INDEPENDENT COMMISSIONER, INSTITUTIONAL OWNERSHIP AND FINANCIAL DISTRESS BANKS IN INDONESIA

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ABSTRACT

This research aim to determine the effect of independent commissioner and institutional ownership to financial distress banks in Indonesia. The existence of the banking crisis occurred in 1997/1998 resulted the collapse of public confidence in banking industry. In 2008, the scale, pattern, and a different scope, we face the reality that seems similar to the condition of the banks in the end of 1997. Financial distress experienced is not only caused by external factors stemming from the bank but also can be caused by internal factors. On the other hand, the financial distress in the banking sector can be caused by governance are not good in running the bank's operations. This study used a quantitative approach. The unit of analysis is the banks in Indonesia with data obtained from directory of Bank Indonesia in 2008-2009. The research sampling techniques use saturated sampling or census. Research design use multiple logistic regression with the cross section. The result from this study indicated that independent commissioners and institutional ownership cannot prevent the financial distress in 2008 and 2009.

Keywords : independent commissioner, institutional ownership, financial distress.

INTRODUCTION

The banking sector plays an important role in the economic development of Asian countries. In 1997, a full-fledged banking and financial crises occurred in countries of South Asia, including Indonesia. Many banks must be bailed out by their government, this course will resist economic growth in the State. Banking crises in 1997/1998 resulted the collapse of public confidence in the banking industry. It would cost more than Rp. 500 Billion to rehabilitate the banking sector, equivalent to 50% of Indonesia's GDP at that time (Bank Indonesia 2010).

Kunt and Detragiache (1998) defines a crisis as a situation which is one of the following conditions are accomplished:

1. Non-performing assets reached 10% of the total assets banking system;
2. The cost to rescue the banking system reached 2% of GDP;
3. Magnitude Transfer of banks ownership of banks to the government; and
4. widespread "bank-run" happened.

Currently, in the scale, pattern, and a different scope, we face the reality that seems similar to the condition of the banks in late 1997. Past events as the retrace time, starting

with the dry liquidity, high interest rates, and depreciation of Rupiah.At the same month, November 2008, the victim began to fall. Century Bank, which is the result of a merger of Bank CIC, Bank Danpac, and Bank Pikko, to be the first victim. Starting from a failure in clearing the transaction on November 13, 2008, the bank liquidity who keeps 15.23 trillion rupiah's getting worse (Pransiska 2008).

Financial difficulties (financial distress) experienced by the bank is not only caused by external factors but can also by internal factors, such as weakness of internal control, non professional management. Internal control is a monitoring mechanism established by management of bank by ongoing basis, in order to: (Directorate of Research and Regulation of Banks, 2003).

1) safeguard and secure the assets of the Bank;
2) ensure the availability of more accurate reporting;
3) improve adherence to applicable regulations;
4) reduce the financial impact / loss, deviation including cheating / fraud, and breach of aspects of prudence; and
5) improve organizational effectiveness and improve cost efficiency.

On the other hand, the Financial Distress in the banking sector can caused by governance with not good in running the bank's operations. The Forum For Corporate Governance In Indonesia (FCGI) defines corporate governance is "a set of rules that govern the relationship between shareholders, trustees (managers) of the company, creditors, government, employees and the holders of internal and external interests relating to the rights and their obligations, or in other words a system that regulates and controls the company. " Besides, FCGI also explained the purpose of Corporate Governance is "to create added value for all interest parties (stakeholders)." In detail, the terminology of Corporate Governance can be used to explain the role and behavior of the Board of Directors, Board of Commissioners, trustees (managers) of the company and its shareholders.

The existence of independent commissioner has been arranged the Jakarta Stock Exchange JSX through the regulations July 1, 2000. It is argued that the companies listed in the Exchange must have an Independent Commissioner proportionally equal to the number of shares owned by minority shareholders (non controlling shareholders). In these regulations, the requirements of a minimum number of independent commissioner is 30% of all members of the Board of Commissioners. While, Bank Indonesia (2006) have decided more portion for independent commissioner less than 50% of total member of commissioners.

Board of Commissioners (BOC) holds very important role in the company, especially

in the implementation of Good Corporate Governance. BOC is one of the element of corporate governance are assigned to ensure the implementation of corporate strategy, controlling the management in managing the company, and requires the implementation of accountability. The point is, the Board of Commissioners is a mechanism to oversee and provide guidance and direction to the manager of company. Remind that management is responsible to improving the efficiency and competitiveness of enterprises, while the Board of Commissioners is responsible for overseeing management in managing the company's Board of Commissioners of parties who are responsible for the company's success.

Other aspects that affect the successful implementation of good governance is the separation of ownership that effect to control and the implementation of management company that caused the manager action do not accordance with the owner interested. TheAgency costs can be minimized with several alternatives, for example the ownership of institutional investors can serve as a monitor agent. Moh'd et al. (1998) stated that the distribution of shares among shareholders from outside the institutional investors will reduce agency costs. The presence of institutional shareholders may encourage greater supervision more optimal for management performance.

Based on above this research aims to prove empirically whether the government's policy on good corporate governance includes the perspective of an independent commissioner and institutional ownership, contributes to preventing financial distress.

This research aim to determine the effect of an independent commissioner and institutional ownership of financial distress at the Banks in Indonesia.

Based on the background, the research problem is whether an independent commissioner and the institutional ownership have influence to financial distress Banks in Indonesia

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Research about the influence of the relationship between ownership, board structure and internal control mechanisms that affect the survival of the banking company by Simpson and Gleason (1999). The result is only affecting the structure of the board of directors of the company's survival.

The study using agency and institutional perspectives with the aim hypotheses test about board structure and performance of companies in Russia conducted by Judge et al (2003). In particular, find negative relationship between the duality of "informal" CEO and company performance.The result is important given Russia's 1996 federal law that prohibits

the CEO also chairman of the board. Overall, these findings suggest that effective corporate governance may be crucial to the companies performance in Russia.

In Taiwan has been studied by Liu et al (2006) about the relationship between the CEO of a public company and change of control, this research analyzes that there is an increasing separation of ownership and management in Taiwan public companies. The results are consistent with the hypothesis that reducing firm control of their family.

Agency problems arise because of the different interest between principal and agent can be prevented or reduced by increasing the oversight effectiveness of the company. Supervision is not only limited by the parties of the company, but also can be done from an external party to enable the monitoring company throught the institutional investors that more independent than the internal. Corporate ownership by institutions will encourage more effective oversight, because the institution is a professional who has ability to evaluate the performance of the company (Murhadi, 2008).

The existence of ownership by institutional investors are defined as investors from the financial sector such as securities companies, insurance companies, banks, investment companies, pension funds and other institutional ownership will encourage more optimal greater supervision for performance management, because the ownership of shares representing a sources of power that can be used to support the existence or otherwise of management.

Research on the prediction of business failure and bankruptcy of banks by using financial ratios CAMEL (CAPITAL ASSET MANAGEMENT LIQUIDITY) models have been carried out by Nasser and Aryati (2000) and Almilia (2005). The results by Nasser and Aryati show that only the ratio EATAR and OPM is able to predict bankruptcy in the Go Public Banking Sector. While Almilia results only CAR and BOPO that can predicts bankruptcy and financial distress.

According to the dictionary of Bank Indonesia (BI), CAMEL is the most influential aspects of the bank's financial condition, which affects the level of bank health; CAMEL is a measure of the object of bank examinations conducted by banks supervisor; CAMEL consists of five criteria, there are: capital (capital), assets (assets), management, earnings and liquidity CAMEL ratings under 81 showed a weak financial condition indicated by the bank's balance sheet, as no current loan ratio to total assets increased; if it is not resolved, the problem may interfere with bank survive; bank listed on the problem banks and considered to be inspected more frequently by bank supervisors in comparison with the bank that is not problematic; banks with CAMEL ratings above 81 is a bank

with strong earnings and little current assets; CAMEL ratings never informed widely (http://www.bi.go.id). Assessment of the health system of commercial banks regulated by Bank Indonesia with Regulation Number: 6/10/PBI/2004 about the Rating System for Commercial Banks. and Circular Letter No. 6/23/DPNP about the Rating System for Commercial Banks.

RESEARCH METHODS

This study used a quantitative approach.

Hypothesis

The hypothesis in this study based on research and reasons of reference:

Ho: The existence of an independent commissioner and institutional ownership can not prevent the financial distress occurrence at Banks in Indonesia.

H1: The existence of an independent commissioner and institutional ownership will streamline the management control function which can prevent the financial distress occurrence at the Banks in Indonesia.

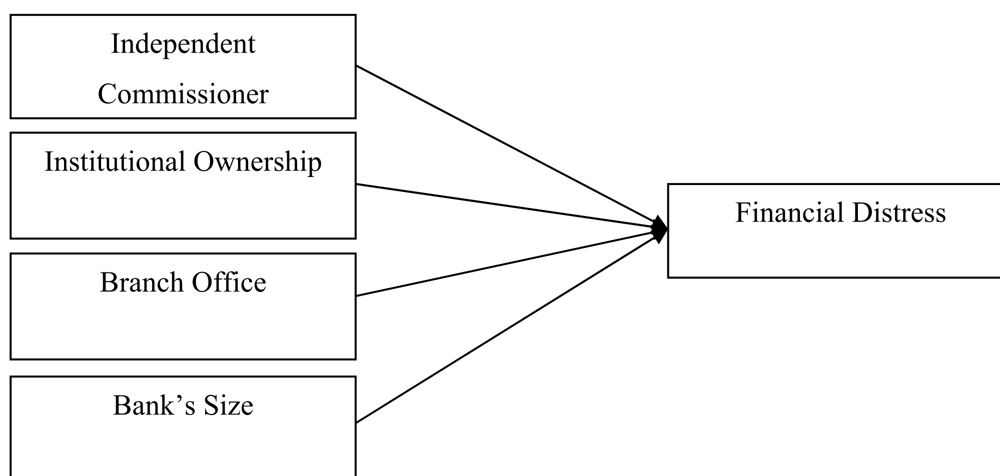
Variable Identifications

This study uses two (2) independent variables, here are: an independent commissioner and institutional ownership, and one (1) the dependent variable is financial distress. The control variable are total branch office and bank's size.

Conceptual Framework

Refer to the research hypothesis, it can be drawn the conceptual framework as follows:

Figure 1 Conceptual Framework



Operational Variables Definition

Independent Commissioner is the commissioner from outside entity or public company, does not have stock either directly or indirectly to the issuer or public company, has no affiliation with the issuer or public company, the commissioner, or the issuer's major shareholders or the public company, and do not have a business relationship directly or indirectly related to the business activities of the issuer or public company. Independent commissioners in this research is calculated by determining the percentage (%) of the total number of independent commissioner at the commissioner's bank annual report in 2008.

Institutional ownership is the ownership of shares in a company which is majority owned by the institutions (insurance companies, banks, investment companies, asset management and other institutional ownership). Institutional ownership in this study uses the percentage of institutional share ownership with ownership of more than 5% of that scan be een in the Bank's annual report for the year 2008 (Graves and Waddock, 1994). When a company is more than one institution that has possession of the company's stock, the stock ownership is measured by calculating the total of all shares held by all institutional ownership.

Financial distress is a weak financial condition of a bank as measured by the CAMEL consisting of CAR1 (Capital Adequacy Ratio 1), CAR2 (Capital Adequacy Ratio 2), ETA, NPM (Net Profit Margin), OPM, ROA (Return on Asset), BOPO (Operational Cost compared with Operational Income), and LDR (Loan to Deposits Ratio). Banks which had CAMEL under 81 showed a weak financial condition, and given the zero score (0), while the banks had CAMEL above 81 given score 1.

Total branch is a number of bank's branch. Total branch input to the control variable because inefficiency branch bank's capital allocation will be decrease financial performance. Bank's size is value of total bank's asset measured by Ln the asset. Bank's size input to the control variable because it's influenced financial performance and bank's ability during financial crisis like as Mitton's opinion (cited in Leung & Horwitz 2010, p.471).

Unit Analysis

This research used Banks in Indonesia as unit analysis.

Population

The population is banks and data obtained from the directory of Bank Indonesia 2008-2009.

Sample

Sample of this study are financial statements of Bank published in 2008-2009 and all data available for this research.

Total Sample

Based on data in the Directory of Bank Indonesia 2008-2009, this study use 21 banks at 2008 and 19 banks at 2009.

Sampling Technique

This sampling techniques is saturated sampling. Saturated sampling is the sample when all the members of the population is used as a sample. The other terms of this saturation is the census sampling.

Research Design

This research use multiple logistic regression with the cross section. Logistic regression was used because the dependent variable in this study is dummy. The multiple logistic regression model is as follows:(http://www.stat.ufl.edu)

$$\text{Logit } [P(y=10] = \alpha + \beta_1 X_1 + \ldots + \beta_k X_k$$

And the formula of probability are as follow:

$$P(y=1) = \frac{e^{\alpha + \beta 1X1 + \ldots + \beta kXk}}{1 + e^{\alpha + \beta 1X1 + \ldots + \beta kXk}}$$

Thus, the multiple logistic regression model in this study were:

$FD_i = \beta 0 + \beta 1\%\ K.INDP + \beta 2\ \%\ K.INTS + \beta 3J.CBG + \beta 4Ln\ T.ASET + \varepsilon i$

FD = Financial Distress using dummy variables, one (1) for the companies that do not have Financial Distress, 0 for a company that have Financial Distress.

i = bank 1 to 40.

β0 = intercept

% KI = Independent Commissioner was measured by percentage of independent commissioners.

β1- β4 = Slope

% KIS = Institutional Ownership is measured by the percentage of institutional ownership.

J.CBG = Total Branch.

Ln T.ASET = Bank's size measured by Ln Total Asset.

Ei = error

This study used SPSS for data analysis.

RESULTS AND DISCUSSION

This chapter present summary descriptive statistic for the sample obtained and run with SPSS.

Results

The first step of logistic regression is block 1, and the result presented below:

Table 1. Omnibus Tests of Model Coefficients Block 1: Method = Enter

		Chi-square	df	Sig.
Step 1	Step	1.022	4	.906
	Block	1.022	4	.906
	Model	1.022	4	.906

Based on the table above, the model can be form within one step. The table show chi square-test = 1,022 the significance value 0.906, it means with level of significance 5% (α = 0.05), HO rejected and the model is accepted and can be continued. The model summary will be show at table 2.

Table 2. Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	29.120(a)	.025	.048

a Estimation terminated at iteration number 4 because parameter estimates changed by less than .001

From table above, the x variable will explain y variable is 4,8% (0.048) and many others variable can be explained the relationship. The Nagelkerke R Square is common use for some research.

Table 3. Hosmer and Lemeshow Test

Step	Chi-square	df	Sig.
1	10.238	8	.249

Table 3 and table 4 presented the Chi-square = 10,238, with sig. value is 0.249 (α = 5%) and the result present the H0 fail rejected**,** it means the model is fit (no differences between preview results and prediction model result) of Hosmer and Lemeshow's Goodness of Fit Test tested the zero hypothesis (H0) which is the empirical data is match or fit with the model. The statistic value of Hosmer and Lemeshow's Goodness of Fit Test is 10,238 with significant probability 0.249 that over 0.05 and the conclusion is model accepted.

Table 4. Contingency Table for Hosmer and Lemeshow Test

		FD = 0		FD = 1		Total
		Observed	Expected	Observed	Expected	Observed
Step 1	1	3	3.817	1	.183	4
	2	4	3.701	0	.299	4
	3	4	3.649	0	.351	4
	4	4	3.612	0	.388	4
	5	3	3.571	1	.429	4
	6	4	3.515	0	.485	4
	7	4	3.444	0	.556	4
	8	4	3.356	0	.644	4
	9	2	3.233	2	.767	4
	10	3	3.103	1	.897	4

Table 5. Classification Table

	Observed		Predicted		
			FD		Percentage Correct
			0	1	
Step 1	FD	0	35	0	100.0
		1	5	0	.0
	Overall Percentage				87.5

a The cut value is .500

Table 5 showed the overall percentage value is 87,5 means accuracy of prediction model or accuracy of classification is 87,5%.

Table 6. Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1(a)	K.INDP	-.008	.029	.078	1	.780	.992
	K.INTS	.012	.022	.298	1	.585	1.012
	J.CBG	.000	.027	.000	1	.987	1.000
	T.ASET	-.282	.573	.243	1	.622	.754
	Constant	1.914	8.324	.053	1	.818	6.781

a Variable(s) entered on step 1: K.INDP, K.INTS, J.CBG, T.ASET.

Table 6 present four predictor logistic model was fitted to the data to test research hypothesis regarding the relationship between the likelihood that financial distress is affect by independent commissioners (K.INDP), institutional ownership (K.INTS), number of branch company (J.CBG) and total assets (T.ASET). The result showed that

Predicted logit of (Financial Distress) = 1.914 + (-0.008)*K.INDP + (0.012)*K.INTS + (0.000)*J.CBG + (-0.282)*T.ASET.

The model means all of X variable are not affect to Y variable because has a sig >5% (with $\alpha = 5\%$).

Discussion

Independent and institutional ownership are governance mechanisms did not affect the bank's financial performance during the financial crisis, this is consistent with the review of the literature on corporate governance issues in the Asia-company by Claessens and Fan (2002) using the period of financial crisis Asia 1997-1998 indicates that the mechanism of conventional corporate governance (takeover and the board of commissioners) are not strong enough to alleviate the agency problem, it is caused by lack of transparency, institutional systems and property rights in developing countries.

The size and the level of independence of the board not affect the company's financial performance, the sample in this study have an average share of independent commissioners at 61.19%, above the prevailing Bank Indonesia on the number of independent commissioners by at least 50% (Bank Indonesia 2006). The higher share of independent commissioners do not guarantee better financial performance of a bank or no influence on performance. Research by Andres and Vallelado (2008) tested the hypothesis of a dual role as the board of directors of Corporate Governance mechanisms in international commercial banks found that an inverted U-shaped relationship exists between bank performance and the size of the Board, and the proportion of non-executive directors and performance. The results indicate that board composition and size associated with the ability of directors to monitor and advise management, and the board is larger and less independent may prove more efficient in monitoring and providing advice, and create more value for the company. It can be concluded that the addition of independent commissioners serving on a certain percentage will actually worsen the bank's financial performance.

Other factors associated with the ownership of institutional governance, the study was not consistent with the research done by Murhadi (2008) who found that a professional institution that is able to evaluate the performance of the company so that it can effectively supervise. This research samples have an average institutional ownership of 82.23%, the rest is individual ownership or management. The number of high institutional ownership does not ensure the preservation of the financial performance of the bank at the time of crisis, according to research by Leung (2010) management ownership can be minimize the conflict between management trainee so that the value of the company shares will rise despite the financial crisis. These results support the Alignment Theory.

CONCLUSIONS AND SUGGESTIONS

Limitations of this study is the value calculated by the researchers CAMEL based on Peraturan Bank Indonesia Nomor: 6/10/PBI/2004 tentang Sistem Penilaian Tingkat Kesehatan Bank Umum. dan Surat Edaran No. 6/23/DPNP perihal Sistem Penilaian Tingkat Kesehatan Bank Umum, as data on CAMEL inaccessible by reason of such data confidential.

The results of this research indicate that the independent and institutional ownership is not associated with the bank's financial distress experienced during the global financial crisis in 2008. There is no assurance that the independent commissioner percentage exceeds the percentage set by Bank Indonesia to maintain the Bank's performance remains good, as well as the portion of institutional ownership.

Future research can use qualitative approaches to find the cause of why the perspective of independent and institutional ownership in corporate governance is not effective in maintaining the bank's financial performance during the financial crisis.

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