

# Exploration of Key Points of Risk Management in Corporate Financial Activities

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## Abstract

Financial activities of the company are exposed to the risk of the market, credit, liquidity, operation and compliance. This paper studies the main links in risk management of corporate finance by examining how enterprises identify and assess financial risks, control risks, monitor risks and report on risks. Based on the above analysis, effective risk management is a multi-faceted approach, and several links need to be built among governance, internal controls, hedging, liquidity planning, scenario analysis and continuous monitoring. Based on recent academic research and institutional guidance, the five main contents of this paper are: risk identification, quantitative assessment, selection of mitigation strategies, design of internal controls, and continuous supervision. Therefore, according to this paper, to manage corporate financial risks effectively, the entire business plan of the company needs to incorporate risk control, set appropriate limits on risk-taking, make decisions based on data, and strengthen the responsibilities of the board of directors.

## Keywords

Corporate finance, risk management, financial risk, internal control, hedging, liquidity.

## 1. Introduction

At the bottom of the firm's financial system, there are many choices that need to be made under conditions of risk. These decisions are investments, financing, dividends, foreign exchange risks, working-capital management and derivatives. All of them have the potential for profit, but there are also financial risks that can reduce cash flow and harm earnings stability and long-term solvency [1, 2].

Recently, research in risk management has also shown that a company's goal is no longer just to reduce and avoid risks. To save cash, lower distress costs for the company, please its shareholders, and keep access to credit markets [3-4]. At the same time, with the spread of globalisation, interest rate fluctuations, digital transactions and stricter regulatory supervision have all increased the complexity of corporate finance. Therefore, the construction of an early warning system for financial crises will be urgently carried out.

This paper studies the main links in risk management for corporate finance. First, the principal risks will be listed; next, the various stages of risk control will be explained; finally, the problem of governance and implementation will be discussed. Good management of financial risk should be in line with the overall development plan of the company and need to keep up with fluctuations in the economy.

## 2. Risk Categories

Most types of risk in a company's finances are generally known. Reasons for fluctuations in market risk include changes in interest rates, foreign-currency and commodity prices, etc. Credit risk refers to the risk of non-payment by the counterparty. A firm is unable to pay off its short-term debts or raise new funds in time. Operational risk includes failures in internal

processes, fraud, system failures and human error. Legal and compliance risks occur when the company's financial operations are in violation of laws, regulations or contracts [2,5].

These categories have overlapping contents. For example, a foreign-currency loan will be subject to market and liquidity risks, and a disruption in the supply chain will also lead to operational and working-capital stress at the same time. Given the interconnectedness of risks, management should not be set up in separate silos. An integrated system will be employed to track how a single risk may be linked to other risks in the future.

### **3. Key Management Points**

#### **3.1. Risk Identification**

The first is the exact identification of the risk. A company should be aware of the amount of its financial risk and which divisions are prone to higher risks. Identify both on-balance sheet and off-balance sheet risks, such as debt structure, accounts receivable, derivatives, guarantees and overseas operations. Guidance on the risk management process consistently points out that identification is the beginning of good control [6, 7].

Identify repeatedly instead of once. Risks will change after an interest-rate rise, a concentration in customers, and a new loan. Therefore, the company needs an organised list of risks that can be regularly updated due to changes in business conditions.

#### **3.2. Quantitative Assessment**

The second is that it will be quantified. Identify risks, and then determine the likelihood, seriousness and independence of each. The above typical tools are scenario analysis, stress testing, Value-at-Risk (VaR), expected loss models and sensitivity analysis [6-7]. Help the organization plan capital allocation more wisely and manage the risk better.

Assess risks more seriously because some are infrequent but very severe. A low-probability liquidity crisis or credit default will cause more harm to the value than a high-frequency, low-impact market fluctuation. The Risk that may not be obvious at the company can be revealed through quantitative methods, and otherwise this risk might remain undetected.

#### **3.3. Mitigation Strategy Selection**

The third is a selection of a suitable reduction way. Reduce the financial risks of a company through hedging, diversification, insurance, contractual clauses, capital cushions and optimisation of operations. Based on the survey, both financial and operational hedging are used by the companies, and the selection between the two is influenced by various factors, such as the kind of risk, business structure, and requirements from all sides [3-4].

Adjust the way to display it. The two kinds of typical risks are generally covered by derivatives. Cash and short-term funds can be used to address liquidity risks through cash reserves, committed credit facilities, etc. Credit risk management will be achieved by the four above means. No single tool is ideal for all purposes; therefore, some should be selected to solve various problems.

#### **3.4. Internal Controls**

The fourth is an internal control system. The most reasonable risk plan will fail due to weak internal control. The definition of control should include the approval authority, separation of duties, transaction limits, documentation standards and escalation paths. Operational risk literature and corporate finance guidance both believe that a good governance and internal control system should be established to prevent undetected increases in risk [2, 6].

Internal control also supports accountability. By dividing the responsibilities, the company will know which party is responsible for a specific risk and which parties need to be informed of

any alterations to that risk. A good control system will not be subject to control failure due to financial risk.

### **3.5. Monitoring and Reporting**

The fifth is continuous observation and reporting. Dashboards and key risk indicators (KRIs) will be used to monitor risk regularly. Monitor this; at the same time, the market and company's actual conditions are constantly changing. Standards and course frameworks for risk management generally place monitoring and reporting at the end of the process, but in practice, they are carried out continuously [7-8].

Report promptly, clearly, and give direction for decision-making. The board and senior management need a summary of the rising risks, which measures are being implemented, and which exposures require attention. Without a report on discipline, a company will not be aware of the risk in time to address it.

## **4. Governance and Strategy**

Given the modifications to the plan, risk control will be feasible. If the level of risk appetite is unknown, the amount and type of risk mitigation will be unsuitable. Therefore, a company should determine the level of risk volatility it can bear, which risks are acceptable and which exposures need to be avoided or offloaded [3, 9]. Thus, the design will not be a passive risk-reduction measure.

The board will also handle it. Top management will determine the upper limit of the risk and then approve the results of the stress test. Based on research by scholars of corporate risk management, in order to meet the demands of all parties involved, enterprises often employ hedging; thus, the two natures of risk management are finance and image [3, 10].

The other is a risk culture problem. If the staff think that only the finance department handles risk management, the risk may go undetected. A high-risk-averse culture will motivate all levels of the organisation to report potential problems truthfully and make principled decisions. Perhaps it is because of culture that the government policies have not been implemented effectively.

## **5. Practical Issues**

Small and medium-sized enterprises have different constraints in practice compared with large foreign-invested enterprises. Generally, small and medium-sized enterprises have a smaller number of products and data and limited access to derivatives markets. As a result, they may be forced to rely more on cash management, customer diversification, insurance and conservative leverage [6, 11]. The company has set up a large-scale hedging device system and an overseas-based risk management office.

The second is digitalisation. Many companies have established all-encompassing risk management systems, analytics and reports. The above instruments have improved the speed and ease of use; however, they also bring new cybersecurity and model-risk problems. Therefore, the scope of risk management should also cover the governance of data quality, system reliability and decision automation.

## **6. Conclusion**

Structure and integration of risk control for corporate financial activities. First, promptly locate the source of the risk, quantitatively determine the extent of exposure, select suitable risk reduction measures based on the level of risk, build an all-encompassing internal control system, and continuously verify the effect of the controls [1, 2, 6, 7]. Connect these elements to

the strategy and board of directors to make risk management about strengthening the foundation of the company rather than merely mitigating risks.

Therefore, most corporate risk control efforts will need to be integrated into the daily work of finance. The first type of company to respond to an economic downturn will build a fund for more than a year before using it to offset lower operational profits. Risk management should not be treated independently of the company's financial operations; therefore, it should be carried out in conjunction with them.

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