

A MODEL FOR DISMANTLING ISOMORPHISM AND RISK MANAGEMENT DECISIONS: BASED ON LITERATURE REVIEW

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Abstract

This paper built a model to reveal the existence of isomorphism pressure that can influence the company's risk management decisions, primarily related to hedging as a risk management mechanism. Companies will always face increasingly complex uncertainties that encourage managers to choose hedging strategies for their risk management. Aside from the nature of technological rationalism, several factors can influence managers' decisions to adopt hedging, including pressure from within and outside the company. These pressures will change the behavior of managers to be more rational. The manager's theory states that managers do not like or avoid risk. This paper develops and reveals the effect of isomorphism pressure on managers' behavior in making corporate hedging decisions. This research is a literature review that offers a new concept to see the company's hedging decisions based on the application of isomorphism theory.

Keyword: Risk Management, Decision, Isomorphism, Hedging, Model, Strategy, Behavior

Introduction

In general, corporate hedging is a company's effort to manage the risks faced by the company due to the complex uncertainty (Geyer-Klingeberg et al., 2019; Hardy & Lyon, 1923). The decision to hedge in several previous studies had always been associated with hedging rationality which consists of how managers attempt to create firm value and increase the wealth of their owners and how managers try to increase their utility (Geczy et al., 1997; Giambona et al., 2018). Data presentations and analyzes related to previous hedging decisions are always associated with technical problems related to pure finance theories (Geyer-klingeberg et al., 2019). Behind a manager's decision, there will always be a driving behavior that influences apart from technical issues (Tim R Adam et al., 2017; Aten et al., 2012; Jensen & Meckling, 1976).

The factors driving this behavior have not been widely discussed in previous hedging studies, even though the study of Jensen & Meckling (1976) stated that behind a manager's or company's decision, there must be behavioral factors that encourage it. The isomorphism theory, which was first developed by DiMaggio & Powell (1983), is expected to explain what driving factors can change manager behavior to be rational following manager behavior theory which tries to avoid risk (Drori, 2020; Li & Ding, 2013). This isomorphism theory is a solid organizational theory that can explore the behavior of both

individual behavior and organizational behavior behind a decision taken by policymakers in the company (Aksom, 2020b; Berthod, 2020). Isomorphism reveals the existence of pressures, both internal and external, that will encourage policymakers to make rational decisions so that the presence of the company itself can be accepted in the eyes of its environment (Jaja et al., 2019; Sakib, 2020). This argument drives this paper to explore the existence of drivers that require companies to take rational policies so that they are in accordance with the rationale for making hedging decisions within the company (Buchko, 2011; DiMaggio & Powell, 1983; Hambrick et al., 2004).

Isomorphism pressure consists of 3 forms or processes: coercive isomorphism, mimetic isomorphism, and normative isomorphism (DiMaggio & Powell, 1983; Hambrick et al., 2004). Each will play a role in the decision-making process (Jepson et al., 2020; Li & Ding, 2013). Coercive isomorphism is a pressure forcing companies to take a policy, including regulatory pressure (Buchko, 2011; DiMaggio & Powell, 1983). Regulatory pressure in the form of regulations can force companies to do what is in accordance with these regulations (George et al., 2020; Hege et al., 2018; Nukpezah & Abutabenjeh, 2018). Mimetic isomorphism is a company's effort to imitate other companies that have successfully implemented a strategy to deal with a problem that has something in common (Li & Ding, 2013; Adriano A Rampini et al., 2020; Yang & Kang, 2020). Meanwhile, normative isomorphism is an effort to legalize a company related to its existence and professionalism by following operational standards in carrying out its operational activities (Jepson et al., 2020). When associated with risk management, especially hedging, companies can adopt certain risk management standards to provide an overview and framework for companies to manage the risks they face (Barafort, 2018; Chen et al., 2019; Ciorciari, 2019; Gamba & Triantis, 2014).

This model reveals the role of behavior in the hedging decision-making process that has not been discussed yet in the previous studies (DiMaggio & Powell, 1983; Hambrick et al., 2004; Jepson et al., 2020). Previous hedging research models still use the concept of a model based on pure financial models, so the discussion of the model is still purely technical (Geyer-Klingenberg et al., 2019). The use of isomorphism theory in the development of the hedging model is expected to be able to reveal the behavior or psychological factors of the decision-maker so that the firm's hedging decision theory is able to describe the behavior of individuals and organizations related to their response to the pressures received (Tim R Adam et al., 2017; Jepson et al., 2020). The company's existence in its environment is related to how it carries out risk management. The choice of strategy to maximize the effectiveness of risk management can be explained using this model.

This paper is divided into several parts. Section 2 discusses risk management decisions, especially those related to hedging. Section 3 deals with isomorphism. Section 4 discusses the model linking isomorphism and hedging. And finally, section 5 talks about the conclusion of this paper.

Method

This research is a literature review of studies related to hedging so that a new model is found that can overcome the gap from these studies.

Discussion

Risk Management Decision and Hedging

In managing effective risk management, decision choices related to the use of clear and appropriate strategies are needed to support risk management success (Stulz, 2016; Woods, 2012). Hedging is one of the attractive options as a risk management strategy, although it has weaknesses such as relatively expensive hedging costs (Geyer-klingeberg et al., 2018; Lalonde & Boiral, 2012). In general, the function of hedging is how to protect the assets owned by the company to minimize the potential risks that the company may face in carrying out its operational activities (Clauben & Daniel, 2019; Khumawala et al., 2016). Hedging is an option, especially when you see other companies have successfully used it to overcome the same problem (Brav et al., 2010; Fearnley et al., 2011; Taylor, 2014).

Basically, the choice of using hedging in companies is based on the rationale of why hedging is needed. Hedging rationality is carried out for several reasons, including (1) hedging can be used as a tool to protect and increase shareholder value, and (2) hedging can be used as a tool to maximize the interests of managers (Gupta, 2017). In terms of shareholder value, hedging can reduce the cost of bankruptcy (K Aretz & Bartram, 2010; Arnold et al., 2014), reduce the occurrence of investment shortages (Bessembinder, 1991; Geyer-klingeberg et al., 2018), and overcome the occurrence of company substitution asset problems (Aretz et al., 2007). Meanwhile, related to the interests of managers, hedging can be used as a representation of the manager's behavior as well as the manager's efforts to show a signal of the reputation, competence, and ability of the manager in terms of managing the risks faced by the company (Geczy et al., 1997).

The choice of hedging made by the company as a risk management strategy is based on the type of risk faced by the company itself (Geyer-Klingeberg et al., 2019; Korn & Nerz, 2019). The choice of using hedging strategies to overcome risk exposure caused by foreign exchange, interest rates, commodity prices, or a combination of the three is adjusted to the risks faced by the company, where the risks faced by each company depending on the characteristics of the company itself (Bartram, 2019). The existence of uncertainty, especially in terms of the company's cash flow, will cause companies to use hedging strategies to respond to this uncertain situation (Ahmed et al., 2018; Korn & Oliver, 2019)). The higher the uncertainty of cash flows that occur within the company, the use of hedging strategies will also be complex, which is indicated by a combination of derivative contracts used (Akron, 2019; Bartram, 2019).

Isomorphism

The main basis of isomorphism is the institutional theory (DiMaggio & Powell, 1983; Hambrick et al., 2004). This will encourage the process of institutionalism in the organization that encourages companies to carry out a strategy as a form of legitimacy for their existence in accordance with what is expected by the organizational environment (Jaja et al., 2019; Sakib, 2020; Srikantia & Bilimoria, 1997). This will encourage the homogenization of organizational strategy, especially when organizations have the same problems with each other (Jepson et al., 2020; Li & Ding, 2013)

The theory of isomorphism in an organization will always be associated with behavior within the organization, be it individual behavior or organizational behavior, especially in the decision-making process, and can also be used to describe various aspects of the organization, including its managerial aspects (T R Adam et al., 2015; Aksom, 2020b; Bae & Kim, 2016; Jepson et al., 2020; Li & Ding, 2013). The isomorphism theory is a closed theory in the development of related studies. It can only use the same prepositions without modification and can be developed with other research concepts (Aksom, 2020b, 2020a; Vailatti et al., 2017).

Apart from being a form of legitimacy, isomorphism can be used by companies as a tool to be able to win the competition or competition, especially related to how the company responds to pressures from the company's environment (Drori, 2020; Jeong & Kim, 2019). It can also illustrate that the isomorphism process that occurs in an organization will be able to explain how the strategic choices chosen by managers or other policies are taken that can affect the sustainability of the company (Aten et al., 2012; Berthod, 2020).

The concept of institutional isomorphism theory and the relationship with rational traits in decision-making in a company was first expressed by DiMaggio & Powell (1983). They revealed that there is an isomorphism process consisting of coercive, mimetic, and normative that can influence managers of a company to make decisions related to the company's desire to win the competition with other companies by using its resources (Hambrick et al., 2004; Li & Ding, 2013). This theory develops institutional theory, which studies the relationship between behavior in an organization and decision making (Aten et al., 2012; Jeong & Kim, 2019; Li & Ding, 2013). The existence of institutional pressures will encourage managers to make the right policies so that the company can respond to these pressures with the right strategy (Tim R Adam et al., 2017; Jepson et al., 2020)

Coercive isomorphism is a form of Pressure Company's face from legal factors. Coercive isomorphism can be in the form of government policies or pressure from the shareholders or company owners to win the competition or achieve the company's goals (Buchko, 2011; DiMaggio & Powell, 1983; Martínez-Ferrero & García-Sánchez, 2017). The presence of an element of uncertainty is one of the things that can grow the potential risks faced by the company. Mimetic isomorphism is a process of imitating other organizational strategies through changes in organizational structure which is the company's response to the uncertainty factor formed due to the complexity and dynamics of environmental movements around the company so that will encourage companies to take a policy to

manage and control this uncertainty (Buchko, 2011; DiMaggio & Powell, 1983). At the same time, normative isomorphism comes from the professionalism of human resources contained in an organization or company. In this case, how are the methods of working and the behavior of human resources so that they can carry out their work well to support the achievement of company goals? (Buchko, 2011; Li & Ding, 2013; Pinsker & Felden, 2015)

A Model Linking Isomorphism and Hedging

As stated above, isomorphism will encourage managers to act rationally in making company policies. In terms of hedging, the rational behavior of managers is judged by the nature of managers who do not like risk or avoid risk. The existence of coercive, mimetic, and normative isomorphism will encourage managers to adopt hedging policies to control the potential risks faced by the company.

The model's rationale linking isomorphism with hedging as a form of risk management strategy is based on several findings of previous research. Several studies have found that the isomorphism process in the organization will encourage more efficient risk management, which may include the selection of hedging strategies. Coercive isomorphism is one of the pressures that encourage managers to take risk management policies (Buchko, 2011; Hege et al., 2018). Why can coercive isomorphism drive hedging decisions? This happens because of the mandatory nature of this coercive, which can force it to do something that has been regulated (Hege et al., 2018; Robotti, 2011; Voort et al., 2019). One form of coercive isomorphism that can force managers to carry out hedging policies is government regulations or regulatory policies. The existence of the regulator's policy will positively impact its ability to force companies to do what has been regulated by the regulator (Buchko, 2011; Shimizu & Ly, 2017). The existence of regulatory policies related to risk management, especially hedging, will encourage managers to take policies to implement these rules as a form of legitimacy and obedience and signal that managers have been able to implement these policies (Voort et al., 2019). The existence of coercive pressure will encourage managers to be more rational in policymaking, including hedging as an alternative to risk control in the company's risk management system (Kifle, 2017).

The second factor of isomorphism that encourages managers to take hedging policies is a mimetic isomorphism. Mimetic is a step to imitate a strategy that has been implemented effectively when the company faces the same problem (Jepson et al., 2020). When managers face a problem, including the pressure of uncertainty, it will encourage managers to implement a homogeneous strategy with other companies that have experienced similar problems (Masocha & Fatoki, 2018). The existence of an imitation process has a positive effect on changes in company policies, which ultimately impact the company's effectiveness in achieving its goals. The imitation process encourages managers to use the same strategy as other companies to overcome the problems faced by the company (Tseng & Chou, 2011). Rampini et al., (2014) and Adriano A Rampini et al. (2020) revealed that when a company reduces its risk exposure by using hedging mechanisms, it will encourage other companies to imitate the strategy when faced with

the same risk exposure as the company.

The third factor of isomorphism is a normative isomorphism. Concerning hedging as a form of risk management mechanism, there are already standards that can be used as a reference. Implementation of risk management standards provides a framework mechanism that will increase companies' potential to use hedging activities as a form of risk management practice (Altuntas et al., 2011; Purdy, 2010). The results of this study are reinforced by research conducted by Scannell et al. (2013) and Gates et al. (2012), which state that the integration and adoption of risk management standards guide risk management activities, including hedging activities within the company. will increase the potential for hedging practices within the company. Companies that apply standards in the implementation of corporate management will tend to improve risk management practices, including the use of hedging mechanisms in their activities to reduce the risks faced by the company (Eckles et al., 2014; Gamba & Triantis, 2014). In another study, Chen et al. (2019) stated that when a company adopts a risk management system as a work reference, it will directly improve risk management practices, including hedging, which is also regulated in the standard so that the process will become more efficient (Ciorciari, 2019).

Conclusion

From the results of the descriptions and findings of previous researchers, it can be concluded that the three processes in isomorphism that occur in an organization can encourage managers to take hedging policies. Coercive isomorphism has a mandatory nature to force managers to use strategies according to what has been set. Mimetic isomorphism tends to encourage managers to implement the strategy as other companies have done to deal with the same problems, including hedging to overcome loss exposures. Meanwhile, normative isomorphism encourages managers to hedge as a form of professional professionalism. It signals to the company environment that it can control the risks faced by the company.

As proof of the description in this paper, further research can use this isomorphism model by using quantitative data using both secondary data and primary data using interview techniques or questionnaires. With this it can be proven whether the concept of isomorphism in an organization or company can influence hedging policies. In the end, a discussion related to hedging can be reached not only as a technical issue but can also touch on hedging policymakers' behavioral side.

Conflict of Interest

The author declares that in writing this paper, there is no conflict of interest whatsoever that accompanies it

Acknowledgments

This research received funding from any party, so the author is very grateful for the help, direction, and comments related to the improvement of this paper

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