



ENTERPRISE RISK MANAGEMENT IN SMALL AND MEDIUM ENTERPRISES – A REVIEW

Bhavana Umanath* A.N.Santosh Kumar**

**Research Scholar, Department of Mechanical Engineering, JSS Science and Technology University, Mysore.*

***Professor, Department of Mechanical Engineering, JSS Science and Technology University, Mysore.*

Abstract

“Risk is like fire: If controlled it will help you; if uncontrolled it will rise up and destroy you.” -Theodore Roosevelt.
Risk surrounds every kind of business every day. In every organization there are uncertainties, and unexpected events can occur. The need for risk management arises because it is a known fact that uncertainty is a reality. Any business objective is confronted with a wide variety of threats, which could become both performance barriers as well as opportunities. In India, there are various risks faced by the Small and Medium Enterprises. Also, it is widely known that the aversion of risk is comparatively higher in SMEs than in larger enterprises. Practicing Enterprise risk management will help in minimizing the exposure to risks and mitigate them. In this regard, this paper discusses the role of SMEs in India and their exposure to risk. The available research papers in the area of enterprise risk management are studied to understand the constraints faced by Indian SMEs, importance of practicing ERM in SMEs and the ways in which it will benefit them.

Keywords: Enterprise Risk Management, Enterprise, Small And Medium Scale Enterprises.

Introduction

An enterprise, also known as a firm, is an organization which involves in the manufacture and trade of goods and services to its customers. Enterprises are classified under various categories such as private, public, individual, community, formal, informal, local, foreign, business, social, small, large, manufacturing and service.

In India, the Small and Medium Enterprises (SMEs) sector has had a remarkable history and continues to be recognized as a driving force of the country’s economy. At the international level, the SMEs are defined based on the standards like the total number of employees within the firm, total net assets, sales and investment level. Within the Indian context, micro, small and medium enterprises as according to the MSME development Act, 2006 are defined primarily based on the funding in plant and equipment for manufacturing enterprises and on equipments for enterprises supplying or rendering services. The classification of Small and Medium Enterprises according to the Micro, Small & Medium Enterprises Development (MSMED) Act, 2006 areas shown in the table-1:

Table-1: Classification Of MSME According To MSMED Act, 2006.

Manufacturing Sector	
Enterprise Category	Investment in plant & machinery
Micro Enterprises	Does not exceed 25 lakh rupees
Small Enterprises	More than 25 lakh rupees but does not exceed 5 crore rupees
Medium Enterprises	More than 5 crore rupees but does not exceed 10 crore rupees
Service Sector	
Enterprise Category	Investment in equipment
Micro Enterprises	Does not exceed 10 lakh rupees
Small Enterprises	More than 10 lakh rupees but does not exceed 2 crore rupees
Medium Enterprises	More than 2 crore rupees but does not exceed 5 crore rupees

Source: Annual Report 2017-18. Ministry of Micro, Small and Medium Enterprises [1].

A study by Parthajeet Das [2] focused on the favorable circumstances present in India for the growth of MSME sector in order to recognize problems and give suggestions to handle the similar. His research reveals that the MSME sector has the capability to increase the growth of industries and also help in programs like ‘Make in India’. Suitable techniques must be developed for the establishment of an empowering system where these organizations get the advantages implied for themselves below a proper and friendly scheme. Also the enterprises should be able to meet the developing challenges of a globally competitive order.

The SMEs in India are playing a crucial role in generating employment, in driving the economy, technology and skill innovation, sector growth, foreign export and trade promotions. In spite of all this contribution, the SMEs are exposed to lot of risks and most of the businesses fail due to this reason. Risk is defined as the likelihood of loss inherent in an organization's operations and environment that may disable its capacity to supply returns on investment. Bringing in the practice of Enterprise Risk Management within the organizations will help in minimizing the exposure to risks.

According to Dickinson, G [3] Enterprise Risk Management is a systematic and integrated approach of the management of the total risks a company faces.

In his book on Enterprise-wide Risk Management, James W. DeLoach [4] defines that "ERM is a structured and disciplined approach that aligns strategy, processes, people, technology and knowledge with the purpose of evaluating and managing the uncertainties the enterprise faces as it creates value. It is a truly holistic, integrated, forward looking and process-oriented approach to managing all key business risks and opportunities - not just financial ones - with the intent of maximizing shareholder value for the enterprise as a whole."

P. Bromiley et al [5] studies suggest ERM believes that handling the risks of every distinctive division is not as effective as dealing with the risk of an entire portfolio. His study also states that ERM includes not only conventional dangers like liability of a product and disasters, but also includes crucial risks like obsolescence of a product or actions taken by competitors. Additionally ERM believes that organizations must no longer consider risk as an issue to mitigate. Organizations which are capable of dealing with a specific risk should look for gaining competing benefits from it. ERM helps an organization to achieve its goal and avoids surprises along the path. Organizations adopt different ERM frameworks to identify, analyze, respond, and monitor risks and opportunities. Some of the ERM frameworks are:

1. Casualty Actuarial Society framework.
2. COSO ERM framework.
3. RIMS Risk Maturity Model.

Constraints Faced By Indian SMEs

Despite the fact that small and Medium Enterprises are crucial to fuel the growing Indian economy, it faces several constraints. Their dependence on government support, lack of access to capital and need for high investment in technology among various other factors exposes these industries to a plethora of risks.

As per the report on Creating Competitive SMEs by Confederation of Indian Industry (CII) and PricewaterhouseCoopers (PwC) [6], some of the challenges faced by Indian SMEs are:

1. Increased cost of credit.
2. Restricted access to finance.
3. Indirect necessities.
4. Issues in catering to departments of government.
5. Procuring the resources at a lower cost.
6. Issues faced in designing or packaging of a product and its storage.
7. Limited access with the worldwide markets.
8. Inadequate exposure to present-day technology.
9. Lack of experienced workforce.
10. Branding and Marketing.

By nature of the operating environment, the risks faced by SMEs are distinctive from those of larger organizations. Another serious issue which impacts the development of ERM is the aversion of risk in SMEs.

According to Robert C. Bird & Stephen Kim Park [7], one of the most fundamental characteristics that would impact the development of ERM is the attitude of firm policymakers toward risk. Not every manager treats risk the same, and there is some evidence to show that small firm leaders may perceive the nature of risk through a different lens. Traditional small business owners may first and foremost seek to preserve the ongoing organization. Such owners may have a lower tolerance for risk and navigate the organization to generate steady income to further personal goals and achieve family stability.

Lap Duong [8] in his paper studies the risk management process in MSMEs concerning project risk management. His research reviews the method of managing risks, its role in firms, risks associated with the projects and the process of management. In order to compare, he carried out interviews with the management team of the company where the case was



studied and also with management of two other organizations. His findings suggest that detailed managerial processes are carried out in larger corporations, whereas risk management in smaller businesses is divided into separate projects for easy follow-up. Thereby risk management strategies differ from size of organizations.

The studies conducted by BandulaJayathilake [9] show that in case of SMEs, the owner managers are the ones who manage and review the process of risk management. The results of his survey confirm that the management of risks in SMEs is inclined towards the owner managers. In addition to that the amount of time invested by the owner managers in developing and exercising of the risk strategy, and the way in which it is conveyed to the employees decides the quality of risk management in those organizations.

Importance of practicing Enterprise Risk Management in SMEs

ReenaAgarwal's [10] study reveals that during the case of emergencies, a competitive advantage is provided by Enterprise Risk Management as it assists in recognizing profitable prospects and imminent dangers. A superior corporate administration is also encouraged. By determining, assessing and mitigating the risks effectively, the upside of risk can be identified by the MSMEs. This leads to creating competence, adaptability, certainty, confidence and security. A continual growth and longevity of the organization is possible with a complete integration of ERM with the goal, vision, mission and activities of MSMEs'.

The research of YolandeSmit and J. A. Watkins' [11] identifies that there are numerous and varied obstacles for the success of SMEs. The studies conducted confirmed the ignorance of SME owner managers' with respect to the risks faced by their enterprises from both inner and outer sources, involving risks originating from entrepreneurial activities. They suggest that by implementing a organized approach to enterprise risk management within SMEs, prospective advantages like reduction in cost, reduction in over managing the risks and organizational alignment towards the SME's mission and objectives can be realised.

Ashok Kumar Panigrahi [12] in his study investigates the risk management practices in small and medium enterprises in India. His study signifies the need for enhancing the knowledge and awareness regarding risk management to the owner managers' by providing proper training and development. Also the need of improving current planning system within the MSMEs is presented. His study concentrates on the contribution of micro, small and medium enterprises to employment, manufacturing output and exports of the country. The specific risks which are subjected to the SME sectors are discussed and he suggests that the functions of risk management should actually be determined by the quality of the records maintained, quality of workforce and the quality of MIS (Management Information System) in place. The results show that risk mitigation efforts are more important and necessary than the allocation of capital for inadequate risk management system.

Conclusion

Unlike large organizations, SMEs are subjected to more risks and the awareness among the owner manager's regarding the ERM is very much required. The conventional risk management looks at risk as individual hazards, whereas the ERM considers risks in the context of business strategy. It builds a portfolio of risk development. Some of the prospective benefits of embedding a structured approach to 'Enterprise Risk Management' within SMEs routine operations are-

1. Creating a risk focused culture within the enterprise.
2. Better perspective on risk.
3. Efficient use of resources.
4. Better access to capital.
5. Reduction of probable losses.
6. Cost cutting.
7. Alignment of the organization to the goals of SMEs.

ERM presents the foundation for risk mitigation. Also the traditional risk management deals with the downside factors like probable losses due to events of risks whereas ERM helps the organization to identify risks with both upside and downside factors.



References

1. Annual Report, 2017-18. Ministry of Micro, Small and Medium Enterprises, www.msme.gov.in.
2. Parthajeet, D. (2017). Micro, small and medium enterprises (MSME) in India: Opportunities, issues of challenges. *Great Lakes Herald*, Vol11, Issue 1, 77-88.
3. Dickinson, Gerry. (2001). *Enterprise Risk Management: Its Origins and Conceptual Foundation*. The Geneva Papers on Risk and Insurance - Issues and Practice. Vol. 26. 360-366.
4. James W. DeLoach. (2000). *Enterprise-wide Risk Management: Strategies for Linking Risk and Opportunity*. London: Financial Times Prentice Hall, p-5.
5. Philip Bromiley, Michael McShane, Anil Nair, Elzotbek Rustambekov. (2014). *Enterprise Risk Management: Review, Critique, and Research Directions*. *Long Range Planning*. Vol. 48, Issue 4, 265-276. <http://dx.doi.org/10.1016/j.lrp.2014.07.005>.
6. *Creating Competitive SMEs - Confederation of Indian Industry (CII) and PricewaterhouseCoopers (PwC)*, October 2010.
7. Bird, Robert C. and Park, Stephen, *Legal and Regulatory Aspects of Enterprise Risk Management for Small and Medium-Sized Enterprises* (April 23, 2015). *Enterprise Risk Management for Small and Medium-Sized Enterprises* (Society of Actuaries, 2015). Available at SSRN: <https://ssrn.com/abstract=2538050>.
8. Duong, L. (2005). *Effective risk management strategies for small-medium enterprises and micro companies a case study for Viope Solutions Ltd*. Degree Thesis: International Business.
9. PradanaMudiyanselageBandulaJayathilake. (2012). *Risk Management practices in Small and Medium Enterprises: Evidence from Sri Lanka*. *International Journal of Multidisciplinary Research*. Vol.2 Issue 7, July 2012, ISSN 2231 5780.
10. ReenaAgrawal. (2016). 'Enterprise Risk Management' Essential for survival and sustainable development of Micro, Small and Medium Enterprises. *International Review* (2016 No.1-2), pp. 117-124. ISSN 2217-9739.
11. Smit, Yolande. (30 May, 2012). A literature review of small and medium enterprises (SME) risk management practices in South Africa. *African Journal of Business Management*. Vol6(21),pp. 6324-6330. DOI: 10.5897/AJBM11.2709. ISSN 1993-8233.
12. Panigrahi, Dr. Ashok. (December 1, 2012). *Risk Management in Micro, Small and Medium Enterprises (MSMEs) in India: A Critical Appraisal*. *Asia Pacific Journal of Marketing & Management Review*. Vol. 1(4), pp.59-72. ISSN 2319-2836. Available at SSRN: <https://ssrn.com/abstract=2342484>.