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Development of a Risk Governance Index and Examination of Its Determinants: An Empirical Study in Indian Context

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Abstract : Risk management has been gaining extensive focus from international organizations like Committee of Sponsoring Organizations and Financial Stability Board, and, the foundation of such an effective and efficient risk management system lies in a strong risk governance structure. In view of this, an attempt (perhaps a first of its kind) has been made to develop a risk governance index, which could be used as proxy for quality of risk governance structures. The index (normative framework) is based on eleven variables, namely, size of board, board diversity in terms of gender, proportion of executive directors, executive/non-executive status of chairperson, proportion of independent directors, CEO duality, chief risk officer (CRO), risk management committee, mandatory committees, voluntary committees and existence/non-existence of whistle blower policy. These variables are scored on a scale of 1 to 5 with the exception of the variables, namely, status of chairperson and CEO duality (which have been scored on a dichotomous scale with the score of 3 or 5). In case there is a legal/statutory requirement in respect of above-mentioned variables and there is a non-compliance with such requirement a score of one has been envisaged. Though there is no legal requirement, for the larger part of study, in context of CRO, risk management committee and whistle blower policy, still a score of 1 has been assigned in the event of their non-existence. Recognizing the importance of these variables in context of risk governance structure and the fact that the study basically focuses on risk governance, the absence of these variables has been equated to non-compliance with a legal/statutory requirement. Therefore, based on this the minimum score is 15 and the maximum possible is 55. In addition, an attempt has been made to explore the determinants of this index. For this purpose, the sample consists of non-financial companies (429) that constitute S&P CNX500 index. The study covers a 10 years period from April 1, 2005 to March 31, 2015. Given the panel nature of data, Hausman test was applied, and it suggested that fixed effects regression would be appropriate. The results indicate that age and size of firms have significant positive impact on its risk governance structures. Further, post-recession period (2009-2015) has witnessed significant improvement in quality of governance structures. In contrast, profitability (positive relationship), leverage (negative relationship) and growth (negative relationship) do not have significant impact on quality of risk governance structures. The value of rho indicates that about 77.74% variation in risk governance structures is due to firm specific factors. Given the fact that each firm is unique in terms of its risk exposure, risk culture, risk appetite, and risk tolerance levels, it appears reasonable to assume that the specific conditions and circumstances that a company is beset with, could be the biggest determinants of its risk governance structures. Given the recommendations put forth in the paper (particularly for regulators and companies), the study is expected to be of immense utility in an important yet neglected aspect of risk management.

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