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The Effect of Good Corporate Governance Practices in Corporate Risk Management Disclosure: An Overview of European Banking Sector

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Abstract

Evidence from contemporary research results proves that good corporate governance practices are a fundamental indicator in determining a company's performance. Corporate risk management disclosure assures stability in a business strategy design and decision-making process. The aim of this study is to obtain significant empirical evidence on the impact of good corporate governance (independence and existence of the committees) and company's performance (return on assets and leverage) and characteristics (company size) towards corporate risk management disclosure. The paper investigates data from the European banking sector evidence. As data source for this study, the information is extracted by Thompson Reuters database and by content analysis of banks published integrated reports during the years of observation. The research questions are addressed by employing regression analysis as a model of research, conducted in IBM SPSS Statistics. The partial results show a possible association between the complexity of risk disclosure, good corporate governance practices and company's performance. Prior studies results demonstrate significant effects of financial performance indicators on corporate risk management disclosure. Also, the company size seems to be positively and significantly related to risk disclosure. Moreover, the effects of corporate governance from previous research are demonstrated; accordingly, similar results are expected from the current study as well. Thus far, the research which assimilates risk management and corporate governance is still limited and in the development phase. This paper may provide consistent results in the research area and supports future approaches.

Keywords: risk management disclosure, good corporate governance practices, financial performance, econometric analysis.

JEL Classification: M14, M16, M21.

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1. Introduction

In light of the prominent accounting misconduct and worldwide magnitude financial crises that characterised the beginning of the 21st century in the economic environment, there has been a heightened focus among scientific research activity on corporate governance practice. Since the interest of researchers has a continuous growth in the realm of the subject of risk management and the various obstacles encountered by companies in unfavourable scenarios (Hazaea et al., 2022).

Through years, the issue of what do good corporate governance practices imply (Einde et al., 2023) and how this may impact the adoption and continuous improvement of risk management processes was raised often. The risk management policies are intrinsically linked to its governance strategies, as robust corporate measures can mitigate poor decision-making (Ghofar et al., 2022).

With the aim of revealing what might be the effects of good corporate practices towards corporate risk management disclosure, the current paper is structured as follows. In the second section, a comprehensive literature review of contemporary studies in the field is conducted. The aim of the study and the research question addressed are uncovered in the third section. The methodology approach, along with the explanation of the econometric model, are presented in Section 4. The results are discussed in the fifth section of this research, followed by the concluding section, which presents the key findings of the study, along with its limitations and possible avenues for future research directions in the domains of corporate governance and risk management.

2. Overview of the Scientific Literature

The assurance of financial stability and the integrity of a business are supported by transparency, trust, and accountability, which are promoted by the corporate governance practice within the organisational environment (OECD, 2023). Dimes and Molinari (2023) argue that the effectiveness of corporate governance mechanisms has gained significant attention among the scientific research activity, as for the last two decades the concepts presents continuous evolution through the expansion of its theoretical framework (Komath et al., 2023).

The field of risk management has also developed into a significant area of studies within the corporate sector, the agency theory serving as one of the pivotal bonds between the concepts of risk management and corporate governance (Einde et al., 2023). Risk management processes involve implementing organisational strategies within a company that is suitable to address each specific risk that a company may encounter (Endang & Indah, 2020). Jing and Zhongtian (2022) state that the concern of risk management disclosure may have a direct impact on the decision-making process. Since risk management disclosure is still relatively less approached, the role of the board of commissioners could be notable in risk disclosure implementation (Baulkaran & Bhattarai, 2020).

Prior studies on corporate governance and risk disclosure generally support the idea that companies with robust corporate governance practices are more inclined to transparently share information about their risks (Yu & Ruxin, 2023). Krishnamurti and Velayutham (2018) contended that the act of disclosing information regarding risks could potentially generate new sources of risk for a company, generating a negative reaction among investors. Moreover, while companies need to present the capability to execute risk management effectively, the act of risk disclosure represents a company's desire to inform annual report users about its facing threats (Endang & Indah, 2020).

Ghofar et al. (2022) examined the effects of independent audit committee on corporate risk management, the findings showing that the level of audit committee independence does not present a significant impact toward risk management disclosure. The findings are supported by Utami et al. (2021), who argue that the independent audit committee is not directly involved in the firm's business processes and may lack access to adequate sources of information necessary for a comprehensive understanding of risk management activities. Sun and Xiao (2024) research also addressed the issue of the independency at the board level, in the context of recent global stock market fluctuations. The results of the study support the impact of board independence on the decrease in corporate risk information disclosure.

Einde et al. (2023) conducted research on how company performance indicators can present effects on risk management disclosure, as good financial performance indicators might encourage a higher probability of wider disclosure of risks. The research presents mixed results, as leverage might have an effect on risk management disclosure complexity, whilst profitability and liquidity does not. Similar research findings from Endang and Indah (2022) show that the return on equity might not have a significant impact toward risk management disclosure.

The significance of corporate governance and transparency is widely debated in the literature on risk disclosure; applying it in practical risk scenarios, companies might be exposed to complex challenges (Luo et al., 2024). Altunbas et al. (2023) observe through the study the effects of disclosure upon risk-taking within the European banking sector, risk disclosure being positively associated with a greater market discipline and with the increase in systematic risk.

In line with the agency theory, prior studies suggest that a company's tendency to disclose risks may be associated with the intention of signalling good corporate governance practices (Raimo et al., 2022). Also, the companies are motivated to increase their risk disclosure complexity as a way to indicate a robust risk management practice and to increase the company's value (Khandelwal et al., 2023).

3. Aim of the Research

The objective of the current study is to obtain significant empirical evidence to the impact of independent corporate governance committees and financial performance and corporate characteristics towards risk management disclosure, within the European banking sector. Independence of committees is seen as a proxy to the use of good corporate governance practices among companies, in line with contemporary scientific literature in the field. Thus, the current study lies under the aim of providing significant results in observing how good corporate governance practices and corporate characteristics may present effects in risk management disclosure.

To date, prior studies that addressed the current matter encourage more research activity considering the effects of corporate governance mechanism towards risk management, by engaging variables such as audit committee independence (Utami et al., 2021), boar independence (Sun & Xiao, 2024) and others associated with good corporate governance practices, and also financial performance indicators (Einde et al., 2023; Endang & Indah, 2022). Therefore, the developed research hypothesis is constructed as follows:

RH1: Good corporate governance practices and corporate financial performance positively affect risk management disclosure complexity.

This research may contribute to the existing literature to broaden the knowledge on corporate risk management by observing the effects of good corporate practices towards risk disclosure.

4. Research Methods

4.1 Research Population and Sample

The current study adopts a quantitative method of research, by incorporating a set of data collected from Thompson Reuters database and company financial statements and annual reports, available in the selected sample companies' websites. For the selection data criteria, there were included in the population only those companies which belong to the financial industry, specifically the banking sector, and whose headquarters are limited within the extent of the European territory. This research observes the effect of good corporate governance practices in corporate risk management disclosure, on 73 banks, whose headquarters are inside the European territory, within three-year observation period 2020-2022. A total of 219 observations were obtained as a sample.

4.2 Measurement of Variables

This study employs Risk Management Disclosure as dependent variable, further denoted as (RMD). Ghofar et al. (2022) and Einde et al. (2023) adopt a variable measurement through which disclosure complexity is scored by the level of meeting the risk disclosure criteria mentioned in the Committee of Sponsoring Organisations of the Treadway Commission Framework (COSO Framework). In line with this, the Risk Management Disclosure variable is given score 0 for no risk disclosure available for public information, score 1 if risk disclosure was available and vague, and score 2 if risk disclosure was not only available, but complex as well (Table 1).

The independent variables employed in this study could be divided as follows: corporate governance performance indicators and companies' financial performance indicators and characteristics. The good corporate governance practices are linked with a higher degree of independence at the level of corporate governance committees (Raimo et al., 2022), therefore, the variables selected for this study are

Board Independence (BI), Audit Committee Independence (ACI), Nomination Committee Independence (NCI), and Compensation Committee Independence (CCI). As good financial performance may be a determinant of good corporate governance practices (Ghofar et al., 2022; Einde et al., 2023), Return on Assets (ROA) and Leverage (Lev) were considered as variables in observing its impact on risk management disclosure. Also, as the company size could be directly linked to the level of risk management implementation, Total Assets (TA) was included as independent variable in the current study's research model.

Table 1. Variables measurement and description

Variable name	Measurement
Risk management disclosure	"0" – no disclosure available "1" – risk disclosure available and vague "2" – risk disclosure available and complex (the company's reports provide significant and explicit information regarding risks)
Board Independence	Percent of independent members from total
Audit Committee Independence	Percent of independent members in the committee from total
Nomination Committee Independence	Percent of independent members in the committee from total
Compensation Committee Independence	Percent of independent members in the committee from total
Return on Assets	Net Income/Equity
Leverage	Total Debts/Equity
Company size	Ln (Total Assets)

Source: author's own research.

4.3 Data Analysis Model

The data analysis method adopted in this study is descriptive statistical analysis followed by the hypothesis testing through the regression analysis technique. Results are obtained using IBM SPSS statistical application version 29. The data analysis model engaged in observing the impact of good corporate governance practices towards risk management disclosure is as follows:

$$RMD = \alpha 0 + \beta_1 BI + \beta_2 ACI + \beta_3 NCI + \beta_4 CCI + \beta_5 ROA + \beta_6 Lev + \beta_7 CS + \varepsilon \quad (1)$$

where:
RMD: risk management disclosure;
BI: board independence;
ACI: audit committee independence;
NCI: nomination committee independence;
CCI: compensation committee independence;
ROA: return on assets;
Lev: leverage;
CS: company size;
$\alpha 0$: constant;
$\beta_{1\ldots}\beta_7$: regression coefficient;
ε: error term.

5. Result and Discussion

5.1 Frequency Analysis and Unidimensional Repartition Parameters

The frequency analysis of the risk management disclosure variable could be observed in the frequencies table below (Table 2). The majority of the observations (124) present complex risk disclosures, covering 56.6% of the total population. Moreover, only 15.5% of the observations were missing the risk disclosure.

Table 2. Risk management disclosure frequency analysis

Valid	Frequency	Percent	Valid percent	Cumulative percent
0 “no disclosure”	34	15.5	15.5	15.5
1 “vague disclosure”	61	27.9	27.9	43.4
2 “complex disclosure”	124	56.6	56.6	100.0
Total	219	100.0	100.0	

Source: author’s own research.

The results obtained above may also be confirmed via the unidimensional repartition parameters, as it can be seen in Table 3. Considering the quartiles values, the population distribution is presented as in 75% of the cases there is at least a vague risk disclosure met in the annual banks’ reports.

Table 3. Unidimensional reparation parameters of risk management variable

Statistical parameter		Values
N	Valid	219
	Missing	0
Median		2.00
Mode		2
Percentiles	25	1.00
	50	2.00
	75	2.00

Source: author’s own research.

5.2 Correlation Analysis

The correlations between the variables of the current research are measured using Spearman’s coefficient. Table 4 presents the results of the bivariate correlation analysis. The results show that a correlation could be observed between risk management disclosure and the nomination committee independence. Spearman’s correlation test indicates that relationships exist between board independence, audit committee independence, compensation committee independence, and company performance indicators. Similar to Ghofar et al. (2022), inconsistences in correlation analysis could be noted, as the effects of the governance variables towards corporate risk management disclosure are limited.

Table 4. Bivariate correlation analysis

		RMD	ROE	Lev	CS	BI	ACI	CCI	NCI
RMD	Corr.	1	0.054	-0.050	-0.006	0.120	0.033	-0.004	0.157*
	Sig.		0.424	0.461	0.927	0.077	0.627	0.948	0.020
	N	219	219	219	219	219	219	219	219
ROE	Corr.	0.054	1	-0.568**	-0.608**	-0.071	-0.093	-0.210**	-0.105
	Sig.	0.424		0.000	0.000	0.297	0.170	0.002	0.120
	N	219	219	219	219	219	219	219	219
Lev	Corr.	-0.050	-0.568**	1	0.644**	0.091	-0.012	0.209**	0.027
	Sig.	0.461	0.000		0.000	0.181	0.856	0.002	0.688
	N	219	219	219	219	219	219	219	219
CS	Corr.	-0.006	-0.608**	0.644**	1	0.100	0.121	0.233**	0.212**
	Sig.	0.927	0.000	0.000		0.140	0.075	0.001	0.002
	N	219	219	219	219	219	219	219	219
BI	Corr.	0.120	-0.071	0.091	0.100	1	0.604**	0.671**	0.110
	Sig.	0.077	0.297	0.181	0.140		0.000	0.000	0.104
	N	219	219	219	219	219	219	219	219
ACI	Corr.	0.033	-0.093	-0.012	0.121	0.604**	1	0.745**	0.172*
	Sig.	0.627	0.170	0.856	0.075	0.000		0.000	0.011
	N	219	219	219	219	219	219	219	219
CCI	Corr.	-0.004	-0.210**	0.209**	0.233**	0.671**	0.745**	1	0.176**
	Sig.	0.948	0.002	0.002	0.001	0.000	0.000		0.009
	N	219	219	219	219	219	219	219	219
NCI	Corr.	0.157*	-0.105	0.027	0.212**	0.110	0.172*	0.176**	1
	Sig.	0.020	0.120	0.688	0.002	0.104	0.011	0.009	
	N	219	219	219	219	219	219	219	219

Note: *. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).
Source: author's own research.

5.3 Regression Analysis

The regression model is performed in order to test the hypothesis of the research on how good corporate governance practices may impact the risk management disclosure. Considering the results presented in Table 5, the engaged regression model considered in this study is statistically significant, as the threshold of 0.05 is not exceeded (Sig. = 0.015).

Based on the hypothesis testing presented in Table 5, the results obtained confirm that corporate governance variables may present significant effects towards the complexity of risk management disclosure.

Table 5. Risk management disclosure frequency analysis

Model	-2 Log Likelihood	Chi - Square	df	Sig.
Intercept Only	423.664			
Final	406.292	17.372	7	0.015

Source: author's own research.

Starting from the tested hypothesis research *RH1: Good corporate governance practices and corporate financial performance positively affect risk management disclosure complexity.* Table 6 presents the results on how corporate variables and financial performance indicators may impact the disclosure risks within the European banking sector. Hence, board independence, audit committee independence, nomination committee independence, and compensation committee independence are used as proxy to determine the effects of corporate governance towards risk disclosure.

Table 6. Risk management disclosure frequency analysis

Model	Unstandardised Coefficients		Standardised Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.849	0.873		0.973	0.032
BI	**0.702**	**0.313**	**0.200**	**2.242**	**0.026**
ACI	0.212	0.313	0.062	0.678	0.499
NCI	**0.416**	**0.164**	**0.175**	**2.529**	**0.012**
CCI	**-0.543**	**0.258**	**-0.206**	**-2.102**	**0.037**
ROA	9.297	7.033	0.106	1.322	0.188
Lev	0.010	0.012	0.074	0.859	0.391
CS	-0.010	0.036	-0.025	-0.281	0.779

Source: author's own research.

The results presented in the table above, show that board independence might have a positive impact on risk management, by recording t – value 2.242 and by reaching 0.026 statistical probability value, which does not exceed the significance threshold of 0.05. In the same line, Sun and Xiao (2024) argue that the existence of independent board members impacts the corporate risk information disclosure.

Similar to Utami et al. (2021), the independent audit committee, however, does not present a significant impact toward risk management disclosure, the Std. Error recording 0.313, however, not statistically significant above threshold (Sig. 0.499). The results might be supported by the fact that the independent audit committee did not take any direct part in the firm business process and may not have disposed of sufficient information source for risk management activity knowledge (Ghofar et al., 2022).

The independence level within the nomination committee may have significant effects towards risk disclosure (Sig. 0.012), while the compensation committee independence level might negatively impact the complexity of risk reports within European banks (B value -0.543, Sig. 0.037), the result being statistically significant. In the same direction, prior research stated that the independence of the board of commissioners might also impact the risk disclosure (Baulkaran & Bhattarai, 2020), the tendency of a company in disclosing information about risk being a sign of robust corporate governance practices (Raimo et al., 2022).

The financial performance indicators, return on assets and leverage, do not present significant influence toward risk management variable, the significant threshold of statistical Sig. being exceeded. Prior studies in the field mark mixed results while analysing the effects of various performance indicators toward corporate disclosure, good financial performance not necessarily suggesting also prominent inclination in the desire of risk disclosure (Einde et al., 2023; Endang & Indah, 2022). Khandelwal et al. (2023), states that if a company's primary concerns lie within the increasing firm value, then the probability of risk disclosure complexity could be higher in order to mark strong risk management practices and to gain investors' attention.

6. Conclusions

The current study aims to observe the effects and to offer empirical evidence on good corporate governance practices (independence and existence of the committees) and corporate characteristics (financial performance indicators and company size) toward risk management disclosure among the European banking sector, observed between 2020-2022. Based on the results of the current study, there is proof that a significant influence of corporate governance mechanisms towards risk disclosure has been met. Corporate governance practices such as board member independence may present a direct positive impact towards risk management disclosure complexity and quality (Gull et al., 2023). The nomination committee and compensation committee might have a considerable influence upon a company’s desire to present corporate risk disclosure implementation (Baulkaran & Bhattarai, 2020). The financial performance indicators used in this research as a proxy in observing the impact of corporate characteristics against risk disclosure seem to not significantly affect the complexity of risk reports. The results show that the bank size does not seem to significantly impact the corporate risk disclosure, as a company profile does not necessarily also suggest a notable inclination in the desire of risk disclosure (Einde et al., 2023), while Abdulla and Elshandidy (2023) support that a bank size may affect the compliance level within an institution, indicating a widened risk disclosure. As good financial performance indicators might encourage a higher probability of wider disclosure of risks, prior studies in the field present mixed results in the effect of a company profile towards risk management disclosure (Einde et al., 2023; Endang & Indah, 2022).

Considering the study’s limitations, the sample of the research addresses only the banking sector which’s headquarters are within European territory, however it may provide a comprehensive observation on corporate governance mechanisms effects towards risk management. Future research may approach an extended objective with a wider period of observation. A cross-sectional analysis between different industries may be suitable and contribute with consistent results to the existing literature evidence in the field as well.

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