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The Role Corporate Governance in Managing Financial Risk: A Qualitative Study on Listed Companies

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ABSTRACT

This qualitative study examines the role of corporate governance in managing financial risk within Company X, a pseudonymized listed company based in West Java. Corporate governance practices play a pivotal role in shaping the strategic direction and operational decisions of modern businesses, influencing their overall performance and long-term sustainability. The research employs in-depth interviews with key stakeholders, including board members, executives, auditors, and financial experts, to gain insights into the practices, policies, and mechanisms employed by Company X to manage financial risk. The findings highlight the significance of effective corporate governance in mitigating financial risks and fostering trust among stakeholders. The study contributes valuable insights into the complex relationship between corporate governance and financial risk management, providing practical implications for enhancing risk governance in Indonesia's business landscape.

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1. INTRODUCTION

Good corporate governance is essential for the long-term success and sustainability of a company. It can stimulate financial risk management and positively impact a company's financial performance. Corporate governance refers to the mechanisms used to control and monitor management performance and ensure corporate accountability to stakeholders [1]. One of the key aspects of good corporate governance is the board of directors, which plays a crucial role in overseeing the company's risk management practices [2]. A well-structured board with independent directors and effective communication with supervisors can ensure efficient risk management practices in a company [2]. Research has shown that board independence, board diligence, and female directorship presence have a significant and positive association with financial risk management in listed healthcare firms in Nigeria [3].

Furthermore, good corporate governance can lead to improved investment efficiency and reduced financial information disclosure risk. A study conducted on companies listed on the Tehran Stock Exchange found that investment efficiency increased with better corporate governance quality, while the risk of financial information disclosure decreased [3]. This implies that good corporate governance can help companies avoid agency conflicts, minimize earnings manipulation by managers, and obtain reliable company performance valuations [1]. In addition to the board of directors, other corporate governance mechanisms, such as block ownership and board gender diversity, have been found to positively affect the level of corporate financial risk disclosure [4]. This is important for investors and regulators, as increased financial risk disclosure implies that efforts by various stakeholders have had a positive impact on the level of financial risk disclosure in the firms examined [4]. In conclusion, good corporate governance is crucial for companies to effectively manage financial risks and improve their financial performance. By implementing sound corporate governance mechanisms, companies can enhance their investment efficiency, reduce financial information disclosure risk, and ensure long-term sustainability. This has significant implications for policy-makers, investors, and regulators, who should continually pursue reforms to encourage firms to follow corporate governance principles that are promoted as good practice [4].

Corporate governance plays an important role in influencing financial risk in various ways. Corporate governance involves the system of rules, practices and processes used to direct and control a company. Good corporate governance can help reduce financial risk, while poor governance can exacerbate it. A well-structured board with diverse expertise, experience and independence can help manage financial risks more effectively [5]. A study of Pakistani companies found a negative relationship between board attributes and corporate risk [5]. In contrast, larger board size in Indonesian listed companies was found to increase the likelihood of financial distress [6]. Effective audit committees and high-quality audits can help identify and address financial risks in a timely manner [5]. In the case of Indonesian listed companies, larger audit committees were found to increase the likelihood of financial distress [6]. However, the relationship between audit quality and the likelihood of financial distress was found to be insignificant in the same study [7]. A firm's ownership structure can also affect financial risk. A study on Islamic banks found that ownership concentration is positively associated with risk-taking behavior [8]. Good corporate governance can help improve risk management practices within firms. For example, a study on Indonesian banks found that the implementation of corporate governance can affect credit risk and liquidity risk [6]. Corporate governance can also have an indirect impact on financial risk through its influence on financial performance. A study on Deutsche Bank found a significant positive relationship between intellectual capital efficiency and financial performance [9]. Good corporate governance can help improve financial performance, which in turn can reduce financial risk.

Regulatory compliance: Good corporate governance can help ensure compliance with financial regulations, such as the Basel standards for banks [8]. This regulatory compliance can help manage financial risks more effectively. In conclusion, corporate governance can influence financial risk through various mechanisms, such as board composition, audit quality, ownership structure, risk management practices, financial performance and regulatory compliance. Good corporate governance can help reduce financial risk, while poor governance can increase financial risk [5]–[9]. Corporate governance plays a pivotal role in shaping the strategic direction and operational decisions of modern businesses, influencing their overall performance and long-term sustainability [10]–[13]. In an increasingly complex and interconnected global economy, effective corporate governance practices are essential for mitigating financial risks, safeguarding the interests of shareholders, investors, employees, and other stakeholders [11], [14]. Ensuring transparency, accountability, and ethical behavior within organizations is fundamental to building trust and enhancing investor confidence, particularly in the context of listed companies.

The Indonesian business landscape has witnessed significant growth and transformation, with West Java being a crucial hub for economic activities. As corporations expand their operations and face dynamic market conditions, they are simultaneously exposed to various financial risks, including market volatility, credit risk, liquidity challenges, and regulatory compliance issues. The successful management of these risks requires a robust corporate governance framework that aligns strategic objectives with risk mitigation strategies.

The primary objective of this qualitative study is to explore and analyze the role of corporate governance in managing financial risk within one of the listed companies in West Java. By delving into the specific practices, policies, and mechanisms employed by the chosen company, this research seeks to shed light on how corporate governance influences risk management decisions and outcomes.

2. LITERATURE REVIEW

2.1 Corporate Governance and Financial Risk Management

Corporate governance refers to the system of rules, practices and processes used to direct and control a company. Corporate governance encompasses the relationship between the various stakeholders involved in a company, including shareholders, management, the board of directors, employees, customers, suppliers and other parties [15]–[17]. Effective corporate governance ensures transparency, accountability and protection of stakeholders' interests, thereby fostering trust and confidence in the company's operations [18], [19].

Financial risk management is an integral component of corporate governance, which aims to identify, assess and mitigate risks that may impact the financial stability and performance of the company. Financial risks can arise from various sources, such as market fluctuations, credit defaults, liquidity limitations, foreign exchange exposures, and compliance violations [10], [20], [21]. Corporate governance mechanisms play an important role in establishing a risk management framework that is aligned with a company's strategic objectives and risk appetite [22]–[24].

Numerous studies have highlighted the positive correlation between strong corporate governance practices and effective financial risk management [22], [25], [26]. Companies with strong governance structures tend to exhibit greater risk oversight and are better equipped to proactively address financial challenges.

2.2 The Role of Corporate Boards in Risk Management

The board of directors serves as a key pillar of corporate governance, responsible for overseeing the company's strategic direction and risk management practices. An effective board plays a critical role in identifying potential risks, evaluating risk exposures and implementing measures to mitigate adverse outcomes [14], [26], [27].

The establishment of board committees, such as risk committees and audit committees, further enhances risk oversight. These committees focus on specific risk categories, ensuring in-depth analysis and monitoring of risk-related issues [28], [29]. In addition, the separation of the roles of CEO and Chairman of the Board of Commissioners can enhance the independence of the Board of Commissioners, thereby promoting more effective risk governance.

3. METHODS

This qualitative research used an exploratory approach to gain in-depth insights into the role of corporate governance in managing financial risk in one of the listed companies in West Java. An exploratory design is suitable for delving into complex phenomena and exploring participants' perceptions, experiences and practices relating to corporate governance and financial risk management.

3.1 Data Collection

Primary data was collected through semi-structured interviews with key stakeholders in the selected listed companies. Interviewees were purposively selected based on their roles and expertise in corporate governance and financial risk management. The stakeholders include:

a. Board members: Including the Chairman of the Board, independent directors, and other board members responsible for risk oversight and governance decisions.
b. Executives: Key executives involved in strategic decision-making and risk management processes within the company.
c. Auditors: External auditors who provide an independent assessment of the company's financial statements and risk management practices.
d. Financial Experts: Professionals with expertise in risk management, financial analysis, and corporate governance practices.

3.2 Sample Selection

The sample consisted of a diverse group of participants with relevant knowledge and experience in corporate governance and financial risk management. The sample selection prioritizes individuals who hold influential positions within the selected companies and have a comprehensive insight into their operations, based on which the sample in this study is 25 informants in 10 listed companies operating in West Java.

3.3 Data Collection Procedure

Prior to conducting interviews, informed consent was obtained from all participants to ensure their willingness to participate in this study. Interviews will be conducted face-to-face or through a virtual platform, depending on the participant's preference. Each interview lasted between 45 minutes to one hour.

Interview questions are semi-structured, allowing flexibility to explore participants' experiences, opinions and perspectives related to corporate governance and financial risk management. The questions covered topics such as:

a. Perceptions of the importance of corporate governance in managing financial risk.
b. Corporate governance practices within the company, including board composition, committee structure, and risk oversight mechanisms.
c. The specific financial risks faced by the company and the strategies used for risk identification, assessment and mitigation.
d. Challenges and limitations in current corporate governance and risk management practices.
e. Suggestions for improving corporate governance and financial risk management in the company.

3.4 Data Analysis

Interview data was audio-recorded and transcribed verbatim to ensure accuracy during the analysis process. Thematic analysis was used to identify recurring patterns, themes and concepts within the data. The analysis process involved several steps:

a. Familiarization: The researcher familiarized herself with the interview data by reading and rereading the transcriptions.
b. Coding: Initial codes were created to categorize meaningful segments of the data.
c. Theme Development: Codes were organized into broader themes, capturing main ideas and patterns.

d. Review and Validation: The analysis was reviewed by multiple researchers to ensure validity and reliability.
e. Interpretation: The researcher interpreted the findings, relating them to the research objectives and existing literature.

4. RESULTS AND DISCUSSION

4.1 Results

a. Corporate Governance Practices at Company X

Analysis of interviews conducted with key stakeholders from Company X revealed insights into the company's corporate governance practices. The board of directors demonstrates a well-rounded composition, comprising independent directors with diverse expertise in finance, risk management and relevant industry knowledge. The presence of independent directors enhances objectivity and impartiality in board decision-making, thereby contributing to effective risk oversight.

To further strengthen corporate governance, Company X has established specialized committees, including a risk committee and an audit committee. These committees play an important role in identifying, evaluating, and monitoring the financial risks facing the company. The risk committee proactively assesses emerging risks and provides recommendations to the board for risk mitigation.

Transparency and disclosure are important components of Company X's corporate governance framework. The company regularly communicates its risk management efforts to stakeholders through comprehensive reporting, thereby fostering trust and confidence among shareholders and investors.

b. Financial Risk Management Strategy

Company X demonstrates a proactive approach to financial risk management. The Company implements a rigorous risk identification process that involves a comprehensive analysis of market trends, credit exposures, liquidity positions, and regulatory compliance requirements.

Periodic risk assessments are conducted to evaluate the potential impact of identified risks on the company's financial health. Management uses risk tolerance levels to prioritize risks and allocate resources effectively. This approach allows Company X to focus on addressing high-impact risks while managing other risks in a structured manner.

The Company uses a combination of risk mitigation techniques to manage financial risks. Financial instruments, including derivatives and hedging strategies, are used to mitigate market and currency risks. In addition, Company X maintains a diversified portfolio and established strong relationships with various financial institutions to reduce credit risk.

c. Challenges and Limitations

Despite the overall effectiveness of corporate governance and financial risk management practices at Company X, several challenges and limitations were identified during the research.

One of the key challenges is the need for continuous monitoring and adaptation to emerging risks. Given the dynamic nature of the financial market and regulatory environment, the company recognizes the importance of remaining vigilant and agile in responding to potential risks.

External factors beyond Company X's control also have potential limitations. Global economic uncertainty, political events, and changes in regulatory policies may affect the effectiveness of risk management strategies.

In addition, stakeholders expressed their desire for more detailed disclosures in certain areas to gain a deeper understanding of specific risk exposures.

4.2 Discussion

The findings from this study suggest that effective corporate governance practices in Company X play a critical role in managing financial risks. The presence of independent directors and active board committees contribute to the company's ability to proactively address financial challenges.

In addition, the financial risk management strategy employed by Company X demonstrates a comprehensive and proactive approach. By continuously identifying and assessing risks and adopting appropriate mitigation measures, the company effectively manages financial risks and strengthens its financial position.

The challenges identified underscore the importance of adaptability and continuous improvement in risk management. Company X recognized these challenges and expressed its commitment to improving its risk management practices to effectively deal with future uncertainties.

Overall, this study provides valuable insights into the role of corporate governance in managing financial risks at Company X. The recommendations offered can serve as practical guidance. The recommendations offered can serve as practical guidance not only for Company X but also for other companies looking to strengthen their corporate governance framework and financial risk management strategies.

This research contributes to the growing body of knowledge regarding corporate governance and financial risk management, providing valuable perspectives for stakeholders to improve sustainability and business performance. In addition, this study confirms previous research such as [16], [19], [30]–[32]

5. CONCLUSION

The findings of this qualitative study underscore the crucial role of corporate governance in managing financial risk within Company X, a listed company operating in West Java. The research shed light on the practices and strategies employed by the company to navigate financial risks effectively, ensuring its long-term sustainability and stakeholder confidence.

Corporate governance practices within Company X demonstrated a well-rounded composition of the board, including independent directors with diverse expertise. The presence of independent directors enhanced objectivity in decision-making and contributed to effective risk oversight. Additionally, the establishment of board committees, such as the risk committee and audit committee, played vital roles in identifying, evaluating, and monitoring financial risks, bolstering risk governance within the organization.

The financial risk management strategies employed by Company X displayed a proactive approach to risk identification, assessment, and mitigation. The company conducted regular risk assessments and utilized risk tolerance levels to prioritize and allocate resources strategically. Leveraging financial instruments and maintaining a diversified portfolio, the company effectively managed market, credit, and liquidity risks.
However, challenges and limitations were identified, emphasizing the need for continuous monitoring, adaptation to emerging risks, and enhanced transparency. Global economic uncertainties and external factors beyond the company's control

highlighted the importance of agility in risk management practices.

The study recommends that Company X strengthens its continuous risk monitoring mechanisms, adopts scenario planning techniques, and engages stakeholders regularly for valuable feedback. Emphasizing enhanced transparency in risk disclosures will further build trust and credibility among stakeholders.

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