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# The Role of Enterprise Risk Management on SMEs Performance: A Review Paper

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**ABSTRACT**
SMEs have proved their ability to contribute to economic growth and become Malaysia's most prominent business economy. As a result, many Malaysians, particularly the younger generation, are involved in this field because they believe that entrepreneurship will help them improve their living standards and income level. Furthermore, government support is one of the reasons why young Malaysians want to be entrepreneurs. However, many Malaysian entrepreneurs have struggled to survive in the first five years of business operation due to the risks and challenges. As a result, using comprehensive literature review, this paper aim to review some of the previous papers on the importance of risk management in SMEs and find gaps from these papers. This review paper can help grasp new research opportunities that can be conducted in the future. Thus, this paper suggested implementing an enterprise risk management index to help entrepreneurs measure their readiness before entering the entrepreneur field.

**Keywords*:*** Enterprise Risk Management, Risk Management, Risk Management Index, Small and Medium Enterprises (SMEs)



## INTRODUCTION

Scientists and experts acknowledge that small and medium-sized enterprises (SMEs) are the foundation of a country's economic development because they contribute to economic growth, increased exports, unemployment reduction, and innovation advancement (Nikolić et al., 2019). It is supported by Ouma-Mugabe et al. (2021) that most businesses worldwide are SMEs which are significant predictors of job creation and market economic growth (Ouma-Mugabe et al., 2021). According to World Bank (2020) statistics, SMEs account for approximately 90 percent of all businesses and more than 50 percent of total productive economic activity (World Bank, 2020). While in terms of GDP, structured SMEs can contribute up to 40 percent of a country's gross domestic product (GDP) (Nimfa et al., 2021).

In Malaysia, SMEs have played a progressively significant role as a contributor in economic growth since 1990s (Chin & Lim, 2018). Until now, they become a major contribution in terms of GDP and main sources of job creation in Malaysia. According to the time series of Malaysian GDP and SMEs GDP, the growth of SMEs GDP is usually greater than that of Malaysian GDP. Malaysia's SME GDP increased by 5.8 percent in 2019 compared to 6.2 percent in 2018. Nonetheless, the performance was higher than Malaysia's GDP and Non-SMEs, 4.3 percent and 3.4 percent, respectively. The sectors that contribute to GDP increased to 38.9 percent from 38.3 percent the previous year (Department of Statistics Malaysia, 2020).

In terms of job creation, SMEs play an important role in addressing Malaysia's unemployment problems because of their potential to develop and create new jobs, find and create opportunities and ensure long-term economic growth (Benbekhti et al., 2021). According to Chin and Lim (2018), the proportion of SMEs employed concerning total employment has increased from 2006 to 2014 (Chin & Lim, 2018). SMEs increased their employment performance by 3.0 percent in 2019 compared to 3.2 percent in 2018. SMEs employed 48.4 percent of Malaysians, a 0.4 percent point increase from 48.0 percent the previous year.

Malaysia's government has emphasized the development of SMEs as one of the primary vehicles for the economy's transition to a high-income nation in the 2020 mission. Thus, the government provides various programs and initiatives to support and encourage Malaysian especially young generations to be involved in SMEs (SME Corporation, 2021). Besides, the growth of SMEs in Malaysia also drives the Malaysian to improve their income level and living standard. Thus, the involvement in the entrepreneurial sector, especially in SMEs, increased day by day among Malaysia, particularly young people under the age of 40.

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Despite the fact that many SMEs have proven to be successful, some have failed (Weking et al., 2019; Kee et al., 2019; Krishna et al., 2016). Statistics show that only 1 out of 10 new business success, the others failed (Krishna et al.,2016). The majority of Malaysian SME entrepreneurs cannot sustain their businesses over time, and most fail within the first five years (Hui Lim & Ban Teoh, 2021). This is due to the nature of the entrepreneurial environment, which is distracted by high-stakes risks despite the abundance of opportunities, innovation, and potential (Weking et al., 2019).

In the midst of severe uncertainty, start-ups are human institutions meant to produce new products and services. As a result, entrepreneurs should consider new tools, management, and leadership as a means of surviving in an environment fraught with risk and unpredictability (da Silva Piñeiro et al., 2017). The failure and success of entrepreneurship has been studied by a number of researchers (Yildiz, 2020; Boonmalert et al., 2020; Weking et. al., 2019; Liaw, J. C., 2019; Kim et al., 2018). Many people have emphasised the relevance of risk management in entrepreneurship since it may help to reduce potential risks while also reducing the effect of prospective losses (Ferreira de Araújo Lima et al., 2020; Prioteasa, A. et. al., 2020; Rehman & Anwar, 2019). Therefore, this study was conducted to discuss the role of risk management and enterprise risk management in the start-up of SMEs and to find the gaps in previous papers. This review can help researcher to grasp new ideas for future research in risk managemnet area.

## LITERATURE REVIEW

### *Risk and Challenges in SMEs*

Although many SMEs have successful founders, past research has revealed that many new enterprises struggle to survive and fail. Start-ups confront problems and hurdles in surviving and sustaining themselves, with failure rates ranging from 50% to 95% in emerging markets like Malaysia (Kee et al., 2019). Furthermore, previous studies on SMEs in Malaysia from 2001 to the most recent (2020) revealed that SMEs faced various challenges, issues, and difficulties that prevented their operations from growing. Many SMEs face challenges in ensuring their long-term viability and remaining competitive in a constantly changing market.

Previous researchers do many studies to discuss the risk of a start-up business. Shevazz Khan & Sakshi Kothari (2020) tried to identify the challenges that might be faced by start-up entrepreneurship. The researchers listed and explained six types of risks for start-ups; market risks, competitive risks, operational risks, people risk, legal and regulatory risks, and financial risks. The researcher concludes that start-up founders expose themselves to various commercial risks whenever they decide to invest. The number of risks varies depending on the type of economic instrument. Hence, risk management is used by fund managers and investors to minimize and control the exposure of investments to such risks. A good risk management plan should include strategies and techniques for recognizing and confronting threats and vulnerabilities that the company faces and possible solutions to the problem (Khan, S. & Kothari, S., 2020).

In another paper by De Araújo Lima, P. F. (2019) also discussed the types of risk exposure to the enterprises, categorized into four types; financial, hazard, operational, and strategic. Market forces, financial assets, or liabilities all pose financial risks. Natural or intentional accidents caused by third parties pose hazardous risks. Human and process errors that can occur in functional business units are the sources of operational risks. Strategic chances are those that may impede the company's ability to achieve its strategic objectives. These include reputational harm, technological innovation, and customer dissatisfaction (Ferreira de Araújo Lima, P. et al., 2020).

Limbong et al. (2019) investigated risk management for new businesses in healthy kitchen restaurants and catering. For new restaurants and food producers, managing risks is critical to avoid losses in project quality, timeliness, and costs related to personnel, marketing, and financial operations. This study state that there are four risks affecting operation of the company which are operational risk, marketing risk, human resources risk, and financial risk (Limbong et al., 2019).

Another study done by Sapura et al. (2021) found 24 risks faced by the start-up business of PT Oesodo Alam Mandiri. The researcher analyzed these risks based on internal and external factors in the context of operations, marketing, finance, and human resources (Saputra et al., 2021). While, Jobo and Phyllis (2020) found entrepreneurial risk consists of strategic, market, technological, financial, and environmental risks (Jobo & Phyllis, 2020).

Based on the previous studies, many risks might occur in SMEs. Thus, entrepreneurs should be aware and good enough to manage these risks to ensure their survival, especially during the start-up stages. Risk management is one of the tools that can help someone manage their risks in any field.

### *Risk Management in Entrepreneurship*

The practise of recognising prospective risks, disasters, or difficulties is known as risk management. Risk management enables business owners to put in place methods to avoid, mitigate, or at the very least cope with risk.Risk management's main goal is to reduce potential threats while limiting the impact of prospective losses (Ferreira de Araújo Lima et al., 2020). The classic risk management strategy, often known as the silo-based approach, and the enterprise risk management approach are the two approaches used to manage risks (Ade et al., 2020; Gordon et al., 2009).

Traditional risk management, or silo-based approaches, manage risks on an individual or separate basis. Risk management activities are focused on minimizing harmful exposures (Sutan Maruhan et al., 2018) and practiced in an isolated manner (Ade et al., 2020). In the traditional enterprise risk management approach, risks are not handled centrally in an organization, and not all types of threats are considered within the basis of traditional risk management (Ade et al., 2020).

The enterprise risk management method takes a comprehensive approach to managing risks and opportunities at the same time (Gordon et al., 2009). Enterprise risk management is a systematic and integrated approach to managing organisational risks in order to produce and optimise value for stakeholders (Razali & Mohd Tahir, 2011). It entails combining and addressing operational, strategic, financial, and other organisational risks at the same time. It also aids in the identification of prospective events that may have an impact on the business and their management to ensure that they are within the organization's risk appetite (Ade et al., 2020).

Several prior research have identified a link between enterprise risk management and SME performance (Rehman and Anwar, 2019; Callahan and Soileau, 2019; Yang et al., 2018). It was created in response to the perceived shortcomings of traditional risk management (Ade et al., 2020). According to Rehman and Anwar (2019), Enterprise risk management can assist SMEs in reducing the considerable losses that may arise as a result of risk management failure (Rehman and Anwar, 2019). It is supported by Ade et al. (2020), who found that enterprise risk management impacts the survival of SMEs in Lagos State (Ade et al., 2020). Enterprise risk management is being used by a growing number of businesses because it has been shown to boost a company's worth (Sutan Maruhun et. al., 2018) and enhance the performance of SME (Callahan & Soileau, 2017).

***Enterprise Risk Management in Entrepreneurship***

The importance of enterprise risk management as a link between company strategy and SME performance was studied by Rehman and Anwar (2019).The researcher sent out a structured questionnaire to 327 Pakistani SMEs. Structural Equation Modelling was used to analyse the data in Amos (SEM). Business management has been found to have an impact on SME performance, with enterprise risk management functioning as a moderator. Furthermore, corporate risk management has a minor impact on SME performance, according to this study. As a result, senior management strategic action is necessary for proper and successful business risk management procedures, which can lead to higher profitability (Rehman & Anwar, 2019).

Another research paper that studied on enterprise risk management done by Ade et al. (2020). The purpose of this study is to see how enterprise risk management practises affect the survival of SMEs in Lagos State. A cross-sectional survey was used to collect data from 400 SMEs in Lagos State, which was then analysed using descriptive and inferential statistical tools. Enterprise risk management has been proven to have an impact on the survival of SMEs in Lagos State. As a result, the researcher urged SMEs to use enterprise risk management as a vital business function that can help them survive. Furthermore, the government should continue to educate SMEs about the benefits of ERM and impose required enterprise risk management rules to compel them to use it (Ade et al., 2020).

Yakob et al. (2019) have also researched the impact of enterprise risk management practices on SME performance. Multiple regression analysis methodologies were used to analyse the data in this study. The researcher argues that organisational resources are the most important factor impacting organisational success, according to the Resources Based View Theory (RBV). The paper argued that effective enterprise risk management in SMEs can reduce the firm's risks and lead SME managers and owners to achieve their business objectives. The researchers recommended SMEs to use enterprise risk management strategies in order to boost their firm's value, optimise profits, and improve their overall performance (Yakob et al., 2019).

These previous studies in line with research done by Kulathunga et. al. (2020) who found that enterprise risk management practises positively impacted the SME performance. Enterprise risk management is used as a mediator between financial literacy and SME performance in this study (Kulathunga et al., 2020). Effective enterprise risk management allows managers to predict the possibilities and challenges that may arise as a result of global economic shifts, allowing them to establish appropriate long-term plans and strategies to boost organisational performance (Yilmaz A.K. and Flouris T., 2017).

A previous study by Sutan Maruhan et al. (2018) also proved that ERM was widely studied by earlier researchers in several industries. However, the researcher found limited number of empirical researches that examines the relationship between enterprise risk management and firm value (Sutan Maruhan et al., 2018). Thus, Sutan Maruhan et al. (2018) developed an effective measurement for enterprise risk management called the enterprise risk management index to fulfil the gap found in enterprise risk management. According to Sutan Maruhan et al. (2018), there is a lack of suitable and comprehensive dimensions available to measure enterprise risk management. Therefore, the researcher constructed an enterprise risk management index based on data gathered from a literature review. This enterprise risk management index can assist practitioners in determining the maturity level of their organization's enterprise risk management programme and academics in conducting empirical research (Sutan Maruhan et al., 2018).

## METHODOLOGY

This study applied comprehensive literature review to review some of the previous papers on the importance of risk management in SMEs and find gaps from these papers. Google Scholar was used to searching for open access journals published from 2018 to 2021, and we restricted our search to papers written in English. We restricted our searching with the keyword “risk management”, “enterprise risk management”, “Small and Medium Enterprises”, and “SMEs”. From 83 papers, we only chose journals that studied on risk management in Small and Medium Enterprises (SMEs), but only four selected journals are chosen because they had cited by many researchers and their findings are fit with our study. The gaps that found in the previous study help the researcher to grasp a new idea for future study.

## FINDING AND FUTURE STUDY

It is found that SMEs faced many risks which can hinder their performance. The common risks that found by previous researchers are market risk and financial risks. However, another important risks that entrepreneurs should aware are operational risks, entrepreneurial characteristics, competitive risks, strategic risks, reputational risks and natural risk. The study had considered these risks because of current situations that occur in SMEs nowadays. Figure 1 shows the framework of factors in risk management in SMEs.

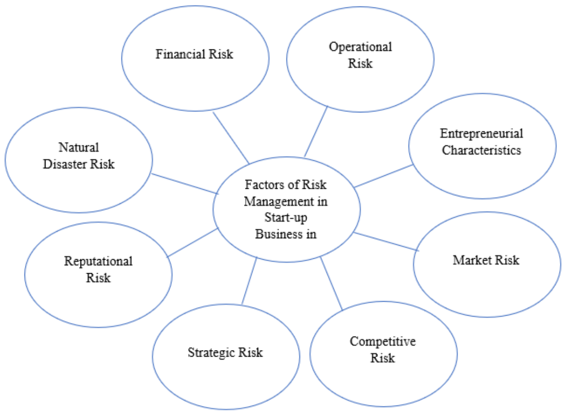


Figure 1: The framework of factors in risk management in SMEs

Because entrepreneurs faced these risks and challenges, a risk management practices should be implemented in SMEs. There are two types of risk management which are traditional and enterprise risk management. It is found by many studies that enterprise risk management is more effective to be used in SMEs. Many previous papers studied on the role of enterprise risk management toward SMEs performance but still there is a gap found among them which presented in Table 1.

Table 1: The summarization of previous literature review on enterprise risk management

| Authors | Objective | Findings | Gaps |
|---|---|---|---|
| Rehman and Anwar (2019) | To investigate the role of enterprise risk management between business strategy and SMEs performance | Enterprise risk management act as a moderator between business management and SME performance. | There is no discussion on measuring enterprise risk management index for a start-up business in SMEs. |
| Ade et. al. (2020) | To investigate the impact of enterprise risk management practices on the survival of SMEs in Lagos state | The enterprise risk management has an effect on the survival of SMEs in Lagos State. | There is no discussion on measuring enterprise risk management index for a start-up business in SMEs. |
| Yakob et. al. (2019) | To study the relationship between enterprise risk management practices on SME performance. | The enterprise risk management practices can increase value of firm, maximize profitability and improve SME performance. | There is no discussion on measuring enterprise risk management index for a start-up business in SMEs. |
| Kulathunga et. al. (2020) | To investigate the impact of techno-finance literacy and enterprise risk management practices on the performance of SMEs | Enterprise risk management practices has an impact on SMEs performance. | There is no discussion on measuring enterprise risk management index for a start-up business in SMEs. |
| Sutan Maruhan et al. (2018) | To fulfil the gap found in enterprise risk management which lack of suitable and comprehensive dimensions available to measure enterprise risk management. | Developed enterprise risk management index to measure enterprise risk management. | There is no mathematical formulation used in developing enterprise risk management index.<br><br>There is no discussion on measuring enterprise risk management index for a start-up business in SMEs. |

Therefore, to fill the gaps found in the previus papers and new idea for future study, it is recommended to develop a mathematical formulation in enterprise risk management index for start-up businesses in SMEs. The factors of risk management for start-up businesses in SMEs, as shown in Figure 1, can be used for developing a new enterprise risk management index. An interview session with expertise in SMEs should be done to verify and get the weightage for each factor. Then, the result from interview session are used to develop a mathematical risk management index for start-up business in SMEs.

## CONCLUSION

This review concludes that risk management and enterprise risk management practices in a start-up business in SMEs are crucial as they help entrepreneurs or managers manage the risk and challenges faced in their business. As many entrepreneurs struggle in the first five years of business operation, a risk measurement index should be created for a start-up business so that they can measure their readiness to start their business. This mathematical formulation will fulfill the gaps found in previous papers and to help entrepreneurs to measure their readiness and preparation to start their businesses. Consequently, it can avoid entrepreneurs from having difficulty in the first five years of business operation and reduce the number of failures in the start-up business. It is still essential that entrepreneurs use risk management in risk transfer even if the system has been developed (Ghazali et. al, 2020, 2019a, 2019b, 2017, 2015, 2012a, 2012b, 2012c & 201d: Azhar et al., 2017). Risk transfer is very important in business for double check and balance before they loss too more in their business.

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