The Role of Risk Management Committee in Firm Performance and Risk Disclosure*

"An Empirical Study on the Egyptian Companies"

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ABSTRACT

This study seeks to examine the impact of risk management committee on both firm performance and risk disclosure for a sample of companies listed on the Egyptian Stock Exchange (EGX) for the period from 2016 until 2020. The results of the study showed for empirical regression model (1) that there is a positive significant association between risk management committee's existence and firm performance. Also, it was found that there is a negative insignificant association between risk management committee's size and firm performance. Finally, the results indicated that there is a positive significant association between risk management committee's independence and firm performance.

Concerning empirical regression model (2), the results showed that there is a positive significant association between risk management committee's existence and risk disclosure. The results also indicated that there is a positive insignificant association between risk management committee's size and risk disclosure. Finally, it was found that there is a positive significant association between risk management committee's independence and risk disclosure.

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1. Research Problem:

Based on the agency theory and the resource dependence theory assumptions regarding the association between risk management committee and both firm performance as well as risk disclosure, this study argues that there are two effects of having risk management committee. The first one is the positive effect on firm performance and the second one is also the positive effect on risk disclosure. Taken together, these effects of risk management committee require an empirical investigation in order to determine to what extent forming risk management committee is beneficial to companies and their stakeholders. In addition, based on prior literature, the association between risk management committee and firm performance as well as the association between risk management committee and risk disclosure have not received any attention in research on Egypt (e.g. Abdullah *et al*., 2017; Badriyah *et al*., 2015).

Accordingly, the current study poses the main research question which is to examine the impacts of risk management committee on financial performance and risk disclosure in Egypt especially after the issuance of the last Egyptian Corporate Governance Code (2016) for a sample of Egyptian companies listed on the Egyptian Stock Exchange (EGX).

2. Research Significance:

The significance of the research stems from several aspects. First, this study contributes to the knowledge by investigating the effects of risk management committee on firm performance and risk disclosure in Egypt. Second, the current study has some practical implications as its results will be useful for creating awareness among companies on the types and level of risk information and how to manage it. Third, the study will be useful for helping the stakeholders including current and potential investors in making appropriate judgments and decisions about the company's performance.

3. Research Objectives:

The objectives of the current research are:

1. Examining the association between risk management committee's existence and financial performance.

2. Examining the association between risk management committee's characteristics and financial performance.

3. Examining the association between risk management committee's existence and risk disclosure.

4. Examining the association between risk management committee's characteristics and risk disclosure.

4. Research Methodology:

In order to achieve the research objectives, both theoretical study and empirical study will be relied upon as follows:

(A) Theoretical Study:

The inductive approach is followed in the theoretical background of the study.

(B) mpirical Study:

Deductive approach is used in this study. The empirical study will be conducted using quantitative data collected from the annual reports of the Egyptian non-financial companies listed on the Egyptian Stock Exchange (EGX) from 2016 until 2020. The final sample consists of 130 companies listed on the Egyptian Stock Exchange (EGX).

5. Research Limitations:

The current study is subject to some limitations. First, it used publicly available data for the time period form 2016 until 2020. Second, companies in the financial sector are excluded, therefore the results of this study cannot be generalized to these companies.

6. Previous Studies:

6.1. Studies Addressed the Association Between Risk Management Committee and Firm Performance:

Little studies aimed to examine the association between risk management committee and firm performance. They found that risk management committee is positively associated with firm performance.

For example, **Abubakar et al. (2018) study** examined the impact of the size of the risk management committee on financial performance using secondary data obtained from the annual reports of 14 banks listed on the Nigerian Stock Exchange from 2014 to 2016. The study found that RMC size increases firm performance.

Badriyah et al. (2015) study examined the impact of the existence of risk management committee on firm performance using a sample of companies listed on Indonesian Stock Exchange (ISE) in 2013. The study found that the existence of RMC increases firm performance.

Yeh et al. (2011) study examined the impact of the independence of risk management committee on financial performance using data obtained from the annual reports of the 20 largest financial institutions in Australia, Canada, France, German, Italy, Japan, the United Kingdom, and the United States from 2005 to 2008. The study found that risk management committee's independence increases firm performance.

6.2. Studies Addressed the Association Between Risk Management Committee and Risk Disclosure:

Little studies aimed to examine the association between risk management committee and risk disclosure. They found that risk management committee is positively associated with risk disclosure.

For instance, **Abdullah et al. (2017) study** examined the impact of the existence of risk management committee on risk disclosure using a sample of 395 non-financial companies listed on Bursa Malaysia in 2011. The study found that risk management committee's existence increases risk disclosure.

Al-Hadi et al. (2016) study examined the impact of the independence of risk management committee on risk disclosure of listed financial companies of the Gulf Cooperation Council (GCC) countries in Bahrain, the Kingdom of Saudi Arabia (KSA), Kuwait, Oman, Qatar, and the United Arab Emirates (UAE) from 2007 to 2011. The study found that RMC independence increases risk disclosure.

Jia et al. (2019) study examined the impact of the size of risk management committee on risk disclosure using a sample of top 100 companies listed on the Australian Securities Exchange (ASX) form 2010 to 2012. The study found that RMC size increases risk disclosure. This result is consistent with **Al-Hadi et al. (2016) study** which showed that there is a positive association between RMC size and risk disclosure.

6.3. Research Gap:

The initial literature has addressed the impact of risk management committee on both firm performance and risk disclosure in Egypt. Based on previous studies, there is a little evidence about the impact of risk management committee on both firm performance and risk disclosure especially after the economic and environmental conditions and events that have occurred in Egypt over the last years. Consequently, the current research seeks to fill this gap in the literature by examining the impacts of risk management committee on both financial performance and risk disclosure especially after the issuance of the last Egyptian Corporate Governance Code (2016) for a sample of Egyptian companies listed on the Egyptian Stock Exchange (EGX).

7.Research Hypotheses Development:

In light of the nature of the research problem and in order to achieve the research objectives, a set of the following hypotheses will be formulated based on the relevant theories and the empirical studies:

- Ceteris paribus, there is a positive significant association between risk management committee’s existence and financial performance.
- Ceteris paribus, there is a positive significant association between risk management committee’s size and financial performance.
- Ceteris paribus, there is a positive significant association between risk management committee’s independence and financial performance.
- Ceteris paribus, there is a positive significant association between risk management committee’s existence and risk disclosure.
- Ceteris paribus, there is a positive significant association between risk management committee’s size and risk disclosure.
- Ceteris paribus, there is a positive significant association between risk management committee’s independence and risk disclosure.

8.Research Structure:

The structure of the research is organized as follows:
First: The Nature of Risk Management Committee
Second: Empirical Study

First: The Nature of Risk Management Committee:

The Risk Management Committee (RMC) became one of the most significant internal corporate governance mechanisms. It can be defined as an independent committee of the board of directors which is mainly responsible for overseeing the process of implementing risk management inside the company (Halim *et al*., 2017).

According to the Egyptian Corporate Governance Code (ECGC) in 2016, the Risk Management Committee (RMC) should consist of not less than three independent non-executive members of the board of directors responsible for performing several functions and responsibilities including (EIOD, 2016):

- Analyzing the risks that face the firm and conducting such analysis precisely at an appropriate time.
- Determining executive frameworks, measures, and regulations approved by the board of directors necessary for handling different types of risks that face the firm including financial risks, operational risks, empowerment risks, information processing and technology risks, integrity risks, strategic risks, and any other risks that are likely to influence the firm's activities and sustainability negatively.
- Determining the level of risk appetite for the overall types of risks that face the firm.
- Helping the board of directors evaluate the firm's risk appetite and ensuring that the firm does not exceed those limits.
- Determining risk policies and specific indicators to measure, follow up, and monitor the firm's risk exposure.
- Measuring the suitability and competence of the risk policies concerning the measurement, follow up, and monitoring of the firm's risk exposure as well as implementing any required amendments to those policies according to the developments

- in the market and the surrounding environment of the firm whether internally or externally.
- Overseeing and examining the effectiveness of risk management as well as guaranteeing that risk management employees are independent from the executive management.
- Guaranteeing the availability of sufficient and competent information and communication systems concerning the follow up and monitoring process of risks. These systems enable the board of directors to receive regular reports from the risk management department which reflect the firm's compliance with the level of risks determined and show the breach to such limits, its reasons, and the proposed plans to solve such cases.
- Preparing periodic, accurate, and reliable reports on the results and recommendations of the risk management committee to be submitted for the board of directors in order to make the appropriate decisions.

In conclusion, the researcher notes that the Egyptian Corporate Governance Code (2016) covers several fields and aspects regarding the duties and responsibilities of the risk management committee. Therefore, the researcher thinks that achieving the duties and responsibilities according to the Egyptian Corporate Governance Code ensures an effective risk management committee which ultimately will lead to improve risk disclosure.

Second:Empirical study:

In order to achieve the main purpose of the study which is to examine the role of risk management committee in firm performance as well as risk disclosure, the current study will employ the regressions as the primary technique used to measure the explanatory power of the independent variables against the dependent variables. Hair et al. (2014) stated that the proper technique of analysis when the research problem involves a single dependent variable assumed to be associated with two or more independent variables is the multiple regression analysis. Therefore, multiple regression analysis is selected as the main method of analysis in this study. The objective of multiple regression analysis is to expect how the changes in the dependent variable are explained by changes in the independent variables. This objective is most often achieved through the statistical rule of least squares (Hair *et al*., 2014).

1. Data Collection and Sample Selection:

The empirical study is conducted using primary data collected from the annual reports of the Egyptian non-financial companies listed on the Egyptian Stock Exchange (EGX) from 2016 until 2020. The annual reports of the listed companies can be obtained from the website of Egypt Mubasher Information as well as from the websites of the sample companies. Listed companies are selected in this study because they comply with the rules and standards set by the regulatory authorities in their business activities. In addition, they are expected to prepare and publish their information according to the accounting practices established (Amer *et al*., 2014). Stata/MP software version 14 will be used in order to perform the statistical analyzes of quantitative data and to test the validity of the research hypotheses which mainly examine the impact of risk management committee on firm performance and risk disclosure in companies' annual reports.

The population of the study is represented in the Egyptian stock companies listed on the Egyptian Stock Exchange (EGX) which are 218 companies in 2022 (EGX, 2022). The final sample includes 130 companies listed on the Egyptian Stock Exchange. The selected sample represents companies which are the most likely to attract and employ efficient and skilled individuals on the board of directors. In addition, these companies have privileged access to capital and other resources which are necessary not only for survival but also for improving their performance. The companies of the sample cover 3 sectors including industrials, consumer goods, and consumer services. Financial sector is excluded in this study because its characteristics are different from those of companies in other sectors in terms of financial statements, profitability measures, and liquidity assessment (Zeitun & Tian, 2007). In addition, it is subject to special accounting practices, regulations, and taxes (Soliman & Abd Elsalam, 2012). Table 1 shows the sample distribution of the current study.

Table 1: Sample Distribution of the Study Classified According to the Sectors

Sectors	Number of Companies	Percentage
Industrials	57	44%
Consumer Goods	45	35%
Consumer Services	28	21%
Total	130	100%

2. Empirical Regression Models:

First Empirical Regression Model: Examining the Impact of Risk Management Committee on Firm Performance:

$$FP_{it} = \alpha + \beta_1 RMCE_{it} + \beta_2 RMCS_{it} + \beta_3 RMCIND_{it} + \beta_4 FSIZE_{it} + \beta_5 FLEV_{it} + \varepsilon_{it} \quad (1)$$

Second Empirical Regression Model: Examining the Impact of Risk Management Committee on Risk Disclosure:

$$RD_{it} = \alpha + \beta_1 RMCE_{it} + \beta_2 RMCS_{it} + \beta_3 RMCIND_{it} + \beta_4 FSIZE_{it} + \beta_5 FLEV_{it} + \varepsilon_{it} \quad (2)$$

Where:

α is the intercept or constant,

$\beta_1 - \beta_5$ are the correlation coefficients,

FP is Firm Performance,

RD is Risk Disclosure,

RMCE is Risk Management Committee’s Existence,

RMCS is Risk Management Committee’s Size,

RMCIND is Risk Management Committee’s Independence,

FSIZE is Firm Size,

FLEV is Firm Leverage,

ε is the error term.

The variables featured in the above empirical regression models can be defined in table 2 as follows:

Table 2: Variables Definition

Acronym	**Definition**
Independent Variables:	
$RMCE_{it}$	Risk management committee’s existence for company i in year t
$RMCS_{it}$	Risk management committee’s size for company i in year t
$RMCIND_{it}$	Risk management committee’s independence for company i in year t
Dependent Variables:	
FP_{it}	Firm performance for company i in year t
RD_{it}	Risk disclosure for company i in year t
Control Variables:	
$FSIZE_{it}$	Firm size for company i in year t
$FLEV_{it}$	Firm leverage for company i in year t

3. Variables Measurement:

3.1. Independent Variables:

- Risk management committee’s existence is a dummy variable which takes the value of one if the company has a separate risk management committee and zero otherwise.
- Risk management committee’s size is measured as the total number of members of risk management committee.
- Risk management committee’s independence is measured as the number of independent members on the committee.

3.2. Dependent Variables:

(A) Firm Performance:

Consistent with prior studies, the current study adopts the ratio of return on assets (ROA) as the measurement for firm performance (e.g. Abdel Atty et al., 2018; Abdur Rouf, 2011).

(B) Risk Disclosure:

Consistent with prior studies, the current study adopts the manual content analysis approach for measuring the extent and quality of risk disclosure in the annual reports of companies (e.g. AL-Shammari, 2014; Dobler & Luckner, 2018).

3.3. Control Variables:

According to prior studies, the following control variables are involved in the empirical regression models:

- Firm size is measured as the natural logarithm of total assets (Baroma, 2014; Elzahar & Hussainey, 2012).
- Firm leverage is measured as total liabilities divided by total assets (Baroma, 2014; Iqbal & Usman, 2018).

4. Multivariate Regression Results:

4.1. Results and Discussion of the First Empirical Regression Model:

The first empirical regression model examines the impact of risk management committee on firm performance. Based on the statistical analysis shown in table 3, the probability of the model is significant (Prob > F = 0) and the overall R^2 (coefficient of determination) is 0.3194 which means that 32% in the variations of financial performance is explained by the independent variables.

Concerning the sixth hypothesis (H1), the panel results indicated that there is a positive significant association between risk management committee’s existence and firm performance ($P = 0.034 < 0.05$ level of significance), which implies that risk management committee’s existence is a factor affecting firm performance positively. A possible explanation for this association is that Risk Management Committee (RMC) enables the company to achieve its business objectives, protect its reputation, improve its financial reporting quality, and ultimately improve its performance (Subramaniam et al., 2009).

Since the RMC is responsible for checking, assessing, and supervising the principles, policies, procedures, and strategies of risk management, this will create a better risk management process, so that the risks that face the company are reduced and even prevented, which ultimately will lead to improve firm performance (Halim et al., 2017). This result is supported by Badriyah et al. (2015) and Halim et al. (2017) who found that there is a positive significant association between risk management committee’s existence and firm performance.

Regarding the seventh hypothesis (H2), it was found that there is a negative insignificant association between risk management committee’s size and firm performance ($P = 0.594 > 0.05$ level of significance). This negative association can be explained in terms of the agency theory and coordination problems that emerge when the risk management committee’s size increases, thus reducing firm performance. This means that companies constrained by excessive risks are less profitable and are also more likely to have a bigger risk management committee. This result is supported by Fali et al. (2020) who found that there is a negative insignificant association between risk management committee’s size and financial performance.

In relation to the eighth hypothesis (H3), the panel results indicated that there is a positive significant association between risk management committee’s independence and firm performance ($P = 0 < 0.05$ level of significance), which means that risk management committee’s independence is a factor affecting firm performance positively. A possible explanation for this association is that independence of the members of the risk management committee (RMC) enables them to better monitor the risk taking activities by the managers of the company and guarantee that the strategies set to protect the company are effective. In addition, independence of the members of RMC enables them to confront any potential managerial power as well as obtain all the necessary information for controlling the company’s risks and ultimately will lead to higher firm performance. This result is supported by Fali et al. (2020) and Yeh et al. (2011) who found that there is a positive association between risk management committee’s independence and financial performance.

With respect to the control variables, the panel results indicated that there is a positive significant association between firm size and firm performance (P = 0.021 < 0.05 level of significance). A possible explanation for this association is that the larger the assets, the more capital invested, the more money circulated and the greater the market capitalization will improve the company's financial performance (Meiryani et al., 2020). This result is supported by Meiryani et al. (2020) who found that there is a positive significant association between firm size and firm performance. In addition, it was found that there is a negative significant association between firm leverage and firm performance (P = 0 < 0.05 level of significance), which implies that firm leverage is a factor affecting firm performance negatively. A possible explanation for this association is that the higher the debt, the higher the risk, and the higher the costs of financing, consequently the lower the firm's profitability. This finding is supported by Iqbal and Usman (2018) who found that there is a significant association between financial leverage and firm performance.

In conclusion, the researcher found that the first and third hypotheses are accepted as consistent with the expected hypotheses. On the other hand, the second hypothesis is rejected compared to the expected hypothesis.

Table 3: Panel Regression Results of the First Model

FP	**Coefficient**	**Robust Std. Err.**	**t**	**P> |t|**	**[95% Confidence Interval]**	
RMCE	0.0506504	0.02343	2.16	0.034	-0.0974715	-0.0038292
RMCS	-0.0038622	0.007217	-0.54	0.594	-0.0182841	0.0105598
RMCIND	0.0193484	0.0005292	36.56	0.000	0.0182909	0.0204059
FSIZE	0.0231179	0.0171508	1.35	0.021	-0.0111552	0.0573911
FLEV	-0.1320737	0.0275454	-4.79	0.000	-0.1871189	-0.0770286
_cons.	-0.3203534	0.2910563	-1.10	0.275	-0.901983	0.2612762
F(7,63) = 6.60 Prob > F= 0 Overall R^2 = 0.3194						

4.2. Results and Discussion of the Second Empirical Regression Model:

The second empirical regression model examines the impact of risk management committee on risk disclosure. Based on the statistical analysis shown in table 4, the probability of the model is significant (Prob > chi2 = 0) and the overall R^2 is 0. 3014 which means that 30% in the variations of risk disclosure can be explained by the independent variables.

Concerning the fourteenth hypothesis (H4), the panel results indicated that there is a positive significant association between risk management committee’s existence and risk disclosure (P = 0.036 < 0.05 level of significance). A possible explanation for this association is that the larger the amount of information gained by the Risk Management Committee (RMC), the better will be the information reported to the board of directors and eventually reported to the company’s stakeholders, which ultimately will lead to increase risk disclosure (Abdullah et al., 2017). This finding is consistent with that reported by Abdullah et al. (2017), Al-Hadi et al. (2016), and Jia et al. (2019).

Regarding the fifteenth hypothesis (H5), it was found that there is a positive insignificant association between risk management committee’s size and risk disclosure (P = 0.269 > 0.05 level of significance). According to the researcher, the risk management committee is one of the board committees that affords the responsibility of guaranteeing the availability of sufficient and competent risk information. Therefore, the risk management committee’s characteristics specifically its size can enhance the monitoring of risk information, thus leading to higher risk disclosure. This result is consistent with the agency theory in that the board of directors is responsible for decreasing the information asymmetry problem between owners and managers of the company by increasing risk disclosure. This result is supported by Al-Hadi et al. (2016) and Jia et al. (2019) who found that there is a positive association between risk management committee’s size and risk disclosure.

In relation to the sixteenth hypothesis (H6), the panel results indicated that there is a positive significant association between risk management committee’s independence and risk disclosure (P = 0.031 < 0.05 level of significance). According to the researcher, the risk management committee is one of the board committees that affords the responsibility of guaranteeing the availability of sufficient and competent risk information. Therefore, the risk management committee's characteristics specifically its independence can enhance the monitoring of risk information, thus leading to higher risk disclosure. This result is consistent with the agency theory in that the board of directors is responsible for decreasing the information asymmetry problem between owners and managers of the company by increasing risk disclosure. This result is supported by Al-Hadi et al. (2016) who found that there is a positive association between risk management committee's independence and risk disclosure.

With respect to the control variables, the panel results indicated that there is a positive significant association between firm size and risk disclosure (P = 0.001 < 0.05 level of significance). According to the agency theory, large firms rely on external finance, hence need to disclose more risk information to different users, which leads to a reduction in agency problems and information asymmetry between owners and managers. Besides, large firms have enough resources to cover the costs of disclosing more risk information (Elzahar & Hussainey, 2012). This result is supported by Elzahar & Hussainey (2012) and Netti (2018) who found that there is a positive significant association between firm size and risk disclosure. In addition, it was found that there is a positive significant association between firm leverage and risk disclosure (P = 0.024 < 0.05 level of significance). According to the agency theory, agency costs are higher in highly leveraged firms. To reduce these costs, firms need to disclose more risk information to satisfy the needs of users (Elzahar & Hussainey, 2012). In addition, the higher the debt, the higher the risk, consequently firms need to disclose more risk information to satisfy the needs of users. This result is consistent with Netti (2018) who found that there is a positive association between firm leverage and risk disclosure.

In conclusion, the researcher found that the fourth and sixth hypotheses are accepted as consistent with the expected hypotheses. On the other hand, the fifth hypothesis is rejected compared to the expected hypothesis.

Table 4: Panel Regression Results of the Second Model

RD	Coefficient	Robust Std. Err.	z	P> |z|	[95% Confidence Interval]	
RMCE	0.4372451	0.4163669	1.05	0.036	-1.269288	0.3947977
RMCS	0.1521264	0.1364662	1.11	0.269	-0.1205795	0.4248324
RMCIND	0.0031009	0.0039078	0.79	0.031	-0.01091	0.0047081
FSIZE	0.0607262	0.1224669	0.50	0.001	-0.1793045	0.3007568
FLEV	0.0549053	0.1257148	0.44	0.024	-0.3013018	0.1914911
_cons.	11.03403	2.617587	4.22	0.000	5.903649	16.1644
Wald chi2 (7) = 5.19 Prob > chi2 = 0 Overall R^2= 0.3014						

Research Results:

Concerning empirical regression model (1), the results showed:

- There is a positive significant association between risk management committee's existence and firm performance.
- There is a negative insignificant association between risk management committee's size and firm performance.
- There is a positive significant association between risk management committee's independence and firm performance.

Regarding empirical regression model (2), the results showed:

- There is a positive significant association between risk management committee's existence and risk disclosure.
- There is a positive insignificant association between risk management committee's size and risk disclosure.

- There is a positive significant association between risk management committee's independence and risk disclosure.

Study Recommendations:

Based on the current study, the researcher can provide the following recommendations:

First: The last Egyptian Corporate Governance Code (ECGC) in its third edition (2016) emphasizes the following items: (1) the role of the board of directors as a major mechanism in managing and directing the company, in addition to its main responsibility for implementing governance principles; (2) the optimal composition of the board of directors in terms of diversity and responsibility; (3) the governmental relations and participations of companies; and finally (4) the establishment of a separate Risk Management Committee (RMC) which helps the board in accomplishing its functions and duties. Accordingly, the researcher recommends that these items should be presented and disclosed in the Egyptian Accounting Standard No. (1) "Financial Statements' Presentation" in order to ensure the possibility of comparing the company's future financial statements with its previous financial statements and with the financial statements of other companies.

Second: According to the rules of listing on the Egyptian Stock Exchange (EGX), the researcher recommends the companies for preparing a separate section in the financial statements in order to report risk disclosure information such as the Management Discussion and Analysis (MD&A) section.

Third: The researcher recommends the regulators for monitoring the application of the Egyptian Corporate Governance Code (2016) in order to enhance the risk disclosure information and impose penalties against companies that violate the code.

Suggestions for Future Research:

Based on the current study, the researcher can provide the following suggestions. First, future research may extend the current study through examining the impact of risk management committee on both firm performance and risk disclosure for a longer time period. Second, future research may explore the impact of risk management committee on both firm performance and risk disclosure in the financial sector.

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