The Value of Enterprise Risk Management: Evidence from the U.S. Insurance Industry

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Abstract

Enterprise risk management (ERM) has been the topic of increased media attention in recent years. Many organizations have implemented ERM programs; consulting firms have established specialized ERM units; and universities have developed ERM-related courses and research centers. Despite the heightened interest in ERM by academics and practitioners, there is an absence of empirical evidence regarding the impact of such programs on firm value. The objective of this study is to measure the extent to which specific firms have implemented ERM programs and, then, to assess the value implications of these programs. We focus our attention in this study on U.S. insurers in order to control for differences that might arise from regulatory and market differences across industries. We use a maximum-likelihood treatment effects framework to simultaneously model the determinants of ERM and the effect of ERM on firm value. In our ERM-choice regression we find ERM usage to be positively related to firm size and institutional ownership, and negatively related to reinsurance use and leverage. By focusing on publicly traded insurers we are able to estimate the effect of ERM on Tobin's Q, a standard proxy for firm value. We find a positive relation between firm value and the use of ERM. The ERM premium is statistically and economically significant and approximately 17 percent of firm value.