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The Effect of Corporate Governance and Firm Characteristics on Firm Performance and Risk Management as an Intervening Variable

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Abstract

The purpose of this study is to examine the effect of corporate governance and firm characteristics on the existence of Risk Management Committee and the effect of the existence of the Risk Management Committee on firm performance. In addition, this study also examines the intervening role of Risk Management Committee on the relationship between corporate governance and firm characteristics and firm performance.The population in this study were non-financial companies listed in Indonesian Stock Exchange for the 2013 financial year and purposive sampling is used as sampling method. Data for this study were taken from company's annual report. The hypotheses were tested by using Partial Least Squre (PLS). The result proved that corporate governance and firm characteristics affect the existence of Risk Management Committee, and the existence of Risk Management Committee affects firm performance. The result also proved that Risk Management Committee act as an intervening variable among corporate governance and firm characteristics on firm performance.

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1. Introduction

Firm performance shows the achievement of company's goals. Firm performance should be maintained and enhanced continuously to attract investors and to maintain good relationship with stakeholders. In very high uncertainty and competitive environment, to maintain and improve company's performance, company is faced with various risks. Achievement of high performance can contain high risk anyway. Therefore it is necessary for management to be aware about those risks, to be able to identify, monitor and control those risks.

Risk management is a way to identify and manage the risks that may affect the achievement of firm performance. An effective risk management system requires an adequate supervision. Currently some companies delegate risk oversight to Audit Committee. Along with the extent of the responsibilities and duties of Audit Committee, it is doubted on whether Audit Committee will function effectively. Therefore, some companies take the

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initiative to make a separate committee of the Audit Committee to perform the role of supervision and oversight of enterprise risk management, namely a Risk Management Committee (RMC).

Development of RMC in Indonesia has started to increase, especially after the issuance of several regulations related to the obligation of the establishment of a RMC. Those regulations require the commercial banks and insurance companies to establish RMC. Meanwhile for sectors other than banking and insurance, the establishment of RMC is voluntary. Therefore, not all companies listed on the Stock Exchange form RMC.

Empirical studies show that the establishment of RMC in companies is affected by corporate governance and firm characteristics (Subramaniam, Mc Manus and Zhang, 2009; Andarini and Januarti, 2012; Ratnawati, 2012; Sambera and Meiranto, 2013). Corporate governance in a company will determine management practices and decision-making process including those associated with formation of a special overseeing committee to monitor company's risk management process. Meanwhile, firm characteristics which can be seen from several factors such as firm size, firm complexity, financial reporting risk and leverage would also have effect on risks faced by company. Therefore, to minimize those risks, management will encourage board of commissioners to form a special committee which is responsible for the oversight of risk management processes, namely RMC. The existence of RMC will increase risk management oversight. It will encourage the achievement of effective risk management so that risk can be anticipated and managed for the purpose of enhancing company's value. Increasing company' value is one way of increasing firm performance. Thus, the existence of a RMC will have an effect on firm performance.

Previous researches on firm performance have examined the direct effects of corporate governance and firm characteristics on firm performance (Indarini, 2008; Karyawati, 2013; Widyati, 2013; Wulandari, 2006; Garg, 2007; Saibaba and Ansari, 2011; Ho, 2011; Sahu and Mana, 2013 and Arifani, 2013). Furthermore, the existence of RMC has also been studied (Subramaniam et al., 2009; Andarini and Januarti, 2012; Ratnawati, 2012 and Sambera and Meiranto, 2013). Past researches have studied some factors that affect the existence of a RMC such as corporate governance and firm characteristics, but, corporate governance and firm characteristics are stated in different indicators. In addition, the effect of these variables on firm performance and to the establishment and implementation of risk management, gave inconsistent results.

Based on the discussion above, the purpose of this study is, firstly, to analyse the effect of corporate governance on the existence of a Risk Management Committee. Secondly, to analyse the effect of firm characteristics on the existence of a Risk Management Committee. Thirdly, to analyse the effect of the existence of Risk Management Committee on firm performance. Fourthly, to analyse the role of a Risk Management Committee as mediating variable between corporate governance and firm performance. Last but not least, the fifth objective of this study is to analyse the role of a Risk Management Committee as mediating variable between firm characteristics and firm performance.

2. Hypotheses Development

2.1. Corporate governance and RMC

The practices of corporate governance in a company are indicated in several factors. Those factors are the size of board of commissioners, independent commissioners, managerial ownership, concentrated ownership and auditor reputation.

The large size of board commissioners allows for the establishment of various committees including the RMC. (Carson, 2002; Chen, Kilgore and Radich, 2009, in Januarti, 2012). Furthermore, the existence of an independent commissioner will encourage the formation of RMC, because independent commissioners found RMC as an important committee in helping them to exercise oversight responsibilities. Companies with a high proportion of independent commissioners tend to be more concerned with the company's risk compared to the low proportion of independent directors (Sullivan, 1997 in Husaini, Saiful, Fadli, Abdullah and Aisha, 2013).

High percentage of managerial ownership cause greater responsibility for management. Therefore, to minimize losses managers will seek to minimize the risks. Managers then try to encourage commissioners to form a special committee which is responsible for overseeing implementation of risk management such as RMC.

The concentrated ownership is related to business risk. Greater level of concentrated ownership demands more information and explanation on the risks that may be encountered by company such as financial risk, operational risk, reputation, regulatory, and information. This is because the group of controlling shareholders (the largest shareholder) has an interest to monitor risks to prevent possible losses that would occur. Therefore, the largest

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