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THE IMPLEMENTATION OF GOOD CORPORATE GOVERNANCE AND OWNERSHIP CONCENTRATION TO THE DISCLOSURE OF ENTERPRISE RISK MANAGEMENT

(Study on Banking Companies Registered at Indonesia Stock Market)

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ABSTRACT

This study aimed to determine the influence of good corporate governance and ownership concentration to the disclosure of enterprise risk management. The elements of good corporate governance consisting of independent directors, board size, the presence of risk management committee, auditor reputation and ownership concentration have an important role to the disclosure of enterprise risk management. Enterprise risk management is needed because of the increasing complexity of business activity resulted in the increasing complexity of business risks that must be faced by the company. In Indonesia, the study upon the enterprise risk management has not been much conducted even though its development has been increasing. Therefore, research on enterprise risk management is very interesting to be conducted since the issue of enterprise risk management is still up to date. Populations used in this study were the registered banking companies at Indonesia stock exchange disclosure at the annual reports from 2009 to 2011. The samples were determined using purposive sampling method with 16 banking companies as the research object. Data of the companies were obtained from Indonesia stock exchange and then analyzed using multiple regression analysis. The results of this study indicated that the presence of independent directors and the risk management committee had negative influence to the disclosure of enterprise risk management. While the board size factor, auditor reputation and ownership concentration had positive influence to the disclosure of enterprise risk management.

Keywords: enterprise risk management, good corporate governance, ownership concentration

INTRODUCTION

Good Corporate Governance (GCG) requires managements to professionally manage any possible incurring risks (COSO, 2004). Therefore, the board of commissioners shall provide an instruction to ensure that the primary stakeholders' interest has been accommodated. The board of commissioners shall also provide limitation that the management's performance should be more professional. Risk management is a strategic element in Good Corporate Governance that is intended to identify and manage any risks that possibly influence the company's performance achievement (Reding, 2007 in Meizaroh and Lucyanda, 2011). Enterprise Risk Management (ERM) is a strategy used to evaluate and manage any risks in a company. An approach to the risk management of an organization is often referred to as risk management (Meizaroh and Lucyanda, 2011). According to COSO (2004) the Enterprise Risk Management (ERM) is defined as a process that is influenced by board of directors' entity, management and other personnel, applied through strategy management throughout the company, designed to identify any occurrence potentials influencing entities, and to manage any risks in risk appetite, in order to ensure the achievement of entity's purposes.

In Indonesia, there are only few studies concerning ERM conducted, although the development of ERM has increased. Therefore, the study upon ERM will be quite interesting, bearing in mind that that ERM is a quite new issue. In addition, the implementation of ERM is closely related to the application of Good Corporate Governance. This is because supervisory aspect performed by the board of commissioners, risk management supervisory committee, and external auditor are crucial key factors in terms of the implementation of an effective risk management system. The availability of concentrated ownership structure shall also be deemed able to increase the quality of a risk management. In consequence, there is a need to perform studies upon ERM in Indonesia in order to confirm the importance of implementation of any available good corporate governance and risk management (Meizaroh and Lucyanda, 2011).

There are several studies previously performed concerning the factors influencing the implementation of ERM, but they have inconsistent results (Meizaroh and Lucyanda, 2011). The results of studies by Beasley *et al.*, (2005) and Desender (2007) indicate that the availability of Chief Risk Officer, independent commissioner, type of auditor, and size of company shall influence on the disclosure of ERM. Kleffner *et al* (2003) finds that the availability of Chief Risk Officer, number of board of directors, and compliance to the procedures issued by Stock Exchange are key factors of successful implementation of ERM. Other studies also indicate that board of directors takes important role in the implementation of ERM (Lam, 2001; Walker *et al*, 2002). According to Andarini and Indira (2010), studies in Indonesia indicate that independent commissioner, number of board of commissioners, auditor's reputation, complexity, financial statement risk, and leverage do not influence the presence of risk management committee. On the other hand, Meizaroh and Lucyanda (2011) indicates that ones influence the disclosure of ERM are not the availability of independent and size of board of commissioners, but the availability of Risk Management Committee, auditor's reputation and concentration of ownership.

THEORETICAL STRUCTURE AND HYPOTHETICAL DEVELOPMENT

Independent Commissioner to the Disclosure of Enterprise Risk Management

The presence of independent commissioner in company, as a party without affiliated relationship with controlling shareholders and directors, makes its position deemed as an intermediary party between agency conflict between the principal and agent. Independent commissioner shall be able to monitor operational activities of company and managerial measures and the owner of company deviating from employment contract as agreed by the principal and agent. Independent commissioner is the best position to perform monitoring function in terms of company with good corporate governance. The condition shall be able to minimize any possible agency conflict and decreasing the amount of cost incurring for agency fee (Pratika and Ardiyanto, 2009).

The studies by Dhione and Thouraya (2004), Andarini and Indira (2010), and Meizaroh and Lucyanda (2011) indicate that the presence of independent commissioner does not positively influence the adoption of ERM. According to the empirical reference as described above, then:

H_1 = *Independent commissioner influences negatively to the disclosure of enterprise risk management.*

The Size of Board of Commissioners to the Disclosure of Enterprise Risk Management

High number of board will result in benefit or loss for company. The benefit of high number of board in a company is that the company will depend of the board in managing its resources properly. The more the need in more effective external relation; the need for higher number of board will also increase (Pfefer and Salancik, 1978 in Wardhani, 2006). The loss for high number of board is that it will increase communication or coordination problems. The problems will decrease the board's ability to control the management, thus it will possibly incur agency problem for division between management and control (Jensen, 1983 and Yermack, 1996 in Wardhani, 2006). According to the empirical reference as described above, then:

H_2 = *Size of board of commissioners influences negatively to the disclosure of enterprise risk management*

The Presence of Risk Management Committee to the Disclosure of Enterprise Risk Management

Risk Management Committee (RMC) is an important element in the course of enterprise risk management. The duties and authorities of RMC are to speculate strategy, to evaluate risk management, and to ensure that the company has complied with prevailing regulations of law (Subramaniam, *et al*., 2009 in Meizaroh and Lucyanda (2011)).

RMC can join to audit committee or be separate and stand alone committee, specifically focusing on risk affairs. A company with RMC will have more time, energy, and capability to evaluate its internal control and to settle any possible risks encountered by the company (Andarini and Indira, 2010). According to the study by Meizaroh and Lucyanda (2011), the presence of Risk Management Committee (RMC) influences positively to the disclosure of Enterprise Risk Management (ERM). According to the empirical reference as described above, then:

H_3: *The presence of Risk Management Committee (RMC) influences positively to the disclosure of enterprise risk management*

Auditor's Reputation to the Disclosure of Enterprise Risk Management

Reputable auditor is often associated with professional and quality auditor. On company's perspective, information obtained from a professional auditor's report will provide a more reasonable certainty, thus it will provide a higher reliability over the issued financial statement. A quality, relevant and reliable audited financial report is resulted from an effective audit performed by a quality auditor. The users of financial statement will rely on an audited financial statement by highly quality auditors compared to less quality auditors, because they are deemed to maintain their credibility, that auditor will be more careful in auditing process in detecting missed presentation or fraud. Reputable KAP shall have strong motivation in maintaining their independency and try to report on information as complete as possible to the shareholders and other stakeholders

(Razaee, 2003 in Widarjo, *et al*., 2010). According to the empirical reference as described above, then:

H_4: *Auditor's reputation influences positively to the disclosure of enterprise risk management*

The Ownership Concentration to the Disclosure of Enterprise Risk Management

Concentration of ownership can be an internal mechanism of management discipline, as one of mechanisms to improve effective monitoring, because great size of ownership will grant shareholder access to significant information to counterbalance information benefit by the management. If this is realized, then any moral hazard measure by management in the form of profit management can be decreased (Hubert and Langhe, 2002).

The study by Meizaroh and Lucyanda (2011) finds that there is influence between business risk and concentration of ownership. The higher concentration of ownership, the stronger demand to identity any possible risk to be encountered, such as financial, operational, reputation, regulation, and information risks. A method to improve the quality of risk management is by ensuring the availability of at least one great size shareholding in the company. According to the empirical reference as described above, then:

H_5: *Concentration of ownership influences positively to the disclosure of enterprise risk management*

RESEARCH METHODOLOGY

Research Type

This is a descriptive study that is a study made upon problems in the form of recent facts of a population related to opinion (individual, group or organization), occurrence or procedure **(**Indriantoro and Supomo, 1999: 141).

Population and Sampling

The population of this study is all banking companies registered in Indonesian Stock Exchange from 2009 to 2011, for 31 banking companies. It uses purposive sampling of company under the following criteria:

a. Banking company that exposes annual report in ISE from 2009 to 2011.
b. Banking company whose shares are actively traded in Indonesian Stock Exchange (ISE)
c. Banking company that provides data concerning the disclosure of good corporate governance and concentration of ownership.

According to the criteria above, the number of samples registered in ISE that is able to be used as study object is 16 banking companies.

Operational Definition and Variable Measurement

Table 1

No	Name of Variable	Definition	Measurement
A.	**Dependent Variable**		
1.	Enterprise Risk Management	The process is influenced by board of directors entity, management and other personnel, applied through strategy management throughout the company, designed to identify any occurrence	Dummy Variable: - Valued 1 if there is disclosure of ERM - Valued 0 if there is no disclosure of ERM

		potentials that influences entity, and to manage risk so that is in risk appetite, in ensuring the achievement of entity's purpose	
B.	**Independent Variable**		
1.	Independent Commissioner (COM_IND)	Proportion of independent commissioner compared to the number of board of commissioners	∑ independent commissioner X 100% ∑ board of commissioners
2.	Size of Board of Commissioners (COM_SIZE)	Number of all members of board of commissioners	Number of members of board of commissioners
3.	Availability of RMC (FIRM_RMC)	Availability of Risk Management Committee in a company	Dummy Variable: - Valued 1 if there is available RMC - Valued 0 if there is no available RMC
4.	Auditor's Reputation (AUD_REP)	Whether the company uses an auditor classified as *Big Four Auditor*	Dummy Variable: - Valued 1 if company uses *Big Four* auditor - Valued 0 if company does not use *Big Four* auditor
5.	Concentration of Ownership (CON_OWN)	Major shareholders with shares ownership more than 50%.	Dummy Variable: - Valued 1 if major shares ownership > 50 % - Valued 0 if major shares ownership < 50%

Source: Desender (2007), Meizaroh and Lucyanda (2011)

Technique of Analysis

Technique of Data analysis being used to test the hypothesis of this is logistic regression analysis, using Hosmer and Lemeshow hypothetical test. The regression equation model to test hypotheses 1, 2, 3, 4, and 5 is as follows:

ERM = α + β1 COM_IND + β2 COM_SIZE + β3 FIRM_RMC + β4 AUD_REP + β5 CON_OWN + e .... (1)

Description:

ERM	=	Enterprise Risk Management
α	=	Constant
β1 – β5	=	Regression Coefficient
COM_IND	=	Independent Commissioner
COM_SIZE	=	Size of Board of Commissioners
FIRM_RMC	=	Availability of Risk Management Committee
AUD_REP	=	Auditor's Reputation
CON_OWN	=	Concentration of Ownership
e	=	Error term, that is default level of the study

DATA ANALYSIS

Hosmer and Lemeshow Goodness of Fit Test

According to Hosmer and Lemeshow of Fit Test, Chi-square value is 2.953 and Sig value is 0.876. The result shows that Sig value is more than 0.05 that means it achieves hypothesis zero. This means that logistic model shall be able to be used in further analysis. The results can be found out in the following table 2:

Table 2

Omnibus Test of Model Coefficient (Simultaneous Test)

Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	63.510	5	.000
	Block	63.510	5	.000
	Model	63.510	5	.000

Source: processed secondary data, 2013

Summary Model

The test result indicates that Nagelkerke R Square value is 73.3%, this means that the independent variable of this study (independent commissioner, size of board of commissioners, availability of RMC, auditor's reputation and concentration of ownership) shall be able to describe dependent variable variant for 73.3%. On the other hand, the 26.7% shall be described by variable other than models of this study.

Table 3

Summary Model Test Result

Summary Model

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	3.554[a]	.761	.733

a. Estimation terminated at iteration number 20 because maximum iterations have been reached. Final solution cannot be found.

Source: processed secondary data, 2013.

Omnibus Test of Model Coefficient (Simultaneous Test)

The test result indicates that chi-square value is 63.510, this means that calculated chi-square is 63.510. Meanwhile, chi-square table for significance level 5% results in chi-square value for 34.764. Because the calculated chi-square value is higher than that of chi-square table, this means that independent variable shall simultaneously influence the dependent variable.

Table 4

Omnibus Test of Model Coefficient (Simultaneous Test)

Omnibus Tests of Model Coefficients

		Chi-square	Df	Sig.
Step 1	Step	63.510	5	,000
	Block	63.510	5	,000
	Model	63.510	5	,000

Source: processed secondary data, 2013

Table 5

Partial Test

Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1[a]	COM_IND	-7.509	.780	5.691	1	.032	.877
	COM_SIZE	5.247	.757	2.023	1	.018	.209

FIRM_RMC(1)	1.709	.280	.963	1	.044	1.778
AUD_REP(1)	.061	.442	.665	1	.037	1.160
CON_OWN(1)	3.064	.661	2.115	1	.043	3.209
Constant	9.077	1.871	5.017	1	.034	.022

a. Variable(s) entered on step 1: COM_IND, COM_SIZE, FIRM_RMC, AUD_REP, CON_OWN.
Source: processed secondary data, 2013

DISCUSSION

The Influence of Independent Commissioner to the Disclosure of ERM

The coefficient value of independent commissioner variable is -7.509 and its significance value is 0.032. This indicates that the factor of independent commissioner influences **negatively** and **significantly** to the disclosure of ERM, this means that the first hypothesis is **proven**. This result of the study supports the studies by Meizaroh, *et al.*, (2011), Andarini, *et al.*, (2010) and Dionne, *et al.*, (2004) that states that independent commissioner influences negatively to the disclosure of Enterprise Risk Management (ERM), but is contrary to the study by Desender (2007) that states that the availability of independent commissioner influences positively to the disclosure of ERM.

Influence of the Size of Board of Commissioners to the Disclosure of ERM

The coefficient value of size of board of commissioners' variable is 5.247 and its significance value is 0.018. This indicates that size of board of commissioners' variable influences **positively** and **significantly** to ERM and this means that the hypothesis of study is **not proven**. This result of the study supports the study by Briana and Didik (2009) that states that size of board of commissioners influences positively to the disclosure of Enterprise Risk Management (ERM), but it does not support the studies by Andarini and Indira (2010) and Meizaroh and Lucyanda (2011) that state that size of board of commissioners negatively to the disclosure of ERM.

Influence of the Availability of RMC to the Disclosure of ERM

The variable value of availability of Risk Management Committee (RMC) variable is 1.709 and its significance value is 0.044, in other words, the third hypothesis is **proven**. This result of the study is in in line with the result of study by Meizaroh and Lucyanda (2011) that states that the availability of RMC influences **positively** and **significantly** to the disclosure of Enterprise Risk Management.

The Influence of Auditor's Reputation to the Disclosure of RMC

The variable value of auditor's reputation variable is 0.061 and its significance value is 0.037, this means that the fourth hypothesis is **proven**. This result of the study supports the result of the study by Meizaroh and Lucyanda (2011) that states that auditor's reputation factor influences positively to the disclosure of ERM. This result of the study also supports the studies by Beasley, e*t al.*, (2005), Desender (2007) and Chen, *et al.*, (2009) that state that there is influence of *Big Four* as external auditor to the adoption level of ERM. The possible underlying reason is that *Big Four* usually assists internal auditor in evaluating and assessing the effectiveness of risk management. This is because *Big Four* is deemed to be skillful in identifying risks, thus it will improve the quality of assessment and monitoring by the company (Meizaroh, *et al.*, 2011)

The Influence of Concentration of Ownership to the Disclosure of RMC

Concentration of ownership variable influences **positively** and **significantly** to the disclosure of ERM and this means that the fifth hypothesis is **proven**. This can be found out that the variable value is 3.064 and its significance value is 0.043. This result of the study supports the study by Meizaroh and Lucyanda (2011) that states that the size of concentration of ownership factor influences positively to the disclosure of ERM. A company with concentrated shares ownership has higher level of disclosure on risk management. The higher concentration of ownership in a company, the stronger demand to identify any possible risk to be encountered, such as financial, operational, reputation, regulation and information risks (Meizaroh and Lucyanda, 2011).

CONCLUSION

Upon the study, we can conclude: (1) Independent commissioner variable influences negatively and significantly to the disclosure of ERM, while the availability of RMC, auditor's reputation, and concentration of ownership variables influence positively and significantly to the disclosure of ERM. This means that the first, third, fourth and fifth hypotheses, according to the test results of this study are **proven**. (2) Size of board of commissioners variable influences positively and significantly to the disclosure of ERM, this means that the second hypothesis that states that the size of board of commissioners influences to the disclosure of ERM is **not proven**.

This study encounters several limitations, such as: (1) The variables being tested in this study are only 5, thus other influences of other than these models of study have not been proven scientifically; (2) Not all companies give explicit information concerning the points of Enterprise Risk Management required by Committee of Sponsoring Organizations of Treadway Commission (COSO). Here are preferable suggestions: (1) For further study, the object should not only use banking companies, but it may also use other financial companies. This is intended to provide a broader description concerning the factors influencing to the disclosure of Enterprise Risk Management, (2) For further company's annual report, it is expected to provide data concerning the disclosure of Enterprise Risk Management in its presentation. This can be used as a control for the company itself concerning to what extent its risk management is, and (3) There is a need of code regulating the standardization of available information of annual report in relation to the disclosure of Enterprise Risk Management required by COSO.

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