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Economic Decision Making and Risk Management:
How They Can Relate

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ABSTRACT

The definition of long-term objectives in corporate management as well as means of achieving them is often associated with uncertainty. The reason for this is apparent: managers in corporate entities cannot predict all circumstances, whether positive or negative, that is likely to occur in the future. Management during the decision-making process must be able to make informed decisions given the existence of insecurities and uncertainties in the course of business operations. Management must, therefore, take into account the risks that might occur in the future. As a result, this article aims at discussing the risks affecting corporate entities. The paper also defines and analyzes the risks, thus explaining how business entities can tackle them through making informed business decisions.

KEYWORDS

Business Decisions, Corporate Risk, Decision-Making, Risk, Risk Management

1. INTRODUCTION

1.1. Topic Background

Decision-making is the process of generating alternate plans of action and choosing the appropriate measures for each situation (Galli, 2018). There are two essential parts to the decision-making process:

1. Identify alternative measures to take, which means that the most ideal solution may not exist or be identifiable
2. Decide on a suitable alternative, which means that there is a process of accepting and/or rejecting certain options

More specifically, economic decision-making involves making financial business choices. Using some accounting data is required with any economic decision and it is typical for data to come in the form of financial reports. When using accounting data to make economic decisions, one must understand the business and economic environment in which accounting information is produced. Additionally, one must be willing to apply any necessary time and energy to decipher accounting statements. There are two types of economic decision-makers: internal and external. Internal decision-makers are individuals working within a company and making choices on its behalf, whereas external decision-makers work outside of organizations to make decisions for the company (Galli, 2018; Galli, 2017).

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Recent news features major corporations in the financial sector and non-financial institutions for failures relating to risk management. These failures were often rooted within poor leadership, as management boards did not fully consider the risks taken by the companies. Such risks include recklessly engaging in risky investments or utilizing faulty risk management systems (Galli, Kaviani, Bottani, and Murino, 2017; Sun et al., 2014). Some examples of corporate mistakes derived from failed risk management systems are environmental disasters (the Water Horizon and Bhopal) and accounting fraud (Olympus and World COM).

The importance of a comprehensive and effective risk management system cannot be over-emphasized. The management of corporate entities should consider various risks in the process of making decisions to determine the most optimal process of business operations.

1.2. Research Background

Latest reports indicate that the global economy is growing significantly. The global Gross Domestic Product was expected to increase from 2.8% to 3.1% in 2018 (Chatrabgoun, Hosseinian-Far, Chang, Stocks, & Daneshkhah, 2018; Galli, 2018). Stable economic zones, such as the Euro zone, were expected to take the lead in economic growth compared to other economic blocs. However, the 2017 World Economic report identified a number of red flags, such as increased social unrest in the Middle East and North Africa. Such results in widening of income gaps, rising unemployment rates, climate change, and constant cybercrimes. All these affect the growth of the future global economy (Chatrabgoun, Hosseinian-Far, Chang, Stocks, & Daneshkhah, 2018; Galli, 2018; Galli, Kaviani, Bottani, and Murino, 2017; Salter, 2015).

Widespread failure in risk management is a leading cause of financial crises in many organizations around the world. The study of financial crisis cases reveals that enterprises failed to manage risk in their business operations or failed to revise corporate strategies to be in line with business-critical risks. Also, risks managers in these institutions worked separately from the rest of management in implementing the organization's strategy, which creating a gap allowing for much error and mistake. As a result, boards of management were not aware of the various risks the companies were facing.

Regulators and standard formulators should understand that risk-taking elimination is not effective management of risk. An objective should be formulated to ensure the understanding and management is appropriately communicated within the organization. Additionally, implementation of effective risk management requires an approach based on the overall setting of the enterprise rather than individual treatment of the company units (Adam et al., 2015). The board should be involved in formulation and review of risk management structures. The board should also formulate the corporate strategy in light of the risk. The company's management and control functions should be autonomous from profit centers, and the overall risk manager should be responsible for reporting directly to the directors of the board.

Study has found that successful companies set to avoid trouble through proper governance and compliance, as well performance improvement through innovative experiments and excellence in operations to combat risk. Protection from downside risks in leading companies involves clinical strategies. The management of this company's uses periodically updated risk management systems that help in identifying operation-critical risks and review various ways of managing risk- prone areas. Both qualitative and quantitative approaches are used to explore risk tolerance in these organizations. Critical risk is often emphasized, and the board of management is notified early through notification systems when the risk is about to exceed acceptable proportions (Rampini et al., 2014). Therefore, risk intelligence is fortified to ease decision-making. Indeed, the performance scorecards of executive management are linked to risk management performance.

Most companies have proper intentions in assessing and controlling enterprise-wide risks, but there are cognitive biases, which reduce the effectiveness of their risk management structures. These biases emphasize experience where risk managers fail to plan against a risk, which the company never experienced. The executive management focuses on well-known financial risks and risk