Analysis of Corporate Governance Effect and Characteristics of Companies on the Existence of Risk Management Committee

Abdillah Arif Nasution¹

¹Department of Accounting, Universitas Sumatera Utara, Medan-Indonesia

*Email :badinst@usu.ac.id

Abstract This study aims to analyze the influence of corporate governance and company characteristics on the existence of the Risk Management Committee (RMC) and type of RMC, whether separated and combined with the audit committee. Variables are broken down into independent commissioners, auditor reputation, market risk, leverage and company size. The statistical method for testing hypotheses is logistic regression analysis. Samples collected using random sampling are included in eighty manufacturing companies listed on the Stock Exchange for 2012-2017. This study uses agency theory, company legitimacy, and signal theory to explain the relationship between variables. This study shows that several independent variables have a positive effect on the existence of RMC, namely the size of the company, as well as the independent variables that positively influence the existence of a separate RMC are the size of the company.

1. Introduction
Risk is the potential for the occurrence of an event that can cause losses [1]. If the risk is not managed properly it will cause losses for the company and even bankruptcy experienced by a number of companies. The Company began the initiative to improve corporate governance with a significant emphasis on the role of risk management [2]. The complexity of risk management makes the quality of internal control higher when the risk management committee is compared to the absence of a risk management committee [2]. However, according to KPMG [3] it was found that the risk management committee still existed which was integrated with the audit committee.

As a result, the broad role and responsibility of a large audit committee increases criticism and doubts about its ability to function effectively [2]. Therefore, internal control of risk management is expected to be higher when the risk management committee is independent than when integrated with the audit committee.

This study aims to analyze and find empirical evidence the influence of board of commissioners independence, auditor reputation, market risk, and company size on the existence of a risk management committee.

2. Literature Review
The risk management committee (RMC) is a subcommittee that has a very important function in the company. The presence of the RMC is expected to assist the board of commissioners in carrying out the supervisory function as an effort to protect stakeholders and achieve the company’s goals. The function of supervision through the RMC is mainly on risk, risk management and internal
control. However, the presence of RMC is still voluntary and there are still many who are members of the audit committee. Though the task of a complex audit committee casts doubts on its accountability and credibility in monitoring corporate risk management. Therefore, this study wants to examine the actual factors that have a positive effect on the presence of RMC and type of RMC.

2.1 Agency Theory
In agency theory, both the principal and agent are assumed to be rational economic people and are solely motivated by their individual interests. From this situation arises a conflict of interest between the principal and the agent. To reduce the actions of agents that are not in accordance with their interests, the principal has two ways, namely [4]

- Supervise agent behavior by adopting audit functions and other corporate governance mechanisms that can align the interests of the agent with the interests of the principal.
- Providing attractive staff incentives to agents and establishing reward structures that can persuade agents to act in accordance with the principal's best interests.

Agency theory is often used as a basis in previous researches on corporate governance, especially regarding the existence of committees. This is due to the importance of the aspect of monitoring (monitoring) for the realization of good corporate governance. When viewed from the agency perspective, there are two general management oversight mechanisms, namely internal supervision and external supervision. The internal control mechanism is the board of commissioners and committees [5; 6; 7], while the external monitoring mechanism is an external auditor [2].

2.2 Signaling Theory
One theory that can be the background of the problem of information asymmetry in markets is the signaling theory. When used in the practice of corporate disclosure, signaling theory is generally beneficial for companies to express good corporate governance practices, to create good corporate quality in the market [2]. One form of signal about the quality of the company is the formation of a committee, which provides information that the company is better in terms of supervision compared to other companies.

According to the signaling theory, although there are no regulations that mandate the establishment of RMC as committees that specifically play a role in risk monitoring, companies can still form RMC in their commitment to the practice of good corporate governance. Harrison [8] states that it may be difficult to observe what work is actually carried out by the committee, but it is possible that the supervisory committee was formed to create a favorable company appearance for outsiders.

2.3 Efficient Market Hypothesis (EMH)
In this theory, efficient terminology refers to information that is informationally efficient. This theory states that if the market is efficient, the price reflects all the information available. Regarding EMH, the Indonesian capital market itself is included in the semi-strong form [9]. Securities prices in the Indonesian capital market react to information published by the issuer, such as financial statements, dividend distribution announcements, and so on.

2.4 Risk Management Committee
RMC has become popular as an important risk monitoring mechanism for companies [2]. This is further reinforced by a survey by KPMG [3] on Australian companies, which stated that more than half of respondents (54%) had RMC, of which 70% were joined by audit committees. In general the area of duty and authority of the RMC is [2]:

- Consider organizational risk management strategies;
- Evaluate the organization's risk management operations;
• Estimating organizational financial reporting; and
• Ensure that the organization in practice complies with applicable laws and regulations.

In its formation, RMC can be incorporated into an audit or can also be a separate and independent committee. Separate committees that specifically focus on risk issues (RMC), are an effective mechanism in supporting the board of commissioners to fulfill their responsibilities in the task of risk monitoring and internal control management [2]. A separate RMC from the audit will be more able to devote more time and effort to combining the various risks faced by the company broadly and evaluating the related controls as a whole [2]. In addition, a separate RMC from the audit also allows the board of commissioners to understand the company's risk profile more deeply [10].

3. Research Method
3.1 Research Variable
In this study, the concept of the existence of RMC was measured by dummy numbers. Code 1 for companies that hold RMC and code 0 for companies that do not hold RMC [2]. The existence of the RMC type is measured by dummy numbers. Code 1 for companies that hold separate RMC and code 0 for RMC companies that are members of the audit committee. The independence of the board of commissioners is measured by the number of independent commissioners owned by the company. Auditor's reputation is measured by dummy numbers, code 1 for Big four members (Deloitte, KMPG, PWC, Ernst and Young) and vice versa is coded 0. Market risk is measured by calculating beta values with regression techniques. Size is measured from total assets company [2].

3.2 Population and Sample
The population to be studied are all manufacturing companies listed on the IDX (Indonesia Stock Exchange). The study period was conducted in 2012-2017 with the reason that there were enough statistics and observations to be obtained statistically. The sampling technique used in this study was Random Sampling. The sample in this study was randomly selected, namely as many as 80 companies listing on the IDX in 2012-2017. Retrieving several samples with sufficient reason and fulfilling statistically qualified and considered to represent the research population.

3.3 Data Analysis Method
The analytical method used to test the hypothesis in this study is logistic regression. Logistic regression does not require a normality, heteroscedastic, and classical assumption test on the dependent variable [11]. Logistic regression was chosen because this study has a dichotomous dependent variable [2] and an independent variable that is a combination of metric and nonmetric (nominal). There are two logistic regression models used to test the hypothesis, namely:

The simple linear regression general equation used in this study is:

\[
\text{Logit (RMC)} = \alpha + \beta_1 + \beta_2 + \beta_3 + \beta_4 + e. \tag{1}
\]

\[
\text{logit(SRMC)} = \alpha + \beta_1 + \beta_2 + \beta_3 + \beta_4 + e. \tag{2}
\]

4. Result and discussion
Based on the tests that have been conducted, the presence of RMC is positively influenced size (company size). Whereas, the existence of separate RMC is positively influenced by the size. The discussion of each variable will be explained as follows:
Table 1. Model I hypothesis test results

| Variable        | Significance value (5%) |
|-----------------|-------------------------|
| Independent commissioner | 0.988                   |
| Auditor reputation | 0.550                   |
| Market risk      | 0.835                   |
| Size             | 0.012*                  |

Note : *) significant  
Source : Output SPSS

Table 2. Model II hypothesis test results

| Variable        | Significance value (5%) |
|-----------------|-------------------------|
| Independent commissioner | 0.036                   |
| Auditor reputation | 0.075                   |
| Market risk      | 0.525                   |
| Size             | 0.000*                  |

Note : *) significant  
Source : Output SPSS

The results of testing hypothesis 1a show that the independence variable of the board of commissioners has a significant probability value of 0.988 and a positive coefficient of 0.002. Whereas, the results of hypothesis 1b show a probability value of significance of 0.036 and a negative coefficient of 0.519. This shows that statistically, the independence variable of the board of commissioners does not have a positive effect on the existence of RMC or RMC separately. The absence of positive influence, because the quality and educational background of the members of the board of commissioners more determines the quality of the board's oversight function than the composition and level of independence. Another possible reason is that there are only independent commissioners to fulfill the rules and are not intended to implement corporate governance in the company. Coupled with the minimum provisions of independent commissioners in the board only 30% so that the policy for decision making to organize RMC is not yet dominant.

The results of hypothesis 2a testing indicate that the auditor reputation variable has a significance probability value of 0.550 and a positive coefficient of 0.195. Whereas, the results of the 2b hypothesis test show a probability value of 0.075 significance and a positive coefficient of 0.749. This shows that statistically, the auditor reputation variable does not have a positive effect on the existence of RMC or RMC separately. The reason that might underlie is that companies tend to use Big Four auditors just to increase their reputation. Big four auditors are also considered able to provide recommendations in corporate governance practices. However, these recommendations have not covered aspects of overall risk monitoring.

The results of testing hypothesis 3a indicate that the market risk variable has a significant probability value of 0.835 and a positive coefficient of 0.017. Whereas, the results of hypothesis testing 3b show a probability value of significance 0.525 and a positive coefficient of 0.129. This shows that statistically, the market risk variable does not have a positive effect on the existence of a separate RMC or RMC. Companies with high market risk tend not to hold RMC. When the market risk is high, the company is in a bad condition. This condition causes companies to act more carefully in activities that increase company costs. On the other hand, the company considers the principle of benefit costs. The principle of benefit costs is a comparison between the benefits obtained with the value to be received. If the costs incurred are greater than the benefits obtained, the company is better not to hold an RMC.

The test results of the size variable in model I have a significance probability value of 0.012 and a positive coefficient of 0.305. Whereas, the results in model II show a significance probability value of 0.000 and a positive coefficient of 1.188. This shows that statistically, the
variable size of the company has a positive effect on the existence of RMC and RMC separately. This is consistent with the results of Andarini’s (2010) study that the size of the company has a significant and positive effect on the existence of separate RMC and RMC. This is contrary to the research of Subramaniam, et al. [2] that company size does not have a positive effect on the existence of separate RMC.

5. Conclusion
The variable independence of the board of commissioners, auditor reputation, and market risk does not have a positive effect on the existence of RMC and RMC separately.

This study has several limitations that might be used as a reference in improving future research. The limitations of this study are that the sample of this study is limited to manufacturing companies listed on the Stock Exchange during 2012-2017. This research has only analyzed several corporate governance factors while there are still many corporate governance factors, company characteristics or other variables that might be indicated to influence the existence of RMC. Based on the limitations above, further research is expected to increase the number of companies or samples so that the results of the research obtained can illustrate better research results. Second, developing corporate governance variables, company characteristics or other variables that have not been accommodated in this study such as the number of audit committees, audit committee meetings, market share, total risk, and so on.

References
[1] Minister of finance regulation Number 142/PMK.010/2009 about risk
[2] Subramaniam, Nava; McManus, Lisa; and Zhang, Jiani, “Corporate Governance, Company Characteristics and Establishment of a Risk Management Committee in Australia Companies” Managerial Auditing Journal, vol. 24, Issue 4, 2009, pp. 316-339, doi:10.1108/02686900910948170.
[3] KPMG, Strategic Risk Management Survey, Accessed November, 29, 2009, www.kpmg.com.au.
[4] Jensen, M C and Meckling W H 1976 Theory of The Firm: Managerial Behaviour, Agency Costs, and Ownership Structure. Journal of Financial Economics, 3(4), 1976, pp. 305-360.
[5] Ruigrok, W, Peck S, Tacheva S, Greve P, and Yan H, The Determinants and Effects of Board Nomination Committees Journal of Management Governance, 10, 2006, pp. 119-148.
[6] Firth M and Rui O M Voluntary Audit Committee Formation and Agency Costs” International Journal of Accounting, Auditing and Performance Evaluation, 4 (2), 2007, pp. 142-160.
[7] Chen,L., Kilgore A, and Radich R, Audit Committees: Voluntary Formation by ASX Non-Top 500 Managerial Auditing Journal, 24(5), 2009, pp. 475-493.
[8] Harrison, J.R, The Strategic Use of Corporate Board Committees California Management Review, 30(1), 1987, pp.109-125.
[9] Mahendra, T Analisis Efisiensi Pasar Modal Indonesia Periode 2003-2005 (Studi Pada PT. Bursa Efek Jakarta), Thesis, 2008 Universitas Muhammadiyah.
[10] Bates, E W, and Leclerc R J, Boards of Directors and Risk Committees The Corporate Governance Advisor, 17(6), 2009, pp. 16-18.
[11] Ghozali, I. Aplikasi Analisis Multivariate Dengan Program SPSS, Semarang 2005, Badan Penerbit Universitas Diponegoro.

Acknowledgments
Authors thank to Allah, lord of the universe who always bestows his grace along with guidance, so that the authors can finish the research.