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CORPORATE GOVERNANCE AND RISK MANAGEMENT - ESSENTIAL PRACTICE IN PERFORMANCE OBJECTION

Associate professor PhD **Florin BOGHEAN**
University Stefan cel Mare of Suceava, Romania
florinb@seap.usv.ro

Abstract:
The last decades highlight an evolution in the appreciation of the concept of risk and uncertainty, and three main trends are observed in the projection of its stage: firstly there is a progressive increase in risk and uncertainty situations; secondly there is an increasing use of the resources of science in the process of risk study; thirdly, there is an increase and diversification of the consequences that the applications and techniques of risk analysis have generated within the social environment, in kind or at the level of each economic agent. The objective of the research is to capture the factors influencing decision making from the perspective of behavioral models adopted by managers in the context of applying corporate governance principles, taking into account the resources of the organization, its operational environment and the identification of decision support systems.

Key words: corporate governance, risk management, internal audit.

JEL classification: G38

1. STAGE OF KNOWLEDGE IN THE FIELD AND METHODOLOGY OF RESEARCH

The bibliographic documentation for this article, a component of the scientific documentation process, was of decisive importance for achieving the proposed objective - *the role of corporate governance and risk management in achieving financial performance*. The paper addresses in an interdisciplinary manner the efficiency of corporate governance, a relatively new theme in comparison to other areas, but which raises an ever more significant interest. Research falls within a positivist scientific approach but is not lacking in critical and interpretive approaches, highlighting possible solutions to identified problems. At international level, there are numerous studies that have addressed different ways of improving decision-making processes through an effective risk management. Multinational companies have already considered the opportunities offered by financial transformations to streamline accounting functions, but have also developed accounting professionals to operate as business partners, helping at the decision-making process within the organization. Financial transformation is already a reality for many companies, giving them a significant competitive advantage. The plan to improve the efficiency of the financial function is clear, but improving business partners to provide policy support becomes even more challenging. There is a need for a change in the management program, starting with a common vision of the role of the function in the future.

Our research has as a general objective to identify the impact of corporate governance elements and risk management on financial performance indicators. A first step was to observe investors' attitudes regarding some information by analyzing stock quote variation. What concerned us was analyzing audit reports and issuing conclusions on the rational or irrational nature associated with investor perception of financial transparency. Through our research we have analyzed the credibility of the financial statements. This is a central issue for regulators in their efforts to protect the public interest. To this end, audit missions respond to information valences by improving the reporting process for businesses, reducing the possibility of misleading or biased information, thus contributing to the expectations of investors. (Soltani, B. 2007).

At international level, there are numerous studies that have addressed differently the ways of improving decision-making processes through effective risk management. Multinational companies have already considered the opportunities offered by financial transformations to streamline accounting functions, but have also developed accounting professionals to operate as business partners, helping to make decisions within the organization. Financial transformation is already a reality for many companies, giving them a significant competitive advantage. The plan to improve the efficiency of the financial function is clear, but improving business partners to provide policy support becomes even more challenging. There is a need for a change in the management program, starting with a common vision of the role of the function in the future.

2. RISK MANAGEMENT ASSOCIATED WITH DECISION-MAKING PROCESSES

Risk is inherent for each process, at the heart of all processes, and the term "risk" is used in the most diverse areas: from financial to political, from medical to military. The economic size of the risk was based on the theory of the estimated value. According to this definition, the risk is characterized by the distribution of the probability of different results. Given the challenge of choosing between two contexts with equal estimated values, the risk-at-risk decider would always choose the situation that offers a safe outcome in a situation that offers a variety of outcomes beyond and below the expected value. A risk appetite person will have opposite preferences and a neutral risk person would be indifferent in both situations because the estimated values are the same. (Mitchell, V. W. , 1995).

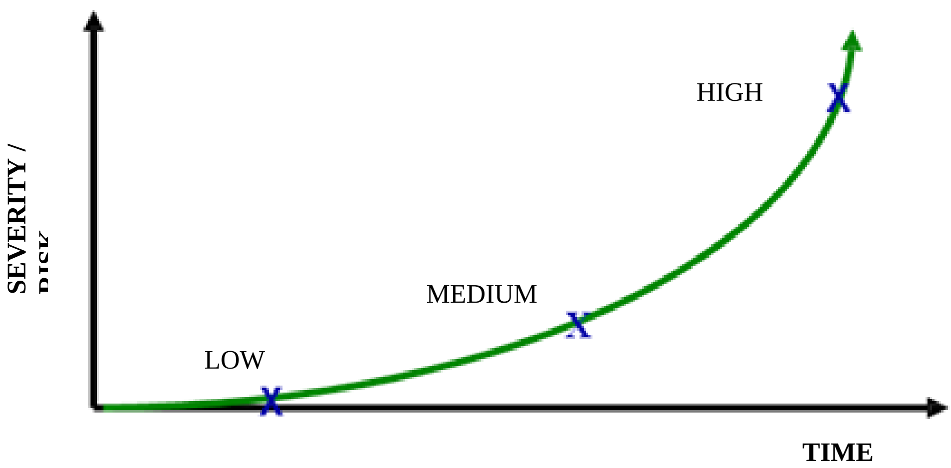


Chart no. 1. The evolution of the untreated risk over time
Source: author's own processing

Considering the positive evolutions as risky, there are some counterintuitive situations, an idea mentioned by Markowitz (1952). For example, if an individual finds a stack of tickets for unclaimed lottery, he will immediately see the degree of risk associated with increasing his net worth, despite the lack of a negative result associated with the tickets. Kaplan and Garrick (1981) similarly consider an heir whose benefactor died. The benefactor's assets have to be valued, but they are estimated to reach 1 or 2 million dollars. The authors point out that while the heir is confronted with considerable uncertainties, it is unlikely that he refers to a situation that contains a risk. Thus, managers who want to diminish both the advantages and disadvantages of risk are advised to avoid similar risk examples that may occur in a corporate context even if the real preferences of a typical manager are asymmetric about each type of risk.

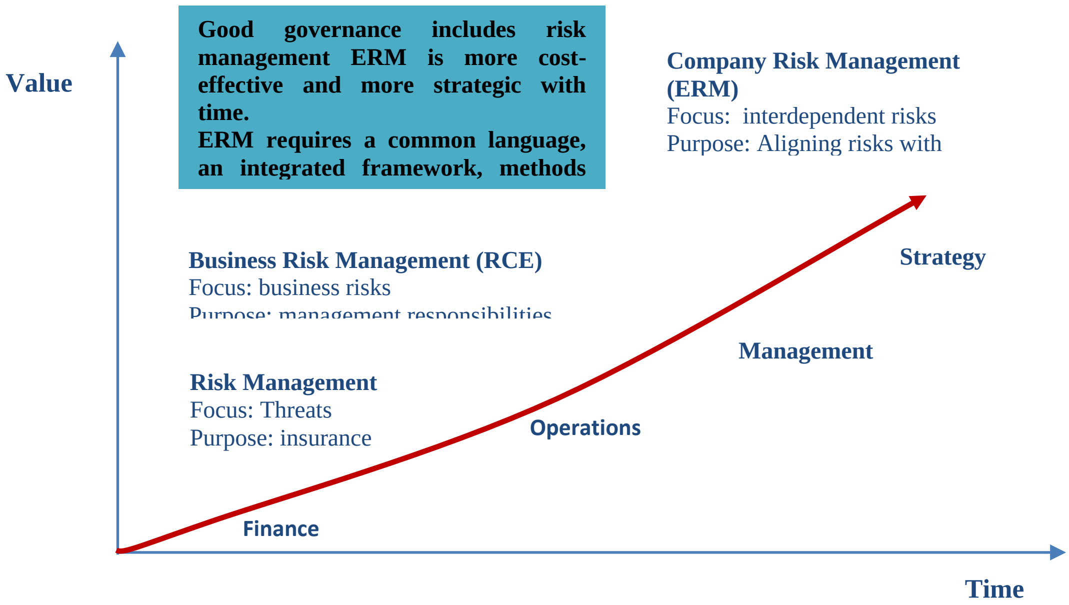


Chart no. 2. Result - time correlation in risk management
Source: author's own processing

Such approaches regarding risk management in financial risk management have not always been well managed or well received. The *long-term capital* management fund included two Nobel laureates, who, after accumulating a large amount of capital, continued to lose more than $ 4 billion over the course of a few months following the financial crisis in Russia in 1998 (Lowenstein 2000). The Fund determined the Federal Reserve to step out of its investments. Excessive and abusive use of such complex analysis instruments has also been blamed for the 2008 global financial crisis (Patterson 2011) and the financial crises in general (Cooper 2008). In fact, some hedge fund managers have earned large amounts of money by exploiting these dysfunctions (Lewis 2010). In his comments on the 2008 financial crisis, Lewis explains that the hypothesis of house prices uncorrelated at national level allowed for diversified combination of poor quality individual mortgages to be sold at higher quality as a result of their priority payment orders and diversification between several mortgage loans (Lewis, M.,.2010).

3. RESEARCH ON THE ROLE OF CORPORATE GOVERNANCE AND RISK MANAGEMENT IN DECISION-MAKING PROCESSES AT ROMANIAN ENTITY LEVEL

Components of the sample were contacted via e-mail. The sampling unit for this research is represented by 17% decision makers, 35% execution staff, 30% associate staff, 3% research and education staff, 15% other organizations in Romania. We tried to find the best mechanism that would not discommode the respondent, not to interrupt them for a long time, but at the same time to have access to the information needed to reach the proposed goals. The questionnaire comprised 23 items. Regarding the types of question, in the construction of the questionnaire I used:

• *Closed questions,* which are characterized by providing the subject with pre-fabricated variants, the respondent choosing the one that best suits his / her situation or opinion*;*

• *Semi-closed questions* used when the answers to a closed question do not exhaust the full range of responses, leading to the closure of the series of variants with one such as: others *(please specify ...);*

In the construction of the questionnaire we also used *identification questions* asking for information about the organization in which it operates and the function it occupies, but specifying that this question is optional, in desire of not meeting reluctance on the part of the respondents and to be as honest as possible.

By applying this questionnaire, the following objectives were considered: Identifying managers' perceptions of the concept of corporate governance; risk attitude, the need to implement risk management in decision-making processes, decision-making issues. The assumptions made by the present research were:

IP1. Romanian companies use risk management recommendations in decision-making procedures.

IP2. This component of corporate governance is integrated into entities.

IP3. The reason for organizations to rely heavily on risk management is determined by different factors.

Within the entities included in the sample, one can notice that the corporate governance model of the unitary type (on one level) is 62.32% and the dualist model (on two levels) to 29% of the entities. Under the unitary model, the company is governed by a **board of directors** and, as the case may be, by **directors**. As a significant difference from the dualist model, in the case of the unitary governance model, the directors may also be **members of the board of directors**. The unitary model also allows for the presence of **censors** in the governance structure of the company.

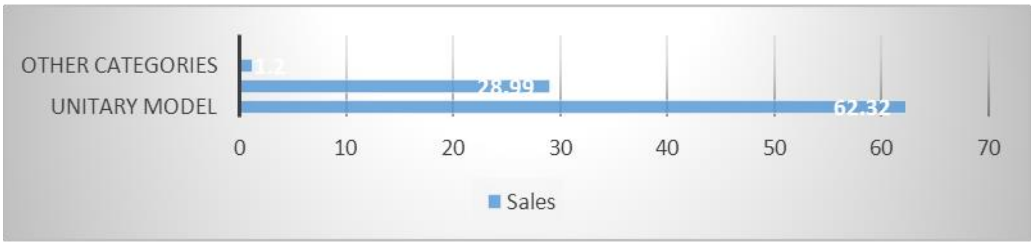


Chart no. 3. Models of corporate governance
Source: author's own processing

We can see from the next model that the standard model of corporate governance (shareholders-directors-managers, performance evaluation / assuming responsibility and the existence of specific regulations) is found at the level of all entities that responded to our request.

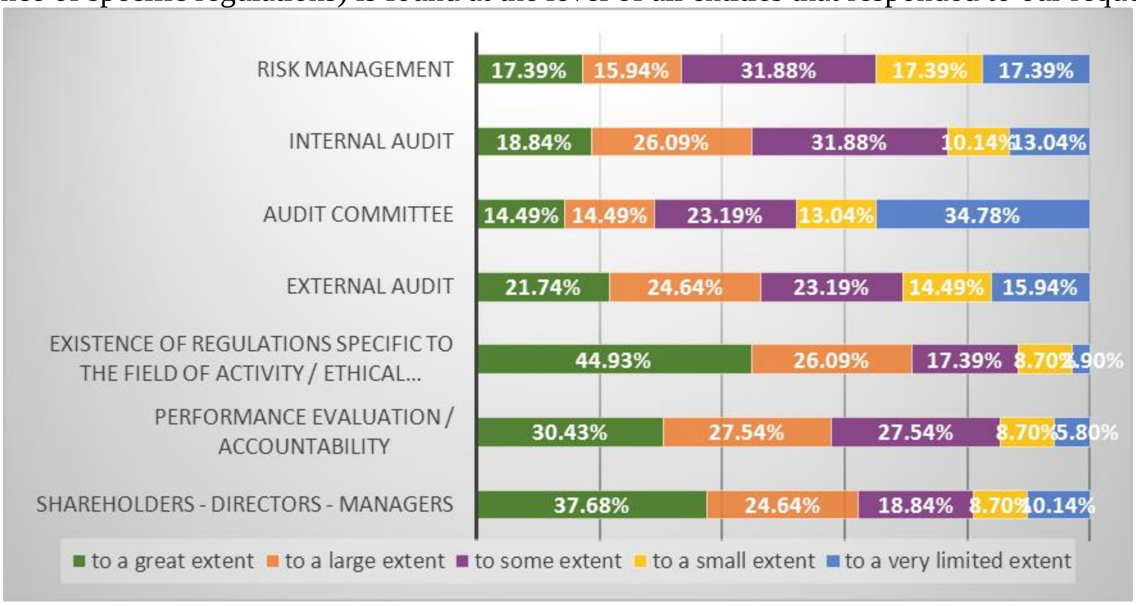


Chart no. 4. Components of a corporate governance model
Source: author's own processing

This model typically presents a number of dysfunctions, many of which refer to the degree of trust that can be put in the reports and results published by large organizations. These potential issues may include the work of the Board of Directors, corporate ethics, responsibilities, etc. The activity of the Management Board may be confronted with the following issues:

- The board of directors is dominated by the executive board chairman who manipulates the company according to his / her personal interests;
- The Board of Directors is useless and consists only of a simple network of friends who fail to represent the shareholders to a real extent;

Risk management is an important solicitude for entities. We can see that risk management is still pioneering in most entities, even if risk management is fundamental to try to mitigate the negative effects of its manifestation.

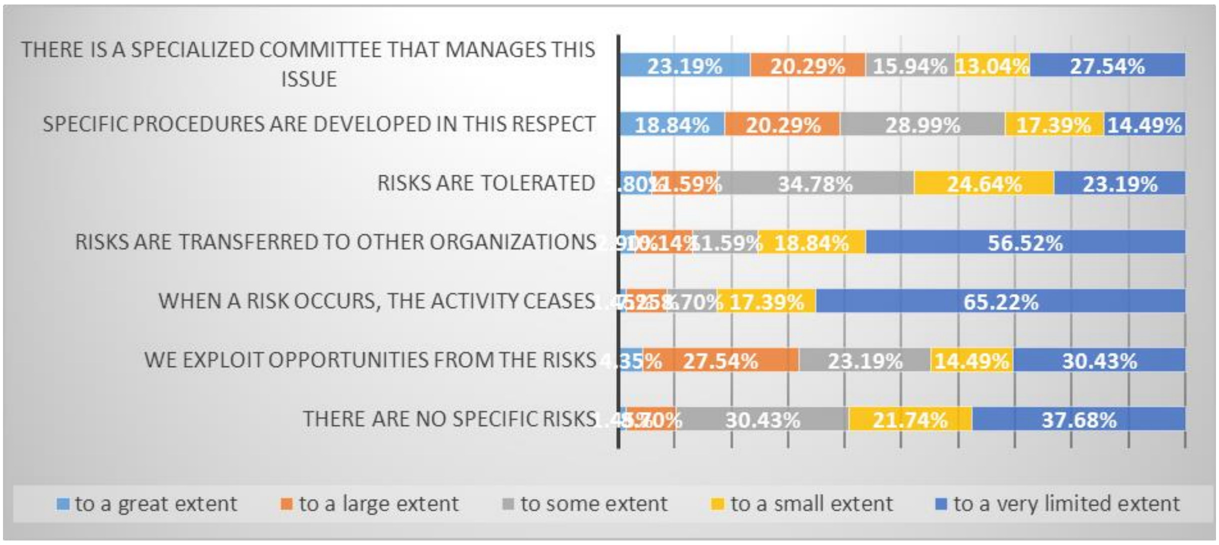
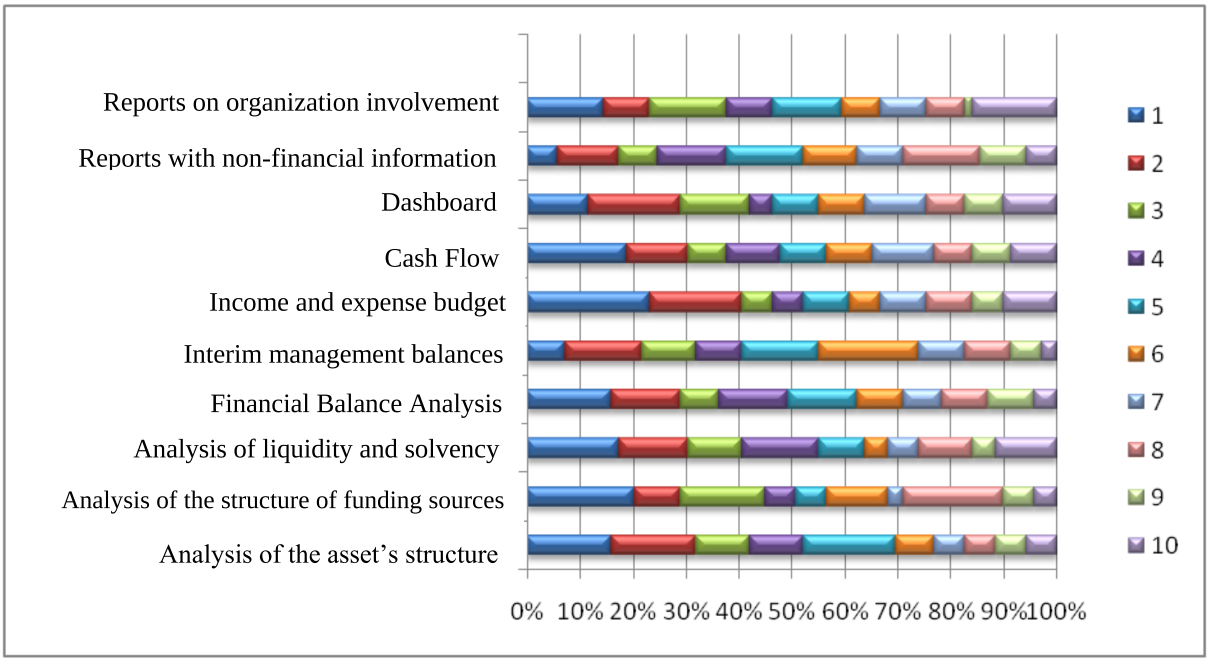


Chart no. 5. Ways of risk management
Source: author's own processing

71.01% of organizations are promoting *a culture that accepts the risk*. Regarding the benefits of incorporating risk management into the organizational culture, we obtained from our research the following:

- greater attention to the issues that matter *(37.68% to a great extent)*;
- reduction of losing driving time with disputes *(36.23% to a large extent)*;
- fewer surprises *(36.23% to some extent)*;
- more satisfied customers *(36.23% to a great extent)*;
- protecting reputation *(49.28% to a great extent)*;
- more attention to doing things in the right way *(42.03% to a large extent)*;
- Greater possibility to achieve the company's objectives *(48.58% to a great extent)*;
- fewer complaints *(37.68% to a large extent)*;
- increased opportunity for initiatives to change and achievement of project / project benefits *(37.68% to a large extent)*;
- risk-taking and more informed decision-making *(37.68% to a great extent)*;
- support for innovation *(33.33% to a very large extent)*;
- lower insurance costs *(33.33% to some extent)*.

In the economic situation of our country, a particularly significant role should be given to liquidity information (4,78) and, of course, to closely monitoring the revenue and expenditure budget (4,61). These reports, together with market research, strict marketing, three-scenario budgeting, inventory optimization, renegotiation of contracts with customers and suppliers, are the means that should be taken by Romanian entities to handle economic and financial risks. The form of submission of this information may vary according to several criteria (legal regulations in force, beneficiaries' requirements, etc.) from verbal communications in response to certain questions of managers or eventual of shareholders to several reports for managers or financial statements addressed to external users.



Grafic nr. 6. Reports, analysis used in the decision-making process

Note: 1 is the most important, with 2 the second, etc

Source: author's own processing

The key to the success of an entity lies in its ability to identify (forecast) sources of value creation and to exploit them appropriately. Value is judged both from the point of view of the products and from the point of view of the organization as a whole. Thus, the interactive use of the accounting management system is largely appreciated by 42.03% of respondents, encouraging employee participation in decision-making is highly appreciated by 18.84%, the use of non-financial information and increased rules which concern the behavior of the staff of 14.49%.

CONCLUSIONS AND PROPOSALS

The limits of any structured decision-making approach are basically the same as in the case of solving problems:

- as a rule, decision-making methods are presented as rational and clear. No complications, iterations, and uncertainties are indicated, and the process seems linear. In practice, managers go through the various stages back and forth several times. Whether you approach decision making in a linear and rational way, or on the contrary, in an iterative way, there are many difficulties that you are most likely to face.
- it is often difficult or expensive to collect all the necessary information.
- it is not always easy to identify goals that could meet your needs as you perceive them. Often, you have to accept a compromise to better meet different divergent interests or goals.
- generating options can be costly and time-consuming.
- you often do not have enough time to think creatively.
- evaluating alternatives can also be time-consuming.
- estimates of expected results often have a high degree of uncertainty.
- finally, even if you reach what you think is an ideal decision, it can be rejected by others.

There are some alternatives inspired by Boone's ideas (2003), namely:

- *addressing the less ideal solution*. Try to view the ideal solution, then choose the option that looks closest to the ideal one and it is likely to be accepted.
- *intuitive approach*. Make the decision of choice intuitively - as you do, of course, often - but be as honest as possible to yourself. Formulate your real reasons for choosing the alternative. Can you justify them openly to others? Are not your real reasons, for example, the convenience or the fear of acting? Would not it have made you think a little longer?
- *negative approach*. Instead of targeting the best option, find reasons to reject the options. Eliminate the weaker options, one by one, until it remains "the worst option".
- *address change of circumstances*. You can remove from the options by analyzing how well they would resist if the conditions were changed, that is, if the forecasts you made about the future would prove to be incorrect. Change those conditions to which one option seems the most sensitive, then choose the one that seems to best withstand the changing circumstances.

Accounting information thus becomes a primary and primordial resource of decision-making procedures used both for the design of strategic development plans in accordance with the organizational culture of each economic entity and for the projection of operational plans in harmony with the medium and long-term development strategy.

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