

The Influence of Enterprise Risk Management on Firm Performance of Family Firms with the Moderating Effect of Managerial Ownership

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ABSTRACT

This study aimed to investigate the influence of enterprise risk management on company performance and examines the moderating effect of managerial ownership on the relationship between enterprise risk management and the performance of family firms listed on the Indonesia Stock Exchange 2010-2016. Two performance proxies were used; specifically accounting-based performance and market value performance. The results of the study showed that enterprise risk management had a positive influence on firm performance. Furthermore, managerial ownership could strengthen the relationship between enterprise risk management and firm performance. Finally, control variable, capital structure had a negative influence on firm performance, while fixed asset growth, firm size, productivity, and economic growth had a positive influence on firm performance.

Keywords: Firm performance, enterprise risk management, managerial ownership.

1. INTRODUCTION

In recent years, there has been a paradigm shift in how to view risk management using a holistic approach. One of the approaches that can be used by firms to manage risk is risk management using the COSO ERM framework [1], which will assist firms better manage financial results. The implementation of enterprise risk management (ERM) can add value to a firm in several ways, such as decreasing volatility in income and stock price, increasing capital efficiency and creating synergy among various risk management activities [2], [3], [4], [5], [6]. According to [7], the relationship between firm risk management and firm performance is influenced by five factors that surround the firm; specifically, environmental uncertainty, industry competition, firm size, firm complexity and board of directors. This relationship depends on the match between the firm and the contextual variables that surround the firm. The implementation of enterprise risk management (ERM) is also considered to reduce the risk of firm failure, and thus, can improve firm performance [7].

It should be mentioned that research findings on enterprise risk management (ERM) relating to firm performance have not shown consistent results. Specific studies presented the straight impact of the implementation of ERM on performance of company [8], [9]; revealing a positive relationship between ERM and firm value by [7], [6], [10]. The implementation of the ERM system was seen as a value driver and not as a cost for the firm. However, the results of the studies conducted by [11], [12], showed that the practice of enterprise risk management did not have a significant impact on firm value. Therefore, further research is essential on the impact of ERM implementation in firms.

The significance of ERM practices in business circles is to reduce threats and to measure opportunities as the best strategy to achieve the firm goals [13]. ERM can improve firm performance [14], [15]. Moreover, enterprise risk management can affect firm performance by means of the role of competitive advantage strengthened by financial literacy [16]; the role of intellectual capital [17]; reducing costs and increasing firm efficiency [18], [19]. The implementation of ERM

will reduce the volatility of income and stock price [18], improve capital efficiency and create synergy among various risk management activities [5]. [20] reported that firms that adopted ERM experienced a reduction in income volatility, but did not find general support for ERM in creating value in a few additional steps.

ERM has not been explored extensively in family firms in various countries. According to [21], the implementation of ERM in family firms is lower, particularly in family firms that have company managers who are family members. This is due to several reasons. First, it is assumed that agency conflict in family firms is relatively low compared to that in non-family firms [22], [23], so the implementation of ERM is not necessary. Second, family firms operate with a lower debt level [24] are less frequently involved in risky ventures, such as internationalisation [25]; internationalise in a more careful way [26]. Third, family firms generally use financial practice and formal accounting which are less sophisticated than non-family firms [27], [28], which might reduce the use of ERM. Consequently, family firms lack the need to introduce ERM mechanisms designed to avoid or reduce these risks. These are the reasons that family firms are regularly managed in a way that is not as professional as non-family firms [21] [29]. Given that ERM can be considered a specialised way to manage risks [30], it can be concluded that family firms demonstrate lower use of ERM compared to non-family firms.

Family businesses certainly do not escape the various problems that are difficult to solve at times, such as the presence of distrust among family members, agency conflicts and so on. One of the ways firms overcome this is to align the interests of the managers with the interests of the owners [31], [32]. With the involvement of share ownership, managers are expected to act by considering each existing risk and to motivate themselves to improve their performance. The increase in managerial ownership helps to connect the interests of internal parties to shareholders and generates better decision-making that will increase firm value. The firms that have managerial ownership with broader firm risk management disclosure are expected to improve firm performance. Therefore, researchers assume that the possibility of managerial ownership can moderate the influence of ERM implementation on firm performance, both with regards to accounting-based performance in the form of increasing profitability and on market value performance in the form of increasing market book value.

The contribution of this study firstly examined the implementation of enterprise risk management (ERM) in family firms that had managerial ownership and were listed on the Indonesia Stock Exchange, which has not been studied so far. Second, this study investigated the relationship between the implementation of enterprise risk management (ERM) in family firms and firm performance, both accounting-based performance and market value performance. Third, this study examined the moderating role of managerial ownership on the relationship between enterprise risk management (ERM) and firm performance using the measures of accounting-based performance (ROA) and market value performance (MBV). And fourth, it has enriched financial literature related to the implementation of enterprise risk management (ERM) in family firms in Indonesia.

1.1. Enterprise risk management (ERM)

To be able to manage the various risks faced by a firm, a risk management instrument is required. The aim of firm risk management is to create a plus point in every organisation's activity continuously. Attempts to improve the quality of risk management implementation is by means of integrated risk management; specifically, the implementation of enterprise risk management (ERM).

Enterprise risk management (ERM) is a process that involves the entire entity starting from the board of directors, management and other officials, applied to the formulation of strategies and encompasses the entire firm, which is designed to identify potential conditions that can affect the entity and to manage risks at certain levels in order to provide reasonable guarantees to achieve the entity's objectives [1]. Enterprise risk management (ERM) is considered to reduce the firm's risk of failure as a whole, and therefore, can improve the performance and value of the firm [7]

Kleffner, Lee & McGannon define ERM as operational and financial risk management employed to maximise the effectiveness of risk management cost within the limit of an organisation's tolerance of risk. [33]. ERM reduces the costs associated with business operations and facilitates a competitive advantage and superior performance [34]. A number of research such as [34], [35], [36], established that ERM practice was aligned with the firm's resource and capability. But, they neglected the actual relationship between ERM and business performance. A competitive strategy, where firms can minimize different costs and offer specific products to their customers, is the main instrument in

relation to gaining a competitive advantage in hectic markets [37], [38]. The implementation of enterprise risk management effects firm value [6], [39]. Furthermore, Nickmanesh investigated relationship enterprise risk management (ERM) with accounting-based performance (ROA) in 175 firms registered in Malaysia, and realised that the presence of a risk management committee in selected sample firms had a significant effect on ROA [40]. [41], related enterprise risk management (ERM) with firm value and determined that the implementation of ERM had a positive significant impact on firm value. In addition, the empirical result showed that ERM increased firm value 3.6-17% more than those firms which had not implemented ERM.

ERM practice does not always lead directly to superior performance; some internal managerial capabilities are also necessary. From this perspective, [42] developed an ERM framework that shows that ERM practice is significantly aligned with manager's behaviour in everyday decision-making. In fact, the practice of ERM is influenced by mindset and managerial behaviour when they face uncertainty in turbulent markets [43] (Arena, Arnaboldi, & Azzone, 2010). The practice of ERM implementation will also be related to senior management, finance and education, which in turn can affect a firm's competitiveness and performance.

1.2. ERM and Firm Performance

Managing firm risk, known as Enterprise Risk Management, is an attempt to establish, analyse and manage the risk in each activity held by firm with the aim of obtaining greater efficiency. ERM in a firm, in fact, plays a crucial role in maintaining the stability of the firm. Besides, high ERM indicates good corporate governance and shows that the firm's internal control is well maintained. Moreover, ERM as non-financial information can be a signal to investors regarding the security of invested funds. The more convincing the information delivered by the company; the more confident investors will be regarding the security of the funds invested. As a matter of fact, the investors believe that the implementation of ERM is a positive signal due to the fact that they can assess the company's prospects by means of this information. Therefore, managers are highly recommended and advised to work in implementing ERM practices to increase firm value and performance [44]. There is no doubt that there is a significant positive relationship between ERM practices and performance of the firm [8], [9], [19]. Based on

theory and previous studies, the hypotheses of this study are formulated as follows:

- H1:** Enterprise risk management has a positive influence on accounting-based performance (ROA).
- H2:** Enterprise risk management has a positive influence on market value performance (MBV).

1.3. Managerial ownership moderates the effect of enterprise risk management (ERM) on performance

Managerial ownership is one of the mechanisms of Good Corporate Governance (GCG) which is believed to be beneficial in overcoming agency conflict due to the information asymmetry between managers and firm owners. The implementation of GCG for firms in Indonesia is highly important in order to support sustainable economic growth and stability. According to [31], managerial ownership is share ownership by firm management as measured by the percentage of shares held by management. The higher the managerial ownership, the greater the effort by the management for the benefit of the owners or shareholders. In fact, managers who act as shareholders will have greater motivation in managing firms, which includes considering risks and improving their performance. Generally, firms which are likely to increase their value are able to reveal comprehensive information with a high managerial shareholding structure. Based on the above-mentioned elaboration, the following hypotheses can be formulated:**H2.1:** Managerial ownership moderates the influence of ERM over accounting-based performance (ROA).

- H2.2:** Managerial ownership moderates the influence of ERM over market value performance (MBV).

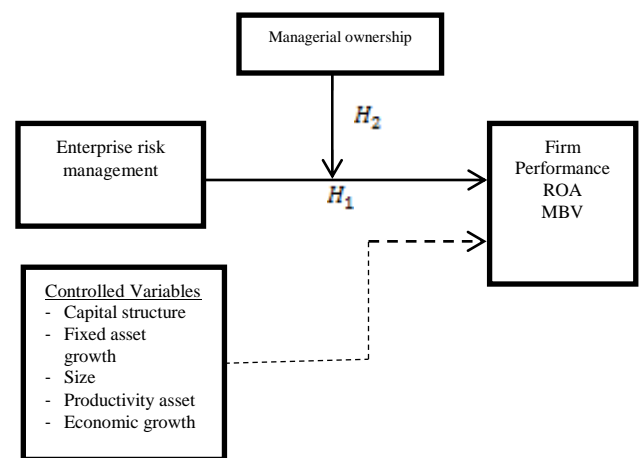


Figure 1 Conceptual Framework

2. METHOD

The data in this study were obtained from non-financial firms registered on the Indonesia Stock Exchange from 2010 until 2016. The samples were chosen using the purposive sampling method in which samples were selected based on certain criteria. The criteria of selection were as follows: a) non-financial firm listed on the Indonesia Stock Exchange from 2010 – 2016, b) have managerial ownership and publish their financial reports, c) included in family firms and, d) including family firm that consistently have managerial ownership from 2010-2016. Firm that is classified as a family firm in which 5% or more shares are owned by a family or there are at least two or more family members involved in the company. These criteria indicate the definition of family firms and moreover, there have been considerable amount of previous studies focusing on this topic [45], [46], [47]. Based on these criteria, from 585 completed observations, 85 family firms deemed suitable to be part of the sample were selected, given that they fulfilled the criteria. For data analysis, the study used Moderated Regression Analysis (MRA)

This study used dependent variable, independent variable, control variable and moderator variables. The dependent variable in this study was firm performance which was the result of management activities in a firm. In this study, firm performance is measured using two proxies, namely accounting-based performance (ROA) and market value performance. Accounting-based performance is measured using the ratio of return on assets (ROA) calculated as earnings after tax divided by total assets, and market value performance using the market to book value (MBV) calculated as the market value to the book value of equity.

Furthermore, Enterprise Risk management (ERM) served as the independent variable. Enterprise Risk Management (ERM) is an integrated risk management system for the purpose of improving company performance. ERM measurements are based on the COSO framework (2004). the COSO ERM Framework includes eight dimensions, such as the internal environment, objective setting, event identification, risk assessment, risk response, control activities, information and communication, and monitoring. We developed an the COSO ERM Index for measuring a firm's ERM. The COSO ERM index is an comprehensive measure of ERM with a list of 108 items related to ERM, scoring one (presence) or zero (absence) composited under the eight dimensions of COSO. The measurement of ERM is based on the aggregate scores of ERM item practices disclosed by each firm [48], [49], [50]. Thus, the

moderating variable in this study was managerial ownership. Managerial ownership is the amount of share ownership owned by management or firm executives, which is measured by the number of shares held by managers divided by the total shares. Next, five control variables were employed: capital structure, growth fixed assets, firm size, productivity and economic growth. (1) *Capital structure*: the comparison between firm debt and equity, which is measured by dividing total debt by total equity. (2) *Growth fixed asset*: the growth of the firm's fixed assets, which is measured by dividing the growth of fixed assets this year by the growth of fixed assets in the previous year. (3) *Firm size*: the firm size is measured by total assets. (4) *Productivity*: the ability of the firm's assets to generate sales, which is measured by dividing the total output (sales) by the input (total assets). (5) *Economic growth*: Indonesia's economic growth rate measured by gross domestic product.

This study used three equation models. The first model was a baseline model, using firm characteristics as control variables; namely capital structure, growth of fixed assets, firm size and the productivity of assets used by the company. The second model combined (ERM) as an independent variable in the model. The third model added managerial ownership as a moderator variable in the model. The regression equation models employed in this study are as follows;

$$\begin{aligned}
 1. \text{Performance}_{i,t} &= \alpha_0 + \beta_1 \text{DER} + \beta_2 \text{GFA} + \beta_3 \text{SIZE} \\
 &\quad + \beta_4 \text{PA} + \beta_5 \text{GDP} + \epsilon_{i,t} \\
 2. \text{Performance}_{i,t} &= \alpha_0 + \beta_1 \text{ERM} + \beta_2 \text{DER} + \beta_3 \text{GFA} \\
 &\quad + \beta_4 \text{SIZE} + \beta_5 \text{PA} + \\
 &\quad \beta_6 \text{GDP} + \epsilon_{i,t} \\
 3. \text{Performance}_{i,t} &= \alpha_0 + \beta_1 \text{ERM} + \beta_2 \text{DER} + \beta_3 \text{GFA} \\
 &\quad + \beta_4 \text{SIZE} + \beta_5 \text{PA} + \\
 &\quad \beta_6 \text{GDP} + \beta_7 \text{MOW} + \beta_8 \\
 &\quad \text{ERM} * \text{MOW} + \epsilon_{i,t}
 \end{aligned}$$

3. RESULT AND DISCUSSION

Descriptive statistical analysis aims to describe the variables used, for example ERM, Managerial Ownership (MOW), Capital Structure (DER), Growth of Fixed Assets (GFA), Firm Size (size), Productivity (PA), economic growth (GDP), Accounting Performance (ROA) and Market Performance (MBV). Based on the results of the study, the minimum, maximum and mean scores of the variables from 2010 to 2016, can be seen in Table 1.

Table 1. Descriptive statistics

Variables	Mean	SD	Max	Min
Market to book value (MBV)	2.043	1.998	16.34	0.100
Return on assets (ROA)	0.073	0.059	0.460	0.002
Enterprise risk management (ERM)	0.397	0.184	0.950	0.100
Managerial ownership	0.069	0.082	0.520	0.001
Debt Equity ratio (DER)	1.130	0.920	4.460	0.071
Growth Fixed asset	0.147	0.259	1.093	-0.702
Firm Size (Size)	14.579	1.623	19.383	10.659
Productivity asset (PA)	1.057	0.694	5.519	0.008
Economic Growth	0.056	0.006	0.065	0.048

It is evident in Table 1 that the average firm performance with the Market to Book Ratio (MBV) proxy is 2.043. This reveals that the average family firm had a market value 2,043 times higher than the book value, with the lowest at 0.1 for and the highest at 16.34 for SCMA. In contrast, the average performance of firms with ROA proxy was 0.073, meaning that the company's ability to generate net income based on assets invested was 7.3%. Additionally, average ERM level based on ERM disclosure is only 39.7%

Table 2 shows Pearson correlation matrices. The correlation values between variables are relatively low. In the line with the correlation matrices result, the

variance inflation factor (VIF) value shows that there is no serious multicollinearity between the independent variables and control variable, as suggested by Hair et al. (2014) and Wesarat et al. (2018).

Table 2. Pearson correlation coefficient

Variable	MBV	ROA	ERM	MOW	DER	GFA	SIZE	PA
ROA	0.562**							
ERM	0.650**	0.483**						
MOW	-0.100*	0.004*	-0.095*					
DER	-0.040	-0.325*	-0.150*	-0.127*				
GFA	0.214**	0.122**	0.119**	-0.057	0.091*			
SIZE	0.274**	0.130**	0.340**	-0.239**	0.064	0.124**		
PA	0.194**	0.144**	0.095*	0.025	0.137**	0.078	-0.176*	
GDP	0.151**	0.171**	0.026	-0.037	0.042	0.087*	-0.139*	0.082

3.1. The Influence of ERM on firm performance

This study employed two measures concerning firm performance, namely accounting-based performance, which is measured using Return on Assets (ROA) and market value performance, in the form of Market to book value (MBV). The prerequisite test are done to find out whether the collected data is proper enough to be analyzed. The results show that the data are normally distributed, and there is no heteroscedasticity for residuals using the White test (1980). The analysis results are shown in Table 3.

Table 3. Regression Analysis

Variables	ROA			MBV		
	Model 1	Model 2	Model 3	Model 1	Model 2	Model 3
Constant	-2.474*** (0.190)	-2.200*** (0.176)	-2.221*** (0.182)	-1.621*** (0.202)	-1.192*** (0.173)	-1.163*** (0.170)
DER	-0.178*** (0.18)	-0.139*** (0.017)	-0.140*** (0.017)	-0.056*** (0.019)	0.005 (0.016)	0.002 (0.016)
GFA	0.148*** (0.59)	0.105*** (0.055)	0.097* (0.055)	0.236*** (0.063)	0.168*** (0.051)	0.158*** (0.051)
SIZE	0.044*** (0.09)	0.012 (0.009)	0.015*** (0.09)	0.073*** (0.009)	0.023*** (0.008)	0.024*** (0.008)
PA	0.149*** (0.29)	0.099*** (0.027)	0.097*** (0.027)	0.181*** (0.030)	0.111*** (0.026)	0.100*** (0.025)
GDP	10.484*** (2.181)	5.740*** (2.030)	9.124*** (2.007)	9.764*** (2.321)	7.285*** (1.880)	7.498*** (1.877)
ERM		0.740*** (0.075)	0.615*** (0.095)		1.161*** (0.070)	1.016*** (0.089)
MOW			-0.554 (0.367)			-0.821*** (0.334)
ERM*MOW			2.108*** (1.104)			2.291*** (0.871)
R ²	0.226	0.351	0.357	0.200	0.480	0.487
Adjusted R ²	0.219	0.343	0.347	0.192	0.473	0.478

Model 1 analysis started from baseline models using five firm characteristics as control variables;

specifically, Capital Structure (DER), Growth in Fixed Assets (GFA), Size, Productivity (PA) and economics

growth (GDP). The results of the analysis of the first model using accounting-based performance (ROA) as the dependent variable, indicate that DER was negatively correlated with ROA at a 1% significance level, while GFA, PA, Size and GDP were positively correlated with ROA, with significance levels of 1% and 5%. Based on findings, r-square value in this study is acceptable as advised by Hair et al (2014). Furthermore, the result of analysis using market value performance (MBV) as the dependent variable revealed that DER was negatively correlated with MBV at a 5% significance level, while GFA, PA, Size and GDP were positively correlated with ROA, by means of a significance level of 1%. The results of the analysis of the second model which added ERM to the baseline model exhibited that ERM had a positive influence on firm performance, both in relation to ROA and MBV at a 1% significance level. Hence, the results of this study suggest that good ERM disclosure in a family firm can improve firm performance, while estimates of firm characteristics as control variables show the same results as model 1. Finally, the analysis of the third model, which is the final model, added managerial ownership as a moderator variable. The results revealed that managerial ownership did not influence firm performance; however, managerial ownership could moderate the relationship between ERM and firm performance in which managerial ownership could strengthen the ERM relationship with ROA and ERM relationship with MBV. This implies that with the involvement of ownership, managers are expected to act by considering all existing risks and motivate themselves to improve the performance of the firm.

The findings supported the first hypothesis which stated that ERM has a positive effect on accounting-based performance (ROA). The implementation of ERM can help firms to manage every risk, which in turn will have an impact on firm performance. One of the factors driving the importance of implementing ERM in family firms in Indonesia is the uncertainty of the business environment with regard to suppliers, newcomers, buyers, substitute products and the increasing intensity of competition. According to [7], the relationship between ERM and performance depends on the compatibility between a firm and the contextual environment variables that surround the firm. Therefore, family firms implementing ERM are able to integrate

each risk in daily operations with the implementation of ERM in the firm. Thus, it will be able to reduce every possible risk in a systematic way, by being able to prevent direct costs, for example, loss and bankruptcy and indirect cost, for example the effect of reputation with customers and suppliers [7],[51], [52]. Hence, it can increase the firm's accounting-based performance (Return on Assets-ROA).

The results of this study supported the second hypothesis which stated that ERM has a positive influence on firm value (MBV). The implementation of ERM is seen as a value driver, not as a cost for the company. Additionally, better risk management by implementing ERM determines the level of investor confidence. This indicates that the market responds positively to ERM disclosure information published by the firm. The results of this study support the previous studies conducted by [6], [10], [53]. who established that the implementation of ERM had a positive and significant influence on firm value. However, the results of this study did not support the study conducted by [11], [12] which revealed otherwise.

The findings revealed that managerial ownership supports the relationship between the implementation of ERM and family firms in Indonesia. It shows that family firms which have managerial ownership with broader ERM disclosures can improve firm performance. Likewise, the share owned by firm managers will encourage firms to complete broader ERM disclosures in order to control the risks faced by companies in integrated and holistic ways. This is due to failure in the approval, assessment and management of risks that can cause immense losses for stakeholders and shareholders.

Managerial ownership helps to connect the interests of internal parties and shareholders and generates better decision making that will improve firm performance. Firms that have managerial ownership with broader ERM disclosure will be able to increase firm value. Therefore, in resolving firm policy, managers of family firms need to implement ERM because family businesses certainly cannot evade a variety of problems that are occasionally difficult to solve, such as mistrust among family members, agency conflicts between controlling shareholders and minority shareholders, in addition to the accounting practices used. Therefore,

ERM implemented by family firms has a positive impact on improving firm performance.

The results of this study also support agency theory, where ERM disclosure activities can prevent problems that may occur between management and shareholders. This is due to the fact that the information on ERM disclosures develops into one of the monitoring tools and shareholders' media communications regarding the company's operational activities and a form of shareholders' assessment of operational performance performed by management. Such activity is certainly supported by managerial ownership. The greater the managerial ownership in the company, the higher the motivation to disclose firm activities carried out by way of ERM disclosure. This is due to the fact that the manager wants the community to understand the firm's activities so that they can be considered a company with good prospects. The more firm activities the risk management committee include in relation to the handling of risk, the more it reflects that the firm has less risk than a firm without managerial ownership. In addition, it is expected to be able to attract people which is a plus point for the firm.

4. CONCLUSION

The results of the study reveal that although the implementation of ERM in family firms in Indonesia remains low, ERM has a positive and significant influence on ROA and MBV. This also shows that via the implementation of ERM, management of firm risks can support the attainment of goals to improve accounting-based performance (ROA), as well as market value performance (MBV). Furthermore, managerial ownership can strengthen the relationship between the implementation of ERM and firm performance. Managerial ownership helps to connect the interests of internal parties and shareholders, and generates better decision-making, so that firms that have more managerial ownership with ERM disclosure can improve their performance. Moreover, the five firm characteristics used as control variables also influence firm performance, where the capital structure control variables negatively correlated with firm performance, in relation to both ROA and MBV. These findings support 'packing order theory' (Myer, 1984), which states that firms prioritise the use of their own capital

rather than debt. Additionally, the control variables for growth in fixed assets, firm size and productivity have a positive influence on and contribute to firm performance

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