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Risk Management in Financial Management: Strategies for Mitigating Uncertainty and Achieving Goals

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Abstract

Introduction –Increasing deregulation, global competition, and arrival of innovative products have brought financial risk management ahead in today's landscape. Identifying various kinds of risks and effective management of them in global financial system would be helpful to relieve financial losses, crisis, and also help in prolonged success of all financial bodies.

Objective –This study is aimed to determine the impact of risk management strategies on financial management and to suggest several strategies related to risk management to mitigate risks and achieve organizational goals.

Methodology –In order to fulfill the above objective, this study is based on both primary and secondary data. The primary data has been collected from online survey conducted through Google Form. Open-ended questions were asked based on 5-Point Likert Scale to know the opinion of participants. The survey data was analyzed using Excel Spreadsheet and SPSS software. In addition, the secondary data has been collected from various studies conducted related to financial management and financial risk management in various organizations.

Results –After collecting responses from 143 participants, it is observed that there is a significant impact of risk management strategies on financial management ($p<0.05$) after performing One Sample T-Test. In addition, some of the best risk management strategies are identifying potential risks, analyzing the severity of those risks, monitoring the success, and choosing the strategy to manage such risks.

Keywords: *risk management, financial management, financial risk management, risk management strategy, financial system*

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1. Introduction

There are several risk factors businesses should care as they are vulnerable to them. Only financial risks are not the part of these risks. For example, there might be macro-level risks like armed conflict, political instability, and climate change, or at company level like brand value, key people, and loss of reputation. There are also some uncontrollable risks like natural disasters and pandemics which are hard to mitigate and plan for. There are some risks which can be managed and expected to some extent, such as business interruptions or cyber threats. But this study is focused mainly on financial risk management. Financial risk may consist of any kind of risk related to financial transactions and financing. It is related to a risk which has potential for financial uncertainty or financial loss. Financial risk is associated with financial operations of the business, as per the "Chartered Institute of Management Accountants (CIMA)" –

- **Currency risk** – Value of financial tool is subject to fluctuate because of changes in rates of financial exchange.
- **Credit risk** – The chance that a loss may take place due to failure of any other party in performing as per contract terms.
- **Funding (or liquidity) risks** – In this type of risk, an entity has problem in raising funds or realizing assets to meet financial needs.
- **Interest risk** – It changes rates of interest to affect financial stability of the business.
- Inflation risk – It affects the value of assets in balance sheet and weakens the pricing power by rising prices.

1.1 Background

In the process of financial risk management, an entity manages and understands financial risks. A shared policy of management risk also covers legal, personnel, and operational risks. The financial risks are likely to fall to senior members of finance team and business owner in a small company, which might affect cost of capital or cash flows. A risk manager or a team of experts might be hired in larger organizations to handle enterprise risk. However, the responsibility to quantify, track, and mitigate financial risk is likely to stay with financial team. There are two large categories of financial risk –

- **Risks specific to companies** – Also known as "unsystematic or diversifiable risks," these risks are related to situation or activities of a company. For example, fraud, loan defaults, and legal issues, especially related to late delivery or payment and infringement of IP. These risks are often identified, managed, and measured by the company with effective controls and other techniques related to risk management.
- **Systematic or market risk** – These risks are related to wider financial environment operated by the company. Some of the common examples are fluctuations in exchange rates or interest rates and rise in prices or uncertainty related to supply chain.

There are three techniques of financial risk management –

- **Risk analysis and audit** – Risk management needs both quantitative and qualitative analysis to get more in-depth knowledge of issues. It might cover audits of how to deal with previous risks and effectiveness.
- **Identifying risks** – It consists of defining, recognizing, and explaining potential financial threats. It can be made possible by meeting of project team to discuss existing, previous, and potential risks, SWOT analysis, risk surveys, and brainstorming.
- **Project planning** – It ensures effective ways for organization to manage and control financial risks.

Risk tolerance levels and attitudes also vary by companies and risk managers should work in such boundaries. However, there are some of the most common techniques for financial risk management, such as, managing and handling operation costs, reducing volatility in earnings and cash flow, managing disruption risks and costs, managing financial costs, and improving value of shares.

2. Literature Reviews

As a way to assess and overcome possible risks with a long-term strategy, financial risk management adds value to the firm (Culp, 2002; Rochette, 2009). Risk management is defined as the process to create value with financial approaches and techniques to control risk exposure (Keizer et al., 2002). Risk management is the process to recognize the exposure to the loss faced by companies as per the most ideal technique (Rejda, 2011). Risk management can be started by identifying external events with impact on achievement of major objectives of the business (Vaughan & Vaughan, 2001).

Analyzing or determining this impact is the next most important step to make rational decision on risk management. It may consist of decision to either reduce, avoid, treat, or transfer the risk for the company and by the company. Hence, the next step is executing and deciding the plan. For example, by guiding staff when the execution of actions is decentralized for risk management. The process ends by evaluating decision in terms of impact of risks on achieving the goals for the companies. It consists of aspects associated with efficiency, effect of risk goals, and risk treatment cost (Beauchamp-Akatova& Curran, 2013).

Like risk management for ISO standard, it is important to have constant risk management and develop process in the strategy (Ciocoiu& Dobrea, 2010). Risk evaluation must be the vital aspect of all decision-making processes. It is institutionalized when all the business managers involve in risk management and assume the ownership of risks and impart the process of risk management to the whole organization with staff training. A strong and constant risk culture is needed along with well-planned organization to embed the process of risk management (Elahi, 2013).

There are events when responsibilities and powers are delegated by the management to junior employees for each of the actions. Risk behavior must be aligned with risk appetite for the managers. There is also a need to align internal risk and risk awareness of staff with objectives and strategies of the organization. SMEs usually spread risk ownership in the whole organization and improve knowledge, skills, and risk awareness (Gao et al., 2013, Nocco &Stulz, 2006; Servaes&Tamayo, 2009). Constant education and formal educational programs are confirmed by employees (Sukumar et al., 2011).

Henschel (2006) conducted an empirical study on German small and medium enterprises and found that risk management is strongly focused on owners and managers and that managing risk is done in a rudimentary manner. There is a lack of proper formation of link between corporate planning and risk management in a lot of companies. Risk-oriented thinking is not incorporated well in daily activities and corporate plans of the business (Servaes& Tamayo, 2009). More effective processes for risk management must be developed by defining goals for evaluating and measuring risk management.

Kim &Vonortas (2014) studied risk management aspects in early-stage and small businesses. They observed that internal risk management plans are used by companies in all sectors to handle operational and technology risks. Tapping formal and informal networks like strategic partnership can manage financial risk. According to Brustbauer (2016), smaller firms usually don’t work very much to identify, monitor, and assess risks as compared to larger companies. It may be due to ability to handle risks and own interpretation of the entrepreneur.

Considering earlier studies, it is found that size of the business shows how bigger risk management is applied (Henschel, 2008; Brustbauer, 2016). In addition, a lot of studies have found a lot of factors contributing to different types of risks like external regulations, accounting, high growth, and volatility of finance (Henschel, 2008). There are also internal factors involved, such as personal risk anticipation of manager and level of risk management (Henschel & Gao, 2011; Dickinson, 2001).

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2.1 Research Gap

To the best of our knowledge, there is a lack of studies related to financial risk management in Indian organizations and finding the ways to mitigate risks and achieve goals have not been discussed yet. In this study, empirical evidence will be gathered to fill this knowledge gap.

2.2 Research Question

- How risk management strategies make an impact on financial management of an organization?
- What are the risk management strategies to mitigate risks and achieve goals in an organization?

2.3 Research Objectives

- To find out the impact of risk management strategies on financial management on an organization
- To suggest various risk management strategies for mitigating risks and achieving organizational goals

2.4. Hypothesis

H1 – There is a statistically significant impact of risk management on financial management on an organization

H0 – There is no impact of risk management on financial management on an organization

3. Research Methodology

3.1 Research Method & Design

Quantitative method has been considered for this study to fulfill the above objectives and solve the hypothesis. A self-structured questionnaire will be prepared using Google Form and submitted to study participants who are employees of selected organizations and engaged in financial management practices. Total 143 responses have been collected from online survey.

3.2 Research Approach

Both primary and secondary data have been collected as part of research approach for this study. Primary data consists of survey responses from target population, while secondary data consists of review of recent literatures in order to find out the research gap and objectives for this study. SPSS Software and Excel spreadsheet have been used as research tools for this study to interpret and analyze data.

4. Analysis of Study

4.1. Demographic Analysis

In this study, out of 143 participants, 44 (31%) participants are aged 36 to 45 years old, 65 (46%) participants are 26 to 35 years old, 30 (21%) participants are above 45 years old, and only 4 (3%) participants are 18 to 25 years old (Table 1) (Figure 1).

Table 1 - Age Group

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	18 to 25 years	4	2.8	2.8	2.8
	26 to 35 years	65	45.5	45.5	48.3
	36 to 45 years	44	30.8	30.8	79.0
	Above 45 years	30	21.0	21.0	100.0
	Total	143	100.0	100.0	

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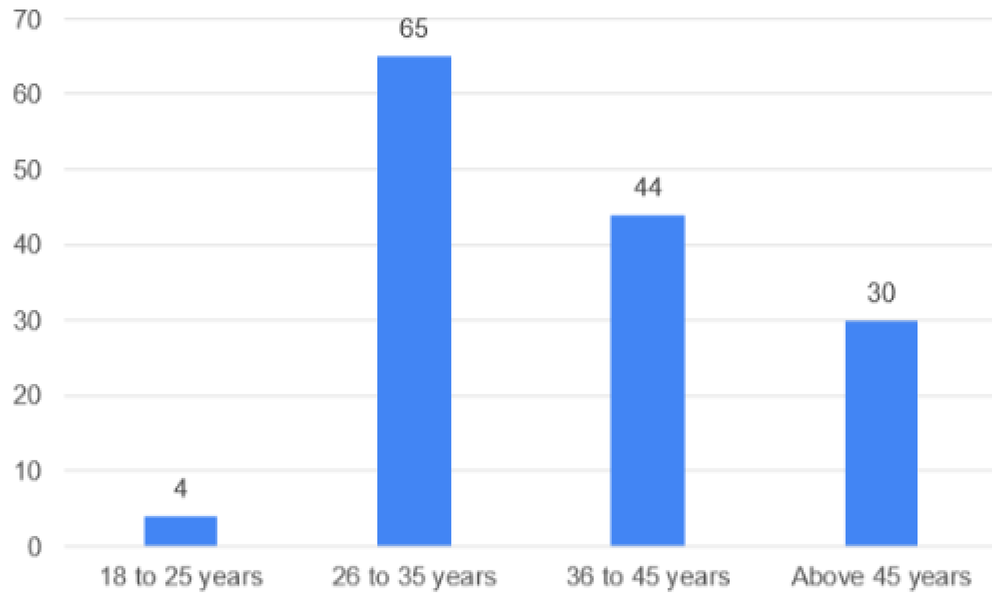
Figure 1 – Age Group



When it comes to gender, 97 (68%) participants are male and 46 (32%) participants are female in this study (Table 2) (Figure 2).

Table 2 - Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Female	46	32.2	32.2	32.2
	Male	97	67.8	67.8	100.0
	Total	143	100.0	100.0	

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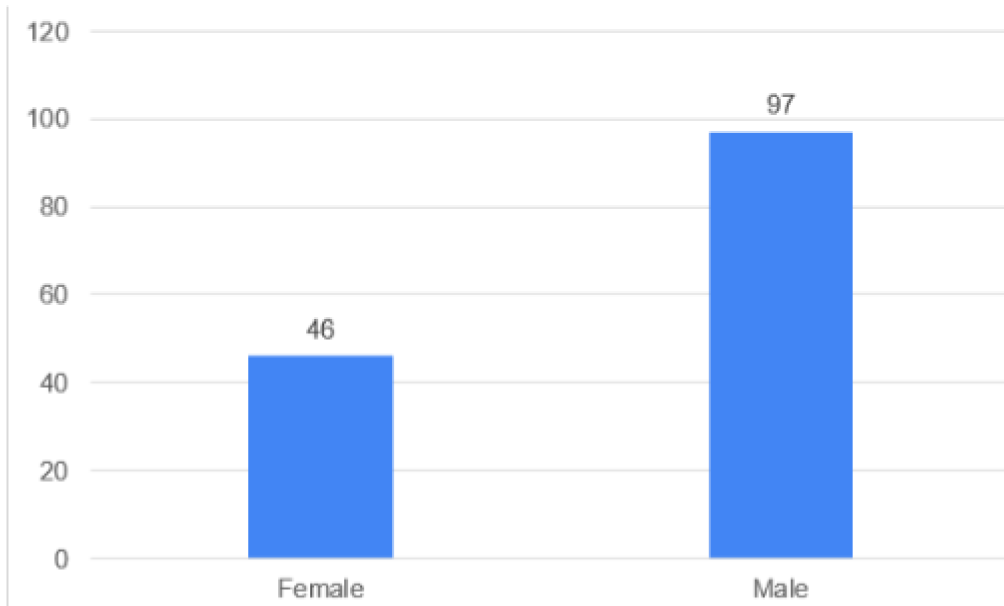
Figure 2 – Gender of the participants

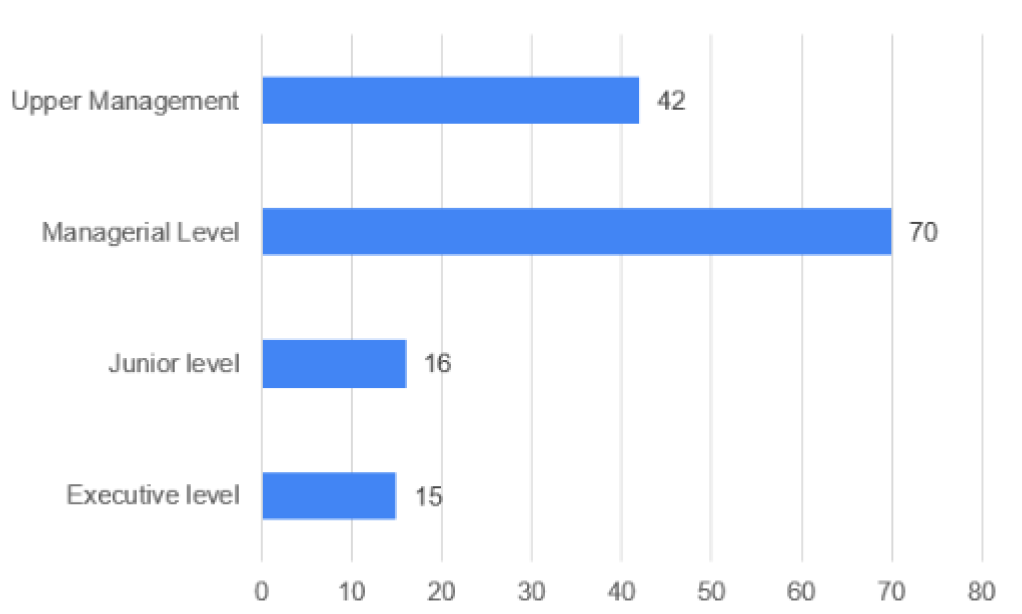


In terms of position in an organization, there are 70 (49%) participants who work at managerial level, 42 (29%) participants were employed in upper management position, 16 (11%) participants had junior level and 15 (11%) participants were appointed at executive level position in their respective organizations (Table 3) (Figure 3).

Table 3 - Position

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Executive level	15	10.5	10.5	10.5
	Junior level	16	11.2	11.2	21.7
	Managerial Level	70	49.0	49.0	70.6
	Upper Management	42	29.4	29.4	100.0
	Total	143	100.0	100.0	

Figure 3 – Position in an organization



When it comes to educational qualification of participants, 86 (60%) participants are post graduate, 12 (8%) participants are graduate, 16 (11%) participants have completed high school education, 15 (11%) participants have completed higher secondary education, and 14 (10%) participants had other qualification (Table 4) (Figure 4).

Table 4 - Educational Qualification

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Graduate	12	8.4	8.4	8.4
	High School	16	11.2	11.2	19.6
	Higher Secondary	15	10.5	10.5	30.1
	Other	14	9.8	9.8	39.9
	Post Graduate	86	60.1	60.1	100.0
	Total	143	100.0	100.0	

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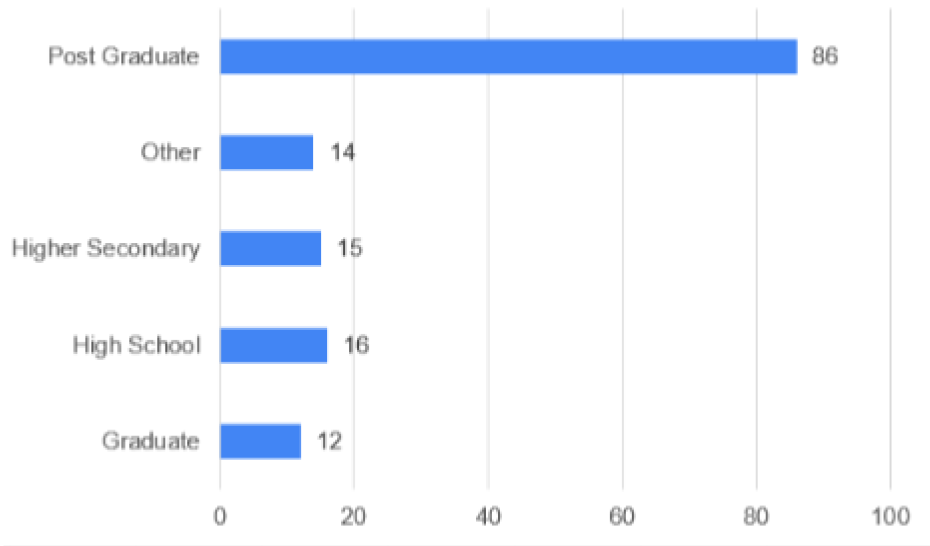
Figure 4 – Educational Qualification of participants



In this study, majority (113, 79%) participants are employed in manufacturing companies, while 11 (8%) participants are employed in sales business, and 18 (13%) participants are employed by suppliers (Table 5) (Figure 5).

Table 5 - Type of Organization

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Manufacturing	113	79.0	79.0	79.0
	others	1	.7	.7	79.7
	Sales	11	7.7	7.7	87.4
	Supplier	18	12.6	12.6	100.0
	Total	143	100.0	100.0	

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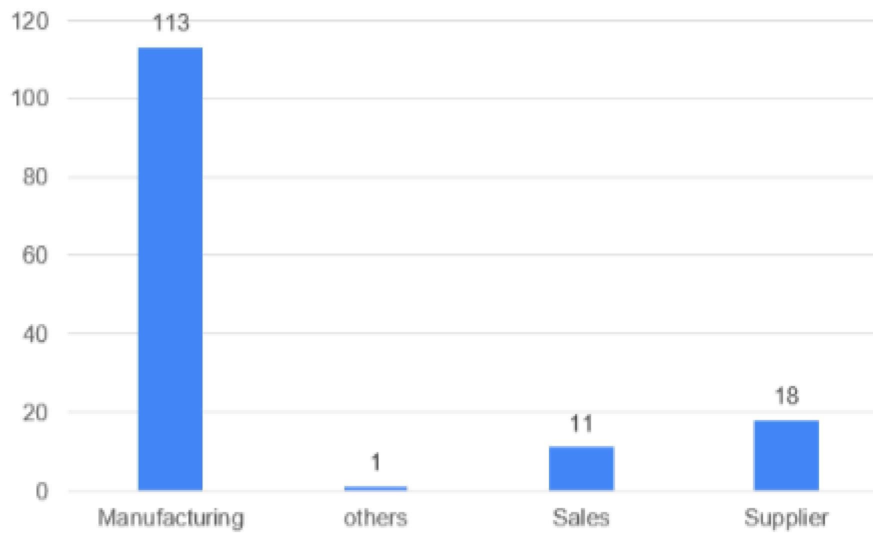
Figure 5 – Type of organization



When it comes to size of business, 118 (83%) participants belong to large-scale organizations and 25 (18%) participants are employed in small and medium enterprises (SMEs) (Table 6) (Figure 6).

Table 6 - Size of business

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Large Scale Enterprise	118	82.5	82.5	82.5
	Small and Medium Enterprise	25	17.5	17.5	100.0
	Total	143	100.0	100.0	

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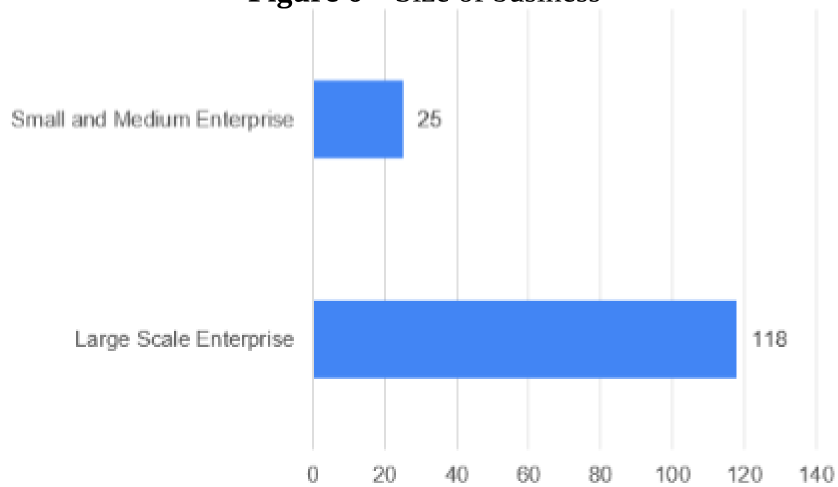
Figure 6 – Size of business



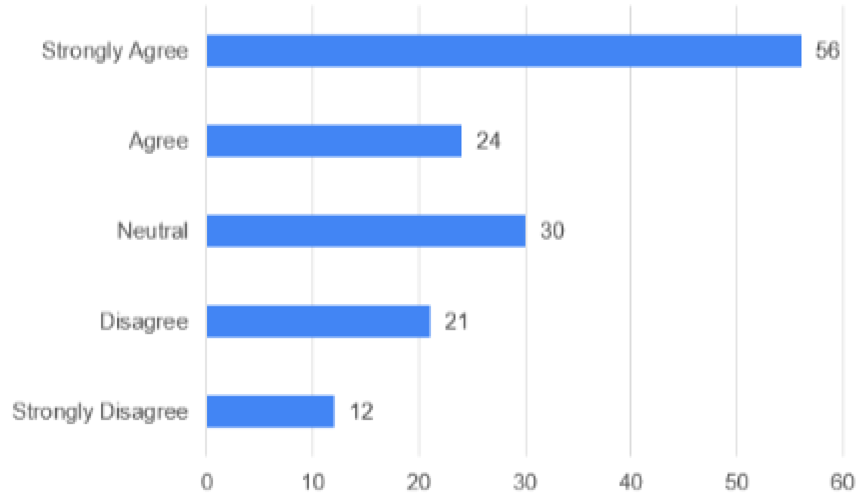
4.2. Financial Risk Management in Organization

There are 56 (39%) participants who strongly agree and 24 (17%) participants agree that their organization has recently made systematic changes because of crisis in financial management, while 30 (21%) participants are neutral, 21 (15%) participants disagree, and 12 (8%) participants strongly disagree (Table 7) (Figure 7).

Table 7 – Changes made in organization due to crisis

Your organization has recently made systematic changes due to current crisis in financial management		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	12	8.4	8.4	8.4
	Disagree	21	14.7	14.7	23.1
	Neutral	30	21.0	21.0	44.1
	Agree	24	16.8	16.8	60.8
	Strongly Agree	56	39.2	39.2	100.0
	Total	143	100.0	100.0	

Figure 7 –Changes made in organization due to crisis

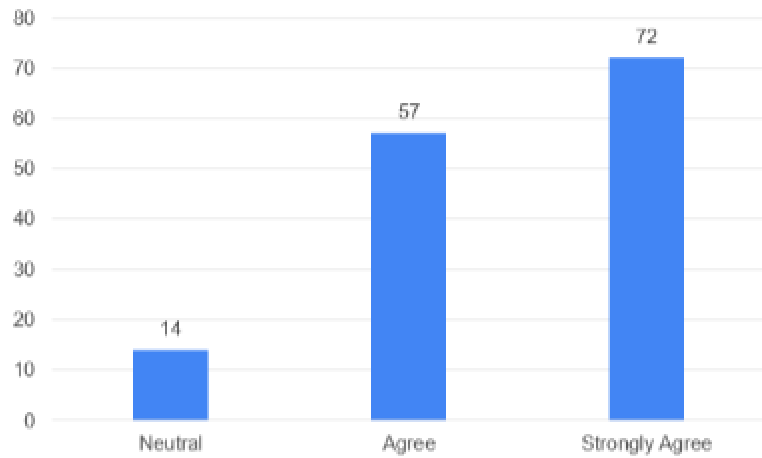


There are 57 (40%) participants who agree and 72 (50%) participants who strongly agree that their organization has a system to track employees' time on various projects (Table 8) (Figure 8).

Table 8 - Your organization has a system to track employees' time on several projects

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	14	9.8	9.8	9.8
	Agree	57	39.9	39.9	49.7
	Strongly Agree	72	50.3	50.3	100.0
	Total	143	100.0	100.0	

Figure 8 – Organization tracks employees' time on various projects

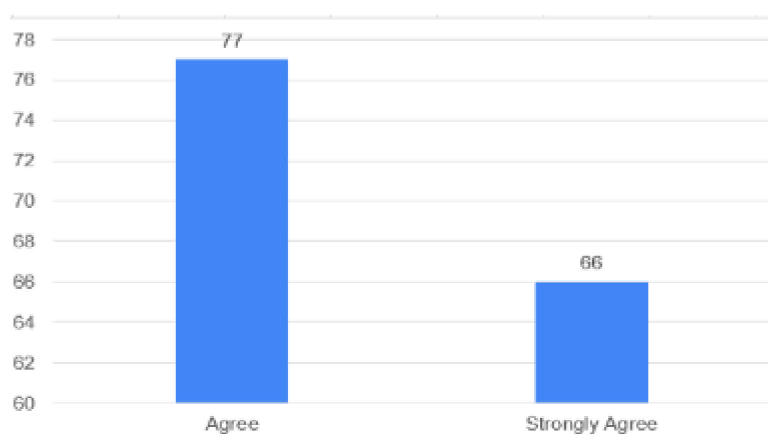


In this study, all the participants agree and strongly agree that their company has implemented proper financial risk management (Table 9) (Figure 9).

Table 9 - Your company has implemented proper financial risk management

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agree	77	53.8	53.8	53.8
	Strongly Agree	66	46.2	46.2	100.0
	Total	143	100.0	100.0	

Figure 9 – Implementation of Financial Risk Management



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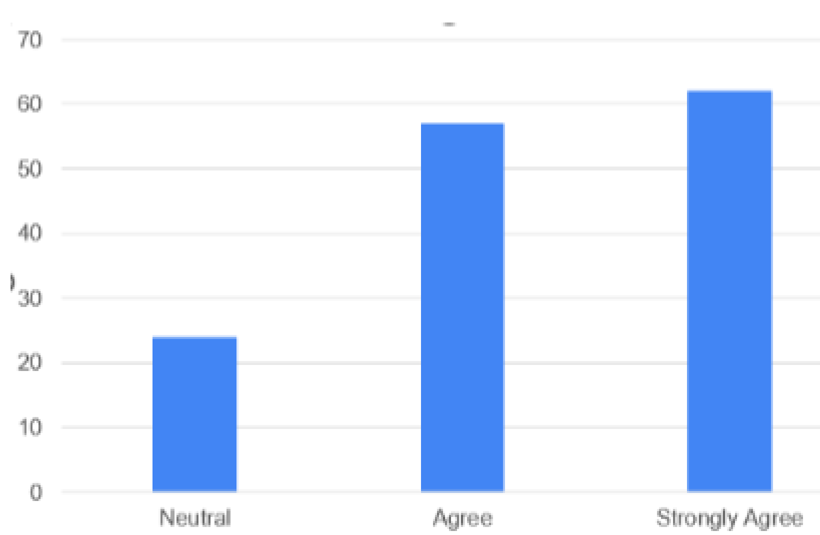
There are 57 (40%) participants who agree and 62 (43%) participants strongly agree that financial risk management has been helpful to overcome previous economic crisis for the organization (Table 10) (Figure 10).

Table 10 - Financial Risk management practices helped your organization to overcome last economic crisis

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	24	16.8	16.8	16.8
	Agree	57	39.9	39.9	56.6
	Strongly Agree	62	43.4	43.4	100.0
	Total	143	100.0	100.0	

Figure 10 – Financial Risk management practices helped your organization to overcome last economic crisis



There are 84 (59%) participants who strongly agree, 24 (17%) participants who agree, 12 (8%) participants were neutral, 19 (13%) participants strongly disagree, and 4 (3%) participants

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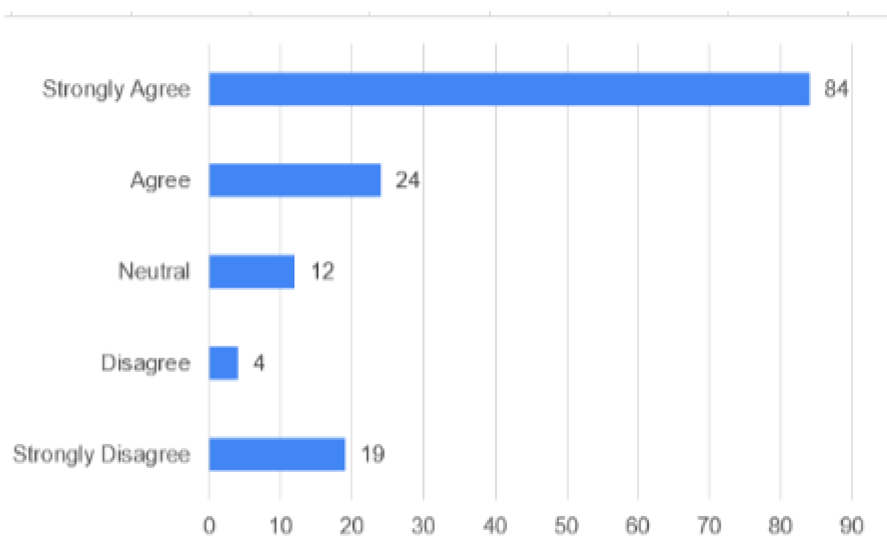
disagree that their organization needs to improve their risk management approaches (Table 11) (Figure 11).

Table 11 - Your organization needs to improve risk management approaches

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	19	13.3	13.3	13.3
	Disagree	4	2.8	2.8	16.1
	Neutral	12	8.4	8.4	24.5
	Agree	24	16.8	16.8	41.3
	Strongly Agree	84	58.7	58.7	100.0
	Total	143	100.0	100.0	

Figure 11 –Your organization needs to improve risk management approaches



There are 51 (36%) participants who agree, 32 (22%) participants who strongly agree, 42 (29%) participants were neutral, and 18 (13%) participants who disagree that their organization can detect early warning signs before taking financial risks (Table 12) (Figure 12).

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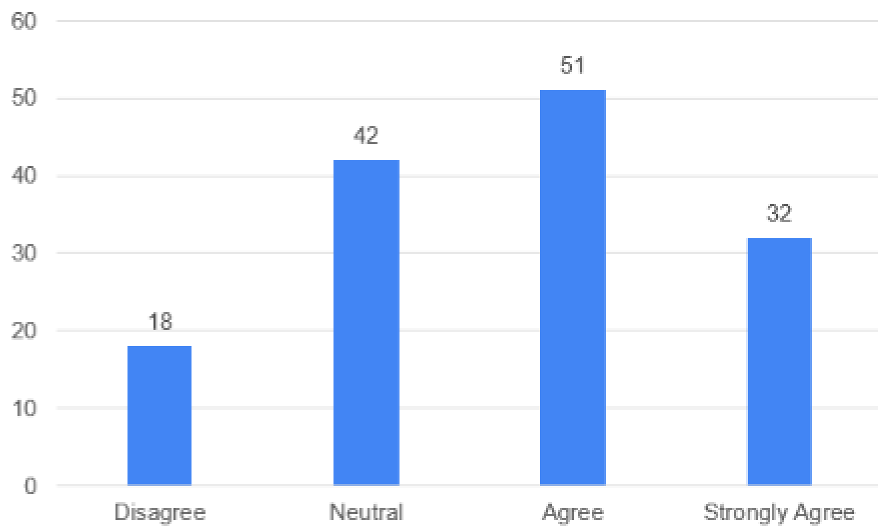
Table 12 - Your organization can detect early warning signs before taking financial risks

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	18	12.6	12.6	12.6
	Neutral	42	29.4	29.4	42.0
	Agree	51	35.7	35.7	77.6
	Strongly Agree	32	22.4	22.4	100.0
	Total	143	100.0	100.0	

Figure 12 – Your organization can detect early warning signs before taking financial risks



In this study, all the participants claimed that their organization has implemented proper crisis management strategies (Table 13) (Figure 13).

Table 13 - Your organization has implemented proper crisis management plans

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Agree	69	48.3	48.3	48.3
	Strongly Agree	74	51.7	51.7	100.0
	Total	143	100.0	100.0	

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Figure 13 – Your organization has implemented proper crisis management plans

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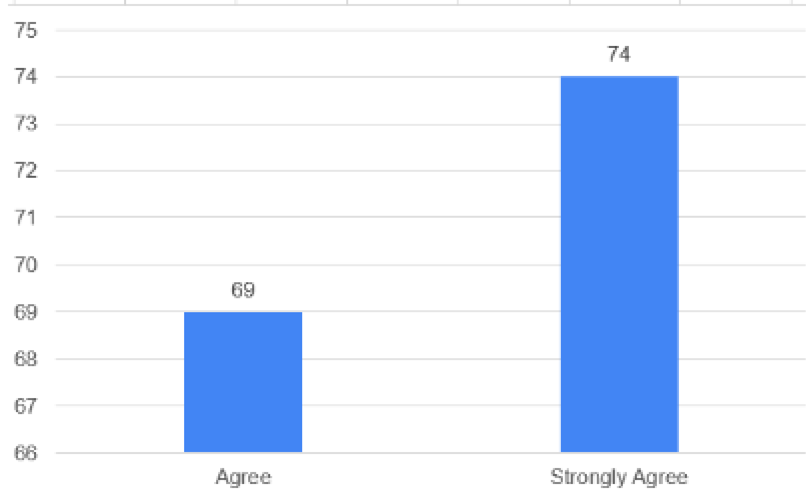
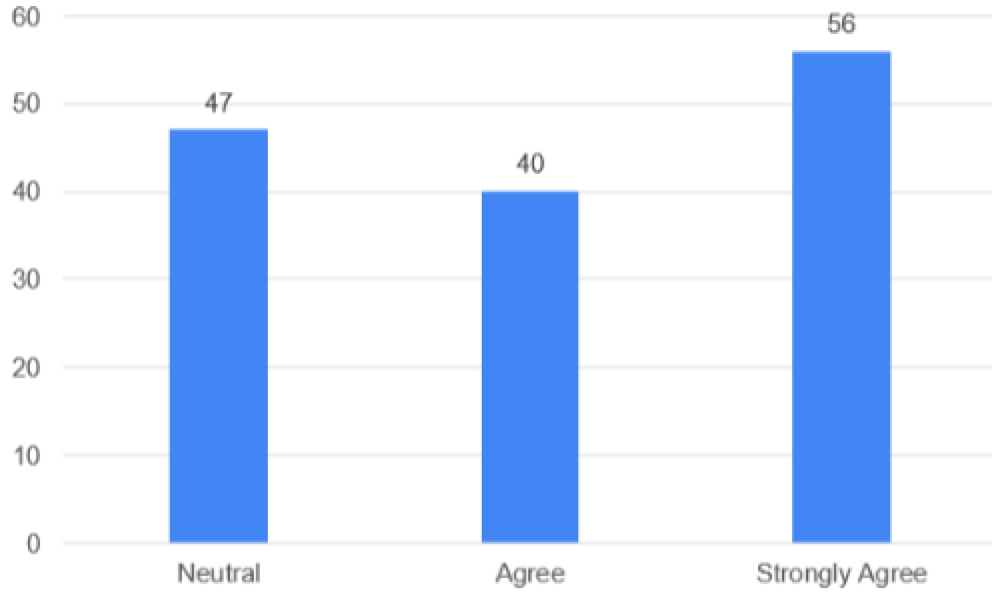


There are 40 (28%) participants who agree and 56 (39%) participants strongly agree that their organization has a dedicated risk management unit to manage financial risks (Table 14) (Figure 14).

Table 14 - Your organization has a dedicated risk management unit to handle financial risks

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	47	32.9	32.9	32.9
	Agree	40	28.0	28.0	60.8
	Strongly Agree	56	39.2	39.2	100.0
	Total	143	100.0	100.0	

Figure 14 – Your organization has a dedicated risk management unit to handle financial risks



In order to solve the following hypothesis, one sample T-test was performed using SPSS software 22.0.

H_1 – There is a statistically significant impact of risk management on financial management on an organization

H_0 – There is no impact of risk management on financial management on an organization

After performing one sample T-test, it is observed that the value of significance p = 0.000 for all the variables ($p<0.05$). It means null hypothesis is rejected and H1 is approved, i.e., "there is a statistically significant impact of risk management on financial management on an organization".

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Table 15 - One-Sample Test

	Test Value = 0					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Your organization has recently made systematic changes due to current crisis in financial management	32.192	142	.000	3.636	3.41	3.86
Your organization has a system to track employees' time on several projects	79.426	142	.000	4.406	4.30	4.52
Your company has implemented proper financial risk management	106.647	142	.000	4.462	4.38	4.54
Financial Risk management practices helped your organization to overcome last economic crisis	69.772	142	.000	4.266	4.14	4.39
Your organization needs to improve risk management approaches	34.318	142	.000	4.049	3.82	4.28
Your organization can detect early warning signs before taking financial risks	45.760	142	.000	3.678	3.52	3.84
Your organization has implemented proper crisis management plans	107.730	142	.000	4.517	4.43	4.60
Your organization has a dedicated risk management unit to handle financial risks	57.205	142	.000	4.063	3.92	4.20

5. Results

There is a four-stage process involved in financial risk management for both organizations and people, which consists of these steps –

- Detecting possible financial risks
- Quantifying the severity of such risks
- Choosing the best strategy to manage such risks
- Tracking the success of strategy

There are different strategies related to risk management available for people, companies, and financial institutions. Here are some of the risk management strategies for individuals –

- **Risk avoidance** – It consists of avoiding activities which can expose the person to risk like debt/credit financing by avoiding the use of credit for shopping purposes.
- **Risk reduction** – It consists of reducing severity of losses or potential losses. For example, by diversifying investment portfolio to reduce risk to the portfolio after extremely negative drops.
- **Risk transfer** – It refers to transfer of risk to third party, for example, buying life insurance cover to transfer the risk to the insurer related to premature death.
- **Risk retention** – It refers to taking responsibility for a risk like not insuring the property deliberately.

There are some risk management strategies applicable at the corporate level, but in quite different contexts –

- **Risk avoidance** – It refers to avoiding activities which can expose the organization to risks. For example, not expanding operation to a location which is highly uncertain in regulatory and political aspects.

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- **Risk reduction** – It refers to controlling severity of possible losses or reducing possible losses. For example, a company may go for hedging on foreign transactions to reduce exposure to fluctuations of currency.
- **Risk transfer** – It refers to the process of risk transfer to third party, i.e., by buying insurance on property, equipment, and plant and transferring risk to the insurer against theft and damage.
- **Risk retention** – It is the process of taking responsibility for a specific risk like volatile costs of input without insurance or hedging.

There are problems in choosing the right strategy to use for the given risk. It is related to the nature of risk or existing risk appetite of corporation or individual. It is important to understand the risk completely before choosing the right strategy.

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6. Conclusion

This study has discussed different types of financial risks and remedies to mitigate or prevent them. Financial risk management is an integrated and systematic way to handle financial risks in short-term. There are two dimensions of financial risk management, i.e., an organizational structure and a well-managed process needed to retain and implement the process. Market risk, operational risk, and credit risk are three types of risks all financial institutions and organizations face. It is also observed that there is a significant impact of risk management on financial management in an organization. All in all, risk management is not all about avoiding or prohibiting any activity which involves risk. Instead, it means taking calculating risk with proper knowledge, clear understanding, and goal consciously. It also helps organization to prevent heavy losses which keeps the business to reach its competitive position.

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