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BOARD GOVERNANCE OF PUBLICLY LISTED COMPANIES IN INDONESIA: TOWARDS SOUND CORPORATE GOVERNANCE IMPLEMENTATION

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Abstract: *The importance of corporate governance practice is to ensure investor protection and oversight. Corporate governance is applied not only in public companies but also applied in the ordinary course of business enterprise.*

This study examined the characteristics of board governance as measured by the independence of the board of commissioners (independent BOD), board size, managerial ownership, board composition, the audit committee, on the implementation of corporate governance as measured through the company's financial performance measured by ROA (Return on Asset), ROE (return on Equity), and PER (Price Earning Ratio). The aim of this study was to obtain an overview of the features of board governance in public companies in Indonesia; particularly in fortifying the role of the board of commissioners in executing corporate governance. The population in this study was all of the non-financial companies listed on the Indonesia Stock Exchange (BEI) during the period from 2005 to 2013.

Cross-tab analysis and regression analysis were utilized to analyze the data used in the study. The results of the cross-tab analysis indicate that the number of independent commissioners within a company is positively correlated to the number of commissioners. Furthermore, the results for cross-tab analysis between independent BOD and managerial ownership suggests that the higher the number of independent commissioners, the lower percentage of managerial stockholding in the company. In regression analysis, the variables independent BOD, board size, audit committee and managerial ownership are positively significant to company's performance measured by ROA and ROE. However, all of the previously mentioned variables are not significant to PER. Independent commissioners play a vital role, especially in regard to the financial performance measured with ROA and ROE.

Keywords: Corporate Governance, Board Characteristics, ROA, ROE, PER, Indonesia Stock Exchange (BEI)

1. INTRODUCTION

La Porta *et al.* (2000) defined corporate governance as a tool to protect investor assets from exploitation by inside parties. In public and business organizations, the concept of corporate governance is closely related to management supervision

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in the decision-making process. According to Syakhroza (2004), leadership (comprising of the board of commissioners and board of directors) quality has a significant role in the implementation of good corporate governance. The board of commissioners acts as company supervisors, while the board of directors is accountable for the company's operational activities. Nonetheless, it is common to find conflict of interests between the two boards. Although the Board of Commissioners is stronger than the Board of Directors in terms of legal position, asymmetric information often leads to conflicts between the two and within the organization.

Furthermore, Syakhroza (2004) states that corporate governance has six elements: (1) focus on the board (2) laws and regulations as instruments of direction and control (3) effective, efficient, economical, and productive organizational management (4) transparency, accountability, responsibility, independence, and fairness (5) organizational purposes, and (6) strategic control.

The links among the Board of Commissioners' characteristics regulate the corporate governance's effectiveness, as explained by Chien (2008): "Board characteristics could affect effectiveness in monitoring the management and the quality of corporate governance."

This study explores the board characteristics which are measured by the following variables: Independence of the Board of Commissioners, Board Size, Managerial Ownership, Board Composition and the Audit Committee. The characteristics are used to measure the implementation of corporate governance—measured by company performance, which, in turn, is measured by ROA (return On Asset), ROE (Return On Equity) and PER (Price Earning Ratio). The purpose of this study is to reinforce the role of commissioners in implementing corporate governance. We hope that the study can contribute to strengthening the role of the board of commissioners in the implementation of corporate governance in Indonesia and enrich the field of administrative sciences, especially in corporate governance.

2. THEORETICAL FRAMEWORK

Lukviarman (2004) defined corporate governance as an integrated unit of legal and cultural aspects and other institutional requirements that determine the following: the actions taken by the corporation, who will control it and how it will be controlled, and the allocation of risks and benefits from corporate activities. Here, the main factor and focus in corporate governance lie in the management, which is centered on the leadership's ability to control all of the company's internal and external activities. The focus is manifested in the central role held by two business organization actors, the Board of Directors (BOD) and Board of Commissioners (BOC). The Board of Directors (BOD) assumes the leadership role full-time and may not have a dual role. It has a central role in managing the company's operational activities through strategic decisions. On the other hand, the Board of Commissioners (BOC) comprises of commissioners, independent commissioners and various committees governed by the Board. The BOC's main function is to be accountable for the strategic planning process and company risks, supervise the directors' performance, oversee the company to ensure that its condition is consistent with established policies, and monitor the direction taken by the company and its operation in accordance to corporate governance principles (Yuristisia and Lukviarman, 2010).

From the point of view of the company's capital ownership structure, ownership is considered as one of the main influences in the implementation of corporate governance in the company. The capital structure reflects the company's needs for funding and financing sources to ensure operational activities go smoothly; these sources can be from inside and outside the company. The composition of the company's ownership structure is reflected by the composition of the capital structure. Higher concentration in capital ownership affects the level of dominance of the owners' interest in achieving the company's objectives. The owners' dominance of the capital structure contributes to the approach used in executing corporate governance, therefore the owners' contribution to the capital structure indicates the owners' dominance of the available investment and capital in regard to the benefits[2] from the company's asset in the future.

The board of commissioners[3] represents the stakeholders who contribute to an effective realization of the organization's objectives in the future. The wide range of perspectives and interests of the board are highly influential in determining the approach used to achieve the organization's future objectives effectively. This will result in variety and uniqueness, which in turn will affect the organizational values reinforced by the company in order to address future opportunities and tackle future obstacles.

When we analyze the Board of Commissioners'[4] role in company activities, it is clear that the board is significant for and contributes to achieving company goals and optimizing company values. This is also due to the fact that that the Board of Commissioners is not only a forum where individual values interact, but also a place for the board members to interact with each other in order to build values, preferences and orientations on an organizational level. Moreover, the board has stronger authority and bargaining power in their intervention in and influence on the company's management. The board's authority and bargaining power in the organization reflects the members' dominance in the organization. Stronger authority by the Board of Commissioners may imply that the majority of the board members represent the company owners. It may also imply that the Board of Commissioners' presence within the company influences the decision-making among the management and directors.

Regardless, the Board of Commissioners also comprises of stakeholders who provide education and advice for the company without directly interfering with the company's management activities. The Board of Commissioners' competence, skills, independence and integrity are also important factors to help them understand the company's situation and issues at present. The Board is expected to have better understanding and perspective in identifying current conditions or problems, since they must provide independent advice and solution for the organization. Higher levels of competence and skills, amplified by high integrity, are expected to assist the Board of Commissioners in providing reliable and precise information, advice and feedback when dealing with issues within the company.

The board's role in the company will indicate the company's accomplishment and the board's power in combining the attitude and expectations of stakeholders involved in achieving company goals and better company values in the future. Better performance from the board results in better performance by the company.

Knell (2006) states:

> "The Board should do what it can by way of providing information, to make shareholders feel they are genuinely part of something. Making the most of the Annual General Meeting as an opportunity to meet with shareholders is strongly recommended."

According to Tricker (2009):

> "The board's responsibility is to be looking inwards at the enterprise and outwards to the firm's external situation, focusing on the past, the present, and the strategic future, and the other side the board which does not have a shared view of the company's future direction and purpose (what some call a corporate vision) cannot develop an effective strategy."

Shaw (2003) also confirms the board's role in the company:

> "Board members do not need to be industry experts, but they should be quick studies around the big issues and major decisions of the industries in which their organizations compete, and to reach it the board must play out the potential consequences of those choices and decisions in ways that identify risks and rewards and establish metrics for monitoring and tracking feedback and learning."

Therefore, it is clear that the board's role in the company is a key factor in developing better competitiveness for the company. The board's independence, honor, competence and skills in understanding the company's potentials are critical for confronting the uncertain risks and addressing various opportunities that may arise from external environments, especially industrial competition. It is also crucial that the above factors are relayed to all members of the board in order to achieve a similar point of view. Such a perspective will reinforce the board's commitment to the company, both individually and as a group, and help them understand both their contribution to the board's authority and their responsibility to better the company's growth in the future.

It is compulsory for the independent members of the Board to work together to maintain a strong and highly effective Board of Commissioners; they need to understand and carry out their duties according to corporate governance principles (Citra and Lukviarman, 2010). According to the Decree from the Ministry of BUMN No. Kep 117lM-MBrJl02, corporate governance implementation can be indicated by the following: 1) transparency 2) disclosure 3) accountability 4) independence and 5) justice.

Fama and Jensen (1983) consider the board of commissioners as a core element in implementing corporate governance. According to Klein (2002), independent members in the Board of Directors supervise more effectively. Cornett, et al. (2008) state that operational performance and stock return improves when there are more independent commissioners in the company. Lio and Lu (2007) imply that board structure does not only control financial reporting, but also prevent shareholders from taking actions that may harm other shareholders. Beasley (1996) finds that companies with a higher number of independent commissioners in the boards have lower financial report manipulation rate. Moreover, Anderson, Mansi, and Reeb (2003) discover that the cost of debt is lower in companies with a higher number of independent commissioners. Ho and Williams in Mangena (2007) state that the presence of non-executive directors (the equivalent of independent commissioners) tends to improve the board's effectiveness, as non-executive directors are relatively more independent in their relationships with the companies' management.

3. RESULT OF RESEARCH

The approach in this research was a quantitative approach by using secondary data obtained from various sources. The data collected consist of annual report and financial statements from companies taken as research sample. The researcher uses non probability sampling technique and purposive sampling method with the following criteria: (a) Samples taken not included in a company engaged in the financial industry, (b) Financial statements of the company as sample are complete and contains all variable needed to analyze. The secondary data used in this research consist of data collected from Bank Indonesia (BI), and Financial Reports of go-public companies obtained from Indonesia Stock Exchange (BEI). The initial number of non-financial companies or subjects of the research is 202. The final samples, chosen according to established criteria, consist of data from 163 of non financial companies from 2005 to 2013. The Table 1 shows the stages of samples taking.

Table 1
Sample of the Research

Step	*Procedure*	*Number*
1	Non-financial companies listed on BEI 2005-2013 period	202
2	Firms not listed consecutively in period of 2005-2013	-39
	Sample Size	163

3.1. Descriptive Analysis for the 2005-2013 Period

Using the 163 companies as samples, the researchers measure the characteristics of their Boards of Commissioners with the following indicators: (1) Independent Board of Commissioners (Independent BOD) (2) BOD size (3) Managerial Ownership (MO) (4) Board Composition (BC) and (5) Audit Committee (AC). Corporate governance implementation is measured through company performance measured by ROA, ROE, and PER. Below is the descriptive statistical data for the 2005-2013 periods.

Table 2
Descriptive Statistics

Variable	*Min*	*Max*	*Mean*	*Median*	*Mode*	*Std Dev*
Independent BOD	0.00	5.00	1.51	1.00	1.00	0.994
Board Size	1.00	13.00	4.40	4.00	3.00	1.941
Managerial Ownership	0.00	0.256	0.0235	0.000	0.00	.0194
Audit Committee	0.00	7.00	1.80	3.000	3.00	1.611
Board Composition	0.00	0.75	0.3396	0.333	0.33	0.1729
Number of observation	1467	1467	1467	1467	1467	1467

- The complete data from the 2005-2013 period shows that each of the majority of public companies in Indonesia in the sample has an independent BOD member. In total, there are companies with five independent BOD members. In the implementation of good corporate governance in a company, independent commissioners are a core element. This is stated in the Bapepam Regulation No. I-A on the General Stipulations for Equity Stock Listing in the Stock Exchange, Point C-1: in order to accomplish good management in a company, at least 30% of the commissioners in a listed company must be independent commissioners.
- The board size variable: During the nine-year period being researched, one to thirteen members are found in the boards. The majority of companies have three commissioners, with a median value of 4 commissioners and mean value of 4.40. This indicates that many non-financial public companies have four commissioners.
- The managerial ownership variable: Most of the commissioners do not own stocks in their companies, although some of them have stocks with a

maximum value of 0.256. The tenure for commissioners is one full year. Most of the public companies being researched have 3 audit committees. Out of the 163 companies, some have audit committees with a maximum of seven members.

- Board composition: During the 2005-2013 period, the most common amount of independent commissioners is 33% of the total number of commissioners, and the highest amount is 75%. Board composition refers to the proportion of independent commissioners to the total amount of commissioners. The researchers further discover that most non-financial companies that have gone public have complied with the Bapepam Regulation No. I-A.
- Bapepam Regulations require a company to have an audit committee, in order for the company to have financial supervision and thus guarantee the security of company assets. The current research finds that most public companies have three audit committees. Thus it can be said that many companies have complied with Bapepam Regulations.

The research shows that most public companies only have one independent commissioner each; thus it can be said that most companies that have gone public have not complied with Bapepam Regulation No. I-A. This situation is counterproductive to the government's requirement for the implementation of good corporate governance in all companies, especially companies that have gone public, in order to develop the national economy. The lack of independent commissioners in a company results in problems, the main ones being: no one to ensure that company strategy is carried out properly, no supervision on company management, and no one to reinforce independent accountability. Boards of Commissioners in companies that have gone public in Indonesia only have, on average, four members, which give rise to the above problems.

Audit committees in limited companies are a sign of improvement in corporations in general. In Indonesia, audit committees are only recently introduced, and its presence in limited companies is legalized in Law No. 40/2007 on Limited Companies (UUPT), which substitutes Law No. 1/1995. Below are the legal bases for audit committees:

- Bapepam-LK Regulation No. IX.1.5: The Establishment of and Work Guidelines for Audit Committees.
- Bank Indonesia Regulation No. 8/4/PBI/2006 on the Implementation of Good Corporate Governance for Commercial Banks.
- Decree from the Minister for State-Owned Enterprises: KEP-117/M-MBU/2002 on Good Corporate Governance Practices in State-Owned Enterprises (BUMN).

The above regulations state that an audit committee is a division with crucial functions that assists the Board of Commissioners in oversight. This is further defined in the audit committee's tasks and responsibilities: to report the various risks faced by the company to the commissioners, to report complaints related to stock issuers, to maintain the secrecy of the company's information and documents, to examine the financial information issued by the company, to review the company's compliance with laws and regulations, and to review the inspection by external auditors.

Although the Board of Commissioners' role needs to be reinforced, it is an unfortunate fact that audit committees are very rare in the public companies taken as samples in the research; most of the companies do not have audit committees. Out of the 163 samples, only a few have audit committees.

Most of the companies have a wide quantity of range in regard to Board of Commissioners members, namely twelve (from 1 = one member to 13 members). On average, the boards have four members. Although there are only a few of these companies have boards commissioners, the relevant legislative body needs to oblige companies to have boards of commissioners as part of their governance structure and a requirement to improve company accountability.

Data on managerial ownership reveals that the majority of commissioners in public companies have a 0% stock ownership. This is very good because it shows the companies' high independence level. The highest rate of stock ownership is 0.256, and the stocks are owned only by a handful of people, thus the situation remains within the limit of normality. Commissioners are representatives of stockholders in RUPS (the annual meeting of stockholders); they also supervise and make decisions for the company. Based on the above data, we can conclude that these roles are carried out independently without intervention on stock ownership.

The board composition variable indicates a company's level of independence. Bapepam Regulations require that at least 30% of board members are independent commissioners, and in all companies taken as samples about 33% of the board members are independent commissioners.

Managerial ownership is categorized as "good" as the stock ownership rate is 0%, indicating that the majority of companies have a high independence level.

3.2. Cross-tab Analysis

Cross-tab analysis is employed to analyze the research. The variables of board governance (Independent BOD, Board size, Managerial ownership, Audit Committee and Board Composition) were categorized into 3 (three) groups, namely 1 = low, 2 = medium, and 3 = high. The results of the cross-tab analysis show the following conclusions:

a) The number of independent commissioners is in direct proportion to the number of members in the board commissioners and statistically significant. The higher the number of board members, the higher the number of independent commissioners. This fact indicates that public companies in Indonesia are sufficiently aware of the importance of independent commissioners.

b) The higher the number of independent commissioners, the lower the percentage of managerial stock ownership in the company. This is an inversely proportional relationship that is statistically significant; and it also shows that the percentage of stocks owned by independent commissioners in Indonesian public companies is relatively low.

c) In public companies in Indonesia, there is a significant association between the number of independent commissioners and the number of audit committees. When a company has independent commissioners, it also tends to have an audit committee.

d) Research results show a significant relationship between the number of independent commissioners with the company's financial performance, measured with ROA, ROE and PER. In non-financial public companies, a higher number of independent commissioners results in a higher performance. These results indicate that independent commissioners do not work mainly to serve the owners or principals; but they also take public interest into account.

e) There is an association between the number of audit committees and the financial performance measured with ROA, ROE and PER. This indicates that there is a link between the number of audit committees and the financial performance. This shows that audit committees play an important role in earning the investors' trust.

f) Judging from the percentage of independent commissioners in the board of commissioners, the former plays an increasingly prominent role in non-financial public companies in Indonesia. A higher percentage of independent commissioners in the board of commissioners indicate better financial performance, measured with ROA, ROE, and PER, and these results are significant. The commissioners' role in implementing corporate governance increases along with the increasing trust from investors, indicated from the financial performance measured with ROA, ROE, and PER.

3.3. Regression Analysis

After conducting descriptive statistics and cross-tab analysis, a regression analysis is performed from variables of corporate governance characteristic on company performance measured with ROA, ROE and PER. The result of the regression is shown in Table 3.

Table 3
Regression for the Research Samples in 2005-2013

Variable	*Coeffficients*		
	ROA	*ROE*	*PER*
Constant	0.34467	1.76969	33.14856
Ind-BOD	0.65543 (*)	1.11394 (*)	-1.44927
	(2.515)	(2.0366)	(-0.44954)
Board Size	0.85196 (*)	1.15175 (*)	-1.12452
	(9.6978)	(6.2457)	(-1.03457)
Board Comp	3.29498 (*)	7.22554 (*)	4.13634
	(2.1441)	(2.2399)	(0.21755)
Audit Comm	0.52021 (*)	0.82177 (*)	-1.50885
	(3.8367)	(2.8874)	(-0.89943)
Manag Ownership	0.44514 (*)	0.58824 (*)	-1.00301
	(4.5294)	(2.8515)	(-0.82488)
R-Square	0.12875	0.06272	0.00322

Note: * Significant at the 5 percent level. The t-statistic is reported in parentheses.

The result of regression shows that all board governance variables significantly influenced company performance measured by ROA and ROE. However, there is no significant effect to company performance measured by PER. This result indicates that investors measure the performance of non financial companies based on profitability ratio measured by ROA and ROE. In order to check the robustness of the regression, logistic regression was also conducted. Logistic regression was utilized since around 13 % to 14 % of the non financial companies have performance (ROA, ROE, and PER) less than zero. The dummy categories of company performance (DROA, DROE, and DPER) are:

0 = if the performance is less than zero, and

1 = if the performance is positive.

The results of the logistic regression are shown in table 4.

The logistic regression result shows that variables of independent BOD, board size, and board composition are significantly influenced company performance measured by ROA, ROE, and PER. In other words, the probability of company's performance is higher with variables independent BOD, board size, and board composition. The results are consistent with the cross tab analysis that independent commissioner has positive and significant effect to the company performance in the non-financial companies in Indonesia.

Table 4
Logistic Regression for the Research Samples in 2005-2013

Variable	*Coeffficients*		
	DROA	*DROE*	*DPER*
Constant	1.04642	1.07666	1.01526
Ind-BOD	0.58692 (*)	0.47574 (*)	0.56617 (*)
	(4.3525)	(3.69197)	(4.18278)
Board Size	0.20010 (*)	0.13801 (*)	0.18277 (*)
	(4.30837)	(3.20392)	(3.93919)
Board Comp	1.84490 (*)	1.35227 (*)	1.76376 (*)
	(2.97156)	(2.17609)	(2.80359)
Audit Comm	0.02858	0.8855	0.09453 (**)
	(0.51092)	(1.58561)	(0.0968)
Manag Ownership	0.15522	0.01998	0.02221
	(1.24009)	(0.60954)	(0.47385)
McFadden R-Square	0.05483	0.03975	0.05379

Note: * Significant at the 5 percent level. ** Significant at the 10% level. The Z-statistic is reported in parentheses.

4. CONCLUSION

The characteristic of board governance in non-financial public companies in Indonesia, when linked to the implementation of corporate governance, shows that independent commissioners play a vital role, especially in regard to the financial performance measured with ROA and ROE. However, the extent of the role needs to be further detailed in the government regulations, as corporate governance is only recently implemented in Indonesia. Unfortunately, the role of commissioners in Indonesia that is currently regulated through UUPT No. 40/ 2007 does not sufficiently detail the commissioners' role in supervising and providing advice; consequently, companies are not motivated to have independent commissioners or audit committees.

This research offers the suggestion that a follow up study using the characteristics of board governance in financial public companies may also be necessary for comparison purposes and to discover whether the commissioners' role in financial public companies also supports the implementation of corporate governance.

Notes

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2. Page's (2005) review states that "Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment."
3. Alex Knell (2006) offers the following perspective on the board's role in a company: "The Board should collectively understand the market place of the business, the needs of the

stakeholders of the business, the personal responsibility of each director, executive or NED, to act in the company's best interests."

4. According to Knell (2006), "All directors must take decisions objectively in the interests of the company."

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