

DOES ENTERPRISE RISK MANAGEMENT DISCLOSURE MODERATE THE EFFECT OF CAPITAL STRUCTURE ON THE FIRM VALUE?

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Abstract: There are many inconsistent research results regarding risk management disclosure research, so this study aims to reexamine the enterprise's risk management disclosures in moderating the effect of capital structure on firm value. The research sample is non-financial firms that disclose enterprise risk management in 2018, amounting to 386 firms. Data analysis uses Partial Least Square (PLS). Measurement of enterprise risk management disclosure variables using checklists developed based on ISO 31000: 2009, measurement of capital structure using debt to asset ratio (DAR), and measurement of firm value using Tobin's Q. The results showed that capital structure has a positive and significant effect on firm value. Disclosure of enterprise risk management is proven to moderate the effect of capital structure on firm value.

Keywords: *Capital structure, enterprise risk management disclosure, and firm value*

INTRODUCTION

The events that hit Enron and Worldcom in 2001 were one of the factors that led to the collapse of many firms in the world because many firms lacked good corporate governance. Therefore, the firm is expected to present more transparent information, including disclosure related to enterprise risk because the information is important for the stakeholder.

In carrying out its business activities, every firm is inseparable from the risks. In business activities, risks are usually directly related to firm activities and investments. The investment is an activity that contains risks and uncertainties. The inherent risks to an investment activity lead to the importance of information presentation by firms that are expected can be minimized the level of risk and uncertainty faced. Risk can not be completely avoided and eliminated. With the existence of enterprise risk management (ERM), it is expected that risk can be managed so that it can be minimized and predicted. ERM is a firm

strategy undertaken to manage and evaluate risk in an integrated way. Obalola et al. (2014) state that ERM is used to integrate and coordinate all types of enterprise risk. Because stakeholders do not know the risks of the firm, then ERM disclosure needs to be done.

ERM disclosure will have an impact on firm value. Fraser and Simskins (2010) opine that ERM's main purpose is to maintain and enhance the value of the firm. The ERM disclosure will provide information on the risk of the firm and the management's intervention to manage those risks. This risk information can be a positive signal for stakeholders. Stakeholders can make decisions appropriately if they have information about ERM disclosure. However, not all stakeholders think that ERM disclosure is a positive thing because among them there are types of stakeholders who tend to avoid risk, so ERM disclosure is considered as negative or threatening.

ERM can be used by firms to manage the risks that arise. One of the risks facing by the firm is the risk of choosing the capital structure. Managers will be exposed to the financial risks that can occur in capital structure decision-making. The Determination of capital structure is done by management to increase firm value. With the proper planning in determining the capital structure, it hopes that the firm can increase the value of the firm and be superior to its competitors in the face of business competition.

Every funding election has a positive and negative impact. Firms that choose the source of funding from the debt will benefit from tax savings, so that will have an impact on increasing the value of the firm. Rao (1995) stated that the use of higher debt will provide benefits in the form of tax payment savings and increase the profit per share that will be accepted by shareholders. In addition to profits, negative impacts can also arise from excessive-high debt, i.e. the firm has a high default risk rate. The firm is required to pay high interest and loan principal beyond the benefits received from the debt, which may cause the firm's value to decline. To prevent the risk of failure in fulfilling its obligations, firms tend to employ chief risk officers to manage risk. ERM disclosure is expected to be a positive signal for stakeholders because management can detect and manage risk, so this information will have an impact on the improvement of firm value.

LITERATURE REVIEW

Theoretical Review and Hypotheses Development, Agency theory explains the relationship between the principal and the agent. This is supported by Jensen and Meckling (1976) who stated that the relationship between the principal and the agent gives rise to different interests. This difference in interest causes each party to try to increase profits for

themselves. Management does the ERM disclosure to shareholders, so this can minimize agency problems.

Signal theory explains that managers give the signal to stakeholders to reduce information asymmetry. This is supported by Wolk et al (2001) that described the signal theory as a reason for firms to present information to stakeholders. These signals can attract the attention of investors and can build the image of the firm. The firm manages risk and discloses risk to the public. ERM disclosures can be a signal to shareholders. The Organizational Sponsor Committee of the Treadway Commission (COSO, 2004) described enterprise risk management (ERM) as a process involving management and implementation in strategic arrangements in the firm.

Gitman and Lawrence (2011) argue that the value of a firm is the actual value per share that a firm owner or shareholders will receive if the firm is sold at market prices. The firm has the main objective of increasing the value of the firm because it will affect the prosperity of the owners or shareholders (Wahidahwati, 2002). The funding decision is related to the selection of funding sources, both internal and external. this decision will have an impact on the firm's value. According to Weston and Copeland (1997), capital structure is a balance or comparison between long-term debt and own capital.

Hypotheses Development, The effect of Capital Structure and Firm Value, Management can increase the value of a firm through financial decisions. The use of debt in the capital structure can control the management from being involved in unfavorable investment projects (Jensen, 1986). Payment of debt installments and other financial burdens can reduce agency

problems. The use of debt will provide additional supervision from creditors. This condition will be responded positively by investors. According to Modigliani and Miller (1958), the value of the firm with debt will be higher than the value of firms without debt. The increase is due to the tax savings. Therefore, the hypothesis is proposed as follows:

H1: Capital structure has a positive effect on firm value

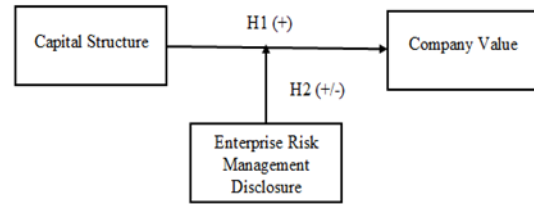
The Effect of Capital Structure, Firm Value, and Enterprise Risk Management Disclosure

ERM disclosure is the risk management information undertaken by the management and the disclosure will impact the firm. ERM in a firm has an important role to maintain the stability of the firm. High ERM illustrates the existence of good enterprise risk governance, including ensuring internal control of the firm is maintained. High-quality ERM disclosures will have a positive impact on stakeholder's perceptions (Baxter et al., 2013). Positive perceptions of stakeholders will increase the value of the firm. Hoyt et al. (2006) stated that ERM implementation information through ERM disclosure can increase firm value. ERM can be used by firms to manage the risks that arise. One of the risks faced by firms is the risk of choosing the capital structure. Managers are faced with possible financial risks in capital structure decision-making. Therefore, the hypothesis is proposed as follows:

H2: Enterprise risk management disclosures moderate the effect of capital structure on firm value.

Research Model

Figure 1. Research Model



METHOD

The sample uses in this research is non-financial firms in Indonesia in 2016. The total sample in this study consists of 386 firms. The sampling technique used in this research the purposive sampling with the criteria of non-financial firms that revealed ERM in 2018. ERM disclosure in this research measured by using the total score index of disclosure items based on the dimensions of ISO 31000: 2009. This variable is measured by giving a score of 1 on firms doing ERM disclosure and score 0 for firms that do not disclose ERM. The firm values in this study were measured using the measurements of Tobin's Q or Q-Ratio. This study refers to Tobin's Q formula as used by Black et al. (2005). The capital structure measured by using debt to asset ratio (DAR). This study refers to the DAR formula as used by Brealey (2007)

The research uses the partial least square software (PLS) to analyze the data. With a sample 386 firm and a 95% significance level. The model used to test the hypothesis are as follows:

Model 1:

$$NPE = \beta_0 + \beta_1 SMO + \epsilon \dots \dots \dots (1)$$

Model 2:

$$NPE = \beta_0 + \beta_1 SMO + \beta_2 ERD + \beta_3 SMO * ERD + \epsilon \dots \dots \dots (2)$$

Where:

- NPE : Value of firm
- SMO : Capital structure
- ERD : ERM disclosure
- SMO*ERM : Moderating of ERM disclosure on capital structure

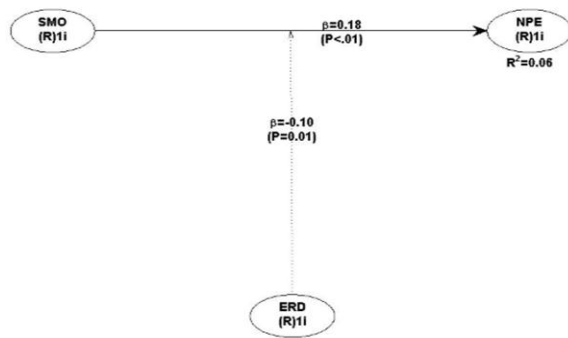
RESULT AND DISCUSSION

This study uses Partial least square analysis to calculate the goodness of fit model. It is calculated from average R-squared (ARS), Average path coefficient (APC), and the average variance inflation factor (AVIF).

Analyze	Prob	Criteria	Result
APC = 0.140	P < 0.001	P < 0,05	Supported
ARS = 0.063	P = 0.039	P < 0,05	Supported
AVIF = 1.539		P < 5	Supported

Source: Processed Data, 2018

Figure 1
Hypothesis Testing



Hypothesis Testing Results

Variable	redict	Model 1		Model 2		Significance	Result
		oeff	rob	oeff	rob		
MO → NPE		,18	0,01			ignificant	Supported
MO → ERD → NPE	/-			0,10	,01	ignificant	Supported

Source: Processed Data, 2018

The effect of Capital Structure and Firm Value, From the test result, hypothesis 1 is supported. The capital structure proved to have a positive effect on firm value. The higher the value of the capital structure, the higher the value of the firm. The value of firms that have

higher debt than the value of firms that do not have debt (Modigliani and Miller, 1958). The results support the previous studies by Deli (2017) and Suryani (2015).

The results support agency theory. According to Jensen and Meckling (1976), agency costs are costs incurred by principals to exercise oversight of agents. The use of debt can control the management from being involved in unfavorable investment projects (Jensen, 1986). Payment of debt installments and other financial burdens can reduce agency problems. The use of debt will provide additional supervision from creditors. This condition will be responded positively by investors. The use of debt gives positive signals for investors so will increase the value of the firm.

The Effect of Capital Structure, Firm Value, and Enterprise Risk Management Disclosure

From the test result, hypothesis 2 is supported. This suggests that enterprise risk management disclosures moderate the effect of capital structure on firm value. The coefficient of the path marked negative means that enterprise risk management disclosure weakens the positive effect of capital structure on firm value.

The results are supporting the signal theory. Signal theory explains that managers give positive or negative signals to stakeholders so information asymmetry can be reduced. Enterprise risk management disclosure is used by investors in considering investment decisions. The manager discloses the risks facing the firm. Enterprise risk management disclosure can be viewed as both an opportunity and a threat by investors as it will affect the investment decision to be decided. In other words, enterprise risk management disclosure can provide a positive or negative signal for stakeholders.

Following the trade-off theory, the greater the debt the greater the risk that will be borne by the firm (e.g. the risk of bankruptcy). The greater the risk of the firm, the more risks, and uncertainties that will be disclosed in enterprise risk management disclosure. For investors who tend to avoid risk, ERM disclosure is considered negative or threatening so that it causes the value of the firm to decrease.

CONCLUSIONS AND SUGGESTION

This study examines whether the capital structure has a positive effect on firm value and enterprise risk management disclosure weakens the effect of capital structure has a positive effect on firm value. This research has a limitation which can be used as consideration for subsequent research because this research uses a year observation year and this research only uses the capital structure as an exogenous variable in its effect on firm value. Further research can improve the limitations by extending the observation period, for example, five years to obtain more accurate results and add other variables, for example, dividend policy.

This research has implications for various interested parties. Management needs to pay attention to the capital structure in improving firm value. Funding firms that are sourced from debt are riskier. Excessive debt will be related to the financial risks that will be incurred by the firm and increase the likelihood of bankruptcy risk. The addition of debt used to finance the assets will result in the greater the likelihood of the firm's difficulty in paying its fixed obligations of interest and principal. This will lower the firm's value and result in a higher bankruptcy risk than tax savings. Investors need to consider various things in choosing a firm as a place to invest. One factor that needs to be considered by investors in investing in the capital structure. Investors also need to consider the enterprise risk management disclosure factor because it is a form of transparency by firm management,

so ERM disclosure can not be assumed as negative or threatening.

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