

Effects of Enterprise Risk Management (ERM) and Economic Issues on the Performance of Manufacturing Sector-SMEs in Malaysia – A Conceptual Framework

UmmuKhadijah Abdul Rauf, JuhainiJabar, NusaibahMansor

Abstract—This study aims to construct a conceptual framework that describes effect of Enterprise Risk Management (ERM) on the relationship among organizational performance and economic issues. The study intended to establish whether ERM adoption and economic issues influence the performance of Small and Medium Enterprises (SMEs) as focusing in manufacturing sector. However, as compared to large businesses, small businesses became one of the highest failure rates. ERM is a form of micro risk management and a full approach to identify risk in all purposeful areas. However, based on previous studies, the study to examine the practices in adopting ERM especially in SMEs and the performance of SMEs are still lacking. Hence, the area of this paper will be focus on SMEs manufacturing which are 380 registered SMEs that listed under SME Corp. Malaysia.

Keywords: Adoption, economic issues, enterprise risk management, institutional theory, Malaysia, performance, small medium enterprises.

I. INTRODUCTION

The concept of business under SMEs is one of the providers in handling opportunity in term of employment opportunities and welfare promise. SME also has been promoted by governments and politicians in programs concept like an entrepreneurship development [12]. Thus, to increase performance in SMEs has more challenging in order to find the variables which may influencing the performance of SMEs not in the short term but for long term. If this happen SMEs can be one of the guidelines for developing countries in economic and one of the source developments in entrepreneurship, still to achieve this, the country need to make an effort in finding the most suitable tool for SMEs in handling the policies and regulations so SMEs will grow their business and expanding the business with more systematic [46]. In Malaysia, there are variety of SMEs industries and one of the GDP contributors in representing the total businesses in different sectors for the country. Thus, these industries played an important role for the country in term of economic development. Based on the previous contribution in SMEs, these industries became the most important to the economy for the country; the government took a step to support these industries in term of

development for SMEs [37]. Thus, SMEs industries are one of the largest industries includes the different group of businesses such as trading, services, manufacturing and agriculture sectors. Hence, for many countries, the 90% total of business establishment came from SMEs. Furthermore, the Malaysian SMEs share 95% of total establishments [42].

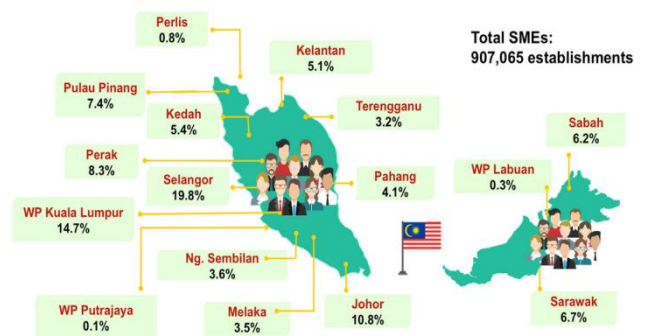


Fig. 1. Overview of SMEs in Malaysia by state [10]

For economy perspective in Malaysia, SMEs is recognized as the backbone of Malaysian economy [35]. Previous researchers found there still lacking and limited in SMEs field in term of strategic planning for SMEs especially in Malaysia [18], [19], [39], [40]. The effects of crises on the SMEs are decreases in sales [51]. In 2016, the inflation at 2.0% to 3.0% as the price adjustments occurred in a few prices administered items [42].

For any country, a successful SME business environment directly translates to a successful economy [48]. Thus, SMEs growth its different following the countries. Malaysia has faced recession symptoms as decreasing in business development and the increases in unemployment rate which caused a huge problem for SMEs in Malaysia. Furthermore, Malaysian Government played their role in recognizing the importance of SMEs where they implemented the different policies, plans and organize programs to help SMEs in handling this type of problem [8]. However, SMEs has faced many problems due to not implementing ERM [3]. In addition, the study related to ERM implementation still lacking in Malaysian SMEs in the Manufacturing Sector. This leaves negative effects on the SMEs companies, and as a result, it is an essential element to take into account of economic issues in the determination of ERM adoption in Malaysian manufacturing SMEs.

SMEs manufacturing industries has been chosen as firm

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for this study because SMEs industries played an important role in economic perspective and the main contributor of GDP for in many countries [36]. This study has been partially adopted the Fiedler contingency model by [13]. Previous studies stated the study on ERM adoption still lacking and limited specially in Small Medium Enterprise SMEs. Based on the previous studies this will be the gap need to be filled for this study. Thus, to fill the gap, this study aimed to study the ERM adoption and propose the ERM adoption for SME manufacturing in Malaysia. Furthermore, this study to propose a framework that will increase the level of the understanding ERM practices by investigating the relationship between risk factors and Malaysian SMEs manufacturing in adopting ERM as mediating variable. This paper will be focusing on the economic that extracted from Institutional Theory by [34], [35]. Based on this, the objectives of this paper are as follows:

1. To examine the effect of economic issues on SMEs manufacturing performance.
2. To examine the effect of economic issues on ERM effectiveness.
3. To examine the effect of ERM on SMEs manufacturing performance.

II. LITERATURE REVIEW

A. Definition of ERM

The definition of ERM is various according to the different interpretation but the accurate definition were developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). COSO defined ERM as a process, affected by an entity's board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives [8].

The previous study stated that the implementation of ERM among companies will sustain the competitive advantages of firms as compared to the firms where managing and monitoring their risk itself without proper tools. ERM played an important role in helping the companies to strengthen the ability of the firm in planning their strategy in handling any risk [33]. Previous studies found that ERM implementation has improved performance of the firm [8], [25], [16], [20]. It is supported by previous studies stated the organizations have increased the level of awareness towards ERM benefits. [27]. Furthermore, many companies seek a positive approach which may help in reducing risk event in order to improve the opportunities in business [2].

B. Economic and Firm Performance

The discussion continues focusing on the relationship between economic issues and firm performance. SMEs represent for its economic growth and became one of the main contributors for all the enterprises in Kosovo which arise to 98 percent [4], [50]. SMEs industries focusing on two factors included developed and developing countries, thus these elements represent as the factor for economic

growth for many countries [1], [23]. Furthermore, the factors influencing performance of the firm stated based on economic tradition context, in order to determine the factors of firm success; the external factors need to take into consideration as one of the important factors [30]. Previous researchers found the significant relationship between economic in manufacturing organization. For the researchers, it is very useful in providing strategy and as a foundation of theoretical perspective as to study on the relationship between market structure and performance of the firm [26], [50]. Hence, the critical issue is to fix tax issue in SMEs industries which caused critical in fixing business environment for SMEs industries [44]. Thus, when this occurred, SMEs industries had faced the interference in their market and caused inefficiency in economic context. At the same time, the allocation of resources for SMESs would be less efficient and turned to negative impact for these industries [15]. It is supported by previous studies found SMEs at the critical stages in economic development for many countries around the world. In addition, Malaysian economy is mainly based on SMEs [31].

H1: There is a positive relationship between economic and performance of Malaysian manufacturing SMEs.

C. Economic and ERM

Furthermore, this study continues to discuss either there is a positive or negative relationship between economic factor and ERM. Another factor that has access in SMEs credit facilities is risk factor [10]. Thus, when the increases amount of debt happened in companies will result to default increase and there will be a result for cash flow limitations and at the same time the firm's interest payments may rely on external financing. When this happen, SMEs industries need to face the increases in financial risk. Moreover, SMEs can be said as one of the riskier enterprises based on previous studies and bring negative affect to the country especially for economic resources [12].

H2: There is a mediating effect of implementation of ERM on economic issues and performance Malaysian manufacturing SMEs.

D. ERM and Firm Performance

The connection between ERM and firm performance remains to be discussed in this chapter. ERM is thought to be an efficient risk management method and is rapidly becoming the norm of best practice. In addition, previous studies have noted that organisations that have embraced a more integrated strategy, and as ERM, have encountered important company performance benefits in handling wide-ranging corporate hazards. Thus, in reality, academics and scientists generally agree that organisations using ERM will improve organisational efficiency [38]. SMEs have faced many problems due to not implementing ERM [2], [5], [6], [32]. Furthermore, SMEs lack of awareness in adopting the approach that can mitigate any potential risk from occur [23]. SMEs industries does not have any strategy to mitigate the risk from occur [45]. Thus, the improvement in

implementing ERM which contributed to positive improvement in performance of organization. Findings of this research indicate that an improvement in the rate of ERM application in businesses contributed positively to the value of businesses [21], [48]. However, based on previous study found that firm's value comes from implementing ERM process [15]. This finding is supported with ERM positively and significantly influences the value of company [19]. Thus, there is a positive relationship between ERM practices and firm value [28].

H3: Perceived ERM has significant relationship with firm performance.

III. PROPOSED FRAMEWORK & RESULTS

This study will continue to suggest theoretical framework. Recent studies have been used as a reference for risk management in the Malaysian manufacturing SMEs [3], [5], [6]. Businesses therefore need resources, procedures and structures that empower scheduled flexibility in order to attain and sustain success. Furthermore, Fred Fiedler's partly adopting and adapting in this study and using Fiedler's contingency model. This is linked to the practices of the ERM, the effectiveness of the ERM method and how it impacts the organisational result. The theoretical frameworks mentioned below guided this research. The theoretical framework for the research is shown in Fig. 2.



Fig. 2. Conceptual framework

IV. CONCLUSION

The research indirect extends knowledge on the SME's readiness in adopting ERM and how it could benefit them. Such knowledge will be useful for the top management in being encouraged to become more proactive in promoting the ERM to increase the chances of success in business development, in order to improve productivity and increase competitiveness. The suggested framework that will explain the impact of ERM process as mediating variable in Malaysian manufacturing SMEs and the relationship between economic issues and organizational performance. Furthermore, this paper can be used as reference by future researchers when studying on the practices ERM. In addition, by reviewing the effectiveness of ERM in this paper, researchers might find the economic issues which frequently occurred in Malaysian SMEs manufacturing which could lead to the positive achievements of ERM adoption This is to make a development to offer the best strategies and driving the healthy practices for ERM development in Malaysian companies and relationship with economic issues will disclose the different type of challenges and risks, frequently occurred in Malaysian manufacturing SMEs companies.

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