Chapter 41
Contemporary Financial Risk Management Perceptions and Practices of Small-Sized Chinese Businesses

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ABSTRACT

This study investigated the current perceptions and practices of financial risk management at small businesses in China. The researchers took an interpretative approach, using interviews within a case study, to collect qualitative data from Chinese business owners. Despite the well-documented importance of financial risk management in light of the 2008 global financial crises, surprisingly, the data indicated that little progress has been made on implementing an effective financial risk management in many Chinese small businesses. Analysis indicated the core problems in the case study organization stemmed from a lack of expertise, along with insufficient operational resources, for applying risk management. Interestingly, the researchers also found that Chinese small business managers perceived financial risks differently from managers of large organizations in China. Specifically, small business owners preferred to utilize risk transfer and insurance cover to hedge against financial risk.

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INTRODUCTION

It is generally accepted that although small businesses have played a crucial role in creating employment and in stimulating technological innovation (see, e.g., Haltiwanger *et al.,* 2013; Nordqvist, 2012; Petty *et al.,* 1993; Romero & Martínez-Román, 2012), they are characterized by higher levels of business, financial and bankruptcy risk (e.g., Dietrich, 2012; Keasey and Watson 1993). Relative to large firms, small businesses are less liquid, exhibit more volatile profit and cash flow measures, and rely more heavily on short-term debt funding (e.g., Daskalakis *et al.,* 2013; Walker & Petty, 1978). Since the 1990s, a large multidisciplinary literature has emerged focusing on small business.

The literature makes it clear that small businesses face many different kinds of business environments and risks (Forsman, 2011). Understanding risk means that small business managers can consciously plan for the consequences of adverse outcomes and, by so doing, be better prepared for the inevitable uncertainty and offer better prices for managing risks than their competitors, particularly large organizations.

Indeed, established large businesses manage to improve the organizing of their sophisticated finances and portfolios, but small businesses still experience basic financial problems such as cash flow and late payment difficulties. Literature searches have yielded very few papers or research directly relating risk management to small business and very little on attitudes to risk and how risk is managed in small business.

This study attempts to investigate the perception and current practice of financial risk management in small business. It is based on the general understanding that management of financial risk in small business is to a large extent different from management of financial risk in large companies. The paper is organized as follows: the next section is the literature review relating to the concepts of risk and financial risk, weaknesses and failures of risk management in small business, and financial risk management process. The following section explains the research methods. Section 4 presents research results and findings. The final section concludes the paper.

LITERATURE REVIEW

Concepts of Risk and Financial Risk

The concept of risk has been used to refer to a wide range of phenomena. The Oxford Dictionary provides the definition of risk as '...possibility or chance of meeting danger, suffering loss or injury, etc...'. Risk can be defined as the volatility of unexpected outcomes, usually the value of assets or liabilities of interest (Jorion & Khoury, 1996, p.2). Risk management has been defined as 'the identification, analysis and economic control of those risks which can threaten the assets or earning capacity of an enterprise.' (Dickson *et al.,* 1995, p.1, 2). Financial risk management is "the controlling of the possibility or chance of suffering a monetary loss" (Eales, 1995, p.1). Financial risk management has become a tool essential to the survival of all business activity (Jorion & Khoury, 1996). Risk management, a systematic approach to identifying, measuring, monitoring and managing various risks faced by an organization, is seen increasingly as a key attribute to the success of small business (Alquier & Tignol, 2006; Gao *et al.,* 2013; ICAEW, 2005; Vickery, 2008). In general, small business managers face two broad types of risks: business (or operating) risk and financial risk.

Risk management is a complex area involving the interactions of various sources of capital and input, along with technology, regulation, governance and communication (Blome & Schoenherr, 2012; Gao