a firm could implement and improve its successful results using right methods to permit that the strategy will be well defined, structured and perceived throughout all the organization. Considering also the results and the interviews made within the firm, has resulted then how the BSC was not intended itself as a “right” or “wrong” tool, even if seemed quite clear in the head of the top decisions makers, the idea that it could tries to respond to an issue sometimes recurrent in the business world: that is, the alignment between the strategy and the perception that there is within the company of the same. This consideration then was made because more and more, valuable managers understand the importance of long-term results; the fact that, even succeeding today with short-term focused goals, does not eliminate the possibility the one might fail in the end. A need for long-term vision is then advised. The BSC thus, has the ability to force the managers to explain the strategy in a clear manner, using few performances and metrics; going continuously to revising it, taking always well firm in mind the need (as the title of one of the cited works by Kaplan and Norton) to translate the strategy into actions. Moreover, considered the visual structure of the BSC, recovers a very significant role for the success of a firm the level of stakeholder involvement. All the stakeholders that come into play in influencing the results that want to be obtained by the firm. Following the practical reasoning by which, the continuous learning processes of a firm may lead the employees to be more motivated and better skilled; achieved this, an amelioration in the internal processes of the firm might be noticeable; the quality of the product or service offered will be then certainly affected by this and, finally, with a strong name on the market and a superior quality product or service offered, the firm may strive to its common and old-fashioned primary goal, the profit. As also spotted in, the integration and the engagement of all the actors and instruments amid the firm are vital. As all the employees must be constantly trained and “up to date”, also all the internal infrastructures of the company have to be well exploited and used on. During the writing of this paper, there was therefore the enthusiasm (maybe the desire) to try to act as a real-life consultant, an actual manager. The fundamental willingness of the work was then to try to analyze and

identify the possible contribution of the BSC in order to improve risk management processes or, at least, raise the awareness on the topic. The BSC has then revealed to include all factors that should be used, in connection with a correct formulation of the strategy and monitoring activity aiming at verifying the results. Factors that, as found, should somehow go to encompass also issues related to the possible risks that the company might encounter. To sum up then, some of most noticeable evidences that were found after this work, it can be given the conclusion that, broadly speaking, integration of risk concept in business strategies has relevant and worthy implications on the persecution of firms' goals. Thenceforth observed the role that the Balanced Scorecard may have in the implementation of the strategy in the firm, it would be possible to affirm that, if the strategy that a company desires to implement is a "risk enhanced" one, benefit for the business will arise. A risk based approach, will it be made through Balanced Scorecard or not, will be useful in order to prevent at a high organizational level the damaging events faceable. The use of a risk based BSC will go to facilitate strategic change, being itself an organizational change for the company. In fact, giving a quite large and equally concise vision of the performances and drivers of them, the managers would be finding it useful in order to implement and communicate a new strategy; allowing though, at the same time, the need to understand and modify the mechanisms and the processes that are in the inner side of the company. If properly used, the Balanced Scorecard gives the possibility to strongly affect the creation of healthy risk culture inside the firm. According to literature and the hands on experience had, risk management concepts seem to have quite noticeable effect on the strategy of the firms. Moreover, taking in mind the evolved strategic role of the BSC, it could certainly be (one of) the tool to be used by managers in order to summarize and spread among the company, a well-structured and risk-aware definition of the actions that want to be undertaken. It would be also appropriate to apply this approach to other performance management tools to understand the relationship between performance management and ERM. Future research might use alternative tools to validate our results.

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