Summary of article

Business

Enterprise Risk Management Corporate risk management is a function responsible for insurance, hedging of financial exposures as well as deal with risks like operational, strategic, and reputational risks. In most organization, the Chief Risk Officer directs this function. The purpose of this article is to analyze Enterprise Risk Management and provide a clear picture on how organizations can prevent and deal with risk to become successful.

Companies that are successful in the implementation of Enterprise Risk Management (ERM) have a competitive advantage over those companies that manage risks individually. ERM creates value to shareholders at the macro and micro levels by enabling senior management manage the risk return tradeoff facing the firm. Likewise, it helps firms access the capital market that helps in implementing a firm's strategy.

In order to determine the right amount of risk to bear, an organization needs to recognize that the costs associated with cash flows cannot exist if the organization has a huge buffer stock of equity invested in liquid assets. Reduction of risks helps minimize expensive equity capital that is required in supporting organizations operating risks. In addition, companies should not be in a position to think that the earnings will never go beyond the level the firm is aiming to protect. This is because, if a firm is operating in a business that is promising more than the risk-free rate, then the chances of falling into a financial distress are high. Therefore, the management can use ERM to eliminate the chances of distress to a level that is likely to increase a firm's value. In addition, companies can use the transition matrix to ensure that the firm's financial health is reliable. The transition matrix helps to estimate the amount of capital necessary to support risk.

For ERM to be effective in an organization, the management should ensure

that all employees understand the importance of ERM and its value. The managers should understand that it is a critical tool for strategy implementation (Nocco & René 14). Moreover, a firm that uses the market, credit, and operational risk tend to have different distributions. Market risk is more like the returns on portfolio of securities that use symmetric distribution. On the other hand, credit and operational risks have asymmetric distribution. With credit risk, the creditor pays in full the amount of money owned to an organization or does not. In addition, when a creditor defaults, it can lead to great losses to the organization. On the contrary, with operational risks, losses tend to be small but in large numbers. However, there are chances of large losses such that the distribution of operation losses has a long tail.

In my opinion, it is important for organizations to implement ERM. This is because it does not eliminate risk but helps individuals have a better understanding of the unexpected losses. Moreover, ERM limits chances of risks and it plays a big role in ensuring that the chances of the risks are low and provides maximum value to an organization and the shareholders.

Work Cited

Nocco, Brian W., and René M. Stulz. " Enterprise Risk Management: Theory and Practice."

Journal of Applied Corporate Finance: 8-20. Print.