BOOK REVIEW

Risk Management Challenge and Opportunity

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INTRODUCTION

This is a book review of Frenkel, Hommel and Rudolf (2005) Risk Management Challenge and Opportunity. This book has emerged as one of the very insightful excellent publications that cover a variety of diverse aspects of risk management in the banking sector, insurance and other corporate companies. The primary purpose is to supply context and provide concrete evidence to highlight the importance of risk management, particularly in reducing the impact of market volatility and other related risks. Consequently, some have embarked on strategic approaches in avoiding market forces, which have made valuable contributions to the field of risk management.

REVIEW AND DISCUSSION

Beginning with the bank risk management view, this book discusses a few risk dimensions relating to banks including credit and operational risk. The risk handling process starts with the three main pillars outlined in Basel II. This guidance focuses on the concept of evaluating the activities and supervision of the risk profile, which will motivate management to act in line with the needs of its customers and shareholders. This principle can motivate the readers to develop strong arguments concerning the role played by the management of banks to comply with Basel II to tackle the financial pressure issues and avoid economic losses. For researchers, this principle can also be seen in the context of measuring the risk management efficiency of banks. An investigation of bank performance will provide a more focused study and the risk management committee will have a clear direction concerning the goal of its risk supervision. The contribution concerns the implications of further developing more
effective remedial action processes, to achieve a reasonable level of efficiency.

This book is certainly insightful and might stimulate future researchers in that, it highlights the role of corporate governance in banking risk management, with a thorough explanation of the conflict of interest taxonomy in the financial services firms. It addresses the conflicts phenomenon between the interests of the owners and managers of financial institutions and firm – client conflicts. It also includes the scenario where the financial firms are confronted by a conflict of interest between clients (inter-client or types of client). As part of that, similar to most common studies, information asymmetries have also been discussed in the context of principal and agent problems. To give more intuitive discussion, the researchers highlight contract theory and integrate between information asymmetry, particularly when dealing with decision making in banking transactions, which certainly benefits from misleading information, unethical behaviour and leads to greater profits (value creation). Consequently, in order to focus on the impact of the conflict of interest in banking institutions and extend to a broad understanding of the competitive advantage issue, academic scholars might consider a comparative study between banks regarding the issue of corporate governance practice, such as the practice of compensation plans in different institutions, locally or internationally. This issue not only influences the reduction in the flow of reliable information to the credit market, but possibly has a severe impact on its performance.

To strengthen the theoretical part, modern financial theory has been explored and some important ideas have been delivered to inform the scholars and practitioners to further investigate the risk management issues. This book concerns the strategies to reduce financial risk and encourage investment activities. It discusses the benefits of diversification strategies in some investment portfolios that enable investors to achieve a higher expected returns. However, the papers do not emphasize the relationship between risk and return as this context extend the relevancies theorem in corporate risk management. Integrating a probability distribution, which highlights the relationship of the possible dollar return from investment activities and the probability of each return, may be considered as being crucial to risk management research. This should include the most important measurements - variance and standard deviation - as these describe the return distribution as well as represent the risk in any single type of investment. For researchers, this issue can be discussed for firms in emerging countries, such as Thailand, Indonesia and the Philippines, as these countries are more sensitive to market risk and receive less investigation.

Hedging strategies received attention in this book. Through understanding the importance of derivative instrument usage in corporate risk management, the paper highlights the advantages of its usage in mitigating financial risk. However, in showing the real effect from the financial derivative instruments, it faces some difficulties, particularly from the accounting treatment strategies. The continuous debate is unresolved since no consensus or specific standards have been established by the accounting experts in reporting the financial instruments and the items that are affected by their usage. The phenomenon opens up huge gaps to be researched, particularly to provide evidence concerning how far the instruments used significantly limit the market risk, and, hence improve the risk management strategy of the firms. Accounting and financial ideas will certainly establish the theoretical developments in both fields.

This book emphasizes the financial and mathematical models to elaborate the financial and risk concept, as well as to measure the performance of the investment portfolios. In the context of the theoretical approach, it might explain a simple scenario, however, in practice, its interpretation and implementation is complicated. Nevertheless, it certainly benefits graduate students and academics as this book has compiled selected empirical papers for educational and research purposes. In addition, it covers the role and strategies that can be considered by the firm’s corporate team in managing
the firm’s risk. Consequently, the suggestions and recommendation from this review can also be considered for future research.

Overall, this is a most insightful book as it includes a comprehensive review of the literature and findings. This book is strongly recommended as research material since it provides the philosophy and principles, from the fundamental to the advanced level of risk management studies.

REFERENCES


Shahsuzan Zakaria is currently a Ph.D candidate at Victoria University, Melbourne, Australia. His research focuses on financial derivatives usage in the Asia-Pacific banking sector, in relation to banks’ efficiency performance. He has Bachelor Degree in Finance and an M.B.A. from Universiti Teknologi MARA (UiTM), Malaysia. He has experience in teaching different courses in finance including Portfolio Management, Financial Markets and Institutions, and Corporate Finance. He is the author of several articles on risk management and efficiency measurement presented at local and international conferences.

Sardar M. N. Islam has 30 years of experience in teaching, supervision, and multi-disciplinary research. He is interested in Finance, Economics, Management Science, Accounting, Business and Law, and has published extensively in these areas. His research has gained international acclaim resulting in several visiting or adjunct professorial appointments. At Victoria University he is associated with the Financial Modelling Program, the Law and Economics program, and the Decision Sciences and Modelling Program.