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Corporate Risk Management, Firm Characteristics, Ownership Structure, and Governance Attributes of Banks: A Case of Malaysia

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ABSTRACT

This research intends to investigate the extent of disclosure of corporate risk management disclosure (CRD) of both conventional and Islamic banks in Malaysia. The study will highlight the relationships of CRD with four categories of variables, which includes (1) firm characteristics, (2) ownership structure, (3) corporate governance attributes, and (4) corporate risk management attributes. . The research will also give insight on Islamic and conventional banks comparison. The research will also contribute in enriching literature on corporate risk management of Islamic banks. Knowledgeable investors in present days, has somehow triggered demand for more information and disclosure of companies to make decision. Amran et al (2009), Linsley and Shrives (2006), and Hassan (2009) conducted research on risk management disclosure (CRD) in Malaysia, UK and UAE respectively. It is worth to note that disclosure requirement or voluntary disclosure between non-financial firms differs from those of financial firms (Mehran, et al., 2011) and geographical diversification of firm also affects level of disclosure (Amran, et al., 2009). Till to date, Malaysia has introduced three Code of Corporate Governance first being in 2000, followed by 2007 and the latest in 2012. Hence, the main objectives of this study are (1) to examine the extent of corporate risk disclosure (CRD) of Conventional (CBs) and Islamic banks (IBs) and (2) to examine various determinants associated with level of disclosure for CRD, which are categorized into four factors i.e., firm characteristics, ownership structure, corporate governance attributes, and risk management attributes, and (3) to examine whether there is any significant differences between CBs and IBs within the CRD context.

Keywords: Corporate Governance, Corporate Risk Disclosure, Conventional Banks, Islamic Banks, Malaysian Code of Corporate Governance

INTRODUCTION

Collapse of Enron (Rosen, 2003), and Worldcom (Sadka, 2006) have motivated more awareness on principal or investor and agent or management monitoring. Hence, it is a notable study to examine disclosure as a monitoring mechanism by examining extent of disclosure for corporate risk management.

Corporate risk management disclosure (CRD) in many countries are still a voluntary disclosure in general, with possibility a minimal mandatory disclosures required by local authority (Samaha, et al., 2012). Corporate risk management is defined as "*managing the direction of and the extent of exposure to risk, and adjusting our risk-taking behavior in a sensible way over the overcautious-to-heedless spectrum*" (Coleman, 2011). Most studies conducted on corporate governance disclosure or risk management disclosure are mainly done on the more developed countries, as it is perceived to have a complete if not the latest framework for such disclosure need (Samaha, et al., 2012). With knowledgeable stakeholders and investors, there is indication of demand for further disclosure in the annual reports other than the mandatory financial and non-financial disclosure.

Risk management studies mainly concentrated on financial risk management, tools of risk management and risk management in the legal framework. Amran et al (2009), Linsley and Shrives (2006), and Hassan (2009) conducted research on risk management disclosure (CRD) in Malaysia, UK and UAE respectively. These studies agreed that size of firm plays a role in extent of risk management disclosure. Amran et al (2009) and Hassan (2009) agrees that, leverage and industry type are positively related to CRD. While Hassan (2009) and Linsley and Shrives (2006) agree that level of risk is positively related to CRD. Other variables in association to CRD found by these researchers are product diversification, geographical diversification, companies listed in the US, and capital reserves are all positively related to CRD except capital reserves, which are negatively related.

This study will explore on the four main areas which includes, (1) corporate governance attributes, (2) corporate risk management attributes, (3) firm characteristics, and (4) ownership structure as an individual variables as well as a collective variables in relation to corporate risk management.

Malaysia

Malaysian Islamic banks (IBs) disclosures and reporting is governed by the Company's Act 1965, Islamic Banking Act 1983, Bank Negara Malaysia (Central Bank of Malaysia), and International Financial Reporting Standards. Bahrain framework for IBs is based on Central Bank of Bahrain Law and Regulations, and International Financial Reporting Standards.

LITERATURE REVIEW

Risk management discourse has been in the research as early as 1970s, and the most common study conducted are on credit risk management, and evolve around financial firms. There are several study done on other types of risk related research including corporate risk disclosure, enterprise risk management, risk management committee and so on.

Financial vs Non-Financial

Mehran, et al. (2011) highlight that corporate governance and risk management structures for financial and non financial firms are different in many ways, this is mainly due to the fact nature of business. Other worth noting differences between financial and non financial firms characteristics identified in Mehran, et. al. (2011) study are, debt composition, stakeholders dispersion, opaqueness of daily activities, insolvency impact of countries' or global financial market, potential free rider monitoring, risk attitudes of shareholders, leverage position within the company as product for financial firms and source of finance for non financial firms, ability to alter risk composition, and executive pay. Due to opaqueness of financial firms, a well structured corporate governance and risk management is more critical than non financial firms.

Firm Characteristics

Prior studies have identified various firm characteristics either as determinant of corporate governance disclosure, corporate governance compliance, CRD, RM tools used, or as control variables of such empirical research. The most common firm attributes being included as variable corporate governance or risk management research are **firm size** (Bauwhede and Willekens, 2008; Beasley, et al., 2005; Eng and Mak, 2003; Gul and Leung, 2004; Hassan, 2009; Ho and Shun Wong, 2001; Linsley and Shrives, 2006), **leverage** (Amran, et al., 2009; Bauwhede and Willekens, 2008; Eng and Mak, 2003; Gul and Leung, 2004; Hassan, 2009; Ho and Shun Wong, 2001), and **industry type** (Beasley, et al., 2005; Eng and Mak, 2003; Hassan, 2009; Ho and Shun Wong, 2001). Other attributes are, growth opportunities, analyst following, stock price performance, profitability, stock volatility, audit fee, audited by Big5/ Big4 audit firm, overseas listing, equity market liquidity, firm issued new share capital following year, short term accrual, non common law, change in stock price, political connection, Bumiputra directors, reserves, product diversification, geographical diversification, market to book equity ratio, listing status, equity financing, liquidity, and high quality of accounting standard. Hence for the purpose of this study, the common firm character such as firm size and leverage will be included, as being part of control variables. Having Big4 (formerly Big5) as **auditor** has a mixed findings being not significant association with voluntary disclosure (Eng and Mak, 2003; Hassan, 2009) and positive association to enterprise risk management implementation association (Beasley, et al., 2005; Hassan, 2009) needs further empirical evidence on association with CRD. **Firm growth**, **stock price performance** and **profitability** also had mixed findings, Eng and Mak (2003) finds no significant association between the variables with voluntary disclosure, while Gul and Leong (2004) find that there is a positive association with voluntary disclosure, hence need for more empirical evidence on the mixed findings.

Ownership structure

There are various types of ownership structure such as directors' ownership, block holders' ownership, managerial ownership, government ownership, concentrated ownership, institutional ownership, external ownership, dispersed ownership and so on. Among the commonly debated type of ownership in relation to corporate governance implementation, risk management implementation and disclosure are directors' ownership, and block holders' ownership.

Eng and Mak (2003) found no significant association between block holder ownership and level of voluntary disclosure, while Samaha et al. (2012) found a negative association between block holder ownership and corporate governance disclosure. Block holders might have the power to influence the decision made within the firm, however, prior study showed that block holder either does not encourage or are not bothered with disclosure matters, either overall voluntary disclosure or specific disclosure such as CRD. Hence, this type of ownership structure could be the negative determinant for level of disclosure for CRD, which might explain the fact that block holder owners that might not need additional disclosure, as they are more closely related to board members, as well the management, hence couldn't be bothered to the extent of any type of disclosure.

Another ownership structure that is worth mentioning is directors' ownership. Samaha et al. (2012) in contrast to negative association of block holder ownership with corporate governance disclosure, finds that directors' ownership has no significant association with corporate governance disclosure. On the other hand, Gul and Leong (2004) find a negative association between voluntary disclosure and directors' ownership. Referring to block holder ownership, directors' ownership variable, has a similar effect on the level of disclosure. Hence, directors' ownership should also be considered as determinant that negatively affect the level of CRD.

Eng and Mak (2003) also discussed about other types of ownerships that are associated with voluntary disclosure. Managerial ownership is negatively, while government ownership is positively, associated with voluntary disclosure. Bauwhede and Willekens (2008) find that there is a negative association between concentrated ownership and corporate governance disclosure. Abdul Wahab et al. (2007) find a positive association between institutional ownership and corporate governance compliance. It can be concluded that, ownership that is controlled by certain influential holders (block holder, directors, concentrated, institutional, and government) has somehow significant effect either positively or negatively on level of disclosure. Hence, structure of ownership will be among the significant determinant to level of CRD.

Corporate Governance Attributes

Research on corporate governance are more focused on specific attribute of corporate governance (Ammann, et al., 2011); **audit committee**; (Al-Ajmi, 2009; Ho and Shun Wong, 2001), **board composition** (Beasley, et al., 2005; Eng and Mak, 2003), **CEO duality** (Gul and Leung, 2004; Yatim, 2009), **proportion of experienced non executive directors** (Gul and Leung, 2004; Ho and Shun Wong, 2001; Yatim, 2009), **board meeting** (Beasley, et al., 2005), **appointment of dominant CEO** (Ho and Shun Wong, 2001), **proportion of family members** (Ho and Shun Wong, 2001), **CEO compensation** (Hermalin and Weisbach, 2011), **and board expertise and board diligence** (Yatim, 2009).

The most commonly discussed corporate governance attributes is existence of audit committee and proportion of non-executive directors. Eng and Mak ((2003), Gul and Leong (2004), and Ho and Shun Wong (2001) finds a positive association with voluntary disclosure, however, Samaha et al. (2012) finds no significant association with corporate governance disclosure. This might be due to the fact that country understudy was of different legal regime, and different period of introduction of corporate governance code of practice. It is important variable to determine disclosure level of firms may it be corporate governance disclosure, corporate risk disclosure or other type of voluntary and mandatory disclosure. It also indicates that audit committee plays an important role in decision making for disclosure purpose.

Proportion of non executive directors is also a commonly discussed CG variable among researchers (Beasley, et al., 2005; Eng and Mak, 2003; Gul and Leung, 2004; Ho and Shun Wong, 2001; Samaha, et. al., 2012). Eng and Mak (2003), Gul and Leong (2004), and Ho and Shun Wong (2001) tried to find association of with voluntary disclosure. Eng and Mak (2003) and Gul and Leong (2004) found negative association with voluntary disclosure, however, Ho and Shun Wong (2001) found no association. However, this study believes that outside or non executive directors would want to show that they are performing well by indicating that they are doing well by having higher disclosure level for corporate governance and risk management, which is consistent with Samaha et al.

(2012) findings of positive association of proportion of non executive directors with corporate governance disclosure.

CEO duality is found to be negatively associated with voluntary disclosure and corporate governance disclosure by Gul and Leong (2004) and Samaha et al. (2012) respectively, however, Puan (2009) find that CEO duality has a positive association with risk management committee existence. The study showed that the separation of role of as CEO and Chairman of Board of Directors would result in a higher disclosure compared to firms that have duality role of CEO. It may be concluded that CEO dualities may affect the level of disclosure for CRD, negatively but at the same time may encourage formation of risk management committee.

Other corporate governance attributes that have been associated with voluntary disclosure, corporate governance compliance, and corporate governance disclosure includes proportion of family members sitting on the board, appointment of dominant CEO, Bumiputra directors, and board size. Ho and Shun Wong (2001) find voluntary disclosure is negatively associated with proportion of family members sitting on board but did not find any significant association with appointment of dominant CEO. On the other hand Abdul Wahab et al. (2007) study finds positive association of corporate governance compliance with Bumiputra directors. Samaha et al. (2012) finds a positive association between corporate governance disclosure and board composition in terms of size, and proportion of non-executive directors. It can be concluded that various corporate governance specific attributes are among the significant determinants of level of disclosure for CRD.

Corporate Risk Management

Puan (2009) study finds that there are several determinants of existence of risk management committees in Malaysian firms. The study showed empirical findings that among the determinants of existence risk management committee covered from corporate governance attributes, risk management attributes, firms' attributes, to ownership structure. Formation of risk management committee is positively determined by separation of CEO duality as CEO and as Chairman of Board of Directors, board expertise and diligence, firm size, firm listing status, complexity of the firms' activities, and firm being in financial sector. Hence, it is expected in this study that overall view of attributes and determinants might influence the extent of disclosure for CRD.

Linsley and Shrives (2006), Amran et al. (2009), and Hassan (2009) all performed empirical research on risk disclosure in UK, Malaysia, and UAE respectively. Linsley and Shrives (2006), Amran et al. (2009), and Hassan (2009) all agreed that firm size and leverage are positively associated with level of risk disclosure, except that Linsley and Shrives did not highlight whether leverage is associated or not to risk disclosure. However, Linsley and Shrives (2006) highlighted that firms' level of risk and environmental risk is positively associated with risk disclosure level. In addition, Amran et al. (2009) finds that leverage, product diversification, and geographical diversification are also positively associated to risk level of disclosure, and Hassan (2009) finds risk disclosure has positive association with industry type, but negatively associated with capital reserve from profit made for the financial period.

SUMMARY

Firm size and firm leverage are the most common variables used in association with corporate governance disclosure, CRD or voluntary disclosure. All of which is found to be positively associated with respective disclosure (Amran, et al., 2009; Bauwhede and Willekens, 2008; Eng and Mak, 2003; Hassan, 2009; Linsley and Shrives, 2006). Other similar variables used by corporate governance disclosure and voluntary disclosure empirical research includes board size, outside directors, directors ownership, and block holder ownership (Eng and Mak, 2003; Gul and Leung, 2004; Ho and Shun Wong, 2001; Samaha, et al., 2012). CEO duality is found to be negatively associated to voluntary disclosure and corporate governance disclosure (Gul and Leung, 2004; Samaha, et al., 2012) , however, audit committee, director ownership and block holder ownership has mixed finding. Audit committees is found to be positively associated with voluntary disclosure (Gul and Leung, 2004; Ho and Shun Wong, 2001), however, no significant association found with corporate governance disclosure (Samaha, et al., 2012). Directors ownership were found not associated with CORPORATE GOVERNANCE DISCLOSURE and voluntary disclosure by Samaha et al. (2012) and Eng and Mak (2003) respectively, however, Gul and Leung (2004) found a negative association with voluntary disclosure. Block holder ownership are negatively associated with corporate governance disclosure

(Samaha, et al., 2012) and no significant association with voluntary disclosure (Eng and Mak, 2003). Hence this study will examine some of the common variables used in determining level of CRD.

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RESEARCH FRAMEWORK :
CORPORATE GOVERNANCE AND CORPORATE RISK