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Contingency perspective: company characteristics, risk management voluntary disclosure, and company performance

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ABSTRACT

Financial Services Authority in Indonesia currently only requires disclosures of financial risk management compared to non-financial risk disclosures. Therefore, this study is expected to provide empirical evidence regarding the importance of voluntary risk management disclosure on firm performance has contingent relationship with considering external factors, consists of (1) business uncertainty, and (2) dynamic environment. This study aims to examine the direct and indirect effect of firm characteristic on company performance through voluntary risk management disclosure based on contingency factors. This study uses secondary data with a content analysis approach to the acquisition of risk management disclosure data based on annual report from sample of companies listed on the Indonesia Stock Exchange in 2017-2019 after the IFRS convergence was implemented in Indonesia. The implication of this research is expected to become a consideration for regulators and entities to disclose non-financial information in the company's annual report because it can affect company performance amidst the uncertain business environment in developing countries such as Indonesia.

Introduction

In recent years, research related to company characteristics on company performance is still a debate and an interesting topic among researchers because it has mixed results. Previous studies related to the influence of company characteristics on company performance raises the suspicion that there are other contextual variables that should be intermediaries between these variables. According to Isbanah (2015), leverage and firm size have a negative effect on the company's financial performance. According to Nurcahya et al. (2014) found that leverage and corporate governance showed a positive influence on company performance. However, on the other hand, company size has no effect on company performance (Sari, 2018; Nurcahya et al., 2014). This study aims to further investigate the existence of other variables that can mediate the relationship between company characteristics and company performance, namely voluntary disclosure of risk management.

Based on previous research, company characteristics can affect the extent of voluntary disclosure of corporate risk management (Malik et al., 2020; Mazaya and Fuad, 2018; Kumalasari et al., 2014). The company's business environment is currently increasingly uncertain and tends to be unstable due to many factors not only coming from financial factors, but also non-financial factors. According to Abdullah et al.

(2015) non-financial factors are the main factors that cause uncertainty in the business environment to be very high, for example recently many events were caused by political uncertainty or regulatory changes, economic and social problems caused by the Covid-19 virus pandemic or natural disasters. others, as well as changes in consumer demand that may affect the stability and sustainability of the company.

Information about these non-financial risks that will be faced by the company now and in the future can be disclosed in the annual report voluntarily. However, if the non-financial information is not disclosed in depth or is not even included in the annual report, it will cause investors to experience information asymmetry in identifying the risks faced by the company, which can lead to investment decision making errors. Furthermore, based on previous research, voluntary disclosure of risk management can improve company performance (Danisman and Demirel, 2019; Abdullah et al, 2015). Managing the impact of risks faced by the company is a fundamental problem faced by corporate entities globally. The application of risk management in each company is very diverse which is influenced by the characteristics of each company. Of course, this is reflected in the differences in the depth of content and the breadth of risk management disclosures in the annual reports of each company. The risk mitigation carried out by the company can reflect the performance of the company's management in managing the impact and potential risks faced.

The effectiveness of risk management in managing the impact of risk is disclosed in the company's annual report which consists of information on financial risks and non-financial risks with a silo perspective approach. However, to date, there is no empirical evidence that reveals that voluntary disclosure of non-financial information has an effect on company performance and has contingencies with external factors for companies in developing countries such as Indonesia. For this reason, this research is interesting to do because it focuses on the importance of comprehensive risk management disclosure, not only financial information, but also non-financial information to assist investors in making investment decisions. This research is a development of previous research that has been carried out by Miihkinen (2013) and Abdullah et al. (2015) which only focuses on the disclosure of risk management and company performance without considering the company's external factors specifically. Malik et al. (2020) revealed that the implementation of risk management (enterprise risk management) has contingencies with external factors of companies in improving the performance of companies in the UK as representatives of developed countries.

However, the regulations in the US are different from that in Indonesia, which has a separation of responsibilities and authorities between the board of commissioners and the board of directors (dual-board). In addition, the regulatory conditions in Indonesia in terms of risk management disclosure in annual reports are different from developed countries. Currently, regulations in Indonesia only require entities to disclose financial risk information, while non-financial information only applies voluntarily to be disclosed. The regulation is contained in Regulation VIII.G.7 (Decree of the Chairman of Bapepam-LK No: KEP-347/BL/2012) which contains disclosures on risks and risk management and requires reporting entities to report the sensitivity of their financial instruments to movements in risks. the. In addition, in PSAK No. 60 (Revised 2010) also requires disclosure of the significance of the effect of financial instruments on the financial position and performance of the company, and quantitative and and qualitative disclosures of risks arising from financial instruments, and determines minimum disclosures regarding credit risk, liquidity risk and market risk, as well as sensitivity analysis on market risk.

In fact, investors want in-depth information about all the impact of risks that will be faced by the company and how the company manages the impact of these risks (Abdullah et al., 2015), not only financial information but also non-financial information such as the risk of technology information, business operation risks, strategic risk, as well as legal aspect risk. Therefore, this research is very important to be carried out in order to provide consideration for regulators regarding the direction of risk management disclosure policies in detail in the future. This research can also provide an overview for entities to be able to disclose the risks faced by the company and how the risk mitigation is carried out as a whole, because relevant information is very useful for company investors.

This study is expected to contribute to providing empirical evidence that (1) there is an indirect effect between company characteristics on company performance through voluntary risk management disclosure, and (2) the relationship between voluntary risk management disclosure and company performance has contingencies with company external factors by modifying research model conducted by Florio and Leoni, (2017), namely adding dynamic environmental risk factors that were not found in previous studies (Miihkinen, 2013; Abdullah et al., 2015). A dynamic environment is an environment that is rapidly changing and unstable, such as changes in technological innovation and market competition. The dynamic environment is one of the important risk factors to be disclosed by the company because the conditions of technological innovation and market competition can change rapidly.

Literature Review And Hypothesis Development

The development of research related to the importance of non-financial risk management information was initiated by Miihkinen's (2013) research which revealed that risk management disclosure affects the company's financial performance because it can reduce information asymmetry that occurs among investors which is reflected in stock trading volume or stock returns in Finland. However, the disclosure of risk management in developing countries is different from that of developed countries which have required disclosure of financial and non-financial risks in their annual reports. The literature related to contingencies in accounting research is one of the vital research streams. According to Gupta and Batra (2016), the approach from the perspective of contingency theory has the assumption that organizational structure is in harmony with various contextual factors such as environment, strategy, and company size and can affect performance.

In the contingency approach, a fit condition can be achieved if there is a combination and a positive influence between the context of certain variables and the organizational structure on the company's performance. Through the moderation approach, it can be assumed that the impact of the independent variable on the dependent variable will have a different magnitude of impact if there is a third variable or called the moderating variable so that a contingency fit will occur. Mazaya and Fuad (2018) reveal that corporate governance as measured by the proportion of the board of commissioners has a positive effect on risk management disclosure. This refers to the agency theory which states that the board of commissioners is a supervisory board whose task is to ensure that the board of directors' decision-making is in line with the interests of shareholders. In addition, previous research also revealed that companies that implement a diversified business strategy have a high complexity, thus requiring wider risk management disclosures (Florio and Leoni, 2017).

H1a: Business strategy has a positive effect on risk management voluntary disclosure
H1b: Firm size has a positive effect on risk management voluntary disclosure
H1c: Leverage has a positive effect on risk management voluntary disclosure
H1d: Board of Commissioner supervision has a positive effect on risk management voluntary disclosure

Companies that implement risk management effectively can improve company performance (Malik et al., 2020; Florio and Leoni, 2017). However, the application of risk management in each company is very diverse even though investors actually need information about all the impact of risks that will be faced by the company and how the company mitigates the risks in order to make investment decisions. According to Abdullah et al. (2015) and Kakanda and Salim (2017), voluntary risk management disclosure can improve the company's financial performance. The company's management will give a signal that the company has a good performance compared to other companies to investors through risk management disclosure in the company's annual report. Thus, the existence of risk management disclosure information can help external parties to increase their confidence in assessing the prospects and performance of the company. Thus, voluntary risk management disclosure can improve company performance.

H2: Voluntary disclosure of risk management has a positive effect on company performance

In recent years, research related to company characteristics on company performance is still an interesting topic among researchers. This is because there are a variety of different findings. According to Isbanah (2015), leverage and firm size have a negative effect on the company's financial performance. On the other hand, according to Nurcahya et al. (2014) found that leverage and corporate governance as measured by various board of commissioner variables showed a positive influence on company performance. This is because, in accordance with agency theory, the supervision of the board of commissioners is needed to overcome agency problems that occur between shareholders and company management. The existence of an independent board of commissioners is expected to be able to be neutral and able to monitor any fraud committed by the company's management, so that it can provide added value for all interested parties in the company. In addition, companies that have good business strategies such as implementing cost leadership strategies or more complex diversification strategies can improve company performance (Malik et al., 2020).

Furthermore, according to Addiyah and Chariri (2014), company size can have a positive effect on company performance in accordance with signal theory, namely companies that have large sizes have greater operational activities, so they will be very careful in maintaining the stability of company performance. However, company size has no effect on company performance (Nurcahya et al., 2014; Sari, 2018). Although large companies basically have great financial strength in supporting performance, large companies are also faced with bigger agency problems because they are more difficult to supervise by the board of commissioners (Nurcahya et al., 2014). In addition, Sari (2018) reveals that companies that have low leverage have good performance, this is because the company has a low level of debt so that the risk of default is lower.

H3a: Business strategy has a positive effect on company performance

H3b: Board of commissioner supervision has a positive effect on company performance
H3c: Firm size has a positive effect on firm performance
H3d: Leverage has a negative effect on company performance

The variety of results of previous studies related to the influence of company characteristics on company performance raises the suspicion that there are other contextual variables that should be intermediaries between these variables. Furthermore, the disclosure of voluntary risk management has an effect on company performance. So, there is an allegation that the characteristics of the company have an indirect effect on the company's performance through the disclosure of voluntary risk management.

H4a: Business strategy has an indirect effect on company performance through voluntary disclosure of risk management
H4b: Board of commissioner supervision has an indirect effect on company performance through voluntary disclosure of risk management
H4c: Company size has an indirect effect on company performance through voluntary risk management disclosure
H4d: Leverage has an indirect effect on company performance through voluntary disclosure of risk management

According to Miihkinen (2012) the relationship between risk management disclosure and company performance is influenced by contingent variables that can strengthen (weaken) the magnitude of the impact of these variables. Anh et al. (2022) revealed that business uncertainty can negatively effect on company performance. One of the external factors of the company is influenced by a dynamic environment which is a rapidly changing and unstable environment such as changes in technological innovation and market competition. The dynamic environment is one of the important risk factors to be disclosed by the company because the conditions of technological innovation and market competition can quickly change and become a determining factor that affects the company's performance.

H5a: Business uncertainty weakens the positive effect of risk management voluntary disclosure on company performance
H5b: A dynamic environment weakens the positive effect of risk management voluntary disclosure on company performance.

Method

The population in this study are all companies listed on the Indonesia Stock Exchange, except the financial and banking industries, this is because these industries have different business characteristics compared to other industries in Indonesia. The research period in this study focuses on after the implementation of IFRS convergence in Indonesia, 2017 to 2019. The sampling method was carried out using the purposive sampling method. The source of data in this study is secondary data taken from the DatastreamWorldscope Database and the annual report of the company's financial statements. The total sample that can be used is 747 observations consisting of 249 companies. The sampling selection process in this study used the purposive sampling method.

The data collection process was carried out using 3 assistants involving students using several supporting software for data coding such as Microsoft Excel basic software to input financial report data and using Atlas.ti software for inputting indexation data from disclosures contained in the company's annual report. Each research assistant is given a completion target according to the specified time limit and always reports the progress of the assistance work every week so that any obstacles experienced during the data coding process can be evaluated.The data analysis model used to test the H1, H2, H3, and H5 hypotheses is Multiple Linear Regression analysis with panel data using Generalized Least Square (GLS). Data analysis was carried out with Eviews.Two Stage Least Square (2SLS) data analysis model is used to test Hypothesis H4 regarding the indirect effect of company characteristics on company performance through voluntary disclosure of risk management.

In measuring company performance, this study uses two measures that have been used in the research of Abdullah et al. (2015), as follows:

$$Perform_i = R_i - [R_f + \beta_i (R_m - R_f)] \quad (1)$$

Where: $Perform_i$ = company performance i, R_i = stock return of company i; R_m= market risk; R_f= risk free rate; β_i = beta of firm i. This measurement is used because the calculation of market return has taken into account the risks faced by the company. The second alternative measurement is using Return on Assets (Abdullah et al., 2015) to see the firm's profitability among industries.

In measuring the characteristics of the company, this study uses 4 (four) measures based on the factors of business strategy, company size, leverage, and supervision of the board of commissioners. Business strategy is measured based on the diversification strategy carried out by the company, using product diversification measures (Bushman et al., 2004). Product diversification is measured based on the HirfindahlHirachman Index (HHI), as follows:

$$\text{Divers} = \sum_{i=1}^{n} \left(\frac{\text{TotalProductSegment'sSales}}{\text{TotalSales}}\right)^2 \quad (2)$$

Referring to the research of Abdullah et al. (2015) , this study uses a risk management voluntary disclosure measure based on Miihkinen (2013)framework. This is because risk disclosure has relevant information about the risks faced by the company (Moumen et al, 2015). This measurement is also in accordance with regulation VIII.G.7 regarding the context of risk management silos regarding the impact and potential risks faced by the company divide risk into six categories, namely financial risk, operating risk, leadership risk, information and technology risk, corporate integrity risk, and strategic risk.

Results and Discussions

In Table 1, Company Characteristics measured by strategy, board of commissioner supervision, and firm size consistently have a positive effect on voluntary risk management disclosure (RMVD). This is evidenced through the regression test in equation (1) in Table 3. The Strategy coefficient value is 0.01 with a significance level of 1%. However, the debt level variable (Lev) has no effect on the company's voluntary risk management disclosure.

Table 1. Company Characteristics on Voluntary Risk Management Disclosure

Variable		Dependent Variables
	'red.	***RMVD (Risk Management Voluntary Disclosure)***
Intercept		2.83***
		(54.85)
Strategy	+	0.01***
		(3.96)
PDKom	+	0.08**
		(2.31)
Size	+	0.04**
		(16.26)
Lev	+	0.01
		(1.45)
Fixed Effect		Yes
Total Obs.		747
F-Statistic		66.46
R^2		0.26
Adjusted R^2		0.25

Variable Descriptions:
STRATEGY = Dummy variable 1 if the company uses a diversified business strategy, 0 if not; PDKOM= Board of commissioners supervision, namely the ratio of the number of independent commissioners divided by the total number of commissioners in company i year t; SIZE = Company size logarithm of total assets in company i year t ; LEV = Leverage total debt divided by total assets in company i year t; RMVD = Index of voluntary Risk Management Disclosure at company i year t. *** < 0.01; ** < 0.05; * < 0.10.

Based on Table 2, the disclosure of voluntary risk management consistently has a positive effect on company performance, this can be seen from the coefficient of the RMVD variable in equations (1) and (2) of 0.04 and 0.00 with a significance level of 1%.

Table 2. Voluntary Risk Management Disclosures on Company Performance

Variables	Pred.	Dependent Variables: *Firm's Performance*	
		StockReturn (1)	***ROA (2)***
Intercept		2.36*** (40.07)	0.10*** (22.90)
RMVD	+	0.04*** (3.64)	0.00*** (3.89)
Fixed Effect		Yes	Yes
Total Obs.		747	747
F-Statistic		6.86	9.46
R^2		0.27	0.39
Adjusted R^2		0.26	0.28

Variable Descriptions:
Stock Return = Stock Return in company i year t; ROA = Return on Assets of company i year t; RMVD = Index of voluntary Risk Management Disclosure at company i year t. *** < 0.01; ** < 0.05; * < 0.10.

Based on the results of the regression test in Table 3, the coefficient value on the Strategy Business variable has a positive effect on company performance in equations (1) and (2) of 0.00 and 0.01 with a significance level of 1%. The supervisory board of commissioners (PDKom) and firm size (Size) variables consistently affect the company's performance. While the debt level variable (Lev) has a negative effect on company performance with the coefficient value in equations (1) and (2) of -0.00 with a significance level of 1%.

Table 3. The Effect of Company Characteristics on Company Performance

Variables	Pred.	Dependent Variables: *Firm's Performance*	
		StockReturn (1)	***ROA (2)***
Intercept		1.39*** (20.28)	-0.15*** (-11.81)
Strategy	+	0.00*** (3.35)	0.01*** (5.82)
PDKom	+	0.19*** (4.33)	0.00*** (3.90)
Size	+	0.03*** (11.84)	0.01*** (16.58)
Lev	-	-0.00** (-2.09)	-0.00** (-1.95)
Fixed Effect		Yes	Yes
Total Obs.		747	747
F-Statistic		43.67	91.96
R^2		0.19	0.33
Adjusted R^2		0.18	0.32

Variable Descriptions:
Stock Return = Stock Return in company i year t; ROA = Return on Assets of company i year t ; STRATEGY = Dummy variable 1 if the company uses a diversified business strategy, 0 otherwise; PDKOM= Board of commissioners supervision, namely the ratio of the number of independent commissioners divided by the total number of commissioners in company i year t; SIZE = Company size logarithm of total assets in company i year t ; LEV = Leverage total debt divided by total assets in company i year t. *** < 0.01; ** < 0.05; * < 0.10.

Based on the previous regression test, it is proven that there is a direct effect of company characteristics on voluntary risk management disclosures, besides that voluntary risk management disclosures also affect company performance. Thus, there is an allegation that there is an indirect effect of company characteristics on company performance through voluntary risk management disclosure (see Table 4).

Table 4 shows evidence that there is an indirect effect of company characteristics on company performance through voluntary risk management disclosure where the RMVD variable in equation (1) and (2) has a positive coefficient of 0.85 and 0.29 with a significance level of 1%. The coefficient value is greater than the coefficient value if using GLS in Table 2. Thus, it can be concluded that the voluntary risk management disclosure variable can mediate the company's characteristics on company performance.

Table 4. Indirect Effect of Company Characteristics on Company Performance through Voluntary Risk Management Disclosure

Variables	**Pred.**	**Dependent Variables:** *Firm's Performance (2SLS)*	
		RETSAHAM	*ROA*
		(1)	*(2)*
Intercept		3.98***	0.29***
		(9.02)	(21.06)
RMVD	+	0.85***	0.29***
		(3.88)	(19.59)
Fixed Effect		Yes	Yes
Total Obs.		747	747
F-Statistic		46.62	60.39
R^2		0.73	0.49
Adjusted R^2		0.60	0.49

Variable Descriptions:
Stock Return = Stock Return in company i year t; ROA = Return on Assets of company i year t; RMVD = Index of voluntary Risk Management Disclosure at company i year t. *** < 0.01; ** < 0.05; * < 0.10.

In Table 5, dynamic business and environmental uncertainty variables are proven to moderate the effect of voluntary risk management disclosure on company performance. This is indicated by the RMVD*UNC variable having coefficients of -0.03 and -0.01 in equations (1) and (2). This shows that business uncertainty weakens the positive effect of voluntary risk management disclosure on company performance. Thus, companies tend to reduce risk disclosure and mitigate risks faced by companies due to the business uncertainty they face.

Table 5. Regression Test Results of Business Uncertainty Moderation and Dynamic Environment on the Effect of Voluntary Risk Management Disclosures

Variables	Pred.	Dependent Variables: *Firm's Performance*	
		StockReturn	***ROA***
		(1)	***(2)***
Intercept		2.36***	0.13***
		(39.98)	(16.53)
RMVD	+	0.07*	0.02***
		(2.27)	(4.28)
*RMVD*UNC*	-	-0.03***	-0.01***
		(-2.72)	(-11.86)
*RMVD*DYN*	-	0.00	-0.00***
		(0.35)	(-3.37)
Fixed Effect		Yes	Yes
Total Obs.		747	747
F-Statistic		6.95	68.87
R^2		0.77	0.21
Adjusted R^2		0.66	0.21

Variable Descriptions:
Stock Return = Stock Return on company i year t; ROA = Return on Assets of company i year t ; RMVD = Index of voluntary Risk Management Disclosure at company i year t; UNC= Business Uncertainty in company i year t; DYN= Dynamic Environment faced by company i year t. *** < 0.01; ** < 0.05; * < 0.10.

This research is a research development related to the role of risk management disclosure on company performance by considering the company's external factors specifically. This research is very important to be carried out in order to provide consideration for regulators regarding the direction of risk management disclosure policies in detail in the future. This research can also provide an overview for entities to be able to disclose the risks faced by the company and how the risk mitigation is carried out as a whole, because relevant information is very useful for company investors.

From this research results, we can see that voluntary risk management disclosure variable can mediate the company's characteristics on company performance.This is in line with Malik et al. (2020) companies that implement risk management effectively can improve company performance.The application of risk management in each company is very diverse which is influenced by the characteristics of each company.Companies that implement good risk management disclosure voluntarily can improve their financial performance. Furthermore, companies tend to reduce risk disclosure due to the business uncertainty they face.

Company Characteristics measured by strategy, board of commissioner supervision, and firm size consistently have a positive effect on voluntary risk management disclosure.This results in line with Nurcahya et al. (2014) and Addiyah and Chariri (2014), that company size, leverage, and independent board of commissioner has positive effect on company performance. According to Signalling Theory, companies that have large sizes have greater operational activities, so they will be very careful in maintaining the stability of company performance. The supervision of the independence board of commissioners is also needed to overcome agency problems that occur between shareholders and company management.

The findings in this study can be used as input for the development of research in financial accounting and CG in measuring the voluntary risk disclosures. In addition, these findings can be used as input for the standards board and the government to enforce good governance and legal system in Indonesia. Because poor governance in a company can have an impact on investors' distrust of company profit information that can be seen from stock return and firm performance. Of course, this research still has limitations, such as the observation period which is only three years. Besides, measurement of risk management is limited to a proxy for index of risk management disclosure sourced from secondary data, which has the potential to have a measurement error. Thus, future research is expected to expand and fill these gaps by use data sourced from primary data such as questionnaires, observations, and interviews, so that it is expected to describe in detail the implementation of risk management in each company.

Conclusions

This study focuses on the importance of disclosing non-financial risk management information for corporate entities which is currently only voluntary to be disclosed in the annual report. Whereas investors need in-depth information about all the impact of risks that will be faced by the company and how the company manages the impact of these risks in order to be able to assess the company's, not only financial information but also non-financial information.

This study found that the characteristics of the company that are seen based on the Business Strategy, Supervision of the Board of Commissioners. Firms Characteristics also proven to have an indirect effect on company performance through voluntary disclosure of risk management. In addition, the results of this study found that business uncertainty moderates risk management on company performance business uncertainty weakens the positive effect of risk management voluntary disclosure on company performance. Business uncertainty tends to have a high risk when interacting with a risk management system that is less reliable and will cause misfits, which can lead to a decrease in company performance.

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