Corporate Board And Firm Value: Perspective Two-Tier Board System In Indonesia

Leni Susanti, Sulaeman Rahman Nidar

Abstract: This study aimed to investigate whether the effect of board commissioners and board of directors toward firm value at companies listed in Indonesia Stock Exchange. Secondary data is used and collected based on time series and cross section from 2010 until 2014, among 184 companies as unit observation. This study uses data panel regression analysis techniques with Generalized Least Square (GLS). Chow test and Hausman test show that the model used as a fixed effect estimation technique. The results show simultaneously the board of commissioners and board directors have a significant effect on firm value. Furthermore, partially the board of commissioners has a negative and significant effect toward firm value. The board of directors has a positive and significant effect toward the firm value.

Keywords: board of commissioners, board of directors, firm value, two-tier board system.

1 INTRODUCTION

Agency theory describes the separation of functions between ownership and management, this can lead to conflict between the principal-agent; manager as agent can pursue their own interests rather than the interests of the owner (Ugurlu, 2000). Agency problems arising from the separation of ownership and management can be reduced by the internal mechanisms of corporate governance, through internal monitoring mechanisms of the Board of directors (Hung, 1998; Yoshikawa and Phan, 2005), because the main task of the board is to protect the interests of shareholders of the fraud management (Shleifer and Vishny, 1997). Corporate board performance has become an interesting research in recent years, especially the many corporate scandals that emerged lately. Many say that the boards are the cause of the decline in shareholder wealth and the failure of the company, due to lack of oversight by the boards (Abidin et al., 2009); Chief Executive Officer (CEO) who holds enormous influence on the function and constitution of boards; boards are too dependent on management (Kumar and Sivaramakrishnan, 2008). Even though, the characteristics of the boards which uphold the interests of shareholders by executing corporate strategy, it can maximize shareholder value (Dalton et al., 1998). There are differences in terms of the corporate board prevailing in Indonesia with other countries. This is because there are two models of board structures; the first based single board system where membership of the board of commissioners and board of directors are not separated. In this model, commissioner concurrently as a member of the board of directors and both are referred to as the board of directors.

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The model is applied in the United Kingdom and the Commonwealth member countries such as Australia, New Zealand, and others. Second, the model two-tier board system or a two board system, this model firmly separating board membership, the board of commissioners as superintendent and the board as a corporate executive. In Indonesia, which is the legal basis in the form of civil law adopts a two-tier board system, which makes a limited company has two boards that board of commissioners and board of directors. If we refer to the Regulations Limited liability Company in force in Indonesia, states that the board of directors is the organ of the company's authorized and fully responsible for the management of the company for the benefit of the company, in accordance with the purposes and objectives of the company and to represent the company either inside or outside in accordance with the provisions of the articles of association. Thus it can be said directors as trustee well as agent for the limited liability company. Told as a trustee because the board of directors to supervise the assets of the company, and as an agent because the directors acted out for and on behalf of the company. Meanwhile, the board of commissioners has an important role, its main task is to oversee the policy and implementation of the directors in running the company and advise the board of directors. Policies that concern board of commissioners are strategic and important. The task of the board of commissioners is often referred to as business oversight because it involves the monitoring of the company to survive, do business and grow/develop. Monitoring role of the corporate board has been studied extensively, and an important measure of monitoring and effectiveness of the board of the company is the frequency of board meetings (Lipton and Lorsch 1992; Jensen 1993; Conger et al., 1998; Vafeas, 1999; Brick and Chidambaran, 2007). Some research on the corporate board toward firm value still does not have uniformity results. Some studies show the positive influence between the frequency of board meetings toward corporate performance (Ntim and Osei, 2011; Mangena and Tauringana, 2008), positive relationship between the frequency of board meetings toward the accuracy of estimates of revenue management (Karamanou and Vafeas, 2005). Some studies show negative effects between the frequencies of board meetings toward corporate performance (Vafeas, 1999a; Agrawal and Knoeber, 1996; Barnhart and Rosenstein, 1998; Fich and Shivdasani, 2006; Hahn and Lasfer, 2007; Lixia and Na, 2009; Al-Najjar, 2012). El Mehdi (2007) who found that the frequency of board meetings do not have a relationship with economic performance. Furthermore, Fich and

Shivdasani (2006) which states that the board is more frequent meetings will be rated poorly by the market. In this paper, we investigate the effects of a board meeting toward firm value for companies listed on the Indonesia Stock Exchange. This research is interesting, because it examines the relationship between board meetings and firm value, using the concept of two-tier board system prevailing in Indonesia. Therefore, this research fills a gap in the literature of the internal mechanism of corporate board with the concept of two-tier system in force in the countries of the legal basis is based on civil law. Our paper is organized as follows: Section 2 contains a literature review and hypothesis development about the relationships between corporate board (board of commissioners and board of directors) and firm value. Section 3 describes the variable descriptions, data and methodology. Section 4 provides the empirical results. Section 5 conclusions this research.

2 Literature Review and Hypothesis Development

Developing the effectiveness of the board of directors is a study of agency theory and corporate governance. If linked to agency theory, is one mechanism to reduce agency problems is through the mechanism of monitoring / internal monitoring, including the board of directors (Bathala et al., 1994). In the internal monitoring mechanism, the board of directors plays an important role in solving the agency problem between shareholders and management (Yoshikawa and H. Pan, 2005). If you are connecting from corporate governance, corporate boards are internal mechanisms of corporate governance, which is a monitoring device for controlling the management (agent) on behalf of its shareholders (principal) (Hung, 1998). Coles et al. (2008) states that the board of directors intended to perform critical functions such as surveillance and provide input / advice to top management. Literatures of management takes a broader perspective again and assume the role of the board of directors of the strategy to include aspects such as defining a business, develop a mission and vision, scanning the environment and select and implement options strategies (Tricker, 1984; Pearce and Zahra, 1991; Hilmer, 1993). Garrat (1997) states that the function of the council as a collective responsibility to; determine the company's goals and ethics, determine the direction that the strategy, plan, monitor and control manager and CEO, report and make a recommendation to shareholders. Bennedsen (2002) states that a company will have two motives to have a board of directors, namely: (1) the motive governance, firm value creation and (2) distributive motive, limiting the benefit of controlling owner. The function of the board of directors will increase the company's financial performance so that firm value will rise. Thinking about the involvement of the board of directors in a company known as active and passive view (Golden and Zajac, 2001). Passive view expressed board only as a rubber stamp (Herman, 1981) or as a means of top management that contributes only to meet the requirements of corporate law (Stiles and Taylor, 2001). According to this view that most of the board's decision is subject to the control of management, especially if it has a strong chief executive officer (Mace, 1971). While the view is active, look at the board as an independent thinker who form the strategic direction of the organization (Davis and Thompson, 1994; Finkelstein and Hambrick, 1996. One view is that the board of directors meeting beneficial for shareholders. Conger et al. (1998) showed that a board meeting is a critical resource in enhancing the effectiveness of the board. An important measure of the strength of monitoring and effectiveness of the board of directors is the frequency of board meetings. Board meeting time is a critical resource in enhancing the effectiveness of the board. Board of directors has the power to make or at least ratified all important decisions, including investment policy, the compensation policy management and governance of the board itself (Bhagat and Bolton, 2008). Board of directors meeting more frequently meets are more likely to perform their duties in accordance with the interests of shareholders. Council meetings are more often likely to generate higher financial performance. In accordance with agency theory, which suggests that corporate boards are more often held meetings has increased their capacity to effectively advise, monitor and discipline management, and thereby improving the company's financial performance. Monitoring becomes more intense in periods of crisis, and companies are more frequent meetings of the board will have a better performance. In this study, using the concept of two-tier board system prevailing in Indonesia so that the corporate board consists of (1) the board of commissioners, which oversees the policy and implementation directors to run the company and advising the board of directors and (2) the board of directors, in charge maintains the assets of the company, and act out for and on behalf of the company.

H_1 : number of meetings of the board of Commissioners has a positive effect towards firm value.

H_2 : number of meetings of the board of Directors has a positive effect towards firm value.

3 Data and Methodology

3.1 Sample Selection

Our sample consists of 184 companies listed on the Indonesia Stock Exchange (IDX). These firms are observed over the 2010-2014 period, allowing us to form a cylinder of panel data of 920 observations. The data used in this research is using secondary data derived from company records that exist in the company's financial statements were obtained from the respective firm’s annual reports and publications of IDX, internet and websites of different firms. A company that must be reported financial statements during the observation period 2010-2014.

3.2 Measurement of variables

Tobin’s Q ratio is a dependent variable as indicator measuring the firm value have been widely used in financial research (e.g., Morck, Shleifer, and Vishny, 1988, McConnel and Serveas, 1990), describes a condition of investment opportunities owned by the company (Lang et al., 1989), or a potential the company's growth (Brainard and Tobin, 1968; Tobin, 1969) and indicated that management has a good performance in managing assets. Tobin's Q value resulting from market value of equity plus book value of debt divided by the book value of assets (Lindenberg and Ross, 1981; Zeitun and Tian, 2007). The Board of Commissioners is responsible and authorized to oversee the actions of management, and provide advice to management if deemed necessary by the board of commissioners. The effectiveness of the task of the board of commissioners proxied by RBOC i.e. the number of meetings held by the board of commissioners for one year. The Board of directors as a company organ in charge and responsible collegial in managing the company. The effectiveness of the task of the board of directors proxied by RBOD i.e. the number of meetings held by the board of directors for one year. However, we apply return on assets (ROA) as a control variable, to check the robustness of our results to alternative accounting based corporate performance proxies. ROA is calculated as net profit divided by total assets (Abor, 2007).

3.3 Model Specifications

This study uses a regression panel data

$$q_{it} = \beta_0 + \beta_1 RBOC_{it} + \beta_2 RBOD_{it} + \beta_3 ROA_{it} + \varepsilon_{it}$$

Where: q = firm value; RBOC= the number of meetings held by the board of commissioners for one year; RBOD= the number of meetings held by the board of directors for one year firm size; ROA=Return on Assets; β_0, β_1, β_2, β_3 = coefficient; ε= error term model Residual in this model as usually follows the assumption of Ordinary Least Square method (OLS). Regression model with panel data, generally resulting in difficulties in the model specification. Residual will have three possibilities, namely residual time series, cross section or a combination of both. Therefore, there are several methods that can be used to estimate the data panel regression model that is common effect, fixed effects and random effect. To determine the type of model to be used needs to be performed a statistical test procedure that Chow Test and Hausman Test. Chow Test, aimed to compare methods: Method of Common-Constant (The pooled OLS Method) with a fixed effect method, in which the null hypothesis, it is a model common effect is better, meaning that there is no difference in effect between individuals (the time if using fixed effects period) on panel data. Hausman test aimed to compare between the fixed effect and random effect method, in which the null hypothesis is random models is better than the fixed effect model.

4 Empirical results

Table 1 present descriptive statistics for 184 firms over five-year period 2010 – 2014 (920 firm-year observations). A meeting of Board of Commissioners has a minimum value of 1 time. These companies have conducted board meetings only 1 time in a year. While the maximum value of its board meetings was 48 times. This shows that the company is very intensive hold board meetings, i.e. 48 times a year. The average value of its board meetings is 6.727 times or 7 times. The number of meetings is in conformity with the Financial Services Authority regulation which states that the board of commissioners shall hold meetings at least 1 (one) time in 2 (two) months, or six times a year. The average company held its board meetings as much as 7 times a year. The standard deviation of RBOC at 6.172. If we compare with the mean value, standard deviation value smaller than the mean value (6.172 <6.727), which means the deviation can be quite good data, because data changes are not moving are varied. A meeting of the Board of Directors has a minimum value of 1 time. The companies have implemented the board of director meeting only 1 time in a year. The maximum value of the board meeting was 78 times. This shows that the company is very intensive convene the board of directors, which is 78 times a year. The average value of RBOD is 17.312 times or 17 times. The number of meetings is in conformity with the Financial Services Authority regulation which states that the board of directors shall hold meetings at least 1 (one) time in 1 (one) month, or 12 times a year. The standard deviation of RBOD at 13.735. If we compare with RBOC the mean value, standard deviation value smaller than the mean (13.735 <17.312), which means the deviation can be quite good data, because data changes are not moving are varied.

TABLE 1

DESCRIPTIVE STATISTIC

Var.	Mean	Median	Max	Min	Std. Dev.	Jarque-Bera	Prob.	Obs.
q	1.2865	0.7789	72.7552	-0.5048	2.9481	5642215.	0.0000	920
RBOC	6.7272	4.0000	48.0000	1.0000	6.1719	7390.323	0.0000	920
RBOD	17.3120	12.0000	78.0000	1.0000	13.7349	319.6639	0.0000	920
ROA	6.6598	5.3750	71.5100	-61.9300	8.8000	4565.342	0.0000	920

q= firm value; RBOC = the number of meetings held by the board of commissioners for one year; RBOD= the number of meetings held by the board of directors for one year firm size; ROA=Return on Assets

Source: *Calculated by the researcher, 2016*

Seen through probability over the Jarque-Bera and a significance level of 95% (α = 5%) determined that the variable firm value (q), the number of meeting BOC (RBOC), the number of meeting BOD (RBOD), and return on assets (ROA) has to be normally distributed. To determine the appropriate model, then tested the chow and Hausman. Here are presented in Table 2:

TABLE 2

THE RESULTS CHOW AND HAUSMAN TEST

Chow and Hausman Test:	
Effect Test	**Probability**
Cross-section F value	0.0000
Cross-section random	0.0010

Source: *Calculated by the researcher, 2016*

Based on the above Table 2, the result chow- test shows that the probability value of cross-section F value of 0.0000 < 0,05 so it can be concluded that the fixed effect model is more precise than the random effect models. Furthermore, the result Hausman test show that the probability value of cross-section random 0.0010 < 0.05 so that we can conclude the fixed effect model is better than the model common effect and random effect. From the test model selection can be concluded that in this study the fixed effect model is better than the model common effect and random effect, without further testing should be performed Langrangge Multiplier (LM). LM test is performed when the chow and Hausman test inconsistent, so the LM test is needed to determine which model is best, fixed effect model or random effect model. This study uses the classical assumption test form multicolinierity and heteroskidastity. Multicolinierity test needs to be done for linear regression using more than one independent variable. If only one independent variable, it is not possible multicolinierity. Heteroskidastity usually occurs in cross section, where panel data closer to the characteristics of cross section data than the time series. Normality test is basically not a condition Best Linear Estimator Unbias (BLUE) (Verbeek, 2003). In the panel data regression, not all the classical assumption is on the OLS method is used, only multicollinearity and heteroskedasticity is needed. This is because the autocorrelation only occurs in the time series data. Testing autocorrelation in the data that are cross section and pool data becomes meaningless. In this study, multicollinearity test will be done by looking at the correlation coefficient between each independent variable, if the correlation coefficient between each independent variable is greater than 0.8, there is a multicollinearity in the regression model (Widarjono 2009; Ajija, 2011).

TABLE 3
CLASSICAL ASSUMPTION TEST RESULTS

Multicolinearity	
Variable:	**Correlation (r)**
RBOC-RBOD	0.3797
RBOC-ROA	-0.0356
RBOD-ROA	-0.0162
Heteroscedasticity	
Variable:	**Probability**
RBOC	0.5988
RBOD	0.9578
ROA	0.0011

Source: *Calculated by the researcher, 2016*

Based on Table 3 shows the absence of a strong enough correlation among the independent variables, because the value of the correlation (r) is smaller than 0.8. So it can be interpreted that the model does not happen correlation between the independent variable or no multicollinearity problems. In this study, to examine the problem of heteroskedasticity using Glejser method. Glejser method is done by performing regression residuals absolute values (resab) with the independent variable. Based on Table 3 shows it can be concluded that for a variable RBOC and RBOD heteroskedasticity problem does not occur. However, the control variable ROA has occurred heteroscedasticity problem. The consequences of going heteroskedastisitas can lead OLS estimates obtained still meet the requirements not biased, but the variants obtained become inefficient, meaning variants tend to be large so it is no longer a minor variant. Therefore, to one of the healing techniques heteroscedasticity is to perform weighting using the Generalize Least Square (GLS) Weights. Table 4 below shows the calculation results of data panel regression with fixed effect method, using a panel EGLS (cross-section weights) for a period of 5 (five) years and cross section as many as 184 companies:

TABLE 4
THE CALCULATION RESULTS OF FIXED EFFECT MODEL

Variabel	Predicted Sign	Coefisien	t-Statistic	Prob.	Result Sign
RBOC	+	-0.014416	-7.200267	0.0000	-
RBOD	+	0.002195	2.387542	0.0172	+
ROA	+	0.048291	18.84590	0.0000	+
R-square	0.924988				
Adj R-Sq	0.905954				
F-statistic	48.59585				
Prob(F-stat)	0.000000				

Source: *Calculated by the researcher, 2016*

Based on table 4, then the regression equation data panel produced by the method of fixed effect is:

$$\text{Կ} = 1.0239 - 0.0144\ RBOC + 0.0022RBOD + 0.0483\ ROA$$

From the data processing obtained Adjusted R-Squared of 0.905954 which means that 90.60% of the change in the variable firm value can be explained by the variable RBOC, RBOD and ROA. With the F test statistic, indicating the probability value is equal to 0.000000 it was explained that the independent variables involved in these models can describe the linear relationship with the dependent variable. In other words, all independent variables simultaneously significant effect on firm value. While t test, showed that the probability value of RBOC, RBOD and ROA is 0.0000, 0.0172 and 0.0000. This means that with a 95% confidence level can be concluded that RBOC is a negative and significant effect toward firm value, RBOD is a positive and significant effect toward firm value, dan ROA is positive and significant effect toward firm value.

5 CONCLUSIONS

Board of Commissioners (BOC) is a council tasked to oversee the policy and implementation of the directors in running the company and provide advice to the board of directors (Kula, 2005). To see the effectiveness of the performance of BOC, the BOC is proxied by the number of meetings held by the board of commissioners within one year. The results of this study indicate the coefficient of BOC (βBOC) that does not comply with the previous projection. The results showed that the RBOC have a negative and significant effect on firm value (Q). This means that the more often the commissioners held a meeting it will lower the firm value (Q). The results of this study are consistent with Agrawal and Knoeber, (1996), Barnhart and Rosenstein (1998), Vafeas (1999), Fich and Shivdasani (2006), Hahn and Lasfer (2007), Lixia and Na (2009), Al-Najjar (2012). A negative relationship of the high frequency of meetings with the firm value, due to the high activity of BOC which tends to be a response to companies with poor performance. BOC has more frequently held meetings rated poorly by the market, because the market considers that the company is experiencing poor performance. The poor performance of the company requires the board more frequently hold meetings with directors in order to discuss performance issues and to provide a quick solution to face such poor performance (Jensen, 1993; Al-Najjar, 2012). In addition, if based on the costs associated with BOC meeting, such as managing time, travel expenses, and the cost of board meetings, then if the company frequently holds meetings BOC means the company will issue a greater cost, therefore the frequency of board meetings that will often negatively related to the value of the company (Vafeas, 1999). When referring to the system prevailing in Indonesia that adheres to a two-tier system, which separates the membership structure of the board, between the membership as a supervisory board of commissioners and board of directors as an executive of the company. In practice, there is some confusion that led to implementation more inclined to the concept of one-tier, as an example of the lack of clear separation between the board of commissioners to the board of directors, commissioners work to solely rely on reports received from the board of directors are often less qualified, not timely and less accurate. This causes all become nature proforma which resulted in the effectiveness of supervision of the board of commissioners was not achieved (Al Aggugi and Silitonga, 2011), further will result in the firm value will decline. Furthermore, to see a negative relationship between the effectiveness of the board of commissioners may refer to understand the use of two-tier board system in Indonesia, which is composed of the General Meeting of Shareholders

(GMS), the board of commissioners, board of directors and executive managers. Members of the board of directors are appointed and dismissed by the GMS, as well as members of the board of commissioners are appointed and dismissed by the GMS. Thus the board of commissioners and board of directors are responsible for the GMS. Based on this rule, as if the position of the board of commissioners and board of directors to become misaligned. It makes commissioners in Indonesia is not as strong as the board of commissioners in the European countries. It can bring understanding that the commissioners did not oversee the board, but instead seemed to be friends because the aligned position. A weak oversight function of the board of commissioners because of concentration of ownership by certain parties that allows the affiliate relationship between the owner, supervisor and director of the company, the ineffectiveness of the commissioners and the lack of law enforcement in Indonesia (Silitonga, 2013). Sato (2004) states that companies in Indonesia are often the manager and owner of the company is the same parties. For the second variable, Board of Directors (BOD) is the organ of the company the duty and responsibility collegially in managing the company. To see the effectiveness of the performance of the BOD, the BOD is proxied by the number of meetings held by the board of directors within one year (RBOD). RBOD have a positive and significant effect on firm value. This means that the more the board of directors held a meeting it will increase the firm value. The results of this study are consistent with Vefeas (1999b), Mangena and Tauringana (2008), Ntim (2009). High frequency of board meeting that improving the quality of managerial performance, so it will have a positive impact on the company's financial performance (Vafeas 1999b; Ntim, 2009). In addition, companies are more likely to hold a board meeting will have a better performance (Mangena and Tauringana, 2008). The presence of the directors in the routine BOD meeting also considered the hallmark of directors are conscientious and responsible duty (Sonnenfeld, 2002), with frequent and regular meetings there will be formal and informal interaction between members of BOD to create and strengthen a cohesive bond between directors (Lipton and Lorsch, 1992), and thus have a positive impact on company performance. Regular meetings allow directors more time to negotiate, strategize, and to assess their performance (Vafeas 1999a). Furthermore, it can help directors to have more information and knowledge about the development of the company, and thus put them in a better position when the company experienced a critical problem (Mangena and Tauringana, 2008).

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