CORPORATE GOVERNANCE AND CORPORATE RISK DISCLOSURE EVIDENCE FROM MALAYSIA

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ABSTRACT

The main objective of this study is to analyse the impact of corporate governace on the corporate risk disclosure of Malaysian corporations. The research has used quantitative methods, namely, regression testing, in the form of descriptive statistics and multiple regression analysis. The data obtained in this research are analyzed by using the Statistical Product and Service Solutions (SPSS). To answer the study objectives, the researcher analyzes the nonfinancial companies listed on Bursa Malaysia. The results of this study indicate that board size affects corporate risk disclosure, while board independence no affects corporate risk disclosure. It shows that the greater the board size, the better the level of supervision and pressure on management, thus encouraging management to be more transparent corporate risk disclosure. This study can contribute to the government as a reference in the preparation of corporate risk disclosure policies to increase investor confidence in company risk disclosure information produced by public companies.

Keywords: Corporate Risk Disclosure, Corporate Governance, Board Size, Board of Independence, Malaysia.

INTRODUCTION

The increasing corporate scandal has led to a lack of investor and creditor confidence in corporate financial reporting. This is evident from well-known companies involved in accounting irregularities due to the absence of risk management information, such as Enron, WorldCom, Xerox, and Parmalat in the late 1990s and 2000s (Cabedo & Tirado, 2004).

Investors due to accounting irregularities ask for more disclosures. One important information from the annual report that attracts investors is the non-financial segment related to corporate governance (Amran, Bin, & Hassan, 2009). Information relating to corporate governance such as a risk management system can convince investors that the organization is free from accounting irregularities. Information asymmetry between managers and investors can be reduced by conducting risk disclosures (Aljifri & Hussainey, 2007).

In Malaysia, the Asian financial crisis in 1997 has caused many companies to collapse. Likewise, the 2008 subprime mortgage crisis in the United States has greatly affected companies. Lack of corporate governance, weak risk management systems are seen as determinants of a collapsing company. The Asian financial crisis taught Malaysian companies valuable lessons, especially in improving the governance and reporting of their company's risks. In response to the Asian financial crisis, the Malaysian government established the Malaysian Code of Corporate Governance (MCCG) in 2000 MCCG's goal is to establish principles and best practices as a guide for companies to carry out their operations in achieving an optimal governance framework including reporting risk.

MCCG and the list of requirements, however, cannot enforce companies to provide good risk management systems in organizations. Interaction of external parties that is independent of management seems to be an important element in monitoring the risk management system and the level of disclosure. Based on agency theory, the presence of an independent board of commissioners is expected to monitor management and protect the interests of shareholders (Fama & Jensen, 1983).

Empirically, the influence of corporate governance such as board size and the proportion of independent board on corporate risk disclosure varies. Studies (Beasley, Clune, & Hermanson (2005), Elzahar & Hussainey (2012) find no effect of board size on corporate risk disclosure, then Abraham & Cox (2007), Lajili (2009), find the relationship between these two variables. Studies Lopes & Rodrigues (2007), Elzahar & Hussainey (2012) find that there is no relationship between the proportion of independent member and corporate risk disclosure, while other studies find that there is a relationship between the two (Abraham & Cox, 2007); (Lajili, 2009);(Olveira, Rodrigues, & Craight, 2011); (Probohudono, Tower, & Rusmin, 2013).

Research on corporate risk disclosure using a weighted index based on the importance of each item on voluntary risk disclosure by considering the views of academics, external audits and audit committees associated with Board of Commissioners variables in non-financial companies so far have not been found by the author. The difference between this research and previous research is that this research uses the risk disclosure of the company weighted index. The preparation of the corporate risk disclosure index in this study considers the views of academics, external audits and audit committees to determine the weighted importance of each voluntary risk disclosure item

Based on the description of the background mentioned above, the purpose of this study is to examine whether corporate risk disclosure is influenced by CG. The main question of this study is whether the CG mechanism represented by board size and proportion of independent board members affect the corporate risk disclosures.

LITERATURE REVIEW

The Agency theory, according to (Jensen & Meckling, 1976) states that the agency relationship occurs when the principal gives the task to the second party or agency to conduct the duties based on the principal interest. This transfer of tasks will cover the transfer of authority to take decisions. Problems will arise when principals and agents maximize their respective interests, so there is a big possibility that agents will not always act on the interests of principals, the differences in interests between principals and agents will cause agency problems (Jensen & Meckling, 1976).

The implementation of good CG is a mechanism to minimize these costs (Judge, Naoumova, & Koutzevol, 2003). This method may increase the harmony between principal and agent (Conyon & Schwalbach, 2000). Cheung & Chan (2005) also explain that the ultimate objective of CG is to monitor management decision-making to ensure that it is in line with shareholder interests and to motivate managerial behavior that increases shareholder value.

According to the agency theory, the larger Board of Directors combines various business expertise that provides a more effective board supervisory role, so it will disclose more risk information in the company's annual report (Singh, Mathur, & Gleason, 2004). The large size of the board is more effective in its controlling role so that it can increase corporate risk disclosure (Elzahar & Hussainey, 2012).

The results of previous studies on the effect of board size on risk disclosure present diverse findings. Beasley et al., (2005) and Elzahar & Hussainey (2012) find there is no effect of board size on risk disclosure. Abraham & Cox (2007) and Lajili (2009) find a positive relationship between the two variables. Based on the explanation above, we proposed the following hypothesis

H1: The board size has a positive influence on corporate risk disclosure.

Based on the agency theory, the monitoring function of the Board of Commissioners is to make sure that management will conform to the stockholder's interest. The Independent Commissioner is a commissioner who does not have any relationship in financial, managerial, shareholding, and family field with other commissioners, directors, controlling shareholders, and other relationships which could affect its ability to act independently (Zulfikar, May, Suhardjanto, & Agustiningsih, 2017). Independent commissioner is expected to provide independent advice for commissioners appointed by the company. The larger the proportion of independent commissioner is expected to increase the effectiveness of controlling role so that it can influence the quality of the accounting reporting and increase corporate risk disclosures (Fama & Jensen, 1983).

The results of previous studies on the influence of independent members proportion in the board on risk disclosure are diverse. Research conducted Lopes & Rodrigues (2007), Elzahar & Hussainey (2012) find that there is no effect on both of two variables, while the others find a positive significant effect(Abraham & Cox, 2007);(Lajili, 2009); (Olveira et al., 2011); (Probohudono et al., 2013). Based on the explanation above, it can be developed hypotheses as follows:

H2: The proportion of independent board positive influences on corporate risk disclosure

METHODOLOGY

This research is a kind of causal research, which aims to test a hypothesis about the influence of one or several independent variables on the dependent variable. The hypothesis proposed in the research is tested using quantitative research methods, namely conducting regression testing in the form of descriptive statistics and multiple regression analysis. The data obtained in this research will be processed using Statistical Product and Service Solutions (SPSS). To perform the test, it is necessary to explain the measurement of the variables used in the research, namely corporate risk disclosure, the board size, independent board, and firm size.

Corporate Risk Disclosure.
Corporate risk disclosure is measured using a corporate risk disclosure weighted index (CRDWI), developed from Linsley & Shrives (2006); Vandemaele, Vergauwen, & Michiels (2009), (Amran et al., 2009), (Miihkinen, 2012), Mokhtar & Mellett (2013), (Ismail &

Rahman, 2013), risks are divided into six parts, namely: financial risk, operations risk, empowerment risk, technology risk, integrity risk, and strategic risk.

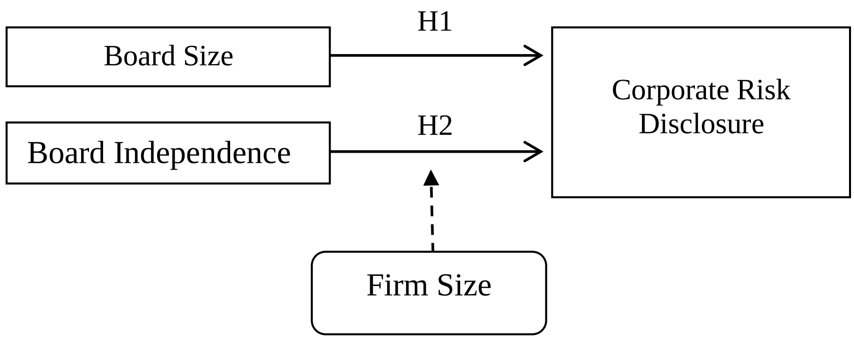

Figure 1. Framework

Financial risk is the risk associated with corporate financial instruments such as commodity risk. Operational risks are related to customer satisfaction, product development, efficiency and performance, resources, obsolescence and shrinkage, product and service failures, environment, health and safety, brand name erosion. Empowerment risk is related to leadership and management, outsourcing, performance incentives, change readiness, communications. Technology risks relate to integrity, access, availability, and infrastructure. Integrity risk is related to management and employee fraud, illegal acts, and reputation. Whereas strategic risk is related to environmental scan, industry, business portfolio, competitors, pricing, valuation, planning, life cycle, performance measurement, regulatory, sovereign and political.

In CRDWI 33 the criteria cover all dimensions. If a company discloses risks based on these criteria, a score of 1 (one) will be given. Whereas if not, then given a score of 0 (zero). The measurement is done by counting the number of items disclosed by the company in its annual report multiplied by the weight of each item of risk disclosure divided by the total number of disclosure items. Measurement variables can be formulated as follows(Cooke, 1992).

$$\text{CRDWI} = \frac{\text{Numbers CRD items that disclosed}}{\text{Total CRD items should be disclosed}}$$

information: CRDWI = Corporate Risk Disclosure Weighted Index

Board Size.

In this study, board size is measured by the total of the board of commissioner members (Ntim, Lindop, & Thomas, 2013).

Board Independence

Board Independence is measured by the proportion of independent commissioners to the total board of commissioner members (Abeysekera, 2010). Board Independence can be calculated by the following formula:

$$\text{Board Independence} = \frac{\text{Proportion of Independent commissioner}}{\text{Total board of commissioner members}}$$

Firm Size

The control variable used in this study is firm size, measured by total assets (Beretta & Bozzolan, 2004); (Lajili & Zeghal, 2005); (Linsley & Shrives, 2006). According to agency theory, large companies need to disclose more information to different users, which leads to a reduction in agency costs, and to reduce information asymmetry (Watts & Zimmerman, 1983).

Firm Size = Ln (Total Assets)

Population and Sample Research

The population studied in this study is non-financial companies listed in the Bursa Malaysia 2013-2017. Samples are selected using purposive sampling with the criteria: 1) a non-financial company listed on the Bursa Malaysia 2013-2017. 2) Companies that publish financial statements and annual reports for 2013-2017. 3) The company has complete data regarding the size of the board of directors and independent directors. Based on these criteria, we obtained a total sample of 200 annual reports.

Data Collection

In this study, the required data is obtained by using archive data collection techniques, namely using documents or secondary data. Data on financial and non-financial statements are obtained from the website of the Bursa Malaysia and the company website, which became the object of research. Additionally, the theoretical data on the issues raised in the research is obtained from literature books, journals, and research results related to the problems discussed in this study.

DISCUSSION

Descriptive Statistics Analysis Results

The variables used in this study are corporate risk disclosure measured by CRDWI, board size measured by the total of the board of commissioner members, board Independence measured by the proportion of independent commissioner to total board of commissioner members, and firm size measured by Ln (Total Asset).

In the testing hypothesis, Corporate Risk Disclosure (CRD) is used as a dependent variable, Board Size (BOARD SIZE), Board Independence (BOARDINDEP) as an independent variable, and firm size as a control variable. The results of descriptive statistical analysis can be seen in Table 1 for the model used in the testing hypothesis.

Table 1: Result of Descriptive Statistics Analysis Model

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Board size	200	2.0000	12.0000	5.5800	2.3500
Board independence	200	0.2500	1.0000	0.6823	0.2209
Firm size	200	98.62	367,601.59	24,838.12	55,707.81
Corporate risk disclosure	200	0.3070	0.7144	0.4810	0.1228
Valid N (listwise)	200				

Source: Processed SPSS Data

Linear Regression Model

This study uses the model of regression analysis: Model test to see whether there is the influence of independent variable (board size, board independence) to the dependent variable (Corporate Risk Disclosure) with firm size as a control variable. Table 2 below shows the results of multiple regression analyses in the model of this study.

Table 2: Results of Multiple Regressions

Variables	Coefficient	t	p-value
(Constant)	-5.120	-1.503	0.135
Board Size	0.306	2.355***	0.020
Board Independence	-1.448	-1.292	0.198
Firm size	0.819	5.291***	0.000
R-Square	0.387		
Adjusted R-Square	0.372		
F	24.547		
Sig	0.000		

Source: Processed SPSS Data

Based on the table above test results, the regression model used in this study is as follows.

CRDWI = – 5.120 + 0.306 BOARD SIZE – 1.448 BOARDINDEP + 0.819 FIRM SIZE + e

Effect Board Size on Corporate Risk Disclosure

The board size (ρ-value 0.020 <0.050 and a positive coefficient of 0.306) indicates that the Board size has a significant positive effect on the corporate risk disclosure. Means hypothesis 1 is accepted. This result shows that the more the number of commissioners, the better the level of supervision and pressure on management to encourage management to be more transparent in disclosing company risks.

Dalton, Daily, Johnson, & Ellstrand (1999) state that the expertise provided by the board of commissioners is a quality service for management and companies that cannot be provided by the market. A large number of commissioners create a combination of the expertise and experience of its members to increase supervision and control of management.

The results of (Collier & Gregory, 1999) showed the greater the number of members of the board of commissioners, the control of the Chief Executive Officer (CEO) and monitoring carried out more effectively. The greater the size of the Board of Commissioners, the better the ability to protect the interests of stakeholders. When associated with disclosure, the board of commissioners with a large size has greater power to pressure management to disclose more information about the company, including disclosure of enterprise risk management. The results of this study are consistent with Singh et al., (2004), Elzahar & Hussainey (2012).

Effect Board Independence on Corporate Risk Disclosure

Board Independence (ρ-value 0.198> 0.050) shows that board independence has no significant effect on corporate risk disclosure meaning hypothesis 2 is rejected. This indicates that the commissioners do not understand and carry out their duties as an independent party in overseeing, directing and evaluating the implementation of corporate governance and corporate strategic policies so that the role of the independent commissioner in non-financial companies in Malaysia has not functioned as it should. The results of this study are consistent with the results of research by Ho & Wong (2001); (Haniffa & Cooke, 2002) where the independent commissioner's projection does not affect the company's risk disclosure.

The average proportion of Independent Commissioners in Malaysia has reached 68.23% of the entire Board of Commissioners, this condition has fulfilled the CG requirements but has not yet functioned optimally, especially concerning company risk disclosure. This indicates that the independent commissioners have not performed their duties properly as a CG mechanism in emphasizing the transparency of company information. This could occur due to several possibilities including the lack of knowledge and concern of the independent commissioner regarding the company's risk disclosure responsibilities.

Control Variables

In this study, there are control variables namely firm size. Firm size (p-value 0,000 <0.050 and positive coefficient 0.819) reflects that firm size has a significant effect on corporate risk disclosure and a positive coefficient indicates that firm size has a significant positive effect on corporate risk disclosure. These results indicate that large companies have a greater ability to implement corporate risk disclosures because of their large resources. The results of this study are consistent with Beasley et al., (2005) show that firm size is associated with a greater degree of risk disclosure adoption.

CONCLUSIONS

From the research results obtained, it can be concluded that the Board size influences corporate risk disclosure in Malaysia. This result shows that the more the number of commissioners, the better the level of supervision and pressure on management to encourage management to be more transparent in disclosing company risks.

Board independence does not affect corporate risk disclosure in Malaysia. This indicates that the commissioners do not understand and carry out their duties as an independent party in overseeing, directing and evaluating the implementation of corporate governance and corporate strategic policies so that the role of the independent commissioner in non-financial companies in Malaysia has not functioned as it should.

Firm size control variable influences company risk disclosure in Malaysia. These results indicate that large companies have a greater ability to implement corporate risk disclosures because of their large resources.

As a limitation of this research, This study has used board structure as one of the essential governance mechanisms. Future research may consider other mechanisms like ownership structure.

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