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THE EFFECT OF BOARD OF COMMISSIONERS SIZE ON RISK MANAGEMENT TRENDS

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ABSTRACT

This study aims to obtain empirical evidence of the effect of board size on risk management tendencies. The data collection technique used was a purposive sampling method in order to obtain a sample of 531 manufacturing sector companies listed on the Indonesia Stock Exchange in 2014-2017. The data analysis used is Multiple Linear Regression Analysis. The results of this study are that a large number of boards has no impact on the volatility of company stock returns. However, it is positively related to cash flow volatility proxies.

Keywords: *Board of Commissioners Size, Concentrated Ownership, Management Risk Preference.*

1. INTRODUCTION

The issue of the importance of risk management in Indonesia is a serious concern, especially in the banking industry. This can be seen by the issuance of BI Regulation Number 8/4/PBI/2006 which was updated by BI Regulation No. 8/14/2006 concerning Implementation of Good Corporate Governance (BI, 2006). This regulation requires Commercial Banks to form a Risk Monitoring Committee, further strengthened by the Financial Services Authority (OJK) through Regulation number 18/POJK.03/2016 which requires Commercial Banks to form a Risk Management Committee (OJK, 2016), so that it can be ensured that all Banks The general public in Indonesia already has a Risk Management Committee. This regulation only applies to the banking sector and has not touched other industrial sectors, even though risks are faced by all businesses in any industrial sector. This regulation was made due to the unique financial risk factors faced by the banking sector, where financial risks are easily affected by global or world market financial turmoil, so that financial turmoil is expected not to impact other industry companies.

Risk in a company is often associated with the amount of decision making that will be accepted by risk takers. Risk can be associated with the success and failure of a business activity. So that the awareness of the company's management is needed in understanding, recognizing, monitoring, and controlling the risks to be

taken. The hope is that by understanding the existing risks, companies are able to prevent failure by identifying stable performance, so as to be able to meet targets, minimize failures within the company, and create profitable opportunities.

Agency conflict associated with managerial risk aversion can be a major cause of suboptimal risk taking, especially share ownership and executive stock options (Cohen, Hall, & Viceira, 2000; Coles, Daniel, & Naveen, 2006; Rajgopal & Shevlin, 2002; Sanders & Hambrick, 2007; Wright, Kroll, Krug, & Pettus, 2007). Another equally important determinant of risk taking is the monitoring role of financial institutions (Wright, Ferris, Sarin, & Awasthi, 1996) and many large shareholders (Mishra, 2011).

The board of commissioners has the duties and responsibilities of supervising company management policies, providing advice to the directors, supervising the implementation of long-term plans, work plans and budgets, provisions of the articles of association and decisions of the General Meeting of Shareholders (GMS), as well as oversight of regulations applicable laws and regulations in accordance with the aims and objectives of the company. The board of commissioners also plays a role in the oversight function regarding the potential risks faced by the company.

The size of the board of commissioners affects the value of the company despite the fact that there is no optimal board size for all companies (Coles, Daniel, &

Naveen, 2008; Eisenberg, Sundgren, & Wells, 1998; Uchida, 2011), strong policy choices and also risk taking . Yermack (1996) finds that the sensitivity of CEO pay performance decreases with board size, suggesting that smaller boards are more likely to drive value increases but potentially make riskier managerial decisions than larger boards. Wang (2012) found that firms with small boards were associated with higher future risk after controlling for the impact of financial decisions on overall firm risk. This supports the hypothesis that board size has a negative effect on corporate risk taking.

Sah and Stiglitz (1986) undertook the development of a theoretical model to analyze the performance of decision-making authority under different structures. The theory suggests that larger groups are more likely to reject risky projects because a project will be accepted only if more group members agree that it is good. For the diversification of the same opinion effect, large groups are also less likely to accept good projects. The implication is that the performance of a firm varies less when a large number of decision makers are involved. In contrast, some findings such as that of Coles et al. (2008) revealed that the size of a large board of commissioners is not always detrimental to company performance.

This research refers to the research of Haider and Fang (2016) who conducted research on board size, ownership concentration and future firm risk. In this study using future firm risk as the dependent variable, board size as the independent variable. The difference in this study and the research of Haider and Fang (2016) is the independent variable used, because in this study the size of the board of commissioners was used, while Haider and Fang (2016) used the size of the board of directors. As well as in this study did not use moderating variables. Researchers are interested in using the size of the board of commissioners because in Indonesia the board of commissioners is the party that represents shareholders in monitoring company performance. The researcher tries to prove that the large size of the board of commissioners can cause monitoring effectiveness problems in decision making which is reflected in the tendency of risk management to be more risk averse. In accordance with the aim of the researcher, namely to obtain empirical evidence of the effect of board size on risk management tendencies.

2. THEORITICAL REVIEW

1. Agency Theory

Agency theory is a theory that explains the working relationship between shareholders (principal) and management (agent). The agent is appointed by the principal to manage the company on behalf of the principal. Agency theory explains that concentrated

ownership can work as a control mechanism to equalize the behavior and actions of managers (Jensen & Meckling, 1976). A good management control system, can indicate its form in a control system that can maximize management influence (Lowe, 1971). Fisher (1995) also explained that supervision is an activity under certain circumstances that can encourage the organization to achieve what is aspired or expected at a certain time in the future. Otley & Pierce (1995) criticized Fisher's (1995) explanation because it was said to be more trying to identify the main contingent factors but could not assess the influence on the control system.

2. Trends in Risk Management

Risk management propensity is a concept that describes what management does when faced with a risky option and a safer alternative, it becomes important from the behavior of someone who is at risk. Bank risk is exposure to the possibility of loss (exposure to the change of loss). Karim (2004) defines risk as a potential event, both anticipated and unanticipated, which has a negative impact on the company's income and capital.

3. Conceptual Framework

Based on previous research, this study obtained a conceptual framework as below, in which it can be seen that the researcher wants to examine the effect of board size on risk management tendencies.

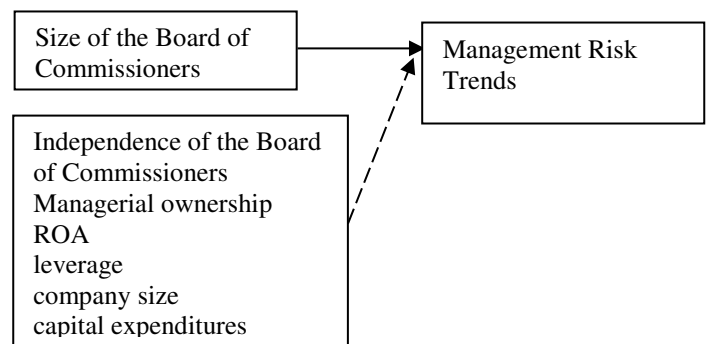


Figure 1. Conceptual Framework

3. RESEARCH METHODS

The type of data used in this research is secondary data. The data used in this study is quantitative data, namely in the form of annual financial report data published by manufacturing companies for four consecutive years, namely 2014 to 2017. The data source used is secondary data obtained through searches from the official website of the Indonesia Stock Exchange (IDX). IDX which provides annual reports of manufacturing companies that have been audited and published from 2014 to 2017, namely from www.idx.co.id.

The population in this study are manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2014 to 2017. With a sample size of 531 data. The data analysis technique used in this study is multiple linear regression using the SPSS 16.0 statistical program. The regression equation used in this study to test the hypothesis is as follows:

$$[OR] MR_{t+1} = \alpha + \beta_1 BSIZE_t + \beta_2 BIND_t + \beta_3 MANOWN_t + \beta_4 ROA_t + \beta_5 LEV_t + \beta_6 FSIZE_t + \beta_7 CAPEX_t + \varepsilon$$

Information:

MRT+1 = market risk t+1

OR = operational risk

BSIZE = size of the board of commissioners t

BIND = percentage of board independence t

MANOWN = percentage of managerial ownership t

ROA = return on assets t

LEV = leverage t

FSIZE = company size t

CAPEX = capital expenditure t

ε = Error term

4. RESEARCH RESULT

1. Multicollinearity Test

The multicollinearity test aims to test whether there is a correlation or linear relationship between the independent variables or not in the regression model and aims to avoid habits in the decision-making process. A good regression model should not have a correlation between the independent variables. The multicollinearity test is carried out by looking at the tolerance value or the Variance Inflation Factor (VIF) value. Multicollinearity occurs when the tolerance value is > 0.10 and the VIF value is < 10 . Table 4.2 below shows the results of the multicollinearity test:

Table 1
Multicollinearity Test

Variable	MR-Model		OR-Model	
	TOL	VIF	TOL	VIF
BSIZE	0.299	3.342	0.299	3.342
OWN.CON	-	-	-	-
BIND	0.356	2.811	0.957	2.811
MAN.OWN	0.957	1.045	0.978	1.045
ROA	0.978	1.022	0.965	1.022
LEV	0.965	1.037	0.314	1.037
FSIZE	0.314	3.187	0.386	3.187
CAPEX	0.386	2.590		2.590

Source: Processed Data, 2022

Information:

MR Model: Effect of BSIZE on Market Risk

OR Model: Effect of BSIZE on Operational Risk

Based on the results in table 1, it can be seen that the independent variables used in the MR and OR models have no signs of multicollinearity between the independent variables. This is shown from the VIF value < 10 and the tolerance value > 0.10 which means that there are no symptoms of multicollinearity.

2. Multiple Linear Regression Results

a. Effect of Board of Commissioners Size on Management Risk Trends (Model 1)

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.029	2.669		-.386	.700
	BSIZE	-.055	.129	-.034	-.423	.673
	BIND	-.410	.257	-.116	-1.593	.112
	MAN.OWN	-1.024	.889	-.051	-1.151	.250
	ROA	.071	.150	.021	.472	.637
	LEV	.151	.252	.026	.598	.550
	FSIZE	.199	.140	.110	1.421	.156
	CAPEX	-.095	.099	-.067	-.963	.336

a. Dependent Variable: M.R

The first test of this research model is to determine the effect of board size on management risk tendencies. To determine the regression equation can be seen in tables 2 and 3 below:

Table 2
Simple Linear Regression Test Results (MR)

Table 3

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.216	.868		2.552	.011
	BSIZE	.118	.042	.129	2.816	.005
	BIND	-.213	.084	-.107	-2.549	.011
	MAN.OWN	.116	.289	.010	.400	.689
	ROA	-.026	.049	-.014	-.539	.590
	LEV	.170	.082	.053	2.073	.039
	FSIZE	.758	.046	.744	16.646	.000
	CAPEX	.052	.032	.065	1.622	.105

a. Dependent Variable: O.R

Simple Linear Regression Test Results (OR)
Source: Processed Data, 2022

To test the hypothesis in this study, a t test was performed. If the significance level of the t test < 0.1 (p-value $< 10\%$), it can be concluded that H1 is accepted and there is a significant influence between the independent variables on the dependent variable. Based on the results of the t test, it is known that the calculated significance value of the t test for the effect of board size on management risk tendencies through market risk proxies is 0.673. This shows that the significance of the t test count > 0.1 so it can be concluded that the size of

the board of commissioners has no significant effect on management risk tendencies through market risk proxies. Meanwhile, the significance value of the t test for the effect of board size on management risk tendencies through operational risk proxies is 0.005. This shows that the significance of the t test count < 0.1 , so it can be concluded that board size has a significant effect on management risk tendencies through operational risk proxies in manufacturing sector companies listed on the Indonesia Stock Exchange in 2014-2017.

3. The coefficient of determination
Table 4

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.820 ^a	.673	.668	.94859

a. Predictors: (Constant), CAPEX, LEV, ROA, MAN.OWN, BIND, FSIZE, BSIZE

Based on the results in table 3 (MR model), it can be seen that the coefficient of determination test obtained a result of 0.005 or 0%. This indicates that the market risk variance cannot be explained by the independent variables used in this study.

Table 5

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.134 ^a	.018	.005	2.91608

a. Predictors: (Constant), CAPEX, LEV, ROA, MAN.OWN, BIND, FSIZE, BSIZE

Meanwhile, based on the results in table 4 (OR model), it can be seen that the coefficient of determination test obtained a result of 0.668 or 66.8%. This shows that operational risk can be explained by 66.8% by the independent variables used in this study, while the remaining 33.2% can be influenced and explained by other variables not used in this study

5. DISCUSSION

a. Influence of the Board of Commissioners on Management Risk Trends

The first hypothesis (H1) states that board size influences management risk tendencies. The results of a simple linear regression test using a market risk proxy (table 2) which is calculated based on the volatility of stock returns t-4 states that board size does not have a significant negative effect on management risk tendencies so that it is known from the p-value $0.673 > 0.1$ which indicates the hypothesis first (H1) is rejected based on stock return volatility proxy. The results of the study show that the larger the size of the board of commissioners cannot affect management risk

tendencies, especially the volatility of company stock returns.

The size of the large board of commissioners does not influence the company's risk decision making. The Indonesian capital market is not efficient enough to process the information available on the Exchange. The movement of shares due to external factors is thought to have a greater influence so that investors have no hope with the number of commissioners.

The second proxy in table 3 shows the relationship between board size and operational risk in the company. Here the dependent variable is the volatility of cash flows from t-3 operations. Board size is significant and positively related to cash flow volatility which is known from p-value $0.005 < 0.1$. This also supports the first hypothesis (H1) in this study that board size influences management risk tendencies, namely the operational risk taken by the company.

A large number of commissioners can improve the quality of decision making to carry out the supervisory function and can improve company performance which has an impact on the volatility of the company's cash flows. This is supported by the research of Singh et al. (2018) who found that the size of the board of commissioners has an effect on company performance. Several previous studies such as those conducted by Pfeffer, J (1972) stated that an increase in the size and diversity of the board of commissioners will benefit the company because it creates a network with parties outside the company and ensures the availability of resources.

6. CONCLUSION

Based on the results of the discussion of the research that has been described, it can be concluded that the results of the study indicate that the larger the size of the board of commissioners cannot affect management risk tendencies. That is, decision making by a large number of boards has no impact on the volatility of the company's stock returns. However, board size is significant and positively associated with cash flow volatility proxies. This also supports the first hypothesis (H1) in this study that board size has an effect on management risk tendencies, namely the operational risk taken by the company. This means that a large number of commissioners can improve the quality of decision making to carry out the supervisory function and can improve company performance which has an impact on the volatility of the company's cash flows.

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