Enterprise Risk Management Disclosure and Firm Value: The Role of Risk Monitoring Committee

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Abstract

Enterprise risk management is one of a firm's strategies to achieve the goals. Meanwhile, the risk monitoring committee is a corporate organ evaluating enterprise risk management. However, not many researchers have discussed the role of the risk monitoring committee. The previous research paid more attention to the role of the risk management committee. The purpose of this study is to identify the role of the risk monitoring committee on the relationship between enterprise risk management disclosure and firm value. The role of the risk monitoring committee was viewed based on size, independent member, female member, education level, financial expert, risk management expert, and meeting. This research was conducted on commercial banks listed on the Indonesian Stock Exchange within a period of 2016-2018. 126 samples were collected using a purposive sampling technique through observation. The results showed that five variables such as committee size, female member, financial expert, risk management expert, and meeting moderated the relationship between enterprise risk management disclosure and firm value, yet the committee of independent member and education level did not moderate the relationship between enterprise risk management disclosure and firm value.

Keywords
Banking, Risk Monitoring Committee, Risk Management, Firm Value

1. Introduction
The global financial crisis occurring a few years ago raised people's awareness focusing on risk disclosure practices (Schmid et al. 2011). Risk disclosure practices represent the quality of corporate governance practices (Solomon et al. 2000) to increase firm value (Schmid et al. 2011; Baxter et al. 2013; Nahar et al. 2016). However, not all empirical studies can prove the impact of Enterprise Risk Management (ERM) on firm value. Some evidence shows that mixed results in response to the geographical and industrial restrictions are difficult to generalize previous empirical results (Lechner and Gatzert 2016). Therefore, the research on management and firm value, particularly in Indonesia, is important and interesting to conduct.

One effort to monitor the ERM process is by establishing a Risk Monitoring Committee. In Indonesia, the National Governance Policy Committee has issued a General Guideline for Good Corporate Governance stating that the board of commissioners should form a supporting committee called Risk Monitoring Committee (RMC). The new policy is only obliged to the banking sector. The regulation on the establishment of a Risk Monitoring Committee on the banking sector is also reinforced with the Bank Indonesia Regulation Number 8/4/PBI/2006 concerning Good Corporate Governance Implementation by Commercial Banks, and also Financial Services Authority Regulation No. 55/POJK.03/2016 concerning the Implementation of Governance for Commercial Banks containing corporate governance implementation in the banking sector.

In various literature, practitioners and academicians emphasize that the synergy between the corporate governance elements is one key element for effective risk disclosure (Viscelli et al. 2016; Beasley et al. 2015). However, there is a limited understanding of the role of governance elements in developing ERM practices and their impacts on firm value. In addition, although the RMC establishment is greatly important, there is only some evidence discussing the role of RMC in the firm value. Most studies only focused their attention on the Risk Management Committee (Schmid et al. 2011; Hines and Peters 2015). In practice, risk management in big banks has followed the prescribed regulatory pressure, yet only a small number of banks can implement good practices. Although most banks have already had a special risk committee, most of them rarely meet, having not sufficient independent members and financial expertise (Schmid et al. 2011). As a result, RMC cannot perform its effective monitoring function. Therefore, this study identifies the role of RMC (size, independence member, female member, education level, financial expert, risk management expert, and meeting) to strengthen the relationship between ERM disclosure and firm value.

This study aims at examining the effect of ERM disclosure on firm value in the Indonesian banking sector. This study also investigates whether or not the existence of RMC can strengthen the ERM disclosure and affect firm value. Similarly, this paper combines and further develops the relevant previous findings from the research's three main areas covering ERM, corporate governance, and firm value. This study uses Tobin's Q reflecting the market perspective or investor's expectations on the firm's future performance (Iswajuni et al. 2018). This study was conducted in banking companies. This sector always faced a high risk-taking which requires higher risk management supervision than the non-financial companies.

2. Literature Review

2.1 The Effect of Enterprise Risk Management Disclosures on Firm Value

ERM disclosure is one form of corporate responsibility to stakeholders (Nahar et al. 2016). This practice not only reduces the agency problems (Jensen and Meckling 1998) but also creates the market participants' positive perceptions (Baxter et al. 2013). Therefore, ERM is used as an instrument to improve the financial performance and firm value (Schmid et al. 2011; Baxter et al. 2013; Nahar et al. 2016; Gatzert et al. 2015; Malik 2017; Farrell and Gallagher 2014) Although most articles have proven that there was a positive relationship between ERM and firm value, other study have shown inconsistent results. A study focusing on companies in Chinese insurance companies documented that ERM did not have a significant effect on shareholder value (Li Q et al. 2014). Apart from the inconsistency in previous research results, the empirical results generally confirmed that ERM system might holistically add the firm value. Thus, a hypothesis is formulated as follows:
H1: ERM disclosure has a positive effect on firm value.

2.2 Risk Monitoring Committee (RMC) Role as a Moderator Between ERM Disclosure and Firm Value

Banks are institutions with high risk-taking. To implement ERM in each activity, RMC requires several characteristics consisting of size, independence member, female member, education level, financial expert, risk management expert, and meeting.

2.2.1 RMC Size

Theoretically, RMC size is used as an indicator showing that the firm commits to invest the competent resources in monitoring the ERM practices. The more the number of RMCs, the more the competency combinations the committee has and can improve the quality of information presented, including risk management information. The large number of RMCs allows the companies to meet good governance requirements, such as gender diversity, independence, education, and special expertise of RMC members (Malik 2017). The previous result found that RMC size increased the risk management function (Ng T et al. 2012; Magee et al. 2014). Other studies have successfully identified that the RMC structure had a positive effect on market risk (Hutchison and Ngoc 2012) and financial performance (Ames et al. 2018). Regarding the company risk, other studies found that RMC size was positively related to risk information which provided a higher market risk (Al-Hadi et al. 2015). Thus, a hypothesis is formulated as follows:
H2: RMC size strengthens the relationship between ERM disclosure and firm value.

2.2.2 RMC Independence Member

Based on the applicable regulations, RMC must have at least two independent members. Independent here means that those RMC members must have no relationship with the shareholders, board of commissioners, or directors. The RMC members coming from outside of the bank may not have any relationship which may result in conflicts of interest and negative impacts with the other banks yet prevent the fraudulent management behavior or financial information concealment (Jensen and Meckling 1998), including risk information. The results of previous studies also provided the empirical supports that independent RMC members might assist in the implementation of ERM (Magee et al. 2014). Independent RMC members might also increase the diversity of opinions to create good communication between company boards of directors, committees, and management. An independent assessment of the key risk area

might minimize the company's exposure to substantial risks, which eventually improves the firm value (Ng T et al. 2012). Thus, a hypothesis is formulated as follows:
H3: RMC independent members strengthen the relationship between ERM disclosure and firm value.

2.2.3 RMC Female Member

Gender may also influence the role of RMC. The presence of women in the corporate governance organs may also improve the quality of supervision because women generally have high conservatism attitudes and are careful in making decisions, tend to avoid risks, and are more details. The literature studies show that when there are opportunistic behaviors in decision making, women generally have a lower tolerance level than men. Women also tend to avoid excessive risk-taking and aggressive income management. Finally, the presence of women (gender diversity) in committees gives a positive signal to the company's external environment (Lückerath-Rovers 2011). Thus, a hypothesis is formulated as follows:
H4: RMC female members strengthen the relationship between ERM disclosure and firm value.

2.2.4 RMC Education Level

One factor determining the RMC members' competence is formal education level. This variable will determine an individual's cognitive abilities, which may affect their ways of thinking and the ability to make decisions. The higher the RMC members' education level, the more extensive the knowledge they may have. So, when solving a problem, they may provide better solutions. RMC members with higher education levels are assumed to have a higher level of conservatism that they may become more carefully assessing the risks. Thus, this study assumes that RMC's formal education level has an effective effect on the company risk information disclosure that eventually improves the firm value. Thus, a hypothesis is formulated as follows:
H5: RMC education level strengthens the relationship between ERM disclosure and firm value.

2.2.5 RMC Financial Expert

RMC consists of at least one independent party with financial expertise. Researchers have proven the positive impact of financial expertise belonging to the members of the board or committee on improving the quality of financial reports (Magee et al. 2014). A committee whose members have financial expertise is likely to reduce the risk of company failure. It contributes positively to the creation of shareholder wealth. An ideal RMC should have financial expert experience. If these requirements are met, the committee may hold effective discussions with the management, especially when identifying possible risks arising in the company. Thus, a hypothesis is formulated as follows:
H6: RMC financial expert strengthens the relationship between ERM disclosure and firm value.

2.2.6 RMC Risk Management Expert

RMC must have at least one independent party with risk management expertise. RMC members may participate in training, workshops, or practice sharing risk management. RMC members may also increase their self-qualification by taking risk management certification exams, such as Enterprise Risk Management Certified Professional, Certified in Enterprise Risk Governance, or Certified Fraud Examiners. The RMC members with good risk management knowledge and understanding may identify, assess, and evaluate the possible potential risks arising in the future, both internal and external. Thus, a hypothesis is formulated as follows:
H7: RMC risk management expert strengthens the relationship between ERM disclosure and firm value.

2.2.7 RMC Meeting

Referring to the applicable regulations, RMC does not have standardized rules regarding the number of meetings to hold. Some banks have implemented the provisions that the committees must hold a meeting at least once every three months, but some have the provisions to conduct a meeting at least once a month. The frequency of RMC meetings reflects the responsibilities of members on monitoring the process effectively (Ellul and Yerramilli 2010). Since risk management is a dynamic and ongoing process, RMC should have a regular meeting to immediately respond to the arising risk changes. The higher the RMC members' meeting frequency, the more effective the risk management monitoring process will be (Malik 2017). Thus, a hypothesis is formulated as follows:
H8: RMC meeting strengthens the relationship between ERM and firm value.

3. Research Method

3.1 Research Population and Samples

The population consisted of banking companies listed on the Indonesian Stock Exchange within a period of 2016-2018. Based on the purposive sampling criteria, this study used 42 companies with 126 observational data. The data was collected using a documentation method derived from the banking companies' annual reports.

3.2 Definition of Variable Operations

3.2.1 Dependent Variable

The dependent variable is the firm value proxied using Tobin's Q. Tobin's Q reflects a long-term performance and describes investors' future expectations (Baxter et al. 2013; Farrell and Gallagher 2014; Lin et al. 2010). This indicator is relevant to the idea of ERM implementation where the benefits of risk management cannot be realized and felt in a short time (Malik 2017).

3.2.2 Independent Variable

The independent variable is the ERM disclosure proxied using the ERM Disclosure Index. This index measures the effectiveness of the ERM process, such as compliance, business strategy, operation, and financial reporting. Referring to previous studies (Gordon et al. 2009), the ERM disclosure index consists of 108 items covering eight dimensions based on the ERM framework issued by COSO: (1) internal environment, (2) setting goals, (3) identification of events, (4) risk assessment, (5) response to risk, (6) surveillance activities, (7) information and communication, as well as (8) monitoring. COSO's framework is not only designed to safeguard assets and financial but also guide to build an effective internal risk assessment (Rustiarini et al. 2019). The data collection method used to analyze the ERM disclosure index is a content analysis of information that the company presents in its annual report. Scoring for each disclosure item uses the un-weighed dichotomous scale. If the company discloses the item, it is given the value of 1 and if not disclosed, the item is given the value of 0. Next, the scores are accumulated to obtain each company's total disclosure score for.

3.2.3 Moderation Variable

The moderating variable is the effectiveness of RMC role determined by the following characteristics:

1) RMC size, the number of RMC members.
2) RMC independence member, in which RMC members having no relationship with shareholders, board of commissioners, or directors, as and personal interests/relationships with the bank. This variable is measured using the percentage of independent RMC members.
3) RMC female member, the presence of women in RMC. This variable is measured using a dummy variable, given the value of 1 if there are women as members of RMC, and vice versa.
4) RMC education level, the formal education level of RMC members. This variable is measured using the percentage of RMC members graduated from the master and doctoral degrees.
5) RMC financial expert, the financial expertise of RMC members. This variable is measured using the percentage of RMC members with educational backgrounds in finance, economics, accounting, management, and banking.
6) RMC risk management expert, risk management expertise which must be possessed by RMC members. This variable is measured using the percentage of RMC members with adequate expertise in ERM characterized by their participations in various activities dealing to risk management, such as certification exams, trainings, workshops, or practice sharing.
7) RMC meeting, a formal meeting conducted by RMC members. This variable is measured by the number of RMC meetings in one year.

3.2.4 Control Variable

The control variables consist of profitability ratio (ROE) and leverage (DER). Theoretically, there is a positive relationship between profitability ratio (ROE) and firm value. A high profitability level makes the company get a positive profit, that is, gaining public trust which can ultimately increase the company profits in the future. Therefore, the profitability ratio is considered affecting the relationship between ERM disclosure and firm value. In the leverage context, there is a negative relationship between leverage ratio (DER) and firm value. Therefore, ROE and DER are used as the control variables, similar to the previous studies (Haniffa and Cooke 2005).

3.3 Data Analysis Technique

This research uses the Moderated Regression Analysis (MRA). This study has two regression models. Model 1 examines the direct relationship between ERM disclosure and firm value. Model 2 examines the relationship between ERM disclosure and firm value moderated by RMC. These two equations are shown in the following regression equations:

$$Y = \alpha + \beta_1 ERMDisc + e$$

$$Y = \alpha + \beta_1 ERMDisc + \beta_2 RMC\_Size + \beta_3 RMC\_Ind + \beta_4 RMC\_Fem + \beta_5 RMC\_Edu + \beta_6 RMC\_Finex + \beta_7 RMC\_Rmex + \beta_8 RMC\_Meet + \beta_9 ERMD*Size + \beta_{10} ERMD*Ind + \beta_{11} ERMD*Fem + \beta_{12} ERMD*Edu + \beta_{13} ERMD*Finex + \beta_{14} ERMD*Rmex + \beta_{15} ERMD*Meet + e$$

4. Result and Discussion

The result of descriptive analysis on the ERM variable generally indicated that the ERM disclosure was at a moderate level, proven by the mean value of 0.44 (44 percent). This figure represented that the company has not provided much information related to the eight dimensions of the ERM framework suggested by COSO. This result started that risk management in big banks has followed the prescribed regulatory pressure, yet only a small number of banks can perform good practices, one of which related to the completeness of risk management information presentation to the corporate stakeholders.

Model 1 testing result

Model testing 1 was used to examine the first hypothesis stating that ERM disclosure has a positive effect on firm value. The results of the regression model 1 were presented in Table 1. Table 1 showed that the Adjusted R Square value was 0.29, meaning that the firm value variable explained by the ERM disclosure variable was 29 percent. The statistical testing results in Table 1 showed that the ERM disclosure variable had a positive effect on firm value with a significance of 0.00, meaning that the results supported the first hypothesis (H1). The results of this study indicated that the ERM disclosed by the banking sector had created a positive perception of market participants (Baxter et al. 2013). Thus, ERM disclosure was considered as an effective instrument to improve firm performance and firm value.

Model 2 testing result

Model 2 testing was used to examine H2, H3, H4, H5, H6, H7, and H8 due to the role of RMC (size, independence member, female member, education level, financial expert, risk management expert, and meeting) on the relationship between ERM disclosure and firm value, were shown in Table 2.

Table 2 showed that the Adjusted R2 value was 0.68, meaning that the firm's value might be explained by the ERM disclosure, RMC characteristics, and ERM interaction variables with RMC characteristic variables of 68 percent. The statistical test results showed that there were four characteristics of RMC variables (RMC size, RMC female members, RMC financial experts, and RMC meetings) to accelerate the relationship between ERM and firm value at the significance level of $\alpha = 5\%$. One other RMC characteristic, that is, RMC risk management expert might moderate at the significance level of $\alpha = 10\%$. Meanwhile, RMC independence member and RMC education level were unable to moderate the relationship between ERM and firm value.

Table 1. Regression analysis - Model 1

Variables	B	t	Sig	Hypothesis	Sign Prediction	Decision
ERM Disclosure	0.92	7.29	0.00	H_1	Positive	Accepted
R R *Square* *Adjusted* R^2	0.55 0.30 0.29					

Source: Primary data (processed)

The interaction testing results of ERM disclosure and RMC size showed a positive direction with a significance of 0.01, meaning that RMC size was able to strengthen the relationship between ERM disclosure and firm value. The RMC size as one company indicator was committed to improving the quality of ERM. The number of RMC members greatly influenced the control and supervision activities. The greater the number of RMC members, the better the combination of expertise in presenting risk information and communicating risk assessments to stakeholders (Ng T et al. 2012; Magee et al. 2014). This result supported H2.

The interaction testing results of ERM disclosure and RMC independence member showed a negative direction with the significance of 0.16, meaning that RMC independence member was unable to strengthen the relationship between ERM disclosure and firm value. The existence of independent RMC members was assumed capable of performing more effective monitoring processes, especially in overseeing the possibility of fraudulent financial reporting or information concealment (Jensen and Meckling 1998). However, this study showed the opposite results probably due to the existence of independent RMC members which was only as a formality to meet the regulations. This condition caused the independent members did not have greater power to monitor the company risk. These results were not consistent with those of previous studies stating that the independent RMC members might assist the ERM process (Magee et al. 2014; Zaman et al. 2011). Thus, this result did not support H3.

The interaction testing results of ERM disclosure and RMC female members showed a positive direction with the significance of 0.02, meaning that the RMC female member was proven to strengthen the relationship between ERM disclosure and firm value. The presence of women in RMC might encourage constructive creations and communication challenges to streamline the monitoring process of all committee members. Since women tended to have a lower tolerance level for aggressive financial reporting actions, women preferred to completely disclose the ERM information. Finally, the presence of women in the company committees had a positive signal to the stakeholders (Lückerath-Rovers 2011; Rose 2007). Thus, the results of this study supported the corporate governance literature confirming that the presence of women in company organs had a positive effect on firm value (Lückerath-Rovers 2011; Francoeur et al. 2007; Srinidhi et al. 2011). This result supported H4.

The interaction testing results of ERM disclosure and RMC education level showed a negative direction with the significance of 0.17, meaning that the RMC education level was unable to strengthen the relationship between ERM disclosure and firm value. Theoretically, the higher the education level of RMC members, the more extensive the possessed knowledge that they were able to provide a better solution to solve a problem. However, the empirical result did not support the theoretical studies. The RMC member competence was not only determined by the education level but also other factors, such as experience in finance and risk management expertise. Therefore, the RMC members who only graduated with a bachelor's degree were able to perform effective corporate risk monitoring because they had equivalent experience in the risk management area. This result did not support H5.

Table 2. Moderated regression analysis - Model 2

Variables	B	t	Sig	Hypothesis	Sign Prediction	Decision
ERM Disc	2.24	3.43	0.00			
RMC_Size	-0.11	-3.38	0.00			
RMC_Ind	0.71	2.22	0.03			
RMC_Fem	-0.24	-2.46	0.01			
RMC_Edu	0.40	1.72	0.08			
RMC_Finex	-1.01	-3.59	0.00			
RMC_Rmex	-0.03	-0.10	0.92			
RMC_Meet	-0.04	-3.53	0.00			
ERMD*Size	0.18	2.52	0.01*	H_2	Positive	Accepted
ERMD*Ind	-1.06	-1.41	0.16	H_3	Positive	Rejected
ERMD*Fem	0.50	2.28	0.02*	H_4	Positive	Accepted
ERMD*Edu	-0.69	-1.39	0.17	H_5	Positive	Rejected
ERMD*Finex	1.95	2.79	0.00*	H_6	Positive	Accepted
ERMD*Rmex	0.93	1.69	0.09**	H_7	Positive	Accepted
ERMD*Meet	0.08	3.85	0.00*	H_8	Positive	Accepted
ROE	0.00	0.09	0.93			
DER	-0.00	-0.27	0.79			
R	0.85					
R *Square*	0.73					
Adjusted R^2	0.68					

Source: Primary data (processed)
*Significance level at α = 5%
** Significance level at α = 10%

The interaction testing results of ERM disclosure and RMC financial expert showed a positive direction with the significance of 0.00, meaning that the RMC financial expert was proven capable of strengthening the relationship between ERM disclosure and firm value. The financial expert, at least one person, was able to reduce the risk of company failure and made a positive contribution to the shareholder wealth creation. The RMC members with financial expertise were expected to improve the ERM reporting quality to increase the firm value. This result supported the previous studies that committees with financial expertise would improve the financial reporting quality (Magee et al. 2014; Haniffa and Cooke 2005) and ultimately increase the company value. Thus, this result supported H6.

The interaction testing results of ERM disclosure and RMC risk management expert showed a positive direction with a significance of 0.09, meaning that RMC risk management expert was proven to strengthen the relationship between ERM disclosure and firm value at the significance level of α = 10%. Thus, RMC should have the risk management knowledge and understanding that RMC might internally and externally identify, assess, and evaluate the possibilities arising potential risks in the future. RMC members with risk management expertise might increase the ERM disclosure to stakeholders and respond positively. This result supported H7.

The interaction of ERM disclosure and RMC meeting showed a positive direction with the significance of 0.00, meaning that the RMC meeting was proven to strengthen the relationship between ERM disclosure and firm value. The frequency of RMC meetings reflected the responsibilities of members in performing a monitoring process (Ellul and Yerramilli 2010). Risk management was a dynamic and ongoing process that RMC should have a regular and consistent frequency of meetings to respond to any risk change. The higher the RMC members' meeting frequency, the more effective the RMC monitored the ERM developments (Malik 2017). This result supported H8.

The results of control variables indicated that ROE and DER respectively had the significance value of 0.93 and 0.79, exceeding the limit level of 0.05. This data proved that profitability and leverage did not affect the relationship between ERM and firm value.

5. Conclusion

In recent years, the regulators and investors have paid more attention to the ERM disclosure information. One of the government's efforts to have more effective risk control was by establishing the RMC. However, this attention has not been followed by the increasing number of studies discussing the topic. At present, not many researchers have discussed the role of RMC. The statistical results of this study showed that the effectiveness of ERM disclosure on firm value was influenced by the RMC characteristics. This study theoretically supported the literature on corporate governance and risk management, particularly in banking industries. This study is also practically expected to provide inputs to regulators and company management that a "strong" RMC is greatly effective to improve the market performance.

This study has two limitations. First, the research was only conducted in the banking sector since the policy to form RMC was only required by banks. Since limited by the use of small samples, this topic may become one productive area for future research. Further researchers may also evaluate the implementation of ERM and firm value in both banking and non-banking companies that the companies which have no RMC will be interested in forming a similar committee. Second, the results identified that the average level of ERM disclosure was still low, at 44 percent or still below 50 percent which was probably due to the ERM disclosure which was only based on the domestic banking regulations. Therefore, researchers may then combine the global ERM model initiated by COSO with the local ERM model established by the regulators to produce more comprehensive conclusions.

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